



Comptroller General
of the United States

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January 27, 1994

The Honorable John Glenn
Chairman
The Honorable William V. Roth, Jr.
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable John Conyers, Jr.
Chairman
The Honorable William F. Clinger, Jr.
Ranking Minority Member
Committee on Government Operations
House of Representatives

To assist you in this year's oversight efforts, we are providing the enclosed updated descriptions of the areas in our high-risk program. As you know, we have carried out this special effort since early 1990 to review and report on selected areas especially vulnerable to waste, fraud, abuse, and mismanagement.

Our program now covers 18 areas--the 17 included in the High-Risk Series reports we issued in December 1992 and the Department of Housing and Urban Development (HUD), which we are adding today. While HUD has made efforts to address the numerous and severe problems that impact program management and delivery, billions of dollars continue to be at risk because of long-standing organizational, systems, and staffing problems. We believe HUD warrants the special focus that comes with the high-risk designation.

Early next year, we plan to provide you and the next incoming Congress with a major program update in which we will discuss in detail the progress agencies have made in addressing these areas. Your support has been most helpful in focusing the attention of Members of the Congress and agency management on actions needed to correct these serious problems.

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We look forward to working with you on our efforts. In the meantime, if you would like further information, please call Gene L. Dodaro at (202) 512-9459 or George H. Stalcup at (202) 512-3406.

A handwritten signature in cursive script that reads "Charles A. Bowsher".

Charles A. Bowsher
Comptroller General
of the United States

Enclosure

DESCRIPTION OF GAO'S HIGH-RISK AREASLENDING AND INSURING ISSUESFarmers Home Administration's (FmHA) Farm Loan Programs

FmHA has made billions of dollars of credit available to the nation's farmers who cannot get help elsewhere. Of the agency's \$20.5 billion in outstanding loans as of June 1992, \$7.6 billion, or about 37 percent, was held by delinquent borrowers, even after FmHA provided almost \$8 billion in debt relief to delinquent borrowers during the period of fiscal year 1989 through the third quarter of fiscal year 1992. FmHA often fails to follow its own standards for making and servicing loans, and FmHA's loan policies--some of which are congressionally directed--do not adequately protect the taxpayers' interests. Losses can be expected to continue until the Congress tells FmHA to better balance its mission of assisting financially troubled farmers with its obligation to provide that assistance in a fiscally responsible manner. While some corrective actions have been initiated, such as providing field office lending officials with credit and financial analysis training, neither the Congress nor the Secretary of Agriculture have addressed fundamental problems involving FmHA's lax loan and servicing policies.

Student Financial Aid

During 1993, over 7 million students received \$27 billion in grants and loans for postsecondary education from the Department of Education, including \$18 billion in guaranteed student loans and \$6 billion in Pell Grants. The large number of banks, state agencies, and schools participating in these programs, coupled with (1) federal financial and management information systems which do not adequately protect the government's financial interest and (2) little or none of the financial risk being shared by nonfederal participants, creates the potential for significant abuse and losses. Defaults during 1993 on guaranteed student loans exceeded \$2.5 billion and outstanding guaranteed student loans exceeded \$70 billion.

Department of Education administrative practices have resulted in inadequate oversight of program participants, erroneous payments, and lost revenue. High loan default rates, abuses by proprietary schools, and additional stress on the Department's systems related to the phasing in of direct lending, highlight the need for strengthened program management and control systems. While we believe that the guaranteed student loan program remains high risk,

we want to acknowledge that Education is making financial management a departmental priority and has efforts underway to reduce financial management and control vulnerabilities.

Bank Insurance Fund (BIF)

Unprecedented numbers of bank failures and the likelihood of additional failures resulted in the Fund's reported insolvency at December 31, 1991. Weak internal controls, flawed corporate governance systems, flexible accounting rules, and lax regulatory supervision put the Fund at risk and further contributed to the problem by making any early warning of problems less likely. The Federal Deposit Insurance Corporation Improvement Act of 1991 contained provisions for rebuilding the Fund and accounting, corporate governance, and regulatory reforms designed to correct weaknesses in the deposit insurance system.

Since passage of the act, the industry's condition has improved significantly as an extended period of low interest rates enabled banks to earn record profits and recognize losses in their asset portfolios. Fund reserves increased from a \$7 billion deficit at year-end 1991 to a \$10.5 billion positive balance at September 30, 1993. FDIC's July 1993 projections show that the Fund will achieve its designated ratio of reserves to insured deposits in 1998 assuming continued improvement in the banking industry's condition. Based on current industry trends, the Fund may achieve the designated ratio sooner. Despite this progress, a number of safety and soundness issues such as effective implementation of certain Federal Deposit Insurance Corporation Improvement Act of 1991 reforms and improved examination practices still need to be addressed to ensure the long-term health and stability of the nation's banking and deposit insurance system.

Resolution Trust Corporation (RTC)

The RTC Completion Act, enacted in 1993, provided an additional \$18.3 billion of funding for RTC to resolve the failed thrifts it has already taken control of and those that fail before July 1, 1995 and moved RTC's termination date up 1 year to December 31, 1995. RTC still has about \$70 billion in assets, most of which will be difficult to sell. The potential for these assets to be sold at bargain basement prices will continue to make this area highly susceptible to fraud, waste, and abuse. RTC will face several challenges during this final phase of operation. First, it must ensure that past contracting and sales problems are corrected. Second, it must implement a series of legislated management reforms directed toward strengthening and improving RTC operations in such

areas as information systems, legal contracting and oversight, minority and women-owned business opportunities, and audit followup, implementation, and oversight. Finally, it must plan for and begin the transfer to the Federal Deposit Insurance Corporation of responsibility for failed thrifts while ensuring that its own operations continue to pursue legislatively mandated goals.

Pension Benefit Guaranty Corporation (PBGC)

PBGC insures the benefits of private defined benefit pension plan participants. PBGC will pay the guaranteed portion of participants' monthly pensions if the plan terminates without being fully funded. PBGC's Single Employer Insurance Fund had a \$2.7 billion deficit as of the end of fiscal year 1992. While the government could be liable for such deficits, the even bigger risk to the government is its exposure to \$53 billion in underfunded liabilities associated with covered plans; about \$14 billion of which relate to financially troubled companies. If several companies with large, underfunded pensions went into bankruptcy, PBGC might have to use its existing assets to pay these additional guaranteed benefits, and this, in turn, could require an infusion of general revenue financing in order for PBGC to continue to meet its obligations.

This risk would be reduced if underfunded plans improved their funding levels. However, current funding rules and proposed legislation may not provide assurances that companies will achieve the goal of full funding of all insured plan liabilities. Without full funding, PBGC and the taxpayers will continue to be exposed to this risk.

Medicare Claims

Medicare's soaring expenditures--\$146 billion in fiscal year 1993, and expected to increase to \$242 billion by 1998--underscore the need for the government to manage the program judiciously. But the government pays little attention to the activities to protect Medicare benefit dollars and is losing opportunities to save billions in Medicare payments. Funding for Medicare internal controls has declined consistently since 1989 and each year this reduction has adversely affected the program's ability to detect and avoid paying inappropriate or erroneous claims. Moreover, HCFA has not provided effective oversight of the contractors it uses to administer Medicare and safeguard program funds. HCFA has little information on fundamentals, such as the computerized edits and payment criteria used by contractors.

Department of Housing and Urban Development (HUD)

HUD is one of the nation's largest financial institutions, insuring and guaranteeing \$400 billion of loans for single and multifamily units and spending about \$25 billion a year on housing and community development assistance. HUD has had a history of fundamental management and organization problems that put billions of these dollars at risk: an organizational structure that blurs accountability; inadequate information and financial management systems which makes it much more difficult to establish adequate internal controls; and staff without the skills needed to effectively manage programs.

Our strategy will be to initially focus on single family and multi family HUD-held mortgages and property disposition (about \$13.8 billion in assets). We also will focus on HUD funding (about \$6 billion annually) which supports Public Housing Agencies/Authorities whose inventories are estimated at around \$70 billion. HUD expects multifamily loan defaults and property inventories to grow because of regional economic downturns, poor underwriting in the past, insufficient monitoring, lack of staff and financial resources, and legislative impediments. In addition, single family HUD-held mortgages and property disposition inventories have increased dramatically in recent years. Public housing programs are at risk because of deteriorating housing stock, high vacancy rates, weak internal controls, and ineffective management. HUD's reinvention efforts which include consolidating regional and field offices are expected to increase accountability by giving headquarters staff control over field resources. In addition, HUD has begun to develop integrated financial management and information systems but implementation is years away.

CONTRACTING ISSUESDepartment of Energy Contract Management

Energy relies extensively on contractors to manage and operate the nation's nuclear weapons complex and national laboratory network. In fiscal year 1992, Energy obligated about \$19 billion to 35 multinational firms and academic organizations. Historically, Energy's contractors have operated largely without oversight or financial risk, and this has placed the government's multibillion-dollar annual investment in contractors' services at risk. Energy lacks the necessary staff expertise and information systems to monitor contractors, and its contracts provide few incentives for cost-effective contractor operations.

Energy recently formed a task force to draft proposed reforms to its contract management policies. However, until the Department remedies its excessive reliance on cost-reimbursable contracts, devotes more attention to contract costs, and strengthens contract administration, reform efforts will not get beyond marginal success.

Superfund Program Management

The Congress has authorized \$15 billion through fiscal year 1994 for the Superfund program, but estimates of complete cleanup costs are much higher. At the end of fiscal year 1993, the Environmental Protection Agency (EPA) had obligated about \$12 billion, but completed cleanup of only 218 of 1,320 sites. EPA has wasted federal resources by not ensuring that parties responsible for cleaning up sites paid their fair share. The agency has also not effectively managed the cleanup contractors that spend a large portion of Superfund monies, although it has taken some actions to improve contract management. In addition, EPA lacks the information needed to rank comparative risks of environmental problems--it can't be sure that it is spending money on the most important areas. EPA recognizes the importance of risk-based funding decisions and is taking steps to move in that direction, but full implementation is a long way off. For example, EPA reviewed how its fiscal year 1994 budget addressed environmental problems of varying risks. However, only limited changes could be made because of information limitations and statutory constraints.

Defense Weapon Systems Acquisition

Despite defense budget reductions, DOD still spends about \$85 billion annually on weapons systems. Historically, DOD's weapon acquisitions cost more than estimated, take longer to field than planned, and/or do not fully meet performance requirements. These problems have persisted over the years despite numerous studies and reform efforts.

The collapse of the Soviet Union coupled with large reductions in defense spending have introduced additional acquisition issues. The threat-based justification for many weapons has been reduced or eliminated and replaced by socio-economic and industrial base concerns associated with delaying or terminating major programs. Cutbacks will also require DOD to rely more on commercial products and practices to reduce costs and assure an adequate defense industrial capability.

GAO believes that needed acquisition reforms require fundamental change. Such changes must address DOD's acquisition culture, including parochial interests and incentives that encourage behaviors that are not in the best interest of DOD or the taxpayer.

Defense Contract Pricing

Inadequate government controls also have resulted in large excess payments to contractors. For example, during a recent 6-month period, contractors returned \$751 million to the government. Most of the returns appear to have resulted from overpayments, and were primarily detected by the contractors.

Further, despite laws and regulations to protect the government, significant unallowable and questionable costs continue to find their way into contractor overhead submissions. During fiscal years 1991-93, DOD auditors questioned about \$3 billion in contractor charges.

While efforts are underway to streamline the acquisition process, such reforms can only be sustained by ensuring the integrity and fairness of the procurement and contracting processes and properly protecting the government's and the taxpayers' interests.

NASA Contract Management

NASA spends about 90 percent of its funds each year on contracts--more than \$13 billion in 1993. Because of serious contract management problems, which the agency has recognized, NASA cannot reasonably ensure that these contract funds are being properly used and accounted for. In some cases, inadequate contractor oversight has contributed to cost increases, schedule delays, and performance problems with space equipment. NASA's difficulties in contract management stem mostly from three major problems. First, the agency has assumed an unrealistically high level of funding. When actual funding levels came in under what was planned for, NASA has had to adjust the content and pace of work under contract. Second, some field centers do not fully comply with NASA contract management requirements. Third, NASA cannot effectively oversee its contractors in part because of inadequate accounting and property management systems.

ACCOUNTABILITY ISSUESDefense Inventory Management

As of September 1992, DOD had inventories of spare and repair parts, clothing, medical supplies, and other support items valued at about \$80 billion, and it has been estimated that \$39 billion of this inventory was not needed to support DOD's operational forces. Poor management practices relating to requirements determination, procurement, distribution, repair, control, and disposal have contributed to DOD continuously purchasing items greatly exceeding its operational and war reserve needs. More extensive use of commercial practices and changes in financial management and DOD's inventory culture are needed.

Internal Revenue Service Receivables

No meaningful improvement has been made by IRS to permit routine and accurate reporting of what is owed and collectible from its accounts receivable and, thus, no reliable assessment can be made of its collection efforts. In addition, while IRS has piloted some efforts to expedite collections, like offers in compromise, its decentralized collection process blurs lines of accountability and generally continues to be lengthy, antiquated, rigid, and inefficient, which in part is evidenced by its continued flat performance in amounts collected from year to year. IRS has not developed a plan for correcting its accounts receivable database--often referred to as the "masterfile"--to enable it to readily identify what are valid amounts owed. This, along with internal control and program weaknesses noted, limit IRS' ability to determine the effectiveness of its collection activities and devise a better strategy for collecting receivables, including optimal allocation of staffing. It also results in inaccurate routine reporting of its accounts receivable during the year to the Congress and others and shows that IRS' management of its accounts receivable continues to need top priority attention.

Management of Seized and Forfeited Assets

The government's seized and forfeited assets program, with an estimated \$1.9 billion of seized inventory in 1992, has historically experienced mismanagement, weak leadership and oversight, poor internal controls, inefficient operations, wasted resources and lost revenues, and unreliable program information. Responsibility for the program rests with the Department of Justice and the Department of the Treasury.

Work we performed between 1986 and 1992 confirmed the existence of such serious problems. Although some management and systems changes have improved program operations, our audit of the U.S. Customs Service's fiscal year 1992 financial statements, its first under the CFO Act, revealed inadequate safeguards over, and incomplete and inaccurate accounting and reporting of seized property. While Customs has devoted considerable attention to its seized property program activities, and policies and procedures have now been put in place to help ensure proper accountability and stewardship, these requirements have not always been met. As a result, millions of dollars of cash, luxury items and tons of illegal drugs have been vulnerable to theft and misappropriation.

Managing the Customs Service

The U.S. Customs Service needs to address several programmatic and financial management problems. Our work indicates that Customs financial management systems do not provide accurate and reliable information to adequately (1) control its financial resources and (2) report on its financial operations. In addition, over time, interrelated weaknesses in mission planning, organizational structure, performance measurement, financial management, information management and human resources management have diminished Customs' capability to detect trade violations in imported cargo and to collect applicable duties, taxes, fees, and penalties.

In response to our September 1992 general management report, Customs embarked on an effort to improve mission planning, develop an effective trade enforcement strategy, create new performance measures, and revitalize its organizational structure. Also, Customs officials are currently seeking solutions to correct the agency's financial management problems identified during our general management review and financial statement audit of Customs. While these efforts are in the early stages, Customs seems to be moving in the right direction. But, it will take a significant and sustained commitment by its top management to resolve the problems.

Management of Overseas Real Property

The State Department is responsible for managing about 10,000 properties overseas, 1,750 of which are government-owned at a value of \$10 billion. State has estimated the backlog of maintenance on these government-owned properties to be about \$350 million. This program has been historically plagued by lax oversight, inadequate information systems, poor planning and mismanagement. Corrective actions over the years have been minimal, but recently State has

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begun to show a commitment to address these issues, and has initiated some important management reforms, particularly in the maintenance area. Sustained commitment to these reforms is needed to correct the chronic management weaknesses.

Federal Transit Administration Grant Management

The Federal Transit Administration (FTA) currently manages over 4,000 active grants with a value of over \$30 billion and awards over \$3 billion in new grants each year. FTA has had serious shortcomings in oversight of grantees, allowing waste, abuse, and mismanagement of scarce transit resources. Despite these problems, FTA has, for the most part, asserted that its level of grantee oversight was sufficient. In 1992, however, FTA reversed its stance and recognized that there were serious pervasive problems in its oversight function, developed an action plan, and made a commitment to meaningful improvements. Unfortunately, there now are indications that FTA's commitment to correct the identified problems has lost momentum.

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