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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Fraud In Government Programs:

~~I~~ How Extensive Is It? *and*

~~I~~ How Can It Be Controlled?

(Volume I)

Fraud against Government programs is widespread. It undermines the integrity of Federal programs and makes people lose confidence in public institutions.



Good systems of internal controls would prevent much of the fraud, or at least detect it sooner. However, controls over Federal programs are often inadequate, nonexistent, or ignored.

Most fraud is undetected. For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim. Further, agencies do not always use the administrative actions available to deter persons from committing fraud. The sad truth is that crime against the Government often does pay.

Agency inspectors general and the Department of Justice are making progress in the fight against fraud. However, more needs to be done to prevent fraud and to punish those who commit fraud.



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

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To The President of the Senate and the
Speaker of the House of Representatives

This is the first volume of a three-volume report which discusses the results of a statistical analysis of fraud and other illegal activities affecting 21 Federal agencies. The analysis was undertaken by our Fraud Prevention Task Force which was established to respond to growing public concern over abuses and misuses of taxpayers' money.

Copies of this report are being sent today to the Director of the Office of Management and Budget and to the heads of the agencies covered in the study.

A handwritten signature in cursive script that reads "Milton J. Fowler".

Acting Comptroller General
of the United States

D I G E S T

Fraud is willful wrongdoing by individuals or public and private organizations that affects the Government's interests. Despite the fact that so much has been written and discussed about fraud in Government programs, there is little concrete information as to its extent and characteristics. Without such data, it is hard to effectively detect and prevent wrongdoing. To rectify that situation, GAO made a statistical analysis of over 77,000 cases of fraud and other illegal activities reported in 21 Federal agencies during the 2-1/2 year period, October 1, 1976, through March 31, 1979.)

FRAUD IS COSTLY

A statistical projection by GAO indicates that the loss to the Government on the 77,000 cases would total between \$150 and \$220 million. These losses are only what is attributable to known fraud and other illegal activities investigated by the Federal agencies in this study. It does not include, of course, the cost of undetected fraud which is probably much higher because weak internal controls allow fraud to flourish. Also, this estimate does not include cases involving Federal funds where State and local jurisdictions had primary investigatory responsibility. Some of those losses were substantial.)

Losses due to fraud and related illegal activities are seldom recovered.) Although agencies planned to recover between 20 and 29 percent of their losses either through court ordered restitutions or administrative actions, GAO believes that actual recoveries are probably much lower. GAO plans, in another study, to address how agencies can increase the recovery of fraud losses. (See pp. 4-5.)

The cost of fraud and illegal activities cannot always be measured in dollars and cents. [Fraud erodes public confidence in the Government's ability to efficiently and effectively manage

its programs. In addition, fraud undermines program effectiveness. In some instances illegal activities have adversely affected public health and safety. (See p. 15.)

FRAUD IS WIDESPREAD

Many types of individuals and organizations commit fraud against the Government. Government employees committed about 29 percent of the frauds included in GAO's study. These employees represented four-tenths of one percent of the total Federal work force in the 21 Federal agencies reviewed by GAO. Other individuals and organizations committed about 40 percent. In the rest of the cases, suspects were never identified. Federal employees detected the majority of the reported frauds. (See pp. 6-7.)

Federal agencies were susceptible to hundreds of different types of fraudulent activities in a wide range of areas. However, four areas were especially prone to fraud:

- Financial assistance to individuals.
- Inventory control and property management.
- Mail service.
- Personal property management.

The types of illegal activities which occurred most often were false statements and theft. (See pp. 8-15.)

CONTROLS TO PREVENT FRAUD ARE OFTEN WEAK

Internal controls are checks and balances over all fiscal and managerial activities of an organization. The controls are designed to prevent the misuse or abuse of money or property. GAO found that weak internal controls often contributed to cases of fraud and other illegal activities. GAO analyzed the adequacy of internal controls for selected cases and found many instances where controls were either inadequate, not followed, or nonexistent. (See pp. 16-19.)

MANY CASES ARE NOT PROSECUTED

For a variety of reasons, the Justice Department declined to prosecute 61 percent of the over 12,900 cases referred by Federal agencies. Although Justice got a conviction or guilty plea in the majority of cases it did prosecute, the courts

often suspended large portions of the sentences or granted probation. About one-third of those sentenced actually spent time in prison.

Fifty-seven percent of those who went to prison were sentenced to 6 months or less. At the other end of the spectrum, over a quarter of those who went to prison were sentenced to serve over 2 years. Information on how much time the individuals actually spent in prison before parole was not readily available. (See pp. 28-32.)

In addition to criminal prosecutions, the Department of Justice can take civil legal action against persons who defraud the Government. The primary civil fraud statute, the False Claims Act, allows the Federal Government to recover double damages from those who make false claims for such things as reimbursement under Government contracts or false statements in applying for benefit programs. It also allows the Government to recover one \$2,000 forfeiture for each false claim made. Justice took civil action in 28 of the 393 fraud cases Federal agencies referred for such action during the period of GAO's review.

Following an October 1979 GAO report which concluded that Justice had not emphasized the civil aspects of fraud cases and needed to better coordinate criminal and civil actions, Justice put greater emphasis on coordinated criminal and civil prosecutions of Government fraud cases. (See pp. 32-34.)

AGENCIES DO NOT ALWAYS TAKE EFFECTIVE ADMINISTRATIVE ACTIONS

Agencies did not always take administrative action against individuals who committed fraud. When the agencies did act it was not always in a way that would deter others from defrauding the Government. For example, one of the major actions against individuals defrauding the Government was declaring them ineligible to participate in the programs they defrauded. This can be an effective deterrent in those cases where eligible program participants are seeking excessive benefits. However, the deterrent effect of this action is nil in those instances where the individuals never were eligible for the programs. (See pp. 34-38.)

PROGRESS IS BEING MADE IN
COMBATING FRAUD

In 1978 GAO reported that Federal agencies were not aggressive in detecting fraud and had not fixed responsibility for identifying fraud in agency programs. GAO also reported that the Department of Justice had been slow to assist, coordinate, and monitor antifraud efforts of Federal agencies. Since then, progress has been made in these areas.

Congressional establishment of offices of inspectors general in 15 Federal agencies has provided an independent focal point for fraud detection and prevention. Among other things, inspectors general have worked together to address common problems, have undertaken joint audits and investigations, and have taken more active approaches in dealing with fraud and other illegal activities. (See pp. 40-43.)

The Department of Justice has also tried to upgrade Federal antifraud activities by (1) reorganizing certain Justice components to offer better services to agencies and allow Justice headquarters to work more efficiently with U.S. attorneys, (2) increasing specialized fraud training for Justice and agency personnel, and (3) working closely with the inspectors general through the Executive Group to Combat Fraud and Waste in the Government--an organization set up by the President in 1979 as a communication network for the inspectors general to share ideas and problems. (See pp. 43-45.)

CONCLUSIONS

Fraud and illegal acts against the Federal Government are a widespread problem. Once they are allowed to occur, the Government fights a losing battle because losses are seldom recovered and the perpetrators are seldom punished.

Weaknesses in internal controls often allow fraud to occur. Given the poor state of controls in many programs, it is probable that most fraud remains undetected.

GAO believes that the key to fighting fraud is to improve internal controls so that fraud and related illegal acts are more difficult to commit. Internal controls in Government are often ineffective and fraud and related illegal acts are

easy to commit. Federal managers must ensure that controls are understood, encouraged, and enforced.

Each Federal agency is required by the Budget and Accounting Procedures Act of 1950 to maintain adequate systems of internal control. GAO believes that internal controls can be made more effective by strengthening existing law. The Congress is considering legislation which would require greater accountability by the heads of agencies for the effectiveness of their organizations' internal control systems. The Federal Managers' Accountability Act of 1981 (H.R. 1526) would, among other things, require agency heads to periodically evaluate controls and report the results to the Congress and the President. GAO believes this legislation would contribute to the development of adequate internal control systems in the Federal Government.

Auditors have an important role in assisting management by testing internal control systems and recommending needed improvements. Auditors can help prevent fraud by keeping surveillance over the effectiveness of internal controls.

GAO believes that the prevention of fraud and related acts through effective systems of internal control is top priority. It also recognizes the deterrent effects of punishing perpetrators. Because the number of cases makes it impossible for the Department of Justice to prosecute every case of fraud referred to it by Federal agencies, it is even more important that Federal agencies take effective administrative actions when warranted. In addition, GAO believes that civil fine authority could be a useful enforcement tool for agencies whose cases the Department of Justice declines to act on.

The Department of Justice is now completing draft legislation which would allow agencies to levy civil monetary penalties. This legislation would authorize Federal agencies to institute administrative proceedings and to levy civil penalties and assessments against persons who defraud the Government. The authority would be triggered when Justice declines to take action but recommends that the agency levy a fine. GAO has not had the opportunity to comment on the specific legislation being developed by Justice. However, GAO endorses the concept of allowing

agencies to levy civil monetary penalties against those who defraud their programs.

RECOMMENDATION TO THE CONGRESS

RS
GAO recommends that the Congress enact the Federal Managers' Accountability Act of 1981.

MATTERS FOR THE CONGRESS TO CONSIDER

The Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud Federal programs. The authority to assess such a penalty should be effective when the Department of Justice declines to take criminal or civil action on a case.

RECOMMENDATION TO
THE DEPARTMENT OF JUSTICE

The Department of Justice should expedite completion of its draft legislation to give agencies the authority to levy civil monetary penalties and should submit the legislation to the Congress for its consideration.

AGENCY COMMENTS

GAO gave each of the agencies covered in the review a chance to comment on a draft of this report. Ten agencies commented--nine generally agreed with the findings, conclusions, and recommendations; the Department of Transportation disagreed. Chapter 7 is an analysis of the comments. The text of each agency's comments is presented in appendixes II through XIV.

The Office of Management and Budget stated that fraud and abuse in the Federal Government must be controlled as quickly as possible and agreed that improved control systems can contribute significantly to solving the problem. The Office stated that it is reviewing the proposed legislation and is also considering administrative requirements for adopting and maintaining more effective internal control systems. (See pp. 61-62.)

The Department of Justice stated that this report reflects a balanced understanding of the Government actions required to effectively respond to the problem of fraud and abuse in Federal programs. In terms of the overall message, the

Department agreed that the cost of fraud and related illegal activities is substantial and that prevention of such activities through effective systems of internal control should be a top priority. The Department plans to continue pursuing this objective in its work with other departments and agencies. The Department believes that the report focused primarily on the efforts of other agencies, and provided a number of comments on some of its own more recent efforts as well as on what it perceived to be some inaccuracies and omissions. (See pp. 70-78.)

The Department of Transportation believes the report oversimplifies the solution to combating fraud by claiming that sound internal control systems are the answer to fraud and illegal activities. The Department also believes additional legislation to improve controls is unnecessary. GAO recognizes that internal controls cannot prevent all fraud, but believes that good systems of control can prevent much of it. GAO believes that the Federal Managers' Accountability Act of 1981 would further encourage agency heads to develop and enforce adequate internal control systems. (See p. 83.)

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ABBREVIATIONS

DLA	Defense Logistics Agency
DOD	Department of Defense
DOE	Department of Energy
FAA	Federal Aviation Administration
GAO	General Accounting Office
GSA	General Services Administration
HEW	Department of Health, Education and Welfare
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget
SBA	Small Business Administration
SSA	Social Security Administration
VA	Veterans Administration

CHAPTER 1

INTRODUCTION

- Three individuals are accused of stealing more than \$10 million from the Small Business Administration and banks in New York and Colorado by getting loans and then defaulting on them.
- A Federal worker uses a Government computer to issue more than half a million dollars in fraudulent welfare checks and then programs the computer to erase all records of the bogus checks.
- A Federal transportation clerk embezzles \$856,000 of funds earmarked for mass transit improvements.

News stories involving fraud against the Government are too common. Even though the Congress, the administration, and the public have recognized that more needs to be done to stop these evils, effective action has often been hampered by a lack of information about the problem.

In September 1978, we reported on fraud detection activities in seven Federal agencies. ^{1/} We concluded that agencies did not have the management information systems needed to deal with fraud and had not made fraud detection a high priority. As a follow-on to our September 1978 report, we have gathered and analyzed information on fraud in 21 Federal agencies. The major purpose of the review was to determine the extent and characteristics of identified fraud in Federal agencies and to provide a better basis for detection and prevention of fraud and illegal activities. This is the first volume of a three-volume report.

This volume discusses, in general terms, the results of our work on a Government-wide basis. Volume II will provide a more detailed discussion and statistical analysis of the data. Volume III will contain fraud profiles for each agency.

WHAT IS FRAUD?

There is no standard definition of fraud. During our review we found that the Department of Justice and each Federal agency had its own list of activities which it considered to be fraud. The term fraud has never been precisely defined because of the difficulty in establishing a definition that encompasses all the potential types of fraud.

^{1/}"Federal Agencies Can, and Should, Do More to Combat Fraud in Government Programs," GGD-78-62, Sept. 19, 1978.

In order to collect comparable data consistently from each agency covered in our overview, we adopted the Department of Defense (DOD) definition of fraud and illegal activities, which is

"* * * any willful or conscious wrongdoing that adversely affects the Government's interests. It includes, but is not limited to, acts of dishonesty which contribute to a loss or injury to the Government. The following are some examples of fraud or other unlawful activity: falsification of documents, such as time cards or purchase orders; charging personal expenses to Government contracts; diversion of Government property or funds for unauthorized uses; submission of false claims, such as invoices for services not performed or materials not delivered; intentional mischarging or misallocation of contract costs; deceit by suppression of the truth; regulatory or statutory violations, such as bribery, theft of Government property, graft, conflict of interest, and gratuities; and any attempt or conspiracy to engage in or use the above devices."

OBJECTIVES, SCOPE, AND METHODOLOGY

While our main objective was to determine the extent and characteristics of identified fraud in Federal agencies, we also wanted to evaluate selected cases to determine if internal control failures had allowed fraud to occur. At each of the 21 Federal departments and agencies covered in our review (see p. 9) we obtained lists of cases of suspected fraud or other illegal activities, hereafter referred to as frauds, opened from October 1, 1976, through March 31, 1979. The lists contained both closed and open cases.

Based on information from agency officials responsible for investigations, we initially identified a total universe of about 134,000 cases of alleged fraud. In the course of our review, we found that the agencies' lists had included about 27,000 cases which did not fit our definition of fraud or were outside the period of our review. For report discussion purposes we deleted (1) about 21,000 other cases where agencies investigated and found no fraud and (2) a little over 9,000 open cases where investigations were still underway or actions on the cases were pending. Therefore, unless otherwise indicated, the analysis in our report is based on a total of 77,211 cases which consists of 72,797 closed cases and 4,414 open cases where some administrative or legal action was taken, or no action was taken because no suspects could be identified. Thus, in places where we refer to "fraud cases" we mean those cases of actual fraud within the meaning of the above definition, as well as suspected fraud.

Using statistical sampling we selected about 5,000 cases for review. We developed a data collection instrument (app. I) to obtain comparable data on sample cases and used a computer to

analyze the data. We based the sample size on characteristics of the universe in each agency and a need to achieve a 95-percent confidence level and an overall reliability factor of + 12 percent. Since all cases reviewed were selected based on specific statistical criteria, our results can be projected to the universe of cases.

Our universe does not cover all fraud involving Federal funds--only cases investigated by Federal agencies. We did not include cases where State or local jurisdictions had primary investigatory responsibility. These include most Medicaid and Aid to Families with Dependent Children cases, as well as cases involving individual recipients of food stamps. Our universe of cases does include food stamp frauds involving grocery stores and illegal trafficking in food stamps because these types of cases are investigated by the Department of Agriculture. The vast majority of Medicare fraud cases is excluded from our universe. The only Medicare cases included are those that were investigated by the Health, Education and Welfare (HEW) 1/ Inspector General.

We did most of our work at the agency offices of inspector general. In those instances where agencies had no inspector general, we did the work at the comparable investigative units within the agencies. A major part of our work involved reviewing agency investigative files on sample fraud cases and recording the information in the files on our data collection instrument. In addition to collecting statistical data, we followed up on selected cases to determine what internal control deficiencies had allowed fraud to occur. In doing this we discussed the cases with agency program officials responsible for the areas where fraud occurred, and reviewed documentation on agency policies and program procedures at 21 agencies. We did our review at the headquarters of each agency as well as numerous agency field offices.

1/Since the period covered by our review, HEW has been reorganized. Its functions have been transferred to two new agencies--the Department of Education and the Department of Health and Human Services.

CHAPTER 2

FRAUD AND RELATED ILLEGAL ACTIVITIES

ARE WIDESPREAD

Fraud and related illegal activities against the Federal Government are a widespread problem. Fraud has been detected in every agency in our review and in all types of activities within these agencies. Actual losses due to fraud and other illegal activities will never be known because most go undetected.

DIRECT DOLLAR LOSSES DUE TO FRAUD ARE SUBSTANTIAL

Based on statistical projections of the data compiled, we identified actual or estimated dollar losses in about 48,800 fraud cases. Using the available data we were able to project that known losses due to fraud in the 2-1/2 year period reviewed were between \$150 and \$220 million. As indicated earlier, this figure includes only those fraud cases investigated by Federal agencies. Our estimated dollar loss does not include cases where State or local jurisdictions had primary investigative responsibility. Some of those losses are substantial. For example, in 1977 we reported that the Federal Government was losing close to \$600 million a year in the food stamp program because of overissued benefits. ^{1/} Complete and accurate nationwide data was not available on the percentage of these losses due to fraud, but at five food stamp projects we visited, available data showed that about half of the overissuances were classified as suspected fraud.

Agencies planned to recover only a small percentage of their losses

Overall planned recoveries were between 20 and 29 percent of total losses due to fraud. Courts ordered defendants to repay the Federal Government a total of nearly \$14 million in about 1,500 cases. In about 13,000 cases, agencies planned to recover about \$29 million through administrative actions, such as working out a repayment agreement with the culprit or taking it out of the culprit's retirement fund. However, the total planned recoveries of about \$43 million were small compared to total losses of between \$150 and \$220 million.

Moreover, the fact that a court orders restitution does not necessarily mean the money is actually recovered. In one case we became aware of during our review, a General Services Administration (GSA) building management specialist took advantage of inadequate controls to establish a fictitious company which received

^{1/}"The Food Stamp Program--Overissued Benefits Not Recovered and Fraud Not Punished," CED-77-112, July 18, 1977.

about \$300,000 in payments for services never performed. In a criminal proceeding the defendant pleaded guilty to embezzlement. In a later civil proceeding in August 1978, the Federal Government was awarded almost \$613,000 under the Federal False Claims Act. The amount awarded included double damages and penalties for false statements. At the time of this report, the Department of Justice had been unsuccessful in its attempts to obtain payment of the award.

In another case, an individual embezzled nearly \$16,000 in Law Enforcement Assistance Administration grant funds. The individual was sentenced to 3 years probation, required to perform 200 hours of community service, and required to repay the stolen money. However, it is doubtful that full restitution will ever be made because, under terms agreed to by the Office of Probation of the Federal district court handling the case, the individual is repaying the Government at the rate of \$20 a month. Thus, it will take her about 65 years to repay the \$16,000.

Although we did not attempt to determine the amounts agencies recovered through administrative actions, we believe that actual recoveries are much lower than planned recoveries. For example, agencies often set up repayment schedules which are not adhered to by the culprit. All too typical is the case where a welfare recipient obtained excess payments of over \$8,000 from Social Security's Supplemental Security Income program. The individual agreed to repay the agency \$3,000 to avoid prosecution, but agency officials told us they actually recovered only \$50.

We did not, as part of this study, evaluate the problems agencies face in recovering losses due to fraud. However, we plan to do another study which will address how agencies can increase the recovery of fraud losses.

Small dollar frauds may indicate big problems

While the public is usually aware of highly publicized cases with large dollar losses, smaller dollar frauds must not be written off as immaterial because they may be the first symptom of serious internal control problems.

An example of such a case is a payroll fraud committed by a clerk at the Military District of Washington Finance and Accounting Office which disburses \$1.5 billion a year.

The employee used her official position to have 12 fraudulent payroll checks totaling about \$17,000 issued to two accomplices. She was able to commit the fraud because there was no separation of duties and no matching of persons paid with persons employed. Clerks had complete control over entering names on the payroll, issuing time and attendance cards, and removing names from the payroll.

As a result of a subsequent review, three more employees confessed or were found guilty of defrauding the same office of over \$16,000. Two others in the office were also arrested for suspected fraud involving \$95,000.

In an audit following the fraud discovery, we found that at least \$308,000 in overpayments and erroneous payments had been made by the Finance and Accounting Office in question. We also found that payroll office personnel had made over \$531 million in unsupported adjustments to accounting records to make them agree with figures reported to the Treasury Department. 1/

MANY DIFFERENT TYPES OF INDIVIDUALS
AND ORGANIZATIONS COMMIT FRAUD

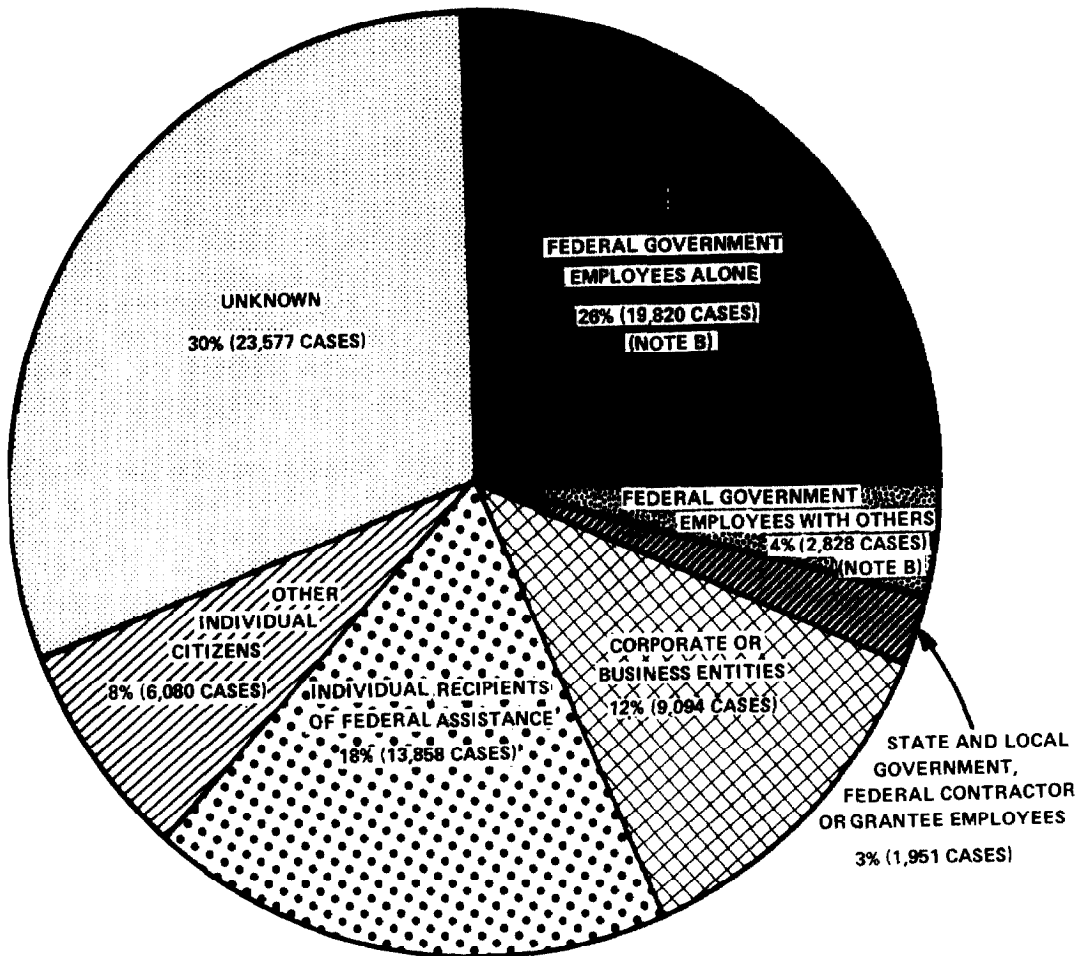
About 29 percent of the cases of fraud against the Government were committed by Federal employees. Consequently, the integrity of Federal employees is being closely scrutinized. The number of cases involving Federal employees is large. Even so, the Federal employees involved represent only about four-tenths of one percent of the Federal civilian and military personnel at the agencies covered by our review. In about one-quarter of the cases, individual citizens committed the fraud. Another 15 percent of the cases involved non-Federal organizations such as contractors, grantees, corporate recipients of financial assistance, and other business entities. In the remaining cases, the Federal agency was unable to identify the suspects.

Most of the cases where the Federal agencies were unable to identify the participants were theft cases. In some instances, noncompliance with established procedures or inadequate controls hampered agency attempts to identify suspects. For example, during a Department of Energy (DOE) audit 15 radios worth almost \$8,000 were missing and were thought to have been stolen. An investigation could not identify any suspects because too many people had an opportunity to steal the items and two years had elapsed since the last inventory. Our review of controls revealed that keys to the storage area were accessible to many employees.

The chart on page 7 shows the participants in the fraud cases identified in the 21 agencies reviewed.

1/"Major Deficiencies in Army's Washington, D.C., Finance and Accounting Operations," FGMSD-80-53, June 5, 1980.

WHO COMMITTED FRAUD?
(NOTE A)



a/Cases total 77,208 rather than 77,211 due to rounding and weighting of the data. Percentages on chart total 101 percent due to rounding.

b/Percentage of cases involving Federal employees totals 30 percent, rather than 29 percent, because of rounding.

FEDERAL AGENCIES HAVE BEEN SUSCEPTIBLE TO MANY TYPES OF FRAUD

As noted in our report "Federal Agencies Can, And Should, Do More To Combat Fraud In Government Programs" one of the prerequisites to controlling fraud is knowing where fraud has occurred and its extent. Our review was done, in part, to develop this information Government-wide.

Fraud occurred in all 21 departments and agencies included in our review. Agencies were susceptible to literally hundreds of different types of fraud in a wide range of functional areas.

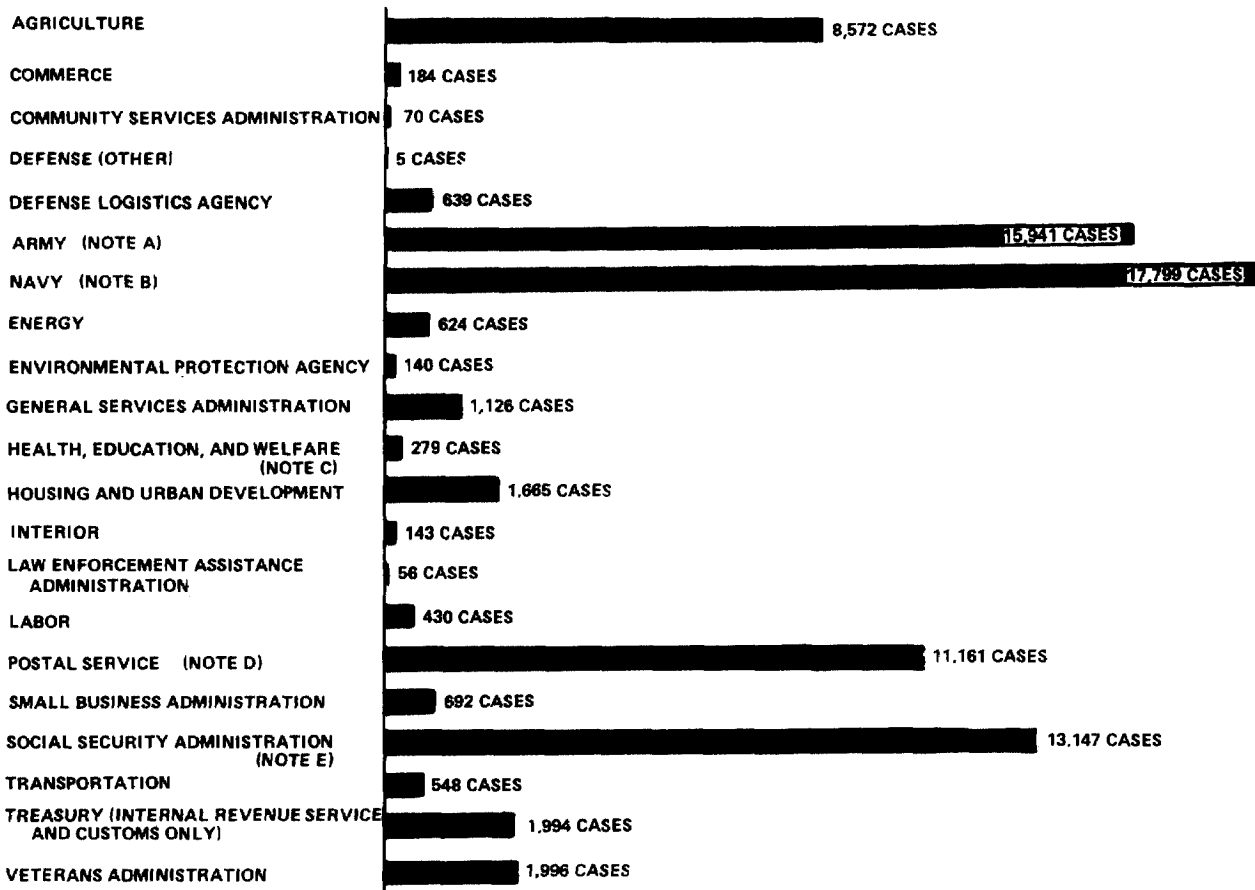
Statistical summary of cases by agency,
functional area, and type of fraud

The following graphs present statistically developed numbers of fraud cases for each Federal agency we reviewed, and for the functional areas and types of fraud identified in these cases.

Analyses and conclusions based on the data presented must be carefully made. Several points should be kept in mind. We did not attempt to evaluate the investigative procedures used or the evidence developed, nor did we independently develop lists of fraud cases, or verify lists provided by each agency. As a result, conclusions that one agency has better fraud detection systems than another because it discovered more cases are not necessarily valid. It would also be incorrect to conclude that because one agency has identified more fraud than another it is more prone to fraud, less well managed, or otherwise not fulfilling its responsibilities.

As shown in the chart below, 66,620 cases or 86 percent of the detected fraud occurred in five agencies (Social Security Administration (SSA), U.S. Postal Service, Department of Agriculture, Department of the Army, and Department of the Navy). Theft was the most common type of fraud in the Postal Service, Army, and Navy. False statements were the most frequent fraudulent acts against SSA, and food stamp irregularities accounted for a majority of the cases in the Department of Agriculture.

FRAUD CASES BY AGENCY



a/Includes 307 Army-Air Force Exchange Service cases.

b/Includes the Department of the Navy and the Marine Corps.

c/Since the period covered by our review, HEW has been reorganized. Its functions have been transferred to 2 new agencies--the Department of Education and the Department of Health and Human Services.

d/The cases in our Postal Service universe only represent a portion of the cases investigated by the Postal Service during the period of our review. Most of the cases we included in our universe were mail theft cases involving Postal employees or contractors. Other types of cases included such things as cash shortages at post offices, theft of supplies and equipment, fraudulent loss claims filed by Postal patrons, money order thefts, time and attendance abuses, and insufficient funds checks where there appeared to be intent to defraud the Service. We did not include cases involving the theft of mail once it was properly delivered to an address because there is usually no liability to the Postal Service in these cases. We also did not include burglaries and hold-ups. While we believe the cases we selected are the bulk of the cases that are of interest in this study they represent only a part of the cases investigated by Postal inspectors each year. For example, the vast majority of mail thefts occur after the mail is properly delivered, and over 90 percent of the persons arrested for the theft of mail in fiscal 1980 were non-Postal employees. According to Postal officials, the Service performed about 45,000 criminal investigations in fiscal 1980 which resulted in about 9,600 convictions for Postal offenses.

e/SSA was formerly part of HEW and is now part of the Department of Health and Human Services. For the purposes of our review, we treated SSA as a separate agency because it investigated and handled almost all the cases involving the Social Security Retirement and Supplemental Security Income programs.

About 93 percent of the cases involved theft, false statements, food stamp irregularities, and a wide variety of miscellaneous frauds. Destruction of Government property and insufficient funds checks were the most common types of miscellaneous fraud detected.

TYPES OF FRAUD COMMITTED AGAINST THE GOVERNMENT (NOTE A)



^a/Cases total 77,212 rather than 77,211 due to rounding and weighting of the data.

As previously noted in the DOD definition (p. 2), theft is considered a type of fraud or illegal activity. It is viewed as a willful or conscious wrongdoing that adversely affects the Government's interests. As the above chart shows, theft accounted for almost half the cases identified by the agencies. In many theft cases we found that Federal agencies failed to adequately control and safeguard Government equipment and supplies. For example, at one DOE facility we evaluated 43 cases, most of which involved theft, and found internal control deficiencies to be a contributing factor in the majority. In one case, \$327 worth of paper disappeared from a contractor's delivery drop point--an unsecured stairwell--at the facility. Although the amount of money involved was relatively small, officials said that they had a continual problem with items being stolen from this drop point. One

contractor official said the contractor was lucky to get half of the items delivered to the stairwell. We found that the contractor did not require signed receipts for supply items and that these items were often left unsecured at delivery points making them highly susceptible to theft.

The next chart shows that 58,470 cases--about 76 percent of the total cases--occurred in four functional areas. The types of fraud most often associated with these functional areas were false statements and theft.

MAJOR FUNCTIONAL AREAS AFFECTED BY FRAUD (NOTE A)



a/Cases total 77,214 rather than 77,211 due to rounding and weighting of the data.

Examples of fraud cases in major functional areas

The cases presented in this section are typical types of fraud in the various functional areas. Dollar amounts identified do not, however, represent the normal or average loss. We included both large and small losses.

Financial assistance to individuals

Financial assistance to individuals is the most fraud-prone functional area identified. A typical case involved an individual who properly applied for and received mother and daughter survivors benefits after the death of her husband, a wage earner covered under Social Security. As part of the application, the individual agreed to notify the SSA when her daughter no longer qualified as a dependent. Under the program, the daughter would be ineligible if she married, and the payments received by the mother would be reduced accordingly.

The daughter married within 6 months after her mother filed for benefits. The mother did not notify SSA of the change in status and received over \$4,300 in excess benefits. After pleading guilty to one count of fraud, she was sentenced to 6 months probation and ordered to repay the money to the agency.

Inventory control and property management

Inventory control cases involve the theft or misuse of Government property such as equipment, parts, vehicles, and supplies.

An example of a case affecting this function is one where a DOE research facility lost Government property costing about \$130,000. Officials at the facility certified that the equipment was worthless and that it had been scrapped. However, a DOE inspector general investigator found no basis for the certification. About \$68,000 worth of the equipment was later found and put back in the property inventory. The rest of the equipment was still missing at the time of our review.

Control over Government property at the facility was weak. At the time of our review, over \$10 million in Government property at the facility had not been inventoried for 2-1/2 years.

Personal property management

The Department of Defense and other Federal agencies have general authority to reimburse their personnel for personal property stolen from, or damaged in, living quarters assigned by the Government up to a maximum of \$15,000. The losses must be incident to the individual's service. A significant number of cases detected in the Departments of the Army and Navy involve the theft of personal property from military barracks.

The Department of the Army paid about \$1.6 million in fiscal 1979 to claimants who had personal property stolen. Although statistics are not available for total claims paid by the Department of the Navy, we believe that the total, based on the number of cases detected, is probably substantial.

Mail service

The mail service cases we looked at consisted primarily of the theft of registered and insured mail. As indicated earlier (p. 9), we did not include the theft of mail after it was properly delivered because there is usually no liability to the Postal Service.

In one incident, Postal investigators suspected a clerk of stealing five mail pouches containing cash, coins, and jewelry. The individual was put under surveillance. He was subsequently tried, convicted, and sentenced to 3 years (with all but 3 months suspended) for thefts committed during the surveillance. The total loss to the Postal Service was about \$112,000.

Personnel

The personnel cases involve the operations and activities of a department's personnel section such as improper hiring, firing, and promoting. False statements on employment applications are the most frequently encountered problem. For example, several DOD cases involved the fraudulent enlistment of illegal aliens into the Marine Corps. The aliens enlisted by presenting false birth certificates or other false proof of U.S. citizenship. In another typical case an Army recruiter, under pressure to fill his quota of enlistments, allegedly encouraged a recruit not to disclose his police record.

Cash control

The cash control functional area includes the use and control of Federal funds. Theft or embezzlement is the most frequent type of fraud in this area.

In one case a purchasing agent at a Veterans Administration (VA) medical center allegedly embezzled more than \$60,000 from an imprest fund over a period of about 5 years. Imprest funds are cash on hand for the day-to-day miscellaneous financial needs of an agency. The agent allegedly covered the losses from the fund with fraudulent purchase orders for goods never delivered. Purchases made from the fund were supposed to be confirmed by certain other employees. However, the agent either got the individuals to verify that goods had been delivered without actually seeing them, or forged their signatures on receiving documents. The documentation he maintained to support purchases from the fund did not include vendor receipts as required by Federal Procurement Regulations. However, the lack of adequate documentation was not questioned during audits and management reviews of the fund over the 5-year period during which the fraud occurred.

The agent was finally caught because the medical center implemented a centralized accounting and management system. Shortly after the system was implemented, a pharmacist discovered that the

pharmacy account was being charged for drugs never received, and reported the matter to the appropriate VA officials.

Loans and loan guarantees

Many Federal agencies administer programs which provide direct loans or loan guarantees to individuals and organizations who meet certain criteria. For example, the Small Business Administration (SBA) makes loans to small businesses. VA and the Department of Housing and Urban Development (HUD) guarantee home mortgage loans for qualified home buyers.

A typical case in this area is one where an individual borrowed \$30,000 from SBA to buy a business. The borrower actually only paid \$12,000 for the business. He allegedly used the rest of the money for purposes other than those allowed in his loan agreement.

Another example of problems in this area is the case of loan guarantees that were issued to nonveterans and ineligible veterans because of collusion between a real estate broker and a VA eligibility clerk. The eligibility clerk allegedly accepted numerous bribes from the real estate broker to issue phony certificates of eligibility for veterans benefits. These certificates were then used to obtain over 100 home loan guarantees for ineligible individuals. A VA investigation of one lending institution which provided loans to 47 individuals purchasing homes through the broker showed that over half the borrowers receiving VA guaranteed loans were not actually veterans.

Payroll

Payroll preparation, processing, distribution, and related activities are common areas of fraud, waste, and abuse. Working hour abuses and false statements on time and attendance documents are the most frequent problems.

In one case, a Government employee assigned to a Social Security Administration branch office was responsible for maintaining time and leave records and sending the information to HEW's central payroll office. The individual added fraudulent overtime hours to her own payroll data before sending it. This same individual also distributed the payroll checks. The fraud was only detected because the timekeeper was absent on a day when the payroll checks were received for distribution. Her supervisor distributed the checks and noticed the timekeeper was receiving excess pay. The individual received \$3,200 in fraudulent overpayments before being caught.

Miscellaneous areas

A large number of cases fell into a wide range of other functional areas. For example, about 2 percent were in law enforcement

and in travel. About 1 percent were in procurement and disposal of surplus property. All the rest of the functional areas affected represented less than 1 percent of the total cases.

THE NONMONETARY EFFECTS
OF FRAUD ARE SUBSTANTIAL

The cost of fraud and other illegal activities cannot always be measured in dollars. Nonmonetary effects must also be considered in evaluating the seriousness of incidents of fraud against the Government.

Possibly the most serious nonmonetary effect is the loss of confidence in the Government's ability to efficiently and effectively manage its programs. This occurs when members of the public believe that individuals can commit illegal acts without fear of prompt, or possibly any, Federal action. Such perceptions, whether valid or not, can result in the view that such activities are the norm.

In over 14,000 cases where no money was lost, individuals did not receive the benefits intended or they received benefits for which they were not eligible. An example is the case where a grocery store accepts food stamps for ineligible items such as beer, wine, and cigarettes. In other cases, veterans sometimes act as "straw buyers" and obtain VA guaranteed home loans for nonveterans. Under this scheme, a veteran purchases a house using his or her VA benefits and then turns the property over to the real buyer. In many of these cases it is difficult to pinpoint a direct dollar loss, but individuals or organizations are clearly receiving benefits to which they are not entitled. Violations such as these threaten program integrity and could lead to the eventual cancellation of the programs involved and loss of benefits for the program participants who obey the rules.

Fraud also has other serious effects which more directly affect people's lives. In about 630 cases the fraud had a potentially harmful effect on public health and safety. A good example is the case where the superintendent of a municipal wastewater treatment plant and at least three other people were involved in a scheme to falsify discharge reports required by Federal law. The individuals intentionally dumped raw sewage into a river and then falsified reports to the Environmental Protection Agency (EPA) on the amount of sewage released.

CHAPTER 3

CONTROL WEAKNESSES ALLOW

FRAUD AND OTHER

ILLEGAL ACTIVITIES TO OCCUR

The Federal Government spends more than \$500 billion and provides a multitude of services annually. Every Federal manager has an obligation to see to it that his or her program's assets are safeguarded against improper use. Strong systems of internal controls designed into each Federal program or operation are the primary mechanism managers have to protect public funds. Internal controls are the first line of defense against fraud. In addition to reducing the amount of fraud, internal controls also aid in earlier detection of questionable activities when they do occur. However, internal controls alone are not enough to prevent fraud. Management has to establish an environment where controls are understood, encouraged, and enforced if the controls are to be effective.

During our review we found many instances where controls were either inadequate, not followed, or nonexistent. In many cases, we believe this was due to a lack of management concern about adequate controls.

STRONG SYSTEMS OF CONTROLS ARE NEEDED TO PROTECT PROGRAMS FROM FRAUD

Strong internal control systems help ensure that specific transactions are carried out correctly. Quite simply, internal controls are checks and balances over all activities of an organization (both fiscal and managerial). Examples of internal controls are separation of duties so that one individual does not completely control a financial transaction; physical security measures that protect Government property, funds, and records; and verification and reconciliation procedures built into an activity to assure that transactions are handled properly.

A recent GAO report concluded that, because of inadequate internal controls, most Federal agencies operate systems that are vulnerable to fraud, physical losses, and waste. ^{1/} The report summarized conditions noted in a series of GAO reports issued between December 1976 and October 1979 and covered financial and accounting operations at 157 fiscal offices in 11 Federal agencies. We reported on numerous internal control weaknesses that made Government operations vulnerable to fraud and other illegal activities. For example:

^{1/}"Continuing and Widespread Weaknesses in Internal Controls Result in Losses Through Fraud, Waste, and Abuse," FGMSD-80-65, Aug. 28, 1980.

- Money collected at many fiscal offices was subject to loss or misuse because of inadequate controls over recording, depositing, and safeguarding funds, and failure to segregate duties. One office lost \$12,000 because it allowed funds to accumulate for several weeks, and in some cases months, before depositing them. This was against Treasury Department requirements which state that agencies should deposit large collections daily and smaller collections at least weekly.
- Expenditures at many offices were subject to diversion and misuse because of inadequate checks on the propriety, accuracy, and legality of payments. At one location a financial clerk was able to embezzle over \$856,000 because the office did not adequately audit vouchers before payments were made.
- Government Transportation Requests in many locations were susceptible to conversion for personal use because of inadequate safeguards and controls. These documents are issued to Federal employees to be used in place of cash or checks to pay for travel on official business. An employee at one location converted Government Transportation Requests amounting to more than \$30,000 over a 2-year period. He was able to do so because he had total control over acquiring, maintaining, issuing, and accounting for the easily convertible documents. This illegal activity was discovered only when other improper activities by this employee were investigated.
- Imprest funds were often exposed to the risk of loss, theft, or misuse because not all agencies were adequately controlling, safeguarding, or managing millions of dollars in such funds. One fiscal office that was not following GAO and Treasury requirements that funds be adequately safeguarded lost about \$209,000. The office kept its imprest funds in an unlocked cashbox stored in a safe which was accessible to several people other than the cashier.

CONTROLS WERE INADEQUATE, NOT FOLLOWED,
OR NONEXISTENT

During our review we found many instances where controls were either inadequate, not followed, or nonexistent. While internal controls cannot put an end to all fraud, we believe many frauds might have been prevented if good control systems had been in place. The following cases illustrate these problems.

Inadequate controls--embezzlement
of funds

The alleged embezzlement of almost \$2 million over a 3-year period from the Department of Defense's Civilian Health and Medical Program of the Uniformed Services shows what can happen without

good controls. The program pays non-Government hospitals and doctors for the medical care of eligible military personnel and their dependents. Because of poor controls, a civilian program administrator in Korea was allegedly able to embezzle funds by preparing and certifying over 3,300 phony medical claims.

The major inadequate control was a lack of separation of duties. One person was responsible for processing and approving all claims received under this program in Korea. Because of this broad responsibility, the administrator was allegedly able to falsify claim forms and later certify the fraudulent claims for payment.

According to DOD investigative files, the administrator instructed hospitals to submit claim forms with the address, cost, and sometimes the authorized provider's signature spaces left blank. He filled in the blanks with inflated amounts and mailing addresses which he controlled. In his role as sole certifying officer, he then prepared another standard form certifying the correctness of the claim, and forwarded both forms to an Army finance and accounting office. The finance and accounting office would mail a Government check made out to the hospital to the address shown on the form. The files indicated that once the checks were delivered to his mailboxes, the administrator allegedly forged the hospital endorsement, cashed the checks, paid the hospitals the actual costs, and kept the difference.

Besides poor internal controls, management supervision was weak. While the administrator was supposed to receive general supervision from the Army Comptroller, we were told that no one ever questioned his activities. Further, we found there had never been an on-site audit to determine if the administrator was following proper procedures.

The alleged fraud was detected by a Defense Audit Service DOD-wide survey of the validity of claims filed under the Civilian Health and Medical Program of the Uniform Services. During the survey, the audit service questioned a claim totaling \$1,424 from a Korean hospital. A follow-on investigation by the Army's Criminal Investigation Command found that the claim should have been for \$294. After investigators started asking more questions about claims in Korea, the administrator resigned and left the country. A Federal grand jury indicted the administrator on November 7, 1979, but by that time the individual had disappeared. The suspect has since been captured and is awaiting trial. Only about \$200,000 has been recovered.

Controls were not followed--
FAA inventory theft case

Government equipment worth \$3,390 was apparently stolen from two Guam Federal Aviation Administration (FAA) facilities sometime between February and July 1978. When the theft occurred, formal

control procedures for building security and inventories included (1) locks on all facilities and (2) property custodians responsible for protecting and safeguarding assets. Although both facilities were equipped with locks, the locks at one site were damaged and did not work, and FAA officials left the doors open at the other site. As a result, unauthorized people could enter the facilities and steal equipment without being detected.

Physical control and accountability for inventories was also poor. FAA officials did not adequately safeguard equipment shipped or received. For example, equipment returned for repair was left unsecured in an administrative office. The office was accessible to many people.

Inventory control problems were not new at these locations. In an evaluation performed in March 1977, an FAA official reported that inventory accuracy could not be determined because property records had been improperly maintained since 1975. Also, he could not determine if property receipts and transfers were properly documented.

Our review revealed that weaknesses at the time of the theft still continue. Because of poor control procedures FAA is still unable to account for significant inventory amounts at the facilities where the thefts occurred. We determined that it was unable to account for at least 40 percent of the equipment on its inventory records at these locations.

Controls did not exist--
DOD procurement case

One of our sample cases involved crude oil deliveries to a Navy facility under a Defense Logistics Agency (DLA) contract. DLA purchases billions of dollars of fuel a year for DOD and certain civilian agencies. Former contractor employees alleged that a private company was shorting the Government on shipments to a Navy facility. The Naval Investigative Service and the Federal Bureau of Investigation investigated but could not determine the dollar loss or identify any suspects because contractor shipments were not adequately measured.

The company made the shipments under a standard contract negotiated by DLA's Defense Fuel Supply Center. Contract specifications did not spell out controls to assure that the amount of fuel the Government paid for was received. The contract merely stated that quantities must be verified by receiving shore tank measurements. We found that controls in this instance were virtually nonexistent. Navy personnel did not measure the tank either before or after the receipt of fuel. Using a dipstick, Navy personnel did check the contents of the tank every 24 hours. However, the storage tank at this facility has a 2-million-gallon capacity and an inaccuracy of as little as one-quarter inch in the dipstick measurement would result in a variance in oil quantities on hand of between 7,000 and 15,000 gallons.

GOOD CONTROLS MEAN
QUICKER DETECTION OF FRAUD

Good systems of internal control will usually prevent fraud. If fraud occurs, the systems will normally enable early detection. However, as indicated earlier, we found agency control systems were inadequate in many cases. This is evidenced by the fact that (1) much of the fraud was found by sources other than internal controls and (2) a significant number of frauds were detected long after they were committed.

Fraud was often detected
by means other than controls

Federal employees detected about 34 percent of the fraud cases during the normal course of their day-to-day activities. In most cases employees discovered fraud by chance. An example is the case of a college professor who certified that he had provided individual tutoring to veterans when he actually had not. In some instances the professor and the veterans split the payments, while in others the professor forged the veterans' signatures and kept the entire amount.

One night two VA employees responsible for processing educational benefits claims were riding home together on the bus. One mentioned that he was receiving a lot of benefits claims from students tutored by the professor. The other VA employee responded that he had also processed a lot of claims for the same man's services. A subsequent investigation based on the large number of claims disclosed the fraud.

In another case a Federal supervisor was driving down a highway when he saw one of his employees in another car. The employee was supposed to be on a business trip over 200 miles away. The employee later submitted a false travel voucher claiming expenses for the business trip. An investigation showed that the employee had been making false travel claims for almost 3 years.

About 20 percent of the cases not spotted by controls were detected by compliance or eligibility reviews. Certain agencies do these reviews periodically to make sure program participants are eligible for benefits and are complying with program regulations. About 90 percent of the cases detected by such reviews involved Federal financial assistance to individuals. An example is the educational compliance surveys done by VA. As part of the surveys, VA employees spot check records at educational and training institutions to make sure persons receiving veterans education benefits are eligible. VA does an annual compliance survey of each institution of higher education where 300 or more students receive VA benefits. Its employees also do annual compliance surveys at vocational training schools. If a spot check of enrollment records reveals a large number of discrepancies, a more extensive review is done. Between July 1, 1977, and March 30,

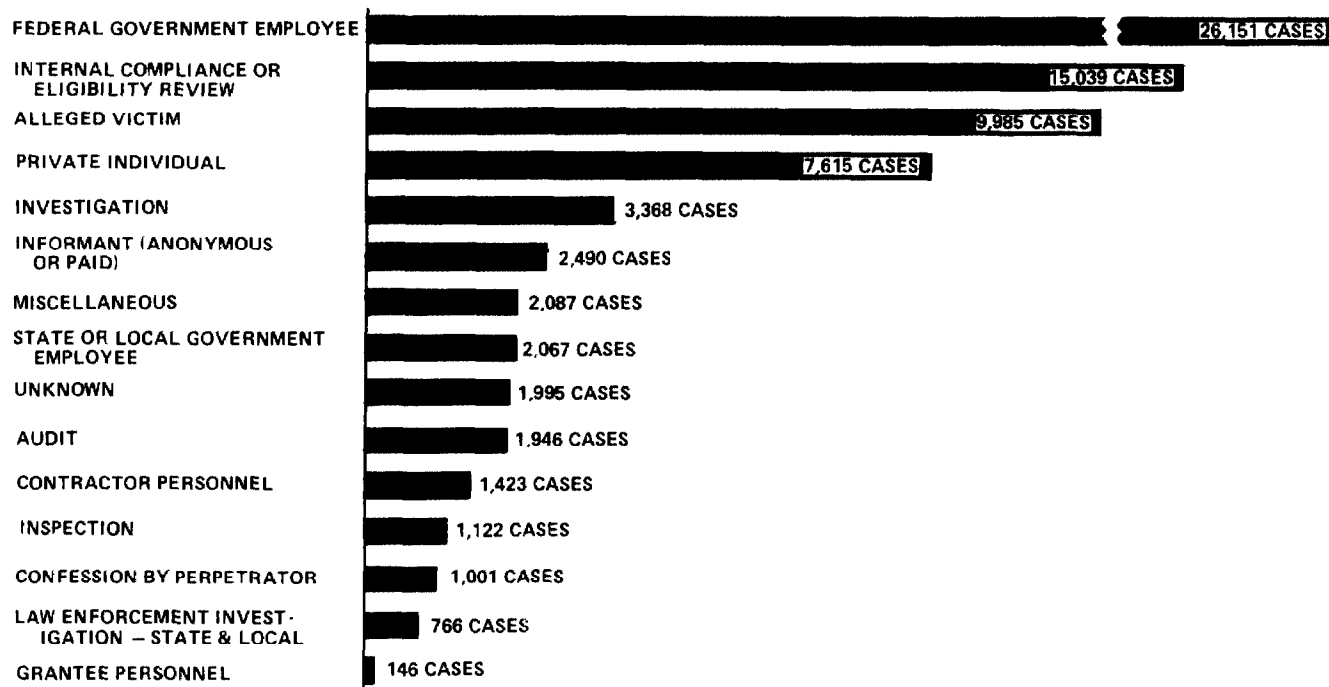
1979, VA did over 28,000 compliance surveys. Compliance investigators found discrepancies at close to 15,000 educational and training facilities.

Compliance and eligibility reviews have been effective in detecting fraud. However, they are after-the-fact checks that can only detect fraud once it has occurred. They are not internal controls because they cannot prevent fraud from happening. In fact, in about 37 percent of the cases, the fraud was not detected by compliance or eligibility reviews until one or more years after it was committed.

Even so, compliance and eligibility reviews are important tools for detecting fraud in programs where it is difficult to establish internal controls. This is especially true in programs such as food stamps and Aid to Families With Dependent Children where third parties are responsible for administering the disbursement of benefits and the Federal Government has no direct control over day-to-day program activities. For example, it is not possible to establish cost effective controls to prevent grocery stores from redeeming food stamps for ineligible items such as beer and cigarettes. The Department of Agriculture uses a computer to generate quarterly reports which identify stores with statistically excessive food stamp redemptions. Agriculture's compliance personnel then visit those stores to determine if the food stamp redemptions are reasonable. If the Department determines that a store's redemptions are unreasonable, undercover investigators visit the store and attempt to catch the owners or employees in an illegal act--either purchasing food stamps at a discount or selling ineligible items.

The rest of the fraud cases were detected through a wide variety of means.

HOW FRAUD WAS DETECTED (NOTE A)



a/Cases total 77,201 rather than 77,211 due to rounding and weighting of the data.

Much fraud went undetected for a long time

Where the information was available, we found that almost a quarter of the fraud in the 21 agencies went undetected for 6 months or more after it first occurred. In 17 percent of the cases, the fraud went undetected for over a year. Moreover, the cases which took longer to discover accounted for a proportionately larger percentage of dollar losses. Half the cases involving losses over \$10,000 took over a year to detect, but only about a quarter of the cases under \$10,000 took more than a year to detect. Adequate controls would have prevented many of these frauds. In a quarter of the cases, the fraudulent acts were committed more than once. In some of these cases where controls did not prevent fraud, they might have at least led to its earlier detection.

An example of inadequate internal controls allowing fraudulent activity to continue undetected for an extended period involves a Customs mail specialist who was responsible for inspecting packages mailed into the United States from foreign countries. The mail specialist stole jewelry and other valuable items at the rate of \$1,000 a day for at least 3-1/2 years.

Total losses in this case were estimated between \$500,000 and \$1,000,000 of which goods valued at \$450,000 were recovered. After arrest, the mail specialist's description of how the items were stolen clearly showed the lack of adequate supervision and internal controls:

- He placed mailing labels for a business owned by his wife over the correct address.
- He carried out small registered packages of jewelry in his apron pocket, his jacket, or lunch box.
- After stealing the contents of a package, he cut up the wrappings and placed the pieces in other packages that were sent out.
- When he stole the contents of a wooden box, he rewrapped the box and labeled it with a false address and false return address. Thus the empty box could not be delivered or returned to the sender.

Since the thefts, Customs has implemented controls to make it more difficult to steal from packages being inspected by its mail specialists. Among other things, Customs procedures now require greater separation of duties.

GREATER MANAGEMENT SUPPORT
OF CONTROLS IS NEEDED

In 1978, we reported that a major cause of fraud was the lack of interest by Federal agencies in protecting their programs from fraud. In this review, we found a much higher awareness of the need to protect programs from fraud but this awareness was often not acted upon. Program management is frequently unconcerned with enforcing the controls needed to prevent fraud. Managers are rated on such things as how much money they spend, how many program participants they sign up, and how many claims they process. These concerns often override concern over whether the money is actually spent properly, and, as a result, controls are often neglected.

In many of the cases we looked at, control procedures had been established but had not been implemented. For example, in the previously mentioned case of the \$17,000 payroll fraud at the Military District of Washington Finance and Accounting Office (see pp. 5-6) separation of payroll duties was required by the Standard Army Civilian Payroll System. This requirement for separation of duties, however, had not been implemented by management. At the time the fraud occurred, managers at the Military District and the Department of the Army had been aware of deficiencies in the payroll operations at the Finance and Accounting Office for several years.

We believe top Federal managers need to be more concerned with ensuring that effective internal controls are operating. Top

managers must insist that middle managers make sure that all operations for which they are responsible contain controls to minimize fraud, waste, and abuse and to ensure effective performance of tasks. When middle managers and employees sense the concern for strong controls they will be more likely to make sure that effective controls are followed.

Proposed legislation could strengthen
accountability for controls

Recognizing the need for strong internal controls over Government operations, the Congress enacted the Budget and Accounting Procedures Act of 1950. The act, among other things, placed the responsibility for establishing and maintaining adequate systems of accounting and internal controls upon the head of each executive agency. More recently, the Congress passed legislation establishing inspectors general in many executive departments and agencies. The Congress is currently considering legislation which would require greater accountability by heads of Federal agencies for the effectiveness of their organizations' systems of internal financial control. The Federal Managers Accountability Act of 1981 (H.R. 1526) would encourage agency heads to establish and maintain effective internal control systems.

The proposed legislation would place greater accountability on Federal managers for their organizations' financial affairs by requiring agency heads to undertake annual evaluations of the adequacy of their organizations' internal control systems. Such evaluations are essential to identifying areas needing remedial action. The legislation would also require agency heads to report the results of such evaluations to the Congress and the President. Agency heads would be required to identify material weaknesses in controls and describe in detail their plans and schedules for remedying those weaknesses.

The requirement for the annual evaluations and reports recognizes the dynamic nature of the internal control environment. Federal agencies are inherently subject to a number of changing conditions which, over time, affect the effectiveness of the agencies' control systems. These conditions include such things as normal personnel turnover, changes in agencies' missions and responsibilities, agency reorganizations, and technological and data processing advances. Regular evaluations are essential to assess the impact of changing environments on internal control systems. If the proposed legislation is enacted, GAO would participate in the evaluation and reporting process by providing guidance for conducting the examinations and by reviewing the results.

THE CONCEPTS OF CONTROL ARE SOUND
BUT IMPLEMENTATION IS OFTEN POOR

Another aspect of our review was an attempt to determine whether existing systems of internal control were effective deterrents to fraud and illegal acts or whether new systems need to be

devised to provide better protection. Our review dealt only with discovered cases of fraud and related illegal acts; consequently, we could not consider frauds and illegal acts that had not been detected. However, many cases were not discovered through internal control procedures. Accordingly, we believe useful conclusions can be drawn from a study of these cases.

Our analysis of these cases, reinforced by our other reviews of internal controls in Federal agencies, leads us to the conclusion that the concepts of internal control currently followed in the Federal Government are reasonably effective. At the same time, we believe that effective use of such controls generally is not high. The reason is that while conceptually the internal controls are generally sound, the concepts frequently are not followed. 1/

As noted earlier, management is often lax in enforcing existing controls. Furthermore, controls designed into accounting systems are often dropped during the implementation of the system or are eliminated while the system is being operated. There are many reasons for this. Some are:

- In computer systems, controls often are eliminated to gain computer memory necessary for other purposes.
- Changes of employees occur and new employees are not thoroughly instructed.
- Controls are eliminated to improve operating efficiency of computer systems without consideration of the loss of control that results.
- Reduction in employees results in doubling up on jobs that originally were assigned to different people for control purposes.

Based on the preceding, we believe the Federal Government's problem is finding ways to get its internal control systems operating effectively rather than devising new controls.

1/An exception to this statement would be the current practice of having certifying officers approve the payment of Government funds. The certifying officers are responsible for assuring that the payments are proper and legal. Both we and the Joint Financial Management Improvement Program have reported that the method used by the Federal Government of having certifying officers attest to the validity and legality of proposed payments has not worked well since the computer became the Government's primary tool for processing payments. We do believe that the certifying officer has a role, but the internal controls of the computer payment systems need to be reviewed periodically. Otherwise the certifying officer does not have sufficient assurance to make meaningful certifications regarding the accuracy and legality of payments.

AUDITORS NEED TO BE MORE ALERT TO FRAUD

Management has the overall responsibility for ensuring that effective controls are in place and are operating. The auditor, on the other hand, performs the very important functions of testing the systems of internal controls in place and making recommendations to management to strengthen those controls. The auditor also serves a deterrent function in that a person is less likely to commit a fraud if he or she knows that the fraud may be detected in an audit.

Despite the auditor's important role as a deterrent, only about 3 percent of the cases in our universe were detected by audit. A little over 20 percent of the frauds detected by audit involved the handling of cash. The typical example would be where auditors counted the cash on hand and discovered the cashier had embezzled some of the money.

The role of the independent auditor in detecting fraud is stated by the American Institute of Certified Public Accountants in section 327.05 of the "Codification of Statements on Auditing Standards" issued in 1980. This section states:

"The independent auditor's objective in making an examination of financial statements in accordance with generally accepted auditing standards is to form an opinion on whether the financial statements present fairly financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles consistently applied. Consequently, under generally accepted auditing standards the independent auditor has the responsibility, within the inherent limitations of the auditing process, to plan his examination to search for errors or irregularities that would have a material effect on the financial statements, and to exercise due skill and care in the conduct of that examination. The auditor's search for material errors or irregularities ordinarily is accomplished by the performance of those auditing procedures that in his judgment are appropriate in the circumstances to form an opinion on the financial statements; extended auditing procedures are required if the auditor's examination indicates that material errors or irregularities may exist. An independent auditor's standard report implicitly indicates his belief that the financial statements taken as a whole are not materially misstated as a result of errors or irregularities."

An example of where auditors were not alert to the potential for fraud is the case of a Head Start grantee who was funded by HEW and the Community Services Administration. The former executive director and other employees of the grantee were accused of numerous fiscal irregularities including receiving unauthorized payments. Although the significant weaknesses in this grantee's

fiscal procedures had existed for years, the certified public accounting firm auditing the grantee always certified that the grantee's accounting and financial system was satisfactory and met HEW guidelines. Further, the auditors did not report control weaknesses even though the executive director maintained almost total control over fiscal matters with virtually no checks and balances.

We recognize the fact that auditors cannot be insurers against fraud. Because of his or her internal control review responsibilities, however, fraud prevention must be considered one of an auditor's most important roles. The auditors' recommendations for control system improvements are often relied on by management, and form the basis for the development and implementation of improved procedures and control systems. In spite of the significance of the prevention role, we believe auditors should devote more effort to detecting fraud. As part of our responsibility for prescribing audit standards for the Federal Government, we recently established standards to make more specific the auditor's role in the detection of fraud and abuse in Government programs and operations. The new standard requires auditors to be alert to situations or transactions that could indicate fraud, abuse, and improper or illegal expenditures.

"Auditors shall: (1) be alert to situations or transactions that could be indicative of fraud, abuse, and illegal acts and (2) if such evidence exists extend audit steps and procedures to identify the effect on operations and programs."

We have also established a standard that auditors should promptly notify the top official of an organization being audited when they become aware of fraud, abuse, or illegal acts or indications of such acts. 1/

1/"Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," U.S. General Accounting Office, 1981 Revision, Feb. 27, 1981.

CHAPTER 4

EFFECTIVE PUNITIVE ACTIONS ARE NOT ALWAYS TAKEN AGAINST THOSE WHO COMMIT FRAUD

It is highly likely that many who commit fraud go unpunished. There are three reasons for this:

- Criminal prosecutions by the Department of Justice are not always possible or desirable.
- Justice may not fully pursue civil remedies against those who commit fraud.
- Federal agency officials do not always take effective administrative actions to punish offenders.

The statistics contained in this chapter are based on 72,797 closed cases where there was some evidence that fraud had occurred and the action taken was the total and final action.

MANY CRIMINAL CASES ARE NOT PROSECUTED

Every year about 200,000 cases of all types of Federal crime including fraud are referred to the Department of Justice for prosecution. With only about 1,600 prosecutors, fewer than those employed in either the State of New York or the State of California, the Department cannot possibly prosecute all the cases referred. Even if the Department could handle all the cases referred, the already overloaded court system would be swamped. Also, more prosecutions would provide an additional burden on the Federal prisons and correctional institutions. Given its limited resources, Justice usually attempts to concentrate on cases which it perceives to have maximum impact and deterrent value. According to our projections, the Department of Justice declined to prosecute about 7,800 cases, or 61 percent, of the nearly 12,900 fraud cases agencies referred for prosecution over the 2-1/2 year period covered by our review.

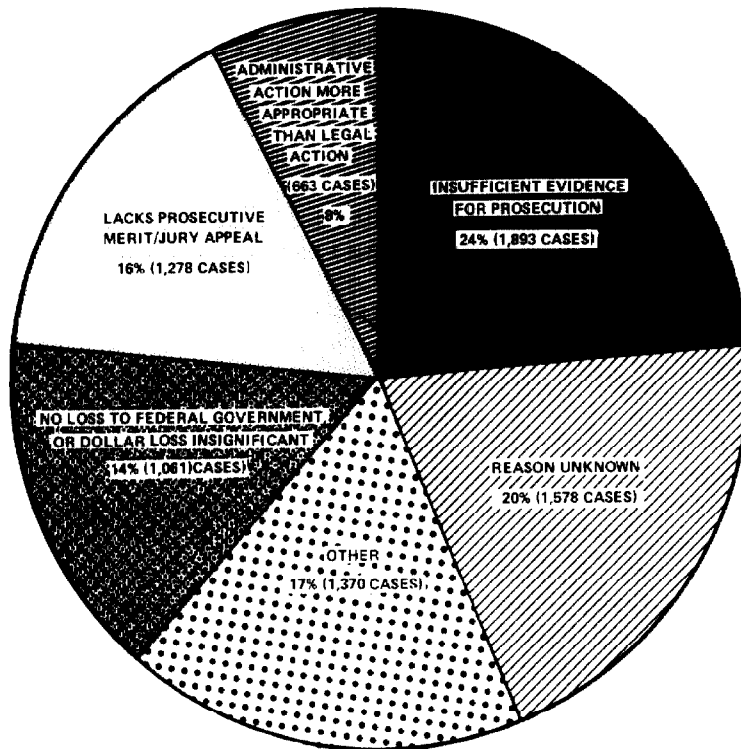
Reasons given by Justice for declining cases

As shown below the reasons most frequently given by Justice for declining cases were related to the adequacy of evidence, the case's prosecutive merit or jury appeal, and the financial loss resulting from the alleged fraud.

WHY THE JUSTICE DEPARTMENT HAS
DECLINED TO PROSECUTE CASES

(7,843 CASES)

(NOTE A)



a/Percentage of cases totals 99 percent due to rounding.

Almost a quarter of the cases were rejected for lack of sufficient evidence. We did not attempt to evaluate the adequacy of the investigations of these cases, or the reasonableness of the declination justification.

About 16 percent of the cases were rejected because they lacked prosecutive merit or jury appeal. "Prosecutive merit" and "jury appeal" have no precise definitions. In these cases U.S. attorneys concluded that, for overriding reasons, prosecution should not be initiated.

U.S. attorneys or Department of Justice headquarters declined to prosecute about 14 percent of the cases because they considered the dollar loss insignificant or there was no loss to the Government. Also, the amount of financial loss to the Government was often a consideration in declining other cases even when it was not the primary reason.

U.S. attorneys and Justice headquarters declined about 8 percent of the cases because they thought agency administrative punitive actions would be more appropriate than legal action. Agencies eventually took administrative action in over 94 percent of the cases declined for this reason. (See pp. 34-38 for a discussion of the administrative actions taken.)

JUSTICE HAS ESTABLISHED PRIORITIES
FOR PROSECUTING WHITE COLLAR CRIME

In August 1980, the Department published national white collar crime law enforcement priorities. Among other things, the priorities are intended to improve the coordination and allocation of limited Federal resources for investigating and prosecuting white collar crime, including fraud against the Government, and to make Federal law enforcement more consistent. Justice intends that the national priorities should be viewed by Federal investigators and prosecutors as indicators of the types of white collar crime that deserve special emphasis.

With respect to fraud against the Government, the new Justice Department priorities emphasize prosecuting fraud cases involving corruption of Federal officials and those fraud cases involving private citizens, acting alone or as part of an organization, which resulted in losses of \$25,000 or more. It appears that at least a quarter of the total prosecuted cases in our review might not have been prosecuted had the new guidelines been in effect. These were cases which involved private citizens, and resulted in losses of less than \$25,000.

In commenting on a draft of this report, the Department of Justice pointed out that the white collar crime priorities are not intended to be guidelines for declining cases. According to the Department, it has emphasized to Federal prosecutors and Federal investigators that the white collar crime priorities describe the types and magnitude of cases that should receive special attention, that priority cases may be few in number, and that cases which may not fall strictly within the priority specifications may nevertheless be very important. In addition, the Department is having each U.S. attorney develop additional priorities to meet the specific needs of his or her own district. According to Justice, as U.S. attorneys define their respective districts' white collar crime priorities, they may, with the Department's approval, deviate somewhat from the national priorities. Therefore, the Department of Justice believes it is not possible to precisely predict the effect of the national and district priorities on the types of cases accepted or declined for prosecution. However, the Department does agree that the priorities will probably mean it will prosecute fewer small dollar fraud cases. We believe, and Justice agrees, that this makes it even more important for agencies to take effective administrative actions against those who defraud agency programs.

JUSTICE IS VERY SUCCESSFUL IN
PROSECUTING CASES

In our sample, Justice got a conviction or guilty plea in 95 percent of the over 4,300 criminal cases it decided to prosecute. In addition, Justice handled about 680 cases through pretrial diversion. Pretrial diversion is a voluntary program which removes suspects from the criminal justice process before trial and places them in a program of supervision, generally by the Federal Probation Service, for a specified period. Successful participants have the charges against them dismissed. We did not obtain information on the number of individuals who successfully completed pretrial diversion.

The Government relies on specific criminal fraud statutes which are suited to a particular fraud, and three general criminal fraud statutes. The three general fraud statutes are the conspiracy to defraud statute (18 U.S.C. 371), the false claims statute (18 U.S.C. 287), and the false statement statute (18 U.S.C. 1001). Fines and sentences vary, but generally the maximum is a \$10,000 fine and a jail term of not more than 5 years. Although most cases are prosecuted under these general statutes, we did not collect data on the statutes under which each case in our sample was prosecuted.

In over 90 percent of the 4,100 cases the Justice Department successfully prosecuted, the courts handed down prison sentences. Some cases involved more than one defendant, and a total of about 4,200 persons were sentenced to prison. The courts often suspended large portions of the sentences or granted probation. About a third of those sentenced actually spent time in prison. The following table shows the time individuals were sentenced to serve in prison. Information on how much time the individuals actually spent in prison before parole was not readily available.

<u>Length of sentences</u> (note a)	<u>Number of individuals</u> (note b)	<u>Percentage of total cases</u>
6 months or less	485	57
7 months to 1 year	39	5
13 months to 2 years	74	9
25 months to 3 years	129	15
More than 3 years (note c)	<u>122</u>	<u>14</u>
Total	<u>849</u>	<u>100</u>

a/Excludes portions of sentences suspended or to be served on probation.

b/Data on the length of sentences was only available on 849 of the 1,337 cases where individuals were sentenced to prison.

c/The longest sentence was 13 years.

In about 1,200 cases the courts fined defendants as shown below.

<u>Amount of fines</u>	<u>Number of cases</u> (note a)	<u>Percentage of total cases</u>
\$1,000 or less	631	65
\$1,001 to \$5,000	198	20
More than \$5,000 (note b)	<u>139</u>	<u>14</u>
Total	<u>968</u>	<u>99</u> (note c)

a/Data on the amount of fine was only available in 968 of the 1,158 cases in which courts levied fines.

b/The largest fine was \$200,000.

c/Does not total 100 percent due to rounding.

JUSTICE MAY NOT FULLY
PURSUE CIVIL REMEDIES

In some instances, civil remedies may be a greater deterrent than criminal prosecutions because civil remedies may be more commensurate with the damage caused by the fraud. Civil remedies are available both in statute and in common law. The principal civil fraud statute is the False Claims Act. The False Claims Act empowers the United States to recover double damages from those who knowingly make false claims for money or property upon the United States, or who submit false information in support of claims. In addition, the United States may recover one \$2,000 forfeiture for each false claim submitted or for each false document submitted in support of a claim. The Department of Justice has proposed changes to the False Claims Act to make it easier to prosecute cases under the act and to provide for stiffer penalties.

In 1979 we completed a study of the Department of Justice's handling of fraud cases with emphasis on the civil aspects of program fraud. 1/ We did the review at nine judicial districts and Justice Department's Civil Division. We found that the Department had not emphasized the civil aspects of fraud cases. Our current study provides additional support for this conclusion. During our 2-1/2 year review period the Department of Justice only filed 28 civil actions out of a total of 393 fraud cases in our universe referred by agencies for civil legal action.

1/"Department of Justice Should Coordinate Criminal and Civil Remedies to Effectively Pursue Fraud in Federal Programs," GGD-80-7, Oct. 25, 1979.

In 1979 we reported that in many fraud cases little consideration, if any, was given to potential civil remedies until after a criminal case was completed. As a result, civil remedies often were not timely, making the total prosecutive effort less efficient and reducing the chance for recovering losses.

We further reported in 1979 that Justice's tradition of giving preeminence to criminal sanctions continued to be implemented in such a manner that the decision to proceed against fraud was made without early consideration of available civil remedies. We also reported that Justice had not provided adequate guidance to address attorneys' concerns about legal barriers to early consideration of civil sanctions, nor had Justice developed an effective referral system to help ensure that fraud cases were reviewed for civil prosecution at an early stage.

In commenting on a draft of this report, the Department of Justice pointed out recent developments in civil and criminal coordination of fraud cases. Justice stated that in recognition of the fact that the investigators and auditors who develop the evidence necessary to bring a civil or a criminal action are a key factor, the Department's Civil Division attorneys have been presenting two to four seminars each month for agency personnel for over a year. Most often, these seminars are given in connection with presentations by Justice criminal attorneys. Justice also noted that it plans to give an indepth course in civil litigation to U.S. attorney personnel this year.

According to the Department, the chiefs of various Civil Divisions of United States attorneys' offices have exchanged plans for the coordination of civil and criminal fraud cases. The Department stated that many of these plans are now functioning and involve early consideration of civil remedies. Justice also said a civil fraud course is being added to the Law Enforcement Training Center's seminar on white collar crime. 1/

According to the Department, a reorganization of the Civil Division has improved anti-fraud activities. The Department stated that more civil attorneys are handling fraud cases and the number of persons screening incoming reports on fraud has quadrupled.

We have not verified the accuracy of these statements. However, we plan to initiate a review of Federal agency efforts to

1/The Federal Law Enforcement Training Center in Glynco, Georgia, is run by the Department of the Treasury. Since December 1978, the Center, in concert with a number of Federal organizations has sponsored a 2-week seminar on white collar crime. The program was developed specifically for experienced investigators, auditors, and others actively combating fraud, waste, and abuse in Government programs. To date, over 1,100 people from over 50 organizations have graduated from this program.

recover losses due to fraud which will include agency actions to take civil remedies against those who defraud their programs. As part of this review, we will examine the improvements that the Department of Justice has made in coordinating civil and criminal prosecutions.

AGENCIES DO NOT ALWAYS TAKE
EFFECTIVE ADMINISTRATIVE ACTIONS

In about 27 percent of the over 47,000 cases where agencies were able to identify suspects, they did not take any administrative action. 1/ However, in about 2,000 of the cases where no administrative action was taken, individuals were prosecuted. In the remaining 11,000, or 22 percent, of the cases no action at all was taken.

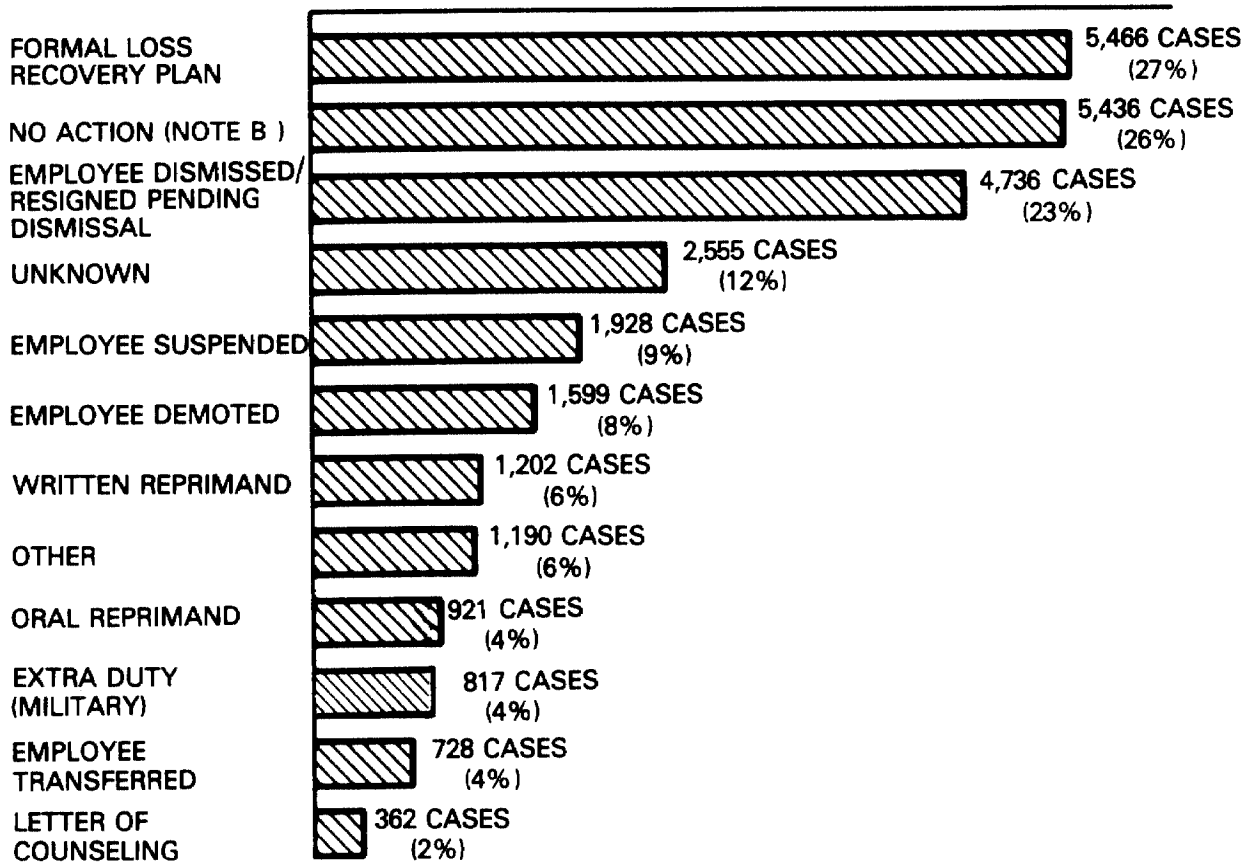
In about a third of the cases where the information was available, the reason most often given by agencies for not taking administrative action was that they did not believe they had adequate evidence. In another 10 percent of the cases, the suspect employees resigned and the agencies felt the cases were not worth pursuing. Agencies gave a wide variety of reasons for failing to act in the remaining cases.

Administrative action against
Federal employees

Agencies took some administrative action in about 74 percent of the cases involving fraud by Federal employees. In many cases agencies took more than one type of action. In about 23 percent of the cases, agencies either fired employees or employees resigned when notified they were being dismissed. In a little over a quarter of the total cases, agencies took administrative action to recover all or part of the loss. The chart on page 35 shows the types of actions taken.

1/In 3,148 cases where suspects were identified we were unable to determine if any action was taken.

ADMINISTRATIVE ACTIONS AGAINST FEDERAL EMPLOYEES (20,582 CASES) (NOTE A)



a/The percentage of actions taken total over 100 percent of the 20,582 cases because in 4,345 instances agencies took more than one administrative action. For example, in 580 cases, agencies fired employees and also took action to recover losses.

b/In 413 of these cases, legal action was taken.

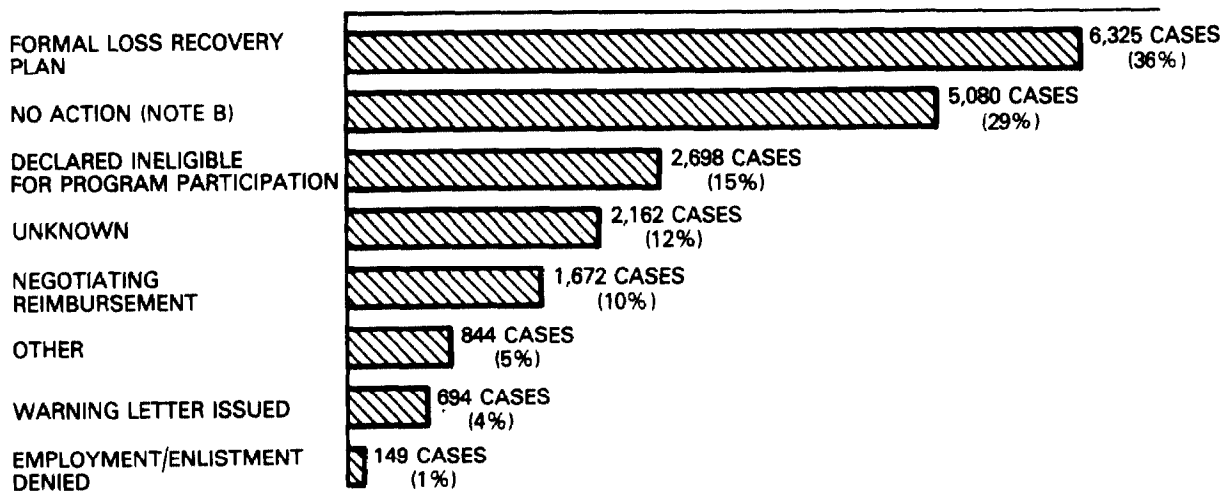
Administrative actions against individuals and organizations outside the Federal Government

The Federal Government can also take administrative action against outside individuals and organizations. These remedies are, however, often less effective than those available against Federal employees.

Overall, Federal agencies took administrative actions against individuals and organizations about 71 percent of the time. Most of these actions were to correct a specific situation and would probably not deter others from committing fraud against the Government. For example, in about 36 percent of the cases involving individuals, the agencies affected took action to recover funds. We agree that agencies should take aggressive actions to recover funds, but such recoveries in themselves provide little deterrence for others considering fraud.

Next to recovering losses, declaring persons ineligible for program participation was the second major type of administrative action taken against individual citizens. Individuals were declared ineligible for program participation in about 15 percent of the cases. The deterrent effect of this action is questionable, since many of the individuals were not eligible for the programs in the first place.

ADMINISTRATIVE ACTIONS AGAINST INDIVIDUALS
(17,536 CASES) (NOTE A)

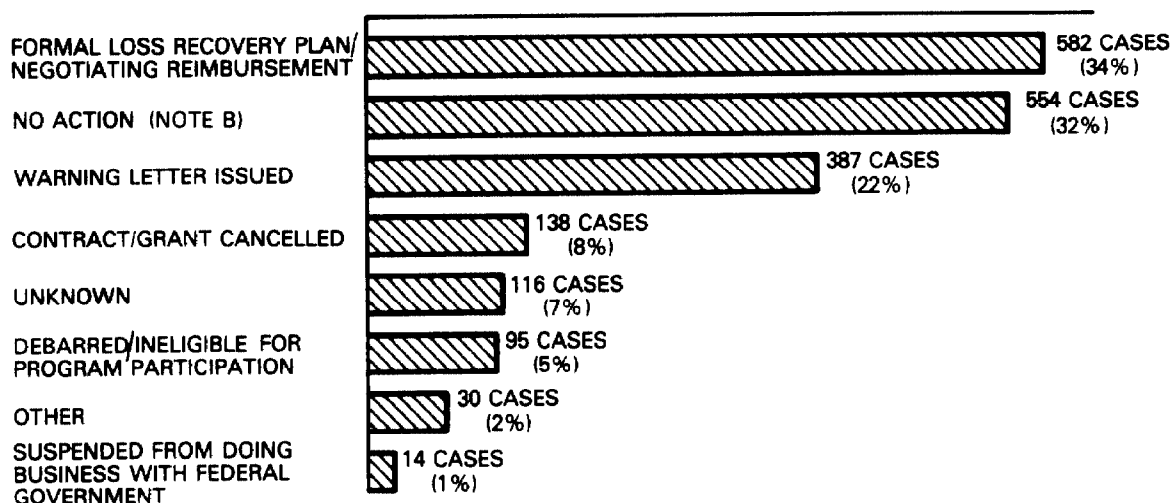


a/The percentage of actions taken total over 100 percent of the 17,536 cases because in 2,051 instances agencies took more than one administrative action.

b/In 1,177 of these cases, legal action was taken.

When Federal contractors, grantees, or State and local governments were involved, agencies attempted to recover the losses in about 34 percent of the cases. In about 22 percent of the cases they sent the organization a warning letter. Agencies cancelled contracts and grants in only 8 percent of the cases. In another 6 percent of the cases, organizations were suspended, debarred, or declared ineligible for program participation.

ADMINISTRATIVE ACTIONS AGAINST CONTRACTORS, GRANTEES, OR STATE AND LOCAL GOVERNMENTS (1,735 CASES) (NOTE A)

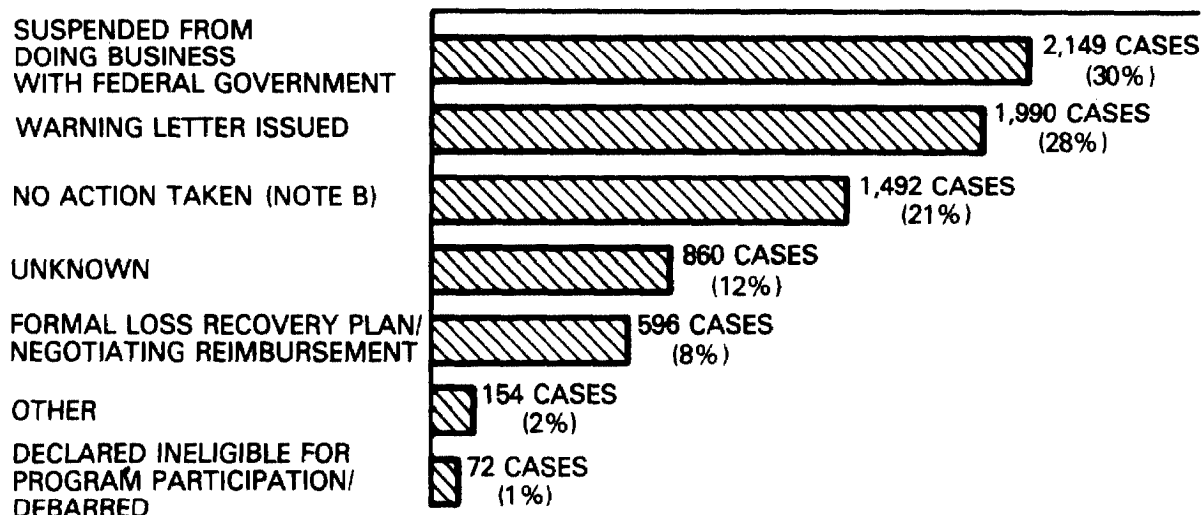


a/The percentages of actions taken total over 100 percent of the 1,735 cases because in 179 instances agencies took more than one administrative action.

b/In 132 of these cases legal action was taken.

Many businesses other than contractors were involved in the frauds. Examples include grocery stores selling ineligible items for food stamps, pharmacies overcharging on medicaid prescriptions, and lending institutions falsifying applications for federally guaranteed loans. In a little over a quarter of these cases, the organizations were suspended from doing business with the Federal Government. In another quarter of the cases, agencies sent the businesses warning letters.

ADMINISTRATIVE ACTIONS AGAINST BUSINESSES OTHER THAN CONTRACTORS (7,200 CASES) (NOTE A)



a/ The percentages of actions total over 100 percent of the 7,200 cases because in 148 instances agencies took more than one administrative action.

b/ In 256 of these cases, legal action was taken.

Civil monetary penalties may be an alternative to prosecution

We believe that Federal agencies should aggressively use available administrative remedies against perpetrators of fraud. In addition, we believe that civil fine authority could be a useful enforcement tool for agencies in those cases where the Department of Justice declines to initiate criminal prosecution or civil suits. Giving certain agencies the authority to levy civil monetary penalties against those who defraud their programs could serve as a strong deterrent against would-be perpetrators of fraud against the Government.

Legislation has been introduced to provide this authority to certain agencies. The Civil Money Penalty Bill (H.R. 4106), which was introduced in the Congress in 1978, would have permitted the Secretary of the former HEW to apply a penalty of up to \$2,000 for each fraudulent claim submitted to the medicaid or medicare programs, and to impose a fine double the amount of such claim. The Secretary could apply the penalties in situations where criminal prosecution was unwarranted or impractical.

More recently, the Federal Property and Administrative Services Act Amendments of 1980 was introduced in the 96th Congress to reform GSA contracting procedures and contract supervisory practices. Among other things, the legislation would have required GSA contractors to certify the truth and completeness of information required to be furnished to the Government. The contractor would be required to certify that

- all material information has and will be furnished;
- the material information furnished is not false, misleading, or incomplete; and,
- the contractor will not furnish false information or fail to furnish revisions of prior submissions to maintain their validity and completeness.

The legislation would have allowed the GSA Administrator to assess a penalty against any person violating the certification. The penalty could range from \$1,000 to double the contract price, depending upon the severity of the miscertification.

Neither bill was passed. However, they illustrate the types of civil monetary penalties that could be imposed by agencies.

The Department of Justice is now completing draft legislation which would allow agencies to levy civil monetary penalties in cases under \$50,000. Under the legislative proposal being considered, the authority would be triggered when the Department of Justice declines to take action in favor of this remedy. In commenting on a draft of this report, Justice said that the remedy is contemplated to be a substitute for civil legal action, but is not intended to replace a criminal prosecution, if appropriate. Under the proposal being considered, a matter could be the subject of criminal prosecution and administrative penalty action. Justice also suggested that the Congress should enact legislation authorizing the offset of tax refunds to recover damages caused by fraud. We have actively supported the concept of offsetting debts against tax refunds.

We have not had the opportunity to comment on the specific legislation being developed by Justice. However, we endorse the concept of allowing agencies to levy civil monetary penalties, where appropriate, against those who defraud their programs. We believe the Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud agency programs when the Department of Justice has declined to initiate criminal prosecutions or civil action.

CHAPTER 5

PROGRESS IS BEING MADE IN

COMBATING FRAUD

In our 1978 report on the need to do more to combat fraud in Federal programs, we pointed out that Federal agencies were not aggressive in detecting fraud and had not fixed responsibility for identifying fraud in agency programs. We also reported that the Department of Justice had been slow to assist, coordinate, and monitor the antifraud efforts of Federal agencies. Since then, progress has been made in agency and Department of Justice attempts to reduce fraud against the Federal Government.

AGENCY INSPECTORS GENERAL ARE COMBATING FRAUD

Over the past 3 years the Congress has established inspector general offices in 15 Federal agencies. By setting up the inspector general offices, the Congress intended to create independent and objective units to conduct and supervise audits and investigations of agency programs and operations; provide leadership and coordination; recommend policies to promote economy, efficiency, and effectiveness; prevent and detect fraud and abuse; and keep the agency head and the Congress informed about problems in administering agency programs, and the necessity for, and the progress of, corrective actions.

The establishment of the inspector general offices in itself has been a big step forward in combating fraud because the 15 agencies now have a focal point for dealing with the problem. An example is GSA. Before the inspector general's arrival, the efforts of the components that now form his office were divergent. The Office of Audits and the Office of Investigations did not coordinate their efforts to attain their mutual objectives. Also, GSA components that now form the Office of the Inspector General were not oriented toward fraud detection and the need for operational controls to prevent fraud in the activities they were examining. The inspector general through reorganization, realignment of priorities, and new methods of operation worked to correct these problems.

In addition to providing a focal point for fraud prevention and detection, agency inspectors general have taken some important steps to improve their fraud prevention and detection capabilities. Among other things, inspectors general have been working together to address common problems, have undertaken joint interagency audits and investigations, and have taken more active approaches in dealing with fraud.

Working together to address common problems

In May 1979, the President created the Executive Group to Combat Fraud and Waste in the Government. The group is an inter-agency mechanism to marshal Government-wide support for the inspector general program and other efforts to combat fraud and waste. The Deputy Attorney General serves as chairman of the group and the Deputy Director of the Office of Management and Budget (OMB) is vice chairman. The Executive Group's membership includes all 15 inspectors general, the Deputy Director of the Office of Personnel Management, and the special counsel of the Merit Systems Protection Board. The Federal Bureau of Investigation, Internal Revenue Service, and Postal Inspection Service are also represented. 1/

The Executive Group has provided a communication network for the inspectors general to share ideas and problems regularly. Mainly the Group has tried to develop more effective procedures and better trained personnel to deal with fraud and waste. The Group has been dealing with problems that go beyond the capacity of individual agencies by sharing the expertise of all the agencies.

In order to study common issues and problems, the Group has set up committees, each chaired by an inspector general, to study four areas: audit and systems; enforcement and investigation; legislation, and congressional relations; and training, staffing, management, and organization. The issues being studied by the committees include:

- Law enforcement powers which might be needed by inspector general investigators, such as the power to arrest or serve warrants.
- Effectiveness of the Government's debt collection procedures.
- Computer security problems.

Joint interagency audit-investigative reviews

Often two or more agencies have similar functions which are vulnerable to the same types of fraud. Some inspectors general have initiated joint interagency audits and investigations to deal with fraud activities that cross agency lines. An example is the joint Veterans Administration/Housing and Urban Development (VA/ HUD) investigations and audits of mortgage practices in Puerto Rico. So far, the VA/ HUD teams have found over 100 single-family

1/In commenting on a draft of this report, OMB said that the administration will be establishing a new council of inspectors general as a successor to the Executive Group to Combat Fraud and Waste.

mortgage loans guaranteed or insured by the VA or HUD which were based on potentially fraudulent loan applications.

Another example is a joint interagency inspector general audit of the acquisition and disposal of office furniture. The joint audit found that, over the last 10 years, Washington-based Federal agencies bought \$1.2 billion worth of new office furniture while \$373 million worth of new or slightly used furniture that could have been used was in storage.

Still another example of inspector general cooperative efforts is a joint investigation by the inspectors general of SBA and the Department of Agriculture to identify recipients of duplicate benefits from the Disaster Lending Programs of both agencies for 1977 crop losses. The investigation found 117 cases of duplicate payments to farmers.

Many other such joint interagency audits and investigations are either planned or underway. Joint audits and investigations can be effective mechanisms for dealing with common problems.

Inspectors general are taking more active approaches against fraud

In 1978, we reported that agencies generally took a reactive, rather than active, approach to fraud detection. Of the seven civilian agencies reviewed in 1978, only one--HUD--had an ongoing, systematic mechanism to actively look for fraud. This mechanism was operational surveys which were concentrated efforts by teams of investigators and auditors to detect fraud and program weaknesses. We reported that the surveys had uncovered numerous occurrences of suspected fraud. Since then, HUD has expanded its operational survey coverage.

In addition, the HUD inspector general established a Fraud Control Division and has assigned it several key responsibilities that increase emphasis on the detection and prevention of fraud and program abuse. Primarily the Division has tried to prevent fraud by concentrating on coordinating the Department's resources to measure and improve the systems and procedures for minimizing losses from fraud or abuse.

Other inspectors general also started programs to actively detect fraud. For example, GSA started 13 active inquiries to detect patterns of fraud and abuse in contract activities that are known to be vulnerable to fraud. The Department of Labor inspector general established a loss prevention program. The program focuses on identifying and eliminating fundamental program and system weaknesses that can lead to waste, fraud, and abuse. Another example of agency attempts to actively deal with fraud is the Fraud and Abuse Control Task Force set up by the Department of Commerce inspector general to do ongoing systematic reviews to prevent and detect fraud and abuse. The task force is supposed to

encourage and aid Department managers in developing administrative control systems that minimize fraud and abuse.

These are a few examples of active approaches undertaken by agency inspectors general to prevent and detect fraud. The majority of inspector general antifraud activities are still reactive. Attempts to take the initiative against fraud have been slow getting started because of inadequate resources. With adequate resources, inspector general programs to seek out and prevent fraud could have a substantial impact in reducing fraud against the Government.

DEPARTMENT OF JUSTICE HAS IMPROVED ITS ANTIFRAUD ACTIVITIES

Since our 1978 report, the Department of Justice has tried several ways of upgrading Federal antifraud activities. It has reorganized certain Justice components, increased the training of its own and other agency personnel, and worked closely with the inspectors general through the Executive Group to Combat Fraud and Waste in the Government.

Organizational changes

The Department of Justice has reorganized both its Criminal and Civil Divisions. The Department believes the reorganization will permit better services to Federal agencies and allow Justice headquarters to work more efficiently with the U.S. attorneys. As part of the reorganization, Justice has added 12 positions to its Fraud Section and 8 positions to its Public Integrity Section. Both these sections have attorneys who work full time on fraud and corruption in Federal programs.

In addition, Justice set up economic crime enforcement units in 21 U.S. attorney's offices nationwide and has allocated 109 attorneys to the program full time. These units are staffed jointly by several assistant U.S. attorneys and one or more economic crime specialists from the Department's Criminal Division. The Division's Office of Economic Crime Enforcement centrally coordinates and directs the program. So that the whole country receives coverage, each unit processes priority white collar crime and public corruption cases in as many as five judicial districts. Fraud against the Government is one of the types of economic crimes handled by the units.

The economic crime specialists, like the assistant U.S. attorneys assigned to each unit, will handle priority cases involving fraud and public corruption. However, case preparation and trial work, which will wholly absorb the assistant U.S. attorneys, will be only part of the specialists' role. The specialists will also be involved in a number of activities directed at coordination, training, information gathering and sharing, planning, and evaluating. The activities will include (1) meeting with investigative

agencies, regulatory authorities, and State and local officials to assess the white collar crime and corruption problems in their district and the effectiveness of existing efforts to deal with these problems; (2) disseminating, both within the district and to other districts, any information about new forms of corruption, particularly criminal groups whose operations extend to other regions, and about successful investigative and prosecutive techniques; (3) working with the investigative agencies to coordinate their enforcement programs and resolve jurisdictional disputes; (4) conducting or arranging for training in such areas as auditing and financial analysis for those investigative agencies weak in these fields; and (5) working with program agencies and the business community to increase awareness of fraud and corruption and to assist these groups in undertaking efforts to detect or prevent such problems.

Primary functions of the specialists will be to assess the extent of white collar crime and public corruption in the districts in which they serve, to evaluate the effectiveness of existing enforcement efforts, and to assist the U.S. attorneys in determining district priorities in these two areas. A two-step process is planned for accomplishing these goals.

The initial phase of the program is to gather information to assist the U.S. attorneys, locally, and the Attorney General, nationally, in setting priorities. Each specialist is charged with collecting information concerning past and present investigations and prosecutions in the area to which he or she is assigned. In addition, the specialist is to obtain information and recommendations from a variety of other sources in the community. From this information, the specialist will develop a report on district public corruption activities and make priority recommendations.

The next program step will be to measure the effectiveness of the units.

More training for Justice and agency personnel

The Criminal Division at Justice has started a variety of specialized fraud training programs and seminars for assistant U.S. attorneys and FBI agents. The training programs are conducted at least twice annually--once on the east coast and once on the west coast--and bring together white collar crime prosecutors and investigators for both training and strategy development.

The Federal Bureau of Investigation is also intensifying its agents' fraud investigative techniques training. The Bureau's training center in Quantico, Virginia, regularly trains agents in Government fraud and financial investigation and computer-related fraud techniques.

In addition to internal training improvements, Justice has increased its training assistance to program agencies. Over the

last couple years, Justice has been giving agency investigators a 1-day training session to improve their ability to deal with major Government fraud matters. The course is taught by two experienced Federal prosecutors and provides instructions on relevant criminal statutes, investigative techniques, task force approaches, grand jury and trial procedures, and other related topics.

Justice has also assisted in several interagency efforts to improve fraud training for investigators and auditors. An example is the assistance it has provided to the Federal Law Enforcement Training Center. For the past 2 years, the Center has conducted a 2-week white collar crime seminar for experienced investigators and auditors. The Criminal Division of the Department of Justice is responsible for 12 hours of the instruction which is provided by senior prosecutors. Over 1,100 investigators and auditors have attended the program to date.

Working with the inspectors general

The Department of Justice is exercising leadership in supporting the Executive Group to Combat Fraud and Waste in the Government. As mentioned earlier, the group is chaired by the Deputy Attorney General. Over the past year, the Department has worked actively with the Executive Group to address common issues facing the inspectors general. In addition, the Subcommittee on Investigative Agencies of the Attorney General's Advisory Committee of United States Attorneys has met during the past several years with the inspectors general and officials of the major Federal investigative agencies in an effort to improve working relationships between the agencies and the U.S. attorneys.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

Fraud is a costly and widespread problem. Once an agency allows fraud to happen, chances are it will never recover the loss. Not only is fraud expensive in terms of dollars and cents, but it also undermines the integrity of Federal programs and makes people lose confidence in public institutions.

Good systems of internal controls would prevent much of the fraud, or would at least result in its earlier detection. Controls over Federal programs are, however, often inadequate, nonexistent, or ignored. Further, Federal managers are often unconcerned with enforcing the controls needed to prevent frauds. Fraud can flourish in such an environment.

Much fraud is detected by chance. Given the poor state of controls in many programs, it is probable that most frauds remain undetected. For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim. Further, agencies do not always use the administrative actions available to deter persons from committing fraud. The sad truth is that crime against the Government often does pay.

Agency inspectors general, along with the Department of Justice, are working to improve the situation. They have initiated programs not only to increase the detection of fraud, but also to improve controls to prevent it. Even so, much more needs to be done.

We believe agencies should emphasize fraud prevention, rather than simply pursuing it once it occurs. Prevention is especially important, since only a low percentage of suspects are prosecuted and agencies often fail to take effective administrative actions against those who commit fraud.

In our view, the Congress' oversight responsibility can be exercised to a greater and more effective degree by strengthening existing law. The Congress is currently considering legislation entitled the Federal Managers' Accountability Act of 1981 that would require greater accountability by heads of Federal agencies for the effectiveness of their organizations' systems of internal financial control. Among other things, the legislation would require agency heads to periodically evaluate the adequacy of their internal control systems and report the results to the Congress and the President. We would participate in this process by providing guidance for conducting the examinations and by reviewing the results. We believe this legislation would contribute to the development of adequate internal control systems in the Federal Government.

We also believe that more needs to be done to assure that those who commit fraud are adequately punished. We recognize that

the Department of Justice cannot prosecute every case referred. This makes it even more important that Federal agencies take effective administrative actions where warranted. In addition, we believe that civil fine authority could be a useful enforcement tool for agencies in those cases where Justice does not take criminal or civil action. We believe the Congress should consider the merits of enacting legislation to allow agencies to assess civil monetary penalties when the Department of Justice declines to take criminal or civil action against persons who defraud agency programs.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress enact the Federal Managers' Accountability Act of 1981.

MATTERS FOR THE CONGRESS TO CONSIDER

We recommend that the Congress consider the merits of enacting legislation to allow agencies to assess civil monetary penalties against persons who defraud Federal programs. The authority to assess such a penalty should be effective when the Department of Justice declines to take criminal or civil action on the case.

RECOMMENDATION TO THE DEPARTMENT OF JUSTICE

The Department of Justice should expedite completion of its draft legislation to give agencies the authority to levy civil monetary penalties and should submit the legislation to the Congress for its consideration.

Chapter 7

AGENCY COMMENTS

We requested that the Office of Management and Budget and the Department of Justice comment on a draft of this report. We also gave each of the other agencies covered in the study an opportunity to review and comment on the draft report. In addition to OMB and Justice, the Departments of Health and Human Services, Housing and Urban Development, Labor, and Transportation, as well as the General Services Administration, the Small Business Administration, the Environmental Protection Agency, and the U.S. Postal Service commented on the report. The agencies generally agreed with our findings, conclusions, and proposals. The full texts of the agencies' comments are in appendixes II through XIV.

OFFICE OF MANAGEMENT AND BUDGET

OMB said fraud and abuse in the Federal Government must be controlled as quickly as possible. The Office agreed that improved control systems can contribute significantly to solving the problem.

The Office said that in addition to the legislative proposals discussed in the report, OMB is considering administrative remedies such as a circular (see pp. 63-64) which would prescribe policies and procedures to be followed by executive agencies in adopting and maintaining more effective internal control systems.

We believe an OMB circular would be beneficial since it would provide a vehicle to implement urgently needed improvements in internal controls. We have reviewed the proposed circular and have given OMB comments on a number of items we believe could be clarified.

DEPARTMENT OF JUSTICE

The Department of Justice said the report reflects a balanced understanding of the Government actions required to effectively respond to the problem of fraud and abuse in Federal programs. The Department basically agreed with the findings, conclusions, and proposals contained in the report. However, the Department believed that the report did not adequately address the recent improvements in coordinating civil and criminal fraud cases. In the body of the report, we included some of the information provided by Justice on recent developments in this area.

Also, we incorporated in the body of the report the Department's clarification of its white collar crime priorities. In addition, the Department made several technical comments which resulted in minor changes to the report. Justice's substantive comments not included in the report are discussed below.

The Department said that the charts on pages 7 and 11 are misleading because they were prepared from agencies' records of

identified fraud cases. According to Justice, one would expect a higher detection rate for Federal employees (and unknowns) simply because this is the readily available "tip of the iceberg" located at the Federal level. Justice said that the report gives the impression that most fraud is committed by Federal employees when, from all indications, the extent of fraud and abuse in federally funded programs at the recipient level is much greater than that committed by Federal employees.

Our report dealt only with cases investigated by Federal agencies as explained in the scope section of our report (p. 2). We agree that if recipient fraud investigated at the State and local levels in such programs as food stamps and Aid to Families With Dependent Children were included in our universe the percentage of Federal employees in our statistics would be very much smaller. Also, the dollar losses would be much higher. However, we excluded State and local investigations because it was not feasible to obtain data on these cases given the large number of separate jurisdictions involved. Also, the Federal Government has little control over these programs.

The Department was concerned that our report did not point out that most fraud cases are referred to the Department by the Federal Bureau of Investigation and not by agencies. According to Justice, about 5,000 reports of potential fraud against the Federal Government are referred to its Civil Division each year. The Department stated that during the 2-1/2 year period studied by GAO, only 685 referrals contained enough evidence of monetary loss to justify assignment to a division attorney for further review. As a result of these referrals, about 70 new fraud cases were filed by Civil Division attorneys during the 2-1/2 year period, and United States attorneys' offices filed additional cases.

Our statistical data did include Federal agency cases referred to the Department of Justice by the Federal Bureau of Investigation. The 5,000 reports of potential fraud referred to the Civil Division by the Bureau are reports of allegations that the Bureau is required to routinely file with the Department's Criminal and Civil Divisions, regardless of the substance of the allegations. Our data is based only on cases where the agencies or the Bureau believed there was enough substance to warrant an investigation. Further, the 685 referrals and 70 cases filed by the Civil Division in the 2-1/2 year period pertain to fraud cases referred from all sources and cover all Federal activities. Our statistics, on the other hand, are based only on cases involving the 21 agencies covered in our review. The Justice comments, however, confirm that the number of civil actions filed during the period was low.

In its comments on the report, Justice noted that the majority of our cases appeared to involve small monetary amounts, and prosecuting these cases would cost several times the amount of potential recovery. The Department believes that the resources

of the civil division and of the United States attorneys' offices are best spent in pursuing recoveries where large amounts are at stake.

We agree that it may not be practical and/or cost effective to pursue civil remedies in many fraud cases. Even so, we believe such remedies should be considered in evaluating each case for possible action. Although not strictly cost effective, selective civil actions in a limited number of small dollar frauds may have a deterrent benefit.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

HUD generally supported the conclusions and proposals made in the report. However, the Department pointed out that agency heads have been responsible for 3 decades for the soundness of their financial systems. (The Budget and Accounting Procedures Act of 1950 requires the heads of the executive agencies to establish and maintain effective internal accounting and administrative control systems.) The Department believes that additional legislative initiatives will not produce the intended results until management's concern for controls is commensurate with its concern for production goals. The Department also said that the proposed legislation will have little impact unless the administration and the Congress provide the resources managers would need to carry out the new law.

We agree that the legislation itself will not improve the situation without a serious attempt by management to follow the intent of the legislation. We believe, however, that the legislation would encourage managers to ensure that their agencies' programs have adequate internal controls. We would participate in this process by providing guidance for conducting the internal control evaluations required by the legislation and by reviewing the results.

With respect to the resource requirements, we recognize that agencies have limited resources that must be allocated among a variety of competing demands. The legislation we are recommending would require managers to take a harder look at the way they use their limited resources. Managers would be required to give a higher priority to establishing and maintaining effective internal control systems than they have in the past.

DEPARTMENT OF TRANSPORTATION

The Department of Transportation believes the report oversimplifies the solution to combating fraud by claiming that sound internal control systems are the general answer to fraud and illegal activities. The Department also stated that additional legislation is not needed since the Budget and Accounting Act of 1921 and the Accounting and Auditing Act of 1950 already cover this requirement. The Department further noted that the Inspector General Act of 1978 added strength to agencies' control over fraud and illegal acts.

We recognize that internal controls cannot prevent all fraud, and say so in the report. The point is that good systems of control can prevent much of the fraud. The deterrent effect of prosecutions and administrative sanctions is another important factor in dealing with the problem.

The laws cited by the Department of Transportation, along with the Budget and Accounting Procedures Act of 1950, were significant milestones in improving the control of Federal funds. The Federal Managers' Accountability Act of 1981, which would require agency heads to evaluate and report on the adequacy of their internal controls, supplements previous legislation on this subject. It further encourages agency heads to develop and enforce adequate internal control systems.

DEPARTMENT OF LABOR

The Department of Labor agreed with our conclusions and proposals. However, this Department noted that staff expertise available to develop and analyze effective fraud and abuse detection and prevention controls may be inadequate.

The legislation we are recommending would require managers to give a higher priority to establishing and maintaining effective internal controls and take a harder look at how they allocate their limited resources.

U.S. POSTAL SERVICE

The Postal Service said that our statements that most losses go undetected and that controls to prevent fraud are often inadequate, nonexistent, or ignored by agency officials do not apply to thefts of registered and insured mail. According to the Service, controls to prevent the theft of registered and insured mail are elaborate and have full support from Postal officials.

We recognize that the statements in question do not apply to every Federal program and activity and that the handling of registered and insured mail is highly controlled. Even so, we believe the lack of adequate internal controls is a serious and pervasive problem throughout the Federal Government.

OTHER AGENCIES

The Department of Health and Human Services, the General Services Administration, the Small Business Administration, and the Environmental Protection Agency agreed with the report's conclusions and proposals. The Department of the Treasury did not comment on our conclusions and proposals, but provided information on Treasury's role in training Federal personnel who combat fraud, waste, and abuse in Government programs.

U.S. GENERAL ACCOUNTING OFFICE
DATA COLLECTION INSTRUMENT FOR
ALLEGED FRAUD CASES

INSTRUCTIONS:

1. Read the Audit Program/Coding Manual
2. Use blue or red pencil
3. Make sure all entries are clear and legible
4. Right justify all numbers
5. Enter Case number where required

Prepared by: _____

Date: _____

Agency Location: _____

Reviewed by: _____

Date: _____

1. Department/Agency Code (Attachment A)
(1-2)
Department/Agency Name _____
2. GAO Case Number (3-6)
3. Card Number (7)
4. Agency case or referral number:

FOR REGIONAL OFFICE USE ONLY

Prepared by: _____

Date: _____

Agency Location: _____

Reviewed by: _____

Date: _____

5. How was alleged fraud discovered? (9-10)
(Check one box only.)
- (01) Routine audit, inspection investigation or review
- (02) Specially requested audit, inspection or review
- (03) Federal employee (knowledge gained through work)
- (04) Former federal employee

- (05) Contractor personnel
- (06) Former contractor personnel
- (07) Grantee personnel (exclude state or local government personnel)
- (08) Former grantee personnel
- (09) State or local government personnel
- (10) Former state or local government personnel
- (11) Private individual (not former employee)
- (12) Anonymous informant
- (13) Consumer Complaint Form
- (14) Paid Informant
- (15) Unsuccessful Bidder
- (16) News media
- (17) Congressional Committee - Member - Staff
- (18) Alleged victim
- (19) Confession by perpetrator
- (20) Law enforcement investigation - state and local
- (97) Not Applicable
- (98) Other (Specify) _____
- (99) Unknown

6. If boxes 1 or 2 were checked in question #5, indicate whether it was an audit, inspection, or investigation? (11)
- (1) Audit
- (2) Inspection
- (3) Investigation
- (4) Internal compliance or eligibility review

7. If boxes 1 or 2 were checked in question #5, indicate:
- Job Number: _____
- Date: _____
- Job (or report) Title: _____

8. In how many locations did the alleged fraudulent activity take place? (12-13)

Number of locations

9. If alleged fraud occurred at only one location, provide appropriate information under principal location. If alleged fraud activity occurred at more than one location, provide the principal location and the second most important location.

Principal location:

City _____

State or Foreign Country (Attachment B) (14-15)

2nd most important location:

City _____

State or Foreign Country (Attachment B) (16-17)

10. What is the functional area in which the alleged fraud occurred? (Check one box only.) (18-19)

- (01) procurement - award
- (02) property disposition
- (03) payroll
- (04) grants
- (05) financial assistance to individuals (excludes loans)
- (06) enforcement (i.e. ATF, Customs, IRS)
- (07) provision of health care or social services
- (08) loans
- (09) loan guarantees
- (10) personnel
- (11) inventory control
- (12) mail service
- (13) Cash control
- (14) Procurement-monitoring
- (15) Travel
- (16) Administrative services
- (17) Training and Education
- (18) Personal property management
- (97) Not Applicable
- (98) Other (please specify) _____
- (99) Unknown

11. Name of agency or major division within department or agency listed in question #1.

Agency/Division Name _____

Agency/Division Code (21-22) (Attachment C)

12. Name of Federal program involved in the fraud. (optional)

Federal program name _____

Federal program code (23-24)

13. Frequency of alleged fraud activity. (25)

- (1) Once
- (2) 2 - 5 times
- (3) 6 - 10 times
- (4) 11 - 15 times
- (5) 16 - 20 times
- (6) 21 - 25 times
- (7) Over 25 times
- (9) Unknown

14. Indicate the period of time over which the alleged fraudulent activity took place. (26)

- (1) Less than 3 months
- (2) 3 to 6 months
- (3) 6 months to one year
- (4) 1 to 2 years
- (5) More than 2 years
- (9) Unknown

15. Approximately how much time had elapsed between the time the alleged fraudulent act was committed and the time it was reported or discovered? (27)

- (1) Less than 3 months
- (2) 3 to 6 months
- (3) 6 months to one year
- (4) 1 to 2 years
- (5) More than 2 years
- (9) Unknown

16. At the time the fraudulent act was committed, who was responsible for the administration of the Federal funds or for the administration of the Federally financed programs or projects involved in the fraud? (28)

- (1) Federal Government officials
- (2) State or local government officials
- (3) Foreign government officials
- (4) Federal contractors
- (5) Non-profit organizations
- (6) Grantees (other than state or local government officials or non-profit organizations)
- (7) Financial Institutions
- (9) Fiscal Agent
- (97) Not applicable
- (99) Unknown

17. Was the computer necessary (material) in committing the fraudulent activity? (29)

- (1) Yes
- (2) No

18. Participants in the alleged fraud. (30)
(Check one box only.)

- (1) Federal Government employees only
- (2) Federal Government employees in conjunction with others
- (3) State and local government employees
- (4) Federal contractor(s)/grantee(s) personnel - other than State and local governments
- (5) Corporate recipient(s) of Federal Government financial assistance
- (6) Individual recipient(s) of Federal Government financial assistance
- (7) Other individual citizens
- (8) Other corporate or business entities (such as lending institutions)
- (9) Unknown
- (10) State and local government employees in collusion with individual recipient(s) of Federal Government financial assistance
- (11) Federal contractor(s)/grantee(s) personnel - (other than State and local government(s) in collusion with individual recipient(s) of Federal Government financial assistance

- (12) Corporate recipients of Federal Government financial assistance in collusion with individual recipient(s) of Federal Government financial assistance
- (13) Other corporate or business entities (such as lending institutions in collusion with individual recipient(s) of Federal Government financial assistance
- (14) Federal Government employees in conjunction with non-Federal Governmental organizations.
- (15) Federal Government employees in conjunction with individual recipient(s)
- (16) Federal Government employees in conjunction with non-Federal governmental organizations and individual recipient(s)

19. How many types of fraud were involved in this alleged fraud case? (31)

- (1) One type of fraud
- (2) Two types of fraud
- (3) 3 to 5 types of fraud
- (4) 6 to 10 types of fraud
- (5) 11 to 25 types of fraud
- (6) Over 25 types of fraud
- (9) Unknown

20. Indicate the type of fraud by selecting the code in the appropriate section of Attachment D that best describes the fraud activity in this case. See Attachment D. If more than one type of fraud was involved, select the code for the principal type of fraud involved in this case and the next most important type of fraud.

Principal Fraud (32-34)
 Second Fraud (35-37)

Federal Government Employees

(This section should be completed only if boxes 1 or 2 were checked in question #18)

21. How many Federal Government employees were involved in the fraudulent activity? (38)

- (1) One
- (2) Two to five
- (3) Six to twenty
- (4) Over twenty
- (9) Unknown

22. Which of the following categories best describes the occupation or position of the Federal employee(s) involved in the fraudulent activity? (Check one box only.) (39-40)

- (01) Accountants
- (02) Attorneys
- (03) Auditors
- (04) Computer personnel
- (05) Contracting and procurement officials
- (06) Program officials - Top policy-making management
- (07) Program officials - managers or supervisors
- (08) Program officials - Staff
- (09) Investigator
- (10) Inspector (housing, food, safety, pollution)
- (11) Law enforcement officer
- (12) Regulatory official
- (13) Logistics and inventory control officials
- (14) Clerical workers
- (15) Members of the Armed Forces
- (16) Skilled craftsman
- (17) Semi-skilled
- (18) Laborers
- (19) Doctors
- (97) Not Applicable
- (98) Other (Please specify) _____
- (99) Unknown

Non-Federal Government Organizations

(This section should be completed only if boxes 2, 3, 4, 5 or 8 were checked in question #18)

23. How many non-Federal Government organizations were involved in the fraudulent activity? (41)

- (1) One
- (2) Two
- (3) Three to ten
- (4) Over ten
- (9) Unknown

24. How many employees of these organizations were involved in the fraudulent activity? (42)

- (1) One
- (2) Two
- (3) Three to ten
- (4) Over ten
- (9) Unknown

25. Which category below best describes the employees of the non-Federal Government organization that were involved in the fraudulent activity. (Check one box only.) (43-44)

- (01) Company or corporate officers (president, VP, treasurer, or secretary)
- (02) Plant manager/superintendent
- (03) Professionals (attorneys, accountants, engineers, etc.)
- (04) Technical (technicians, para-professionals, etc.)
- (05) Sales workers
- (06) Skilled craftsman, foreman, skill trades, skilled and kindred workers
- (07) Operators (semi-skilled)
- (08) Laborers
- (09) Clerical
- (10) State and Local Government officials
- (97) Not applicable
- (98) Other (Specify) _____
- (99) Unknown

26. From the listing in Attachment E insert the code that best describes the product or service provided by the non-Federal Government organization.

Product or Service Code
 (45-47)
(Attachment E)

Individual Recipient of Federal Financial Assistance

(This section should be completed only if boxes 2, 3, 6, 7, or 8 were checked in question #18.)

27. How many individual citizens were involved in the fraudulent activity? (48)

(1) One

(2) Two

(3) Three to ten

(4) Over ten

(7) Not applicable (9) Unknown

28. Which category below best describes the role of the individual citizen(s) at the time they were engaged in the fraudulent activities? (Check one box only.) (49)

(2) Welfare recipient

(5) Medicare/medicaid recipient

(7) Not applicable

(8) Other (Specify) _____

(9) Unknown

(10) Current or former federal employee dependent

(11) Job applicant

(12) Loan/mortgage applicant

(13) Housing loan/mtg. guarantee recipient

(14) Education loan guarantee recipient

(15) Housing direct loan recipient

(16) Education loan recipient

(17) Disaster loan guarantee recipient

(19) Pensioner and/or dependent of pensioner

(20) Disability recipients

(21) Education benefits/grants recipient

(22) Death benefits recipient

(23) Disability/medical care recipient

(24) Disaster assistance recipient

(25) Housing (mortgage/rent) assistance

(26)

(27) Training/Education recipient

(28) Taxpayers

(29) Designated representative of assistant recipient

(30) Postal patrons

Loss (or Potential Loss) Due to Fraud

29. If the specific dollar amount of the loss incurred by the Federal Government in this fraud case has been identified, insert it below.

(50-57)

(If multiple violations, indicate total amount of loss)

If the specific dollar amount of the loss is not available, please estimate the dollar amount of the loss incurred by the Federal Government for this case. (58-59)

(01) Less than \$100

(02) \$101 to \$1000

(03) \$1001 to \$10,000

(04) \$10,001 to \$100,000

(05) \$100,001 to \$500,000

(06) \$500,001 to \$1 million

(07) Over \$1 million

(08) Monetary loss but unable to estimate loss to Federal Government

(97) Not applicable because no monetary loss involved

30. If the fraudulent activity did not result in a direct dollar loss to the Federal Government, indicate the effect that occurred or may occur. (Check one box only.) (60)

(1) Potential harmful effects to the health or safety of individuals

(2) Received benefits for which ineligible

(3) Received benefits greater than entitled to

(4) Intended recipients did not receive benefits

(5) Potential harmful effect to state on local economies

(7) Not applicable

(8) Other (Describe)

(9) Unknown

(10) Recipients did not receive intended benefits

(11) Preferred Treatment

(12) Unauthorized disclosure of information

(13) Potential loss of claim is made and approved

31. Indicate whether a final decision or determination on the alleged fraud case has been made (closed case) or whether the investigation or prosecution on the alleged fraud case has not been completed (open case). (61)

- (1) Closed Case
- (2) Open Case

32. Indicate whether administrative action, legal action or both types of action were taken.

- (1) Closed cases- administrative action only - no action taken
- (2) Closed cases - administrative action only - some substantive action taken
- (3) Closed cases - only legal action taken
- (4) Closed cases - both administrative (substantive) action and legal action taken
- (5) Closed cases - no action taken since participant is unknown
- (6) Closed cases - type of action taken is unknown
- (7) Open cases - administrative action only - no action taken
- (8) Open cases - administrative action only - some substantive action taken
- (9) Open cases - legal action only taken
- (10) Open cases - both administrative (substantive) action and legal action taken
- (11) Open cases - no action taken since participant is unknown
- (12) Open cases - case is pending

33. Is the alleged "open" fraud case under investigation at source agency or has it been referred to another agency for investigation or prosecution. (Check one box only.) (63-64)

- Case #
- (01) Case under investigation or consideration by source agency (Skip to question #50)
 - (02) Case referred to FBI
 - (03) Case referred to U.S. Attorney or other Justice Department division for prosecution
 - (04) Case referred to State or local authorities
 - (05) Case referred to IRS
 - (06) Case referred to Postal Service
 - (07) Case referred to GAO
 - (08) Case referred to Secret Service
 - (09) Case referred to Department of Labor
 - (10) Case referred to other Federal agency. (Please specify)
 - (98) Other (Please describe) _____
 - (99) Unknown

34. What is the current status of the alleged fraud case referred to another agency? (Check one box only.) (9)

- (1) Case under investigation
- (2) Case under advisement
- (3) Case scheduled for prosecution
- (4) Case being prosecuted
- (8) Other (Please describe) _____
- (9) Unknown

35. If prosecution declined for this case, what was the reason given? (Check one box only.) (10)

- (1) Insufficient evidence for prosecution
- (2) No loss to Federal Government
- (3) Dollar loss insignificant
- (4) Case lacks jury appeal
- (5) Statute of limitations
- (6) Insufficient staff resources
- (7) lacks prosecution merit
- (8) Other (Please specify) _____
- (9) Unknown
- (10) No apparent violation of Federal Law
- (11) Declined in lieu of Administrative Action

Skip to question #50

ADMINISTRATIVE ACTION

36. Indicate the type of administrative action taken against Federal Government employees. (Check all that apply.)

- (01) No action taken (Skip to question #39) (11)
- (02) Federal Employee dismissed (12)
- (03) Federal employee suspended (13)
- (04) Federal employee issued warning letter (14)
- (05) Federal employee issued letter of counseling (15)
- (06) Federal employee issued oral warning (16)
- (07) Federal employee demoted (17)
- (08) Federal employee transferred (18)
- (09) Formal loss recovery plan agreed to: (Indicate total amount of planned recoveries)

_____ (21-28)

- (10) Extra duty (military)

- (11) Employee resigned pending dismissal
- (97) Not applicable
- (98) Other
- (99) Unknown

37. Indicate the type of administrative action taken against non-Federal Government organizations (contractors, corporation, non-profit organizations, state and local governments, etc.) or individuals involved in the fraud case. (Check all that apply.)

- (1) Suspended from doing business with the Federal Government (30)
- (2) Debarred from doing business with the Federal Government (31)
- (3) Contract/grant cancelled (32)
- (4) Issued warning and they agreed to take corrective action (33)
- (5) Formal loss recovery plan agreed to (Indicate total amount of planned recoveries) (34)
 (36-42)
- (6) No action taken (35)
- (7) Negotiating reimbursement (8-9)
- (8) Declared ineligible for program participation under status claimed (10-11)
- (9) Employee/enlistee dismissed; application/enlistment denied (12-13)
- (97) Not applicable (14-15)
- (98) Other
- (99) Unknown (18-19)

37a. Indicate the type of administrative action taken by a non-Federal organization against another organization (sub-contractor, sub-sponsor, sub-recipient, etc.) employees of individuals involved in the fraud case. (Check all that apply.)

- (01) No action taken (21-23)
- (02) Employee dismissed (23-24)
- (03) Employee suspended (25-26)
- (04) Employee reprimanded (27-28)
- (05) Employee demoted (29-30)
- (06) Formal loss recovery plan agreed to with employee (indicated total amount of recoveries) (31-32)
 (33-40)

- (07) Contract/grant cancelled (41-42)
- (08) Contract/grant not renewed (43-44)
- (09) Formal loss recovery plan agreed to with other organizations or individuals (indicate total amount of recoveries) (45-46)
 (47-53)
- (10) Other (please specify) (54-55)

- (11) Unknown (56-57)

38. Why was administrative action taken rather than legal action? (Check one box only.) (44-45)

- (01) Isolated incident
- (02) Immaterial amount
- (03) Minor infraction
- (04) Evidence and documentation insufficient for legal action
- (05) Department of Justice declined case (if checked go to #35)
- (06) U.S. Attorney declined case (if checked go to #35)
- (07) Other Federal agency declined case
- (08) Foreign nationals involved and legal action considered detrimental to the U.S. Government interest
- (09) Statute of limitations
- (10) Hardship cases
- (11) Funds recovered
- (98) Other (Please describe) _____
- (99) Unknown

Skip to question #50.

39. Indicate the reason no administrative action was taken in the alleged fraud case? (Check one box only.) (46)

- (1) Case investigated by agency and dismissed because no evidence of fraud found.

- (2) Federal employee resigned and agency felt the alleged fraud matter was not worth pursuing.
 - (3) Foreign nationals involved and administrative action considered not in the best interest of the U.S. Government.
 - (4) Statute of limitations
 - (5) Fraud (or crime) committed and case investigated but no suspect found.
 - (6) Lack of adequate evidence and documentaion
 - (7) Not applicable
 - (8) Other (please describe)
-
- (9) Unknown
 - (10) Immaterial amount/Isolated incident
 - (11) Fraud committed/suspect identified/prosecution declined
 - (12) Insufficnet evidence for legal action
 - (13) Contractor or Grantee took action against an employee
 - (14) Perpetrator (s) not Federal employee or otherwise subject to administrative action
 - (15) Civil action or prosecution
 - (16) Suspect could not be found

SKIP TO QUESTION #50.

LEGAL ACTION

40. Was this case prosecuted as a civil or criminal case? (47)
- (1) Civil case
 - (2) Criminal case
 - (3) Civil and criminal prosecution
 - (4) Pre-trial diversion
 - (5) Court martial
41. Indicate the outcome of the criminal prosecution? (48)
- (1) Acquittal
 - (2) Conviction (quality plea, nolo contendere)
 - (3) Other (Please specify)

- (9) Unknown
42. Indicate the outcome of the civil proceeding. (49)
- (1) judgment for plaintiff
 - (2) judgment for the defendant
 - (3) case dismissed
 - (9) Unknown

43. If the defendants convicted, indicate the amount of fines, recoveries, and restitutions.

Fines (51-58)

Recoveries (61-68)

Restitutions (71-78)

Sentencing Data

- 44(a) Actual sentence (in months) (9-11)
- 44(b) Sentence suspended (in months) (12-14)
- 44(c) Portion of sentence to be served on probation (in months) (15-17)
- 44(d) Portion of sentence to be served in prison (in months) (18-20)

If more than one person sentenced provide following information on additional persons.

SECOND PERSON

- 45(a) Actual sentence (months) (21-23)
- 45(b) Sentence suspended (months) (24-26)
- 45(c) Portion of sentence to be served on probation (months) (27-29)
- 45(d) Portion of sentence to be served in prison (months) (30-32)

THIRD PERSON

- 46(a) Actual sentence (months) (33-35)
- 46(b) Sentence suspended (months) (36-38)
- 46(c) Portion of sentence to be served on probation (months) (39-41)
- 46(d) Portion of sentence to be served in prison (months) (42-44)

FOURTH PERSON

- 47(a) Actual sentence (months)

--	--	--	--

(45-47)
- 47(b) Sentence suspended (months)

--	--	--	--

(48-50)
- 47(c) Portion of sentence to be served on probation (months)

--	--	--	--

(51-53)
- 47(d) Portion of sentence to be served in prison (months)

--	--	--	--

(54-56)

FIFTH PERSON

- 48(a) Actual sentence (months)

--	--	--	--

(57-59)
- 48(b) Sentence suspended (months)

--	--	--	--

(60-62)
- 48(c) Portion of sentence to be served on probation (months)

--	--	--	--

(63-65)
- 48(d) Portion of sentence to be served in prison (months)

--	--	--	--

(66-68)



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAR 12 1981

D. L. Scantlebury
Division Director and
Chief Accountant
General Accounting Office
Washington, D. C. 20548

Dear Mr. Scantlebury:

Thank you for the opportunity to review your draft report, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

Fraud and abuse in the Federal Government, such as that described in your report, must be brought under control as quickly as possible. As the draft report concludes, improved internal control systems can make a significant contribution to solving this problem.

The Office of Management and Budget is in the process of reviewing both the proposed House and Senate bills which you recommended be enacted. In addition to these legislative proposals, we are considering administrative remedies such as a circular (copy enclosed) which would prescribe policies and procedures to be followed by executive agencies in adopting and maintaining more effective internal control systems. We appreciate the positive contributions that the GAO made to the inter-agency task force which developed the proposed circular.

Among other things, the circular would require each agency head to:

- o issue an internal control directive and submit it to OMB for approval;
- o set up administrative mechanisms to enforce internal control requirements;
- o make vulnerability assessments and risk analyses of all major programs;
- o arrange for audits of all internal control systems, and of agency compliance with the systems;

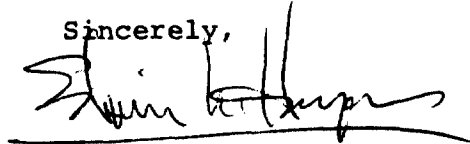
- o specify the internal control responsibilities of each top manager; and
- o incorporate these responsibilities into the performance appraisal of top managers.

The issuance of a circular such as this would provide a framework for agency internal control systems. But this Administration is committed to going much farther in addressing the problems of fraud and waste in Government.

As your draft report acknowledges, the creation of statutory Inspectors General in late 1978 has resulted in progress. We believe more needs to be accomplished. The Administration will be taking positive steps to reenforce the impact of that program. We will be establishing a new council of Inspectors General which will be a successor to the Executive Group to Combat Fraud and Waste. This council will more vigorously address issues such as vulnerability assessments, joint audit and investigations, audit follow-up including recoveries of sustained findings, and the adequacy of agency internal controls. We feel that the work of the individual Inspectors General, augmented by a vigorous interagency group, will ensure a concentrated attack on the types of problems raised in your draft report.

We want to continue to work closely with the General Accounting Office in identifying opportunities for reducing fraud and waste in Federal programs.

Sincerely,



Edwin L. Harper
Assistant to the President
and Deputy Director

Attachment

OFFICE OF MANAGEMENT AND BUDGET

Internal Control Circular; Proposed for Comment

AGENCY: Office of Management and Budget.

ACTION: Comment—Proposed OMB Circular, "Internal Control Systems."

SUMMARY: This notice offers interested parties an opportunity to comment on a proposed OMB Circular concerning internal control policies of Federal agencies.

The proposed Circular is the product of an interagency task force composed of representatives of major Federal agencies, under the leadership of the Office of Management and Budget. The Circular is intended to provide policy guidance to Federal agencies on the development, implementation, and review of internal controls against theft, fraud, waste, and misuse of resources.

The Office of Management and Budget has, as yet, made no decisions with respect to the provisions of the proposed Circular. All interested parties are encouraged to make their views known.

Comments should be submitted in duplicate to the Financial Management Branch, Budget Review Division, Office of Management and Budget, 6002 New Executive Office Building, Washington, D.C. 20503. All comments should be received within 45 days following publication of this notice. The proposed OMB Circular is set forth below in its entirety.

FOR FURTHER INFORMATION CONTACT: Mr. David J. Gribble, Financial Management Branch, telephone 202/395-4773.

TO OBTAIN A COPY OF THE PROPOSED CIRCULAR, CONTACT: Document Distribution Center, Office of Administration, C-236 New Executive Office Building, Washington, D.C. 20503, telephone 202/395-7332.

John J. Lordean,
Chief, Financial Management Branch.

Circular No. A—To the Heads of Executive Departments and Establishments

Subject: Internal Control Systems.

1. *Purpose.* This Circular prescribes policies and standards to be followed by executive agencies in adopting and maintaining internal control systems.

2. *Background.* Despite the efforts Federal agencies have made, there continue to be reports of numerous cases of theft, fraud, waste, and misuse of Government resources. Review of these cases consistently points to weaknesses in internal controls or to breakdowns in compliance with internal control systems. These systems need improvement to properly assist managers from the first line supervisor to the agency

head in meeting their proper responsibility to safeguard resources—while efficiently and effectively conducting programs.

3. *Definitions.* For the purposes of this Circular, the following terms are defined:

a. *Agency*—Any department or independent establishment of the executive branch of the Federal Government.

b. *Agency Component*—A major organizational subdivision of the agency having a separate system of internal control.

c. *Internal Control*—The plan of organization, and all coordinate measures, adopted by an organization to safeguard resources, facilitate effective and efficient program management, assure compliance with law and policy guidance, and assure accurate, reliable and timely reports.

d. *Internal Control Directive*—A statement issued by an agency head to prescribe agency policies on internal control and to assign responsibilities. This document will guide the development, maintenance, and review of internal control systems.

e. *Internal Control System*—The overall plan of organization, procedures, and records of an organization prepared in compliance with agency's internal control directive.

f. *Internal Control Regulations*—Procedures, organization charts, instructions, manuals, etc., documenting the internal control system.

g. *Vulnerability Assessment and Risk Analysis*—A vulnerability assessment is a review of an agency component resulting in an estimate of susceptibility to theft, fraud, waste, or misuse of resources. A risk analysis is a more detailed evaluation intended to identify and measure the types of errors or problems that might affect a program or function. Its purpose is to determine the specific internal controls that are needed.

4. *Responsibility.* Each agency head will issue an internal control directive and submit it to OMB for approval no later than 180 days following the effective date of this Circular. In cases where an agency head requires the issuance of internal control regulations for components of the agency, the head of the agency shall ensure that such regulations are consistent with the agency directive.

Further, the agency head will ensure that vulnerability assessments and risk analyses are made for each agency component on a 5 year or shorter cycle.

Inspectors General or other audit officials will review internal control directives, systems, regulations, and compliance and provide advice to the agency head.

5. *Objectives of Internal Control.* The objectives of a system of internal control are to:

a. Safeguard resources against theft, fraud, waste, or misuse.

b. Facilitate accomplishment of Federal program objectives.

c. Assure compliance with laws, regulations, executive orders, and other legal requirements.

d. Assure compliance with policy and budget guidance from the President, the Congress, and agency management.

e. Assure the propriety of accounting records and the accuracy, timeliness, and usefulness of financial reports by

—preventing unauthorized financial transactions or access to resources.

—properly recording all financial transactions, providing means for the timely detection of losses and accounting errors.

8. *Requirements for Agency Internal Control Directive.* The agency internal control directive will place specific internal control responsibilities on managers and prescribe requirements for the comprehensive internal control systems that managers will use to carry out their responsibilities. The agency directive will provide for the following as a minimum:

a. Establish an internal control committee or other appropriate means to oversee development, maintenance, review, and improvement of the agency's internal controls. This group must provide for coordination between program managers and financial systems staffs so that financial systems serve managers' needs for decisionmaking, control, and review—while providing for adequate internal control.

b. Assign responsibility for internal control to officials in each major operating component of the agency.

c. Provide that internal control responsibility and standards of performance be incorporated in each appropriate official's performance appraisal.

d. Provide a plan for vulnerability assessments and coordinated risk analyses on a recurring cycle of not more than 5 years. These reviews should identify agency programs and functions where internal control systems need either to be strengthened or streamlined in response to changes in the nature of the program, the magnitude of the resources involved, or recent experience with theft, fraud, waste, and misuse of resources. These reviews should draw on audit reports and other sources. A vulnerability assessment and risk analysis should also be made for each planned and newly authorized agency program.

e. Provide that the agency's regulations provide for each of the elements of internal control described in paragraph 7.

f. Establish administrative mechanisms to enforce internal control requirements. These mechanisms should include reports to the agency head on all significant internal control violations, and appropriate disciplinary actions for responsible individuals.

g. Provide for periodic internal audit to determine effectiveness of control systems.

h. Establish response mechanisms to address internal control system weaknesses disclosed by audit, discovered loss, or other means.

7. *Common Elements of Internal Control.* Six generally accepted elements of internal control must be included in any system dealing with acquisition, use, or accountability of Federal resources. Such systems include, as a minimum, agency planning, budgeting, accounting, revenue, expenditure, property, inventory, cash management, debt management and related ADP systems. The design of each system should consider the entire transaction cycle. Where transactions cross organizational or functional lines or when more than one system is involved, integrated controls must be established.

a. *Documentation.* Internal control procedures, policies, authorities and responsibilities must be clearly and adequately documented. Once documented they must be available to personnel involved in their execution. Documentation usually takes the form of operations manuals and organization charts which describe and depict the roles and responsibilities of all individuals involved in the control system. Proper documentation provides assurances that methods and responsibilities are clearly communicated, and is often a valuable tool in training new employees.

Documentation must also be provided for all financial transactions and for the custody of all resources.

b. *Separation of Duties.* No individual or small group of individuals should be in a position to control all aspects of a financial transaction. Responsibilities must be separated and tasks structured to preclude an individual from performing more than one "key" processing function or activity—such as authorizing, approving, certifying, accounting, disbursing, or keeping custody of resources.

c. *Supervision.* Qualified and continuous supervision is necessary to assure agency management that approved procedures are followed both to facilitate effective, efficient program management and to safeguard the resources of the agency.

d. *Security of Property and Records.* Physical security must be provided for accounting records, negotiable instruments or securities, and other resources of the agency. Procedures should be employed to ensure that appropriate recordkeeping and archive procedures exist and are followed.

e. *Internal Audit.* An internal audit or review function must continuously monitor policies, procedures, and practices related to financial transactions and custody of resources. Where appropriate, reviews should include examining and testing of transactions. Also, procedures should exist to assure followup of audit findings and recommendations, and to assure timely corrective action by management.

f. *Competency of Personnel.* Personnel should be competent, by education, training and experience, to execute the control responsibility to which they are assigned.

8. *Special Internal Control Guidelines.* In addition to providing for the basic elements of internal control in the body of this Circular, guidelines on various special aspects of internal control will be issued separately by OMB. (See Attachment for list of guidelines.) Agency Regulations should be revised on a cycle basis to incorporate the substance of each guideline as appropriate.

9. *Reporting.* Agencies will be required to include specific information on the progress of internal control systems reviews as part of their annual report to OMB on financial management improvement.

10. *Effective Date.* This Circular is effective on publication.

11. *Inquiries.* All questions or inquiries should be addressed to Financial

Management Branch, Office of Management and Budget, telephone number 202/395-4773.

James T. McIntyre
Director

Attachment—Circular No. A—

List of Guidelines

- A. Fund Control
- B. Cash Management and Handling
- C. Debt Collection
- D. Certifying and Disbursing
- E. Automated Data Processing
- F. Procurement
- G. Grants.

(FR Doc. 81-338 Filed 1-6-81; 8:48 am)
BILLING CODE 3110-01-M



United States
Department of
Agriculture

Office of
Inspector
General

Washington,
D.C.
20250

FEB 25 1981

Mr. Henry Eschwege
Director, Community and Economic
Development Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

We have reviewed the GAO draft report entitled "Fraud and Related
Illegal Acts: A Serious Governmental Problem Which Can Be More
Effectively Controlled" and have no comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert E. Magee".

ROBERT E. MAGEE
Acting Inspector General



DEPARTMENT OF DEFENSE
OFFICE OF GENERAL COUNSEL
WASHINGTON, D.C. 20301

February 19, 1981

D.L. Scantlebury
Division Director and
Chief Accountant of GAO
United States General Accounting Office
Washington, DC 20548

Dear Mr. Scantlebury:

This is in reply to your letter of January 19, 1981 forwarding 16 copies of the draft report entitled "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled" (Code 911020) (OSD Case #5599). As there were no recommendations specifically directed to this department, no comments are being provided on the draft report.

Thank you for the opportunity to review and respond to the draft report.

A handwritten signature in black ink, appearing to read "M.J. Cifano".

M.J. Cifano
Office of the Associate General Counsel
(Intelligence, International &
Investigative Programs)



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

10 FEB 1981

Mr. Gregory J. Ahart
Director, Human Resources
Division
U.S. General Accounting
Office
Washington, D.C. 20548

Dear Mr. Ahart:

The Secretary asked that I respond to your request for our comments on your draft report, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

Your report very aptly illustrates the seriousness and pervasiveness of this problem. We also very much agree with the emphasis placed by the report on the need for managers to place continuing and great emphasis on the quality of their systems of internal control.

Thank you for letting us review this report in draft form.

Sincerely yours,

Bryan B. Mitchell
Bryan B. Mitchell
Acting Inspector General



DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20410

February 24, 1981

IN REPLY REFER TO:

FEB 25 1981

Mr. Henry Eschwege
Director
Community and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

We have read with interest your draft report, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled." We believe the report points out the problems and ramifications associated with fraud and program abuse in government operations. In general, we support the conclusions and recommendations made in the report. However, we do have comments for your consideration that we believe will strengthen the recommendations and clarify other sections of the report.

The report concludes that Congress can help deter fraud by making agency heads more accountable for good internal controls. This would be done through currently pending legislation; S-3026, the Financial Integrity Act, and HR-8063, the Federal Managers' Accountability Act of 1980. Within the past year, we have commented favorably on these bills. However, there are two issues that we wish to address concerning the report--our reservations concerning legislative solutions and a need to update certain portions of the report.

First, GAO's recommendations seek legislative remedies and focus only on financial control. Agency heads have been responsible for three decades for the soundness of their financial systems. Defining that responsibility more clearly still does not give these executives the incentives to reverse the current adverse trends. Further legislative initiatives will not produce the intended results until management's concern for controls is commensurate with its concern for production goals.

In this regard, it is our opinion that:

- A. The report should clarify the existing laws and directives regarding internal controls. A discussion is needed to bring to light the piecemeal and overlapping actions being taken by Congress, OMB and Federal agencies, and how these proposed bills might correct these problems. The following could be cited:
 - Public Law 96-304 requires OIG to submit to Congress (starting with the HUD 1982 budget) an annual evaluation of the Department's progress in implementing effective management controls over consultant service contractual arrangements.
 - OMB's July 1980 directive for agencies to develop a plan for implementing improved controls for procurement practices.

- OMB proposed circular, "Internal Control Systems," which is intended to provide policy guidance to agencies regarding controls.
- The Accounting and Auditing Act of 1950.

A discussion of these and other laws should reconcile the present requirements regarding controls and how the pending legislation would correct cited problems.

- B. Even with the pending bills, there will be no guarantee that managers would have the full capacity to carry out the new laws. As the GAO itself notes on page 52, the implementation of the Inspector General Act has suffered from inadequate resources. These bills will have little impact unless the Administration and Congress attend to the resource issue; and
- C. Since the report supports legislation that positively affects fraud control, it should also point out a pending bill having adverse effects. Specifically, certain provisions of the working draft, "Criminal Code Revision Act of 1979" would severely impair the Department's ability to prosecute and deter fraudulent practices. Our comments objecting to certain provisions of the draft are attached for your consideration.

Our second concern is that the draft could be updated in Chapter 5, "Progress is Being Made in Combating Fraud." A number of initiatives taken by this Department and the Office of Inspector General include:

- HUD's Committee on Fraud, Waste and Mismanagement that advises the Secretary on policy matters in minimizing fraud and abuse in HUD programs. Formed in November 1978, the Committee has proven successful in completing several important projects.
- The Fraud Vulnerability Assessment System, implemented in November 1979, designed to shut off opportunities for fraud and abuse in all new or substantially revised HUD programs.
- The Management Control Assessment System, started in July 1980, to evaluate the controls in HUD's existing programs on a continuing and systematic basis.
- An employee awareness program to alert OIG and program personnel to potential risks by preparing Fraud Information Bulletins and Fraud Alert Memorandums issued to all appropriate employees, training courses attended by 100 OIG and program staff, and a video tape presentation for all HUD employees.

These and other activities are detailed in the attached excerpts from our latest Semiannual Report to Congress.

We appreciate the opportunity to comment on the draft report.

Sincerely,


Paul A. Adams
Deputy Inspector General

Attachments



U.S. Department of Justice

Washington, D.C. 20530

March 9, 1981

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This letter is in response to your request to the Attorney General for the comments of the Department of Justice (Department) on your draft report entitled "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

In many respects this report, more clearly than other General Accounting Office (GAO) reports, reflects a balanced understanding of the government actions required to effectively respond to the problem of fraud and abuse in Federal programs. That is, the problem can only be addressed through the coordinated employment of all available corrective remedies--civil suits, administrative actions, program adjustments and criminal prosecution. In terms of the need to employ these corrective remedies, GAO's contention is indeed true that fraud and related illegal activities "not only deplete the treasury but also undermine the image of government to the people it serves and the effectiveness of its programs." We would like to add a further observation that the failure to promptly and properly address fraud and waste also tends to undermine employee confidence and consequently reduces their effectiveness in controlling and administering Federal programs.

The Department is basically in agreement with the findings, conclusions, and recommendations contained in the report. The report makes some favorable and accurate comments about the Department's efforts, but focuses primarily on the efforts of other agencies. For this reason, the comments contained in this response elaborate on some of the Department's more recent efforts, as well as point out several inaccuracies and omissions.

Since the subject matter of this report encompasses the activities of several organizations within Justice which have a role in combatting fraud and related illegal activities, the comments of each organization are set out separately.

CRIMINAL DIVISION

The Criminal Division agrees with the rationale of the report that all available corrective remedies--civil suits, administrative actions, program adjustments and criminal prosecution--should be considered in

addressing the problem of fraud and abuse in Federal programs. Over the past year, the Criminal Division has increased its emphasis on promptly identifying investigations and prosecutions with substantial civil remedy potential. The "joint VA/HUD investigations and audits of mortgage practices in Puerto Rico" mentioned on page 41 of the report is a current example of such increased attention. The Criminal Division has worked closely with the Inspectors General and Department of Defense representatives in examining the effectiveness of various administrative remedies and encouraging their use even during the course of a criminal investigation. Over 2 years ago, the Criminal Division recognized that other remedies, in addition to prosecution and civil suit, were desirable for handling smaller fraud and false claims matters. In fact, the idea emanated from the initiative of the then Inspector General of the Department of Health, Education and Welfare as reflected in H.R. 4106 (page 38). For the past 2 years, the Criminal Division, together with the Civil Division, has been developing legislation to create a civil money penalty remedy to address these serious areas of program fraud and abuse.

The following minor comments are offered to improve the accuracy of that portion of the report pertaining to the Criminal Division:

1. Discussion of the civil money penalty remedy on pages v and 38 of the draft report does not specify the types of cases contemplated (under \$50,000), and, of course, will not operate where the Department of Justice "refuses" to initiate civil or criminal action, but rather where the action is declined in favor of this remedy. Most importantly, the remedy is contemplated to be a substitute for the civil process, but in no way is intended to replace a criminal prosecution, if appropriate. If enacted, a matter could be the subject of criminal prosecution and administrative penalty action just as at present criminal and civil actions can be applied to the same matter.
2. With respect to the Economic Crime Enforcement program mentioned on page 43, units presently exist in 21 districts. The current total of attorney allotment, including both specialists and Assistant U.S. Attorneys, is 109. Due to current budgetary constraints, no immediate growth is possible.
3. The report is complimentary of the increased training efforts of the Criminal Division, but neglects to mention a major ongoing effort. For the past 2 years, the Federal Law Enforcement Training Center in Glynco, Georgia, has conducted a 2-week White Collar Crime Seminar for experienced investigators and auditors. The Criminal Division is responsible for 12 hours of the instruction conducted by senior prosecutors. Over 1,100 investigators and auditors have attended this program to date.
4. GAO's discussion of the Department's national white collar crime law enforcement priorities on page 30 indicates a misunderstanding of the meaning and impact of the priorities initiative. In particular, the statement, "It appears that at least a quarter of the total prosecuted cases in our review might not have been prosecuted had the new guidelines been in effect" is troubling. The clear implication of this and the sentence following is that the national priority guidelines are intended to be, or will be treated as, declination guidelines by Federal prosecutors.

That is not accurate. The Department has emphasized to Federal prosecutors and Federal investigators that the white collar crime priorities describe the types and magnitude of cases that should receive special attention, that priority cases may be very few in number, and that cases which may not fall strictly within the priority specifications may nevertheless be very important (see, e.g., Report of the Attorney General, "National Priorities for the Investigation and Prosecution of White Collar Crime," August 1980, page 48). Indeed, U.S. Attorneys have been cautioned repeatedly that the national and district priorities should not be used or interpreted as declination guidelines.

GAO should also be aware that as U.S. Attorneys define their respective district white collar crime priorities, they may, with the Department's approval, deviate somewhat from the national priority definitions. Thus, for example, while Federal program fraud schemes not involving corruption, with losses of \$25,000 or more, are national priorities, in a particular Federal district, the U.S. Attorney may declare similar offenses involving \$10,000 or more in losses a district priority. Predicting the precise effect of the national and district priorities initiative on the types of cases accepted or declined for prosecution is, therefore, not possible.

In offering the above comments on white collar crime, it is important to understand that the Criminal Division does not quarrel with the draft report's general conclusions on page 30 that (1) the priorities initiative will probably mean that the Department will prosecute fewer noncorruption, small dollar fraud cases in the future, and (2) the Department's attempt to focus criminal prosecutive resources on the larger program fraud cases makes it even more important for agencies to take effective administrative action against those who defraud their programs. The Department simply wants to make the point very clear that the white collar crime priorities are not intended to be, and will not be, employed as guidelines for declining cases.

CIVIL DIVISION

The Civil Division agrees in general with the conclusions and recommendations included on pages iv to vi of the draft report. However, there are several misleading statements and omissions within the report deserving comment which would improve its accuracy.

On page 28, the report concludes "Justice attorneys generally give no consideration or untimely consideration to possible civil remedies, . . ." This statement ignores the fact that an entire branch of the Civil Division is currently involved in civil fraud litigation. Even during the period of GAO's audit, approximately 20 Department attorneys were responsible for this work, in addition to the numerous Assistant United States Attorneys who concentrate on civil litigation. During the period covered by the audit, some Department attorneys may have failed to consider civil remedies at the most advantageous time, but certainly all Justice Department attorneys cannot be charged with failure to act, and this area is receiving extensive treatment as discussed later in the Civil Division's comments.

The same erroneous conclusion is restated on page 32 as "Justice Usually Does Not Pursue Civil Remedies." Apparently, this conclusion is supported by the statement on page 32 that only 28 civil actions were filed out of 393 fraud referrals by agencies. The report fails to recognize that most fraud cases are referred to the Department by the Federal Bureau of Investigation (FBI) and not by agencies. Approximately 5,000 reports of potential fraud are referred to the Civil Division each year. During the 2 1/2 year period studied by the GAO, only 685 referrals contained enough evidence of a monetary loss to justify assignment to a Division attorney for further review. Many of these matters were later closed because additional evidence demonstrated that the government suffered no monetary loss, the case lacked a solvent defendant, adequate administrative sanctions existed, or the cases were plagued by material legal insufficiencies. Approximately 70 new fraud cases were filed by Civil Division attorneys during the period under study; most involved large monetary amounts. United States Attorneys' offices filed additional cases. The current rate of case filings is nearly double the rate during the study period. Because fraud cases take several years to process through the courts, hundreds of active court cases are handled at any one time by the Civil Division.

The report is correct in stating on page 33 that the Justice Department recognizes the need to coordinate civil and criminal fraud actions. However, the report is incorrect in stating that "little progress has been made in implementing these policies." In view of the almost 2 years that have passed since the period of the GAO study, it seems appropriate to comment on recent developments in civil and criminal coordination of fraud cases.

Recognizing that the investigators and auditors who develop the evidence necessary to bring a civil or a criminal action are key factors, Justice Civil Division attorneys have been presenting two to four seminars per month for agency personnel for more than a year. Most often, these seminars are given in connection with presentations by Justice criminal attorneys. An in-depth course for United States Attorney personnel will be given this March. In addition, every recent meeting of United States Attorneys has included some discussion of civil fraud litigation. Recently, the Chiefs of various Civil Divisions of United States Attorneys' offices exchanged plans for the coordination of civil and criminal fraud cases. These plans, many of which are now functioning, involve early consideration of civil remedies.

Other Justice Department training efforts have been extensive. Apart from addressing United States Attorney personnel and investigators from individual agencies, seminars have been given for agency counsel, for Inspectors General personnel, for local government groups, and for Justice Department personnel. A civil fraud course is to be added to the Law Enforcement Training Center's seminar on white collar crime. Moreover, various written materials on civil fraud have been provided to numerous agencies, and the Civil Division publishes its own manuals for the use of its attorneys and the United States Attorneys' offices. These efforts should amply demonstrate that the statement at page 33 that "the Department has not emphasized the civil aspects of fraud cases" is clearly incorrect.

Although not every case warrants simultaneous criminal and civil prosecution, cases are so handled when it is advantageous to the government. For example, United States v. McDonnell Douglas Corporation, No. 80-2714, D.D.C., which involves allegations of secret overseas payments, was filed before a criminal trial was conducted. In another case, United States v. Transport Tire, No. 80-1266, D. Idaho, not only did the Civil Division, in advance of criminal trial, file a suit to recover damages for fraud in connection with the sale of subgrade tires to the government, but simultaneous administrative action was taken to withhold contract payments and suspend the contractor.

In some cases, successful civil suits will follow unsuccessful criminal actions, as in United States v. Hangar One, Inc., CA 74-P-646-S, N.D. Ala., or a criminal indictment will follow a successful civil action, as in United States v. Harry M. Borcheding, and the Institute of Computer Technology, Civil Action No. 5-71231, E.D. Mich. As indicated, coordination of administrative actions and judicial proceedings is an important area which is not ignored. Prompt referral to the Justice Department by agencies can result in avoiding payment on the false claim, which is certainly the most economical way to proceed. For example, in United States v. Medico Industries, Inc., No. 80-C-6434, N.D. Ill., the Civil Division filed suit to declare the unpaid administrative claim of the defendant unenforceable because of a conflict of interest. Similar coordinated judicial and administrative efforts are encouraged by the Contract Disputes Act of 1978, which provides for penalties for the submission of false claims even if the Government ultimately suffers no loss. In other words, the facts of each case will dictate whether criminal, civil or administrative remedies are most appropriate and in which order.

On page 39, the report suggests that Congress enact legislation to allow agencies to assess civil money penalties against persons who defraud Federal programs. The report is correct in noting that the Department has proposed such legislation to OMB,^{1/} but other congressional action could assist the government in its attempts to recover the damages caused by fraud. Congress could enact legislation to allow the setoff of debts owed the government against all types of credits due from the government. For example, an employee's salary cannot be offset against an employee's general debts to the government. 58 Comp. Gen. 501 (1970). In this regard, page 7 of the report indicates employees are responsible for 30 percent of fraud cases. Although common law allows the setoff of retirement funds, statutory provisions would greatly simplify this process.

^{1/} The report incorrectly states that administrative remedies may be approved only after criminal or civil declination. The proposed administrative remedies may be appropriate even when there is a criminal prosecution. The bill only requires Attorney General approval before administrative proceedings involving a fraud case or class of cases go forward.

Statutory restrictions on access to tax return information make the offset of tax refunds virtually impossible. Legislation allowing access to tax information and specifically authorizing the offset of tax refunds would be useful.

On page 43, the report notes that a Civil Division reorganization has improved anti-fraud activities. Specifically, more civil attorneys are handling fraud cases and the number of persons screening incoming reports on fraud has quadrupled. This has resulted in the elimination of a backlog in reviewing reports for closing or assignment to attorneys.

On page 45, the report notes that: "The Department is exercising leadership in supporting the Executive Group to Combat Fraud and Waste in the Government." The Civil Division regularly attends meetings of this Group in order to better coordinate its efforts with the Inspectors General. In addition, Civil Division attorneys meet with Inspectors General's counsel monthly. These formal activities are in addition to continual ad hoc discussions and coordination efforts.

From the chart on page 9, it appears that over 70 percent of the cases discussed in the report involve very small monetary amounts. Assuming a suit was legally tenable in each case and that a defendant could be found (this is unlikely in most theft cases), several times the amount of potential recovery would be spent in prosecuting the case. This would result in a high net loss to the government.^{2/} The resources of the Civil Division and of the United States Attorneys' offices are best spent in pursuing recoveries where large amounts of money are at stake.^{3/} For example, following a criminal conviction in a case of fraudulently misgraded shrimp, a few weeks of attorney time resulted in a \$1,000,000 recovery. Several million dollars have been recovered as a result of Civil Division follow-up of an Agriculture Department investigation of shortweighing and misgrading of grain at certain grain elevators. It is interesting to note that the first page of the report cites the case of a Federal transportation clerk who embezzled \$856,000. A fraud judgment and subsequent collection efforts resulted in recoveries of almost \$600,000.^{4/} Obviously, these types of cases can take enormous amounts of time and effort, but the recoveries justify the expenditures.

^{2/} These cases are largely of the type which the report describes as individual frauds involving the Social Security Administration and Agriculture food stamp programs, or thefts of government property from the Postal Service, Army and Navy. The chart on page 7 also indicates the wrongdoers are unknown in 30 percent of the cases, a factor which obviously makes any judicial action impossible.

^{3/} On page 30, the report seems to recognize this in its discussion of the white collar crime priorities which are concerned with monetary losses.

^{4/} United States v. Seibert, Civil No. 77-1391 (D.D.C.).

Procurement contracts are often the source of the largest civil claims. These cases make up a small portion of the number of cases which flow through the Department of Justice, but their monetary impact is enormous. These cases were not specifically discussed in the report. Departmental efforts to strengthen the False Claims Act, which is discussed on page 32 of the report, have failed thus far, in large part because of the potential effect of those suggested amendments on procurement contracts.

Overall, the report contains the following conclusions with which we agree: First, costly civil litigation is not the best way to recover every debt resulting from fraud. Second, even administrative remedies cannot solve the problem in all cases. Third, program control is the answer to a great part of the problem. We support the concept of legislation creating enforceable administrative sanctions for fraudulent acts, and for creating a system of manageable and effective program controls as a preventive measure.

LAW ENFORCEMENT ASSISTANCE ADMINISTRATION (LEAA)

LEAA generally agrees with those portions of the report pertaining to their activities and offers the comments noted below.

The chart on page 7 showing "Who Committed Fraud?" tends to be misleading. This chart was prepared from agencies' records of identified fraud cases. One would expect a higher detection rate for Federal employees (and unknowns) simply because this is the readily available "tip of the iceberg" located at the Federal level. Consequently, the report tends to give the impression that most fraud is committed by Federal employees. From all indications, the extent of fraud and abuse in Federally funded programs at the recipient level is much greater than that committed by Federal employees. The chart on page 11 may be misleading for essentially the same reason.

The example on page 5 involving an embezzlement of \$16,000 in LEAA grant funds gives the reader the impression that LEAA administratively established a repayment schedule which would take the individual 65 years to repay the full amount of the embezzlement. It should be made clear in the final report that the repayment schedule was directed by the Office of the Probation Officer, United States District Court for the District of Columbia, and was not administratively determined by LEAA.

LEAA fully supports the GAO theme "Fraud and Related Illegal Acts: A Serious Problem Which Can Be More Effectively Controlled." In this regard, the Office of Audit and Investigation, Office of Justice Assistance, Research and Statistics (OJARS) hosted a 3-day workshop on the subject of "Prevention and Detection of Fraud, Waste and Abuse of Public Funds" on November 14, 15 and 16, 1979, at the Department of Justice, Washington, D.C. The workshop evolved as a response to a need for information on current anti-fraud activities of Federal, State and local officials and by the private sector. Thus, persons with experience in, or job responsibility related to, the prevention and detection of fraud, waste and abuse of public funds were invited to participate in the workshop to identify and discuss: (1) problems and needs in prevention and detection, (2) prevention and

detection activities considered most effective in combatting fraud, waste and abuse of public funds, and (3) types of activities which could be developed and implemented for the greatest impact on a national fraud, waste and abuse effort. Also discussed were the various processes that Federal Inspectors General and the Office of Management and Budget are currently using to perform vulnerability studies or risk analyses of their department's respective programs. The purpose of the discussions was to determine whether these types of processes could be utilized by State and local officials to analyze their programs/responsibilities and reduce the potential for fraud, waste and abuse.

The workshop participants included 26 State officials representing 17 States, 13 city or county officials representing 12 local governments, 12 Federal officials (United States Attorneys, representatives from various Federal Inspectors General offices, and Department of Justice personnel), and 9 nongovernment researchers, educators, etc. In addition, staff from two committees of the Congress of the United States attended.

Also, during the past several years, the National Institute of Justice has supported several research efforts to examine the nature of public corruption, and fraud, waste and abuse in government benefit programs. Two recent efforts have included the development of a resource training package, entitled "Managing Municipal Integrity," which is based on the Institute's program model on Prevention, Detection and Correction of Corruption in State and Local Government, and a monograph on the importance of a prevention approach in reducing fraud. Finally, the Office of Research Programs is currently funding an examination of the nature and extent of fraud and abuse in the food stamp and medicaid programs, and the most effective strategies and mechanisms for controlling fraud and abuse.

In our judgment, enactment of legislation as suggested in the report should serve as a deterrent and result in control systems being subjected to closer scrutiny, but such legislation should not be regarded as a panacea in the government's efforts to reduce fraud, abuse, and waste of public funds. More needs to be done at all levels of government.

FEDERAL BUREAU OF INVESTIGATION

The FBI agrees with GAO that stronger systems of control are needed to protect programs from fraud, and effective punitive actions should be taken against those who commit fraud. Since the establishment of the Offices of Inspector General (OIG), the FBI has strongly advocated that maximum impact upon fraud, waste and abuse in government programs and operations would require the OIG role to be primarily oriented toward detection and prevention functions. As the OIG role developed, the FBI was disillusioned to see increased emphasis being placed on criminal investigations rather than detection and prevention. The FBI views as a positive sign the fact that GAO, through its own independent research, has reached the same conclusion as the FBI that ". . . agencies should emphasize fraud prevention, rather than simply chasing after it once it occurs. . . ."

The report also points out the need for better trained personnel to deal with fraud and abuse and refers to the FBI's enhancement of its Special Agent Training Course in the program fraud area. We believe it is equally important to mention the ongoing FBI-sponsored training program offered OIG personnel at the FBI Academy, Quantico, Virginia.

EXECUTIVE OFFICE FOR U.S. ATTORNEYS (EOUSA)

The EOUSA considers those portions of the report pertaining to U.S. Attorneys' activities to be generally fair and accurate. The report makes reference to a number of Departmental efforts to upgrade Federal anti-fraud activities and notes a number of actions in progress to improve central coordination and direction of anti-fraud activities within Justice and with other agencies.

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In terms of the overall message conveyed in the report, the Department agrees that the cost of fraud and related illegal activities is substantial. We also agree that the prevention of fraud and related acts through effective systems of internal control should be a top priority and the Department plans to continue pursuit of this objective in its working relationships with other departments and agencies.

We appreciate the opportunity to comment on the draft report. Should you desire any additional information, please feel free to contact us.

Sincerely,

Kevin D. Rooney
Kevin D. Rooney
Assistant Attorney General
for Administration

U. S. Department of Labor
Inspector General

MAR 02 1981

Mr. Gregory J. Ahart
Director
Human Resources Division
U.S. General Accounting Office
Washington, DC 20548

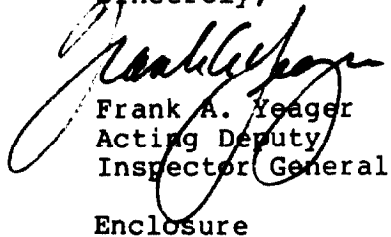
Dear Mr. Ahart:

This is in reply to your letter to the Secretary requesting comments on the draft GAO report entitled, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

The Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,



Frank A. Yeager
Acting Deputy
Inspector General

Enclosure

U.S. Department of Labor's Response To
The Draft General Accounting Office Report
Entitled---

"Fraud and Related Illegal Acts: A Serious
Governmental Problem Which Can Be More
Effectively Controlled."

Comments:

The Department concurs with GAO's findings that internal controls in Government operations need to be better examined, evaluated, strengthened, and enforced. The Department is greatly emphasizing the assessment and enhancement of fraud and abuse controls and their implementation. The Office of Inspector General is engaged in a number of comprehensive studies to identify internal control weaknesses in selected program areas and to recommend remedial countermeasures to Department management. In addition, a number of loss control initiatives are being undertaken in specific DOL agencies. For example, the Employment Standards Administration (ESA) has recently formed a Loss Prevention Task Force and is also engaged in loss vulnerability projects in select ESA program areas.

The Department notes that GAO recommends enactment of proposed legislation requiring greater accountability by agency heads for the effectiveness of their organizations' internal control systems. We agree with the report that more encouragement must be provided for top management to establish and maintain effective fraud and abuse control systems and, thus we concur with the spirit and basic intent of the legislation.

The pending bills would require agency heads to undertake annual evaluations of their organizations' internal accounting and administrative control systems and certify the adequacy of such systems to the Congress and the President. Any weakness that prevents the agency head from expressing an unqualified opinion must be identified and a detailed plan and schedule described for remedying those weaknesses.

The GAO draft report observes that enforcing fraud and abuse controls is frequently not a primary concern of program managers, who are usually rated on the services they are responsible for delivering. Further, managers often believe that fraud control should be the concern of investigators and auditors.

In order to encourage program managers to have effective fraud and abuse prevention and detection controls in their operations, they should be rated and judged and rewarded or penalized according to the success or failure of their efforts. In order to be held strictly accountable, however, the requisite tools must be made available for their use.

The examination, evaluation, design, and testing of financial, administrative, and ADP internal controls requires specialized staff resources; the detection, assessment and resolution of fraud and abuse activity also requires special skills. Staff expertise in this area will very likely, be inadequate to undertake such analyses.

The Department also strongly supports GAO's endorsement of the concept of allowing agencies to levy civil money penalties. Such authority, if properly and equitably administered, would serve as a strong deterrent to fraud activity. The Department's Office of Inspector General is in full agreement with the intent of the "Program Fraud Civil Penalties Act" proposed by the Department of Justice, and has given active support to this legislation.

Additional Comments:

The Department notes that, over the past few years, GAO has issued a substantial number of reports dealing with Federal fraud and abuse problems, relationships between fraud and abuse and internal controls, the need for improved internal controls, and the need to do more in combating fraud, waste and abuse. In our view, these analyses have been valuable in assisting agencies identify problem areas and evaluate recommended corrective action.

However, the Department believes that, in addition to the attention given to problem identification, what is most needed now is the development of effective means to control waste, fraud, and abuse. The Government needs to know what techniques work, how specific loss prevention models can be designed and implemented, what specific management initiatives can be undertaken to insure compliance with internal controls and other loss control measures, how loss prevention efforts can be evaluated, etc. The Department suggests that the GAO is in a unique position to undertake a number of projects on a Government-wide basis which could make substantive contributions to effectively control waste, fraud, and abuse related losses. For example GAO is in an ideal position:

- to serve as a Federal clearing house for the identification and evaluation of innovative fraud and abuse control applications at all levels of government and in the private sector;
- to evaluate fraud and abuse control organizations and procedures and design and recommend a composite model for Government-wide replication;
- to design and recommend model ADP detection and front-end prevention applications for various information processing systems including Federal benefit payment operations;

- to develop standardized Government-wide criteria for quantitative evaluative measures of investigative, audit, systems analysis, and related fraud control capabilities; to design and recommend uniform methods to assess savings, cost avoidance, prevention, deterrence, and overall asset protection effectiveness; and
- to design and recommend model eligibility screening and verification systems for various categories of Government service programs.

The above suggestions are, examples of valuable projects that could effectively be undertaken by GAO's centralized program, in joint efforts with relevant Departments, to contribute to Government-wide fraud, waste, and abuse control. We understand that GAO plans to address a number of these issues, and are confident that the results of such programs will significantly assist our Department. We would be pleased to contribute, in any appropriate manner, to the success of these efforts.



U.S. Department of Transportation

Office of the Secretary of Transportation

Assistant Secretary for Administration

400 Seventh Street, S.W. Washington, D.C. 20590

February 27, 1981

Mar 4 1981

Mr. Henry Eschwege
Director, Community and Economic
Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This is our reply to the General Accounting Office (GAO) draft report, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled," dated January 27, 1981.

We have reviewed the report and, of course, agree with its intent that fraud and illegal acts must be controlled and their occurrences must be brought to a minimum. However, we are not sure this report offers anything new in the form of detection and prevention. In September 1978, the GAO reported formally on fraud detection activities in seven Federal agencies. The initial report was sufficient, pointing out the deficiencies uncovered and their seriousness. In addition, financial implications were recognized, and the effect on public confidence in Government employees and the integrity of Government processes were treated with understanding.

We believe, however, that this most recent report, which is based on a projection of sampled statistics, oversimplifies the solution to combatting fraud. In our opinion, to claim that sound internal control systems are the answer generally to all fraud and illegal activities is less than complete and correct. The solution appears to ignore the human behavior factor involved in fraudulent activity. Secondly, the report recommends to the Congress that legislation be enacted to require heads of Federal agencies to certify annually to the effectiveness of their internal control systems. It is our view that additional internal control legislation is not needed since the Budget and Accounting Acts of 1921 and 1950 already cover this requirement. Also, the Inspector General Act of 1978 added strength to agencies' control over fraud and illegal acts.

We will be happy to discuss these matters with you or your representatives.

Sincerely,


Robert L. Fairman
Acting



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FEB 13 1981

Dear Mr. Anderson:

This is in response to your request dated January 19, 1981, that the Department of the Treasury review the proposed GAO report to the Congress entitled: "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled." We have reviewed the report with interest and wish to provide a comment with respect to the observations made in Chapter 5 regarding training programs.

Treasury is the lead agency in the Executive Branch for administering the Federal Law Enforcement Training Center in Glynco, Georgia. Since December 1978, the Center, in concert with a number of Federal organizations, has sponsored a two-week seminar on white collar crime activity. This program was developed specifically for experienced investigators, auditors and other personnel actively engaged in combating fraud, waste and abuse in government programs. To date over 1,100 personnel from more than 50 organizations have graduated from this program.

The Department regards this program as one of the most important efforts being made on a continuing large-scale basis in the Federal government to improve the effectiveness of personnel in detecting, investigating and prosecuting sophisticated financial crime matters. Therefore, we urge that consideration be given by GAO to including a statement about the Center's program in its final report to the Congress.

Sincerely yours,

John P. Simpson
Acting Assistant Secretary
(Enforcement and Operations)Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548



General Office of
Services Human Resources
Administration and Organization Washington, DC 20405

13 FEB 1981

Mr. D. L. Scantlebury
Division Director and Chief Accountant of GAO
Accounting and Financial Management Division
U.S. General Accounting Office
Washington, DC 20548

FEB 17 1981

Dear Mr. Scantlebury:

Thank you for the opportunity to comment on the draft General Accounting Office report, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

We have reviewed the report and find that it presents a comprehensive analysis of the problem. We concur with the recommendations to the Congress.

Sincerely,

W. M. PAZ
Assistant Administrator
for Human Resources and Organization



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

FEB 20 1981

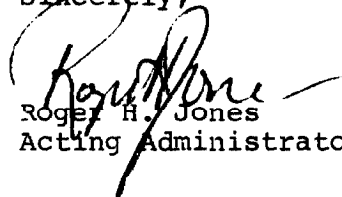
Mr. Henry Eschwege
Director
Community and Economic Development
Division
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your letter of January 27, 1981, requesting this Agency's comments on your draft report entitled, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

We have reviewed the report with interest and we in general agree with its content and, therefore, we do not have any substantive comments to make.

Sincerely,


Roger H. Jones
Acting Administrator



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

27 FEB 1981

OFFICE OF
PLANNING AND MANAGEMENT

Mr. Henry Eschwege
Director, Community & Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

The Environmental Protection Agency (EPA) has reviewed the General Accounting Office (GAO) draft report entitled "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

We concur with the general thrust of the report that fraud and other illegal activities are a costly and widespread problem, and that improvements in internal control systems are needed to prevent such problems.

EPA agrees with GAO that good systems of internal controls would prevent much of the fraud and other problems, or would at least result in quicker detection. We also recognize that EPA should emphasize fraud prevention rather than reacting to it once it occurs. In this regard, the Inspector General, in October 1980, established "Project Look" whereby a team composed of auditors, investigators and engineers reviews selected construction grant projects to look for indicators of fraud, abuse, waste and mismanagement.

Similarly in January 1981, the Office of Inspector General established the Vulnerability Assessment Task Force, comprised of audit and investigative staff to facilitate proper coordination and leadership in implementing an effective program to detect and prevent fraud, mismanagement, waste and abuse. As part of the Task Force's overall responsibility, it is in the process of developing a program to assess the vulnerability of EPA programs and operations to such problems.

We appreciate the opportunity to comment on the report's content prior to the report's issuance.

Sincerely,

C. William Center

for

Roy N. Gamse
Acting Assistant Administrator
for Planning and Management



THE POSTMASTER GENERAL
Washington, DC 20260

March 17, 1981

Dear Mr. Anderson:

Thank you for the opportunity to comment on your draft report entitled, "Fraud and Related Illegal Acts: A Serious Governmental Problem Which Can Be More Effectively Controlled."

The report indicates that the mail service cases included in your study consisted primarily of the theft of registered and insured mail, and that such cases are included in the report's definition of fraud and in its statistical tabulations. The report also indicates that most losses due to fraud go undetected and that controls to prevent fraud are often inadequate, non-existent or ignored by agency officials.

These generalizations about detectability and controls are not applicable to thefts of registered and insured mail.

An indemnity is paid for loss or damage of registered and insured mail and a record is kept of each piece registered and insured. The indemnity feature makes it very unlikely that a loss of registered or insured mail will go unreported to the Postal Service. Reports of losses are analyzed on a continuing basis to detect patterns that suggest theft. Where such patterns emerge, they are thoroughly investigated. Accordingly, we do not think that most losses arising from the theft of registered or insured mail go undetected.

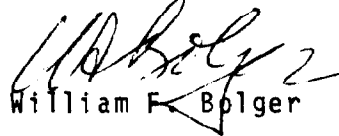
Controls to prevent the theft of registered and insured mail are elaborate and have full support from postal officials.

The Postal Service conducts a criminal history background check on all new employees and they must attend orientation sessions on the sanctity of the mail. We also have programs of containerization, hand to hand receipts for valuable mail, vehicle sealing, accountability escorts, and uniformed security police officers, all directed towards preventing thefts.

In fiscal year 1980, the number of claims paid by the Postal Service for the loss of insured articles represented approximately 0.2% of all insured articles mailed; the number of claims paid for the loss of registered articles represented approximately .0025% of all registered articles mailed. It should be noted that these are claimed losses from all causes, not just theft. Numerous losses of insured, registered and ordinary mail are due to fires, airplane accidents, natural disasters and the like.

The fact that we have such a low loss rate from all causes, including theft, indicates that our controls are effective. Our experience supports your view that proper controls can help prevent theft.

Sincerely,



William F. Bolger

Mr. William J. Anderson
Director, General Government
Division
U.S. General Accounting Office
Washington, D.C. 20548

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