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REPORT BY THE

Comptroller General

OF THE UNITED STATES

The Federal Audit Function In The Territories Should Be Strengthened

The audit function presently performed by the U.S. Government Comptrollers in American Samoa, Guam, the Northern Mariana Islands, the Virgin Islands, and the Trust Territory of the Pacific Islands needs to be independent and more effective. But a strengthened Federal audit function alone is not enough. More Federal technical assistance, coupled with the assumption of greater responsibility by the territories for financial management, is needed to improve audit effectiveness.

GAO is recommending, among other things, that the Congress transfer the audit authority and staff of the U.S. Government Comptrollers to the Office of the Inspector General, Department of the Interior.

UNITED STATES GENERAL ACCOUNTING OFFICE

AFMD-82-23
MARCH 25, 1982

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

B-204007

The Honorable James A. McClure
Chairman, Senate Committee on Energy and Natural Resources

The Honorable Morris K. Udall
Chairman, House Committee on Interior and Insular Affairs

This report discusses the results of our evaluation of the Offices of the U.S. Government Comptrollers for American Samoa, Guam/Trust Territory of the Pacific Islands/Northern Mariana Islands, and the Virgin Islands. We made this review as part of our continuing work to improve the Federal internal audit capability.

The report contains recommendations to the Congress for strengthening the Federal audit function in the territories. Your committees have requested that we prepare suggested legislative language for the recommendations. That language will be provided under separate cover.

We are sending copies of the report to the Director, Office of Management and Budget, the Secretary of State, the Secretary of the Interior, and the territorial Governors. We are also sending copies to various congressional committees and other interested parties.

Charles A. Bowsher

Comptroller General
of the United States

REPORT BY THE COMPTROLLER GENERAL OF THE UNITED STATES

THE FEDERAL AUDIT FUNCTION IN THE TERRITORIES SHOULD BE STRENGTHENED

D I G E S T

The principal U.S. territories of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands, and the Trust Territory of the Pacific Islands have longstanding problems in their financial management systems. The Department of the Interior's U.S. Government Comptrollers presently are responsible for auditing all significant aspects of governmental operations and Federal programs in these territories. Because of the substantial Federal assistance provided to the territories and their difficulty in improving and maintaining adequate financial management systems, the Federal audit function is still needed, but it needs to be independent and more effective. More Federal technical assistance, coupled with the assumption of greater responsibility by the territories for financial management, would further improve audit effectiveness.

GAO reviewed the organization and functions of the Offices of the U.S. Government Comptrollers as part of its continuing efforts to improve the Federal internal audit capability.

AUDIT FUNCTION NEEDS TO BE INDEPENDENT

The Comptrollers are located in a line organization that has management responsibility for the activities being audited and do not report to a high enough level in the Department of the Interior. Consequently, their independence has been impaired. (See p. 17.) Also, the establishment of close relationships between auditors and territorial officials, and the auditing of programs by the same individuals who provided technical assistance on those programs, may have affected the Comptrollers' ability to work and report findings in an impartial manner. (See p. 21.) GAO is recommending that the Comptrollers' audit function be transferred to the Inspector General, who reports to the Secretary of the Interior.

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EFFECTIVENESS OF AUDIT FUNCTION NEEDS TO BE IMPROVED

A large portion of the Comptrollers' limited audit staff is devoted to preparing a legislatively mandated but ill-defined "annual report of the fiscal condition of the government," which is reducing their audit coverage of other territorial programs and operations. (See p. 28.) A comprehensive annual financial report as defined by the National Council on Governmental Accounting should replace the present report. It should be prepared and published by the territorial governments, not by the Federal auditors. Furthermore, the territorial governments should be responsible for arranging an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards.

Very few Federal grant programs in the territories are audited by the Comptrollers or other audit organizations. (See p. 32.) If the Office of Management and Budget designated Interior's Inspector General as the "cognizant Federal audit agency" under the single audit concept, Interior would become responsible for audit coverage of Federal grant programs in the territories.

MORE TECHNICAL ASSISTANCE AND GREATER TERRITORIAL GOVERNMENT RESPONSIBILITY ARE NEEDED

A strengthened Federal audit presence alone is not enough to improve the economy and efficiency of the territorial governments. The territories need to assume greater responsibility for establishing and maintaining strong financial management systems to ensure proper control and accountability over Federal and local funds, but they cannot do the job alone; they need Federal technical assistance. (See p. 39.) Such assistance, coupled with an improved territorial government internal audit capability, would further enhance Federal audit effectiveness.

RECOMMENDATIONS TO THE CONGRESS

GAO recommends that the Congress amend the organic acts for Guam (48 U.S.C. 1422d) and the Virgin Islands (48 U.S.C. 1599), and public laws (48 U.S.C. 1681b) relating to the Northern Mariana Islands and the Trust Territory of the Pacific Islands and enact legislation relating to American Samoa to

--transfer the audit authority and staff from the U.S. Government Comptrollers to the Office of the Inspector General, Department of the Interior, for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight of the governments of American Samoa, Guam, the Virgin Islands, the Northern Mariana Islands, and the Trust Territory of the Pacific Islands; and

--require the Governors of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands, and the High Commissioner of the Trust Territory of the Pacific Islands to (1) prepare, publish, and submit a comprehensive annual financial report in conformance with standards of the National Council on Governmental Accounting within 120 days of the close of the fiscal year to the Secretary of the Interior and the Congress, (2) arrange for an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards for governmental units, and (3) submit to the cognizant Federal auditors, the Secretary of the Interior, and the Congress a written statement of actions taken on Federal audit recommendations within 60 days of the issuance date of the audit report.

In addition, GAO recommends that the Congress further amend the organic acts for Guam (48 U.S.C. 1422d) and the Virgin Islands (48 U.S.C. 1599), and public laws (48 U.S.C. 1681b) relating to the Northern Mariana Islands and the Trust Territory of the Pacific Islands to eliminate the provisions requiring the U.S. Government Comptrollers to

--provide reports at the request of the territorial Governors and High Commissioner and

--submit an annual report on the fiscal condition of the government to the territorial Governors, High Commissioner, and the Secretary of the Interior.

Furthermore, upon termination of the agreement under which the United States administers the Trust

Tear Sheet

Territory of the Pacific Islands, GAO recommends that the Congress enact legislation to provide Federal audit oversight in the Northern Mariana Islands.

RECOMMENDATIONS TO THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

GAO recommends that the Director designate the Office of the Inspector General, Department of the Interior, as the cognizant Federal audit agency in the territories under the single audit concept.

RECOMMENDATIONS TO THE SECRETARY OF THE INTERIOR

GAO recommends that the Secretary

--direct the Inspector General to establish formalized audit report followup systems in Interior's territorial audit offices;

--develop and submit to the Congress a comprehensive technical assistance plan, including a determination of what resources are needed, to establish effective financial management systems for the governments of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands; and

--report to the Congress on the resources needed to assist the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau in establishing their financial management system requirements.

RECOMMENDATIONS TO THE PRESIDENT'S PERSONAL REPRESENTATIVE FOR MICRONESIAN STATUS NEGOTIATIONS

GAO recommends that the President's Personal Representative, when negotiating the remaining agreements terminating the Trust Territory of the Pacific Islands--specifically the subsidiary agreement on auditing--develop a Federal audit capability with respect to the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau with authority and responsibilities comparable to those of the U.S. Government Comptrollers.

RECOMMENDATIONS TO THE GOVERNORS OF AMERICAN SAMOA, GUAM, THE NORTHERN MARIANA ISLANDS, AND THE VIRGIN ISLANDS

GAO recommends that the Governors

--establish an audit followup system to ensure that recommended corrective actions on all Federal and independent audit reports are implemented and followed through to completion and

--strengthen their internal audit function by increasing the size of staffs, improving staff capabilities, expanding the scope of audit coverage, and ensuring audit independence.

AGENCY COMMENTS

GAO provided a draft of this report for comment to the Office of Management and Budget; the Departments of the Interior and State; Interior's Inspector General; the U.S. Government Comptrollers for American Samoa, Guam/Trust Territory of the Pacific Islands/Northern Mariana Islands, and the Virgin Islands; a former U.S. Government Comptroller for the Virgin Islands; the Governors of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands; and the High Commissioner of the Trust Territory of the Pacific Islands. (See app. VI, pp. 53-81.) GAO did not receive comments from the Governor of the Northern Mariana Islands.

With the exception of Interior's Office of Territorial and International Affairs and the High Commissioner of the Trust Territory of the Pacific Islands, all comments are in general agreement with GAO's recommendations. The Office of Territorial and International Affairs and the High Commissioner objected to the recommendation for transferring the U.S. Government Comptrollers to Interior's Office of Inspector General because it could lead to a reduction in audit effort in the territories. GAO clarified its recommendation by adding that the transfer shall be for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight in the territories.

Contents

ABBREVIATIONS

CETA	Comprehensive Employment and Training Act
GAO	General Accounting Office
NMI	Northern Marina Islands
OMB	Office of Management and Budget
OTIA	Office of Territorial and International Affairs
TTPI	Trust Territory of the Pacific Islands

CHAPTER 1

INTRODUCTION

For many years, the U.S. Government Comptrollers have been responsible for auditing all significant aspects of governmental operations and Federal programs in the principal U.S. territories--American Samoa, Guam, the Northern Mariana Islands (NMI), 1/ and the Virgin Islands--and the Trust Territory of the Pacific Islands (TTPI). Until recently, the Comptrollers have also provided technical assistance to improve territorial financial management systems. The primary objective of our review was to evaluate the organization and functions of the Offices of the U.S. Government Comptrollers.

U.S. GOVERNMENT RESPONSIBILITIES IN THE TERRITORIES

The United States is committed to a policy of encouraging the self-determined political, economic, and social development of its territories. The determination of U.S. policy is fundamentally within the Congress' jurisdiction under the U.S. Constitution, which provides in Article IV that the Congress shall "make all needful Rules and Regulations respecting the Territory * * * belonging to the United States." The Congress can delegate power with respect to the territories to the executive branch or to the territorial governments.

In discharging its responsibilities for the principal territories, the United States is required to comply with the provisions of Chapter XI of the United Nations Charter, which requires that the United States ensure the "political, economic, social, and educational advancement" of the inhabitants. Chapter XII of the Charter, pertaining to the International Trusteeship System, requires that the United States promote the political, economic, social, and educational advancement of the inhabitants of the Trust Territory of the Pacific Islands, and their progressive development toward self-government or independence. Additionally, the United States is obliged by the treaties of cession to protect American Samoans' property and native customs.

For over 30 years, the Department of the Interior has been the primary executive agency charged with administering the U.S. territories. However, with the installation of the first popularly elected chief executives in Guam (1971), the Virgin Islands

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1/Technically, NMI will not become a U.S. territory until the trusteeship agreement under which the U.S. administers the Trust Territory of the Pacific Islands is terminated. For purposes of this report, however, we consider NMI a U.S. territory. Furthermore, we use the terms "territories" generally to refer to the U.S. territories and TTPI. We note that TTPI is not a U.S. possession.

(1971), American Samoa (1978), the Northern Mariana Islands (1978), and the new governments within the Trust Territory of the Pacific Islands--the Federated States of Micronesia (1979), the Marshall Islands (1979), and Palau (1981)--and with popularly elected legislatures in all the territories, each now enjoys substantial local self-government and conducts much of its own local governmental administration. As a result of this change, Interior is no longer directly involved in territorial internal affairs. Its new territorial role is fostering private sector economic development, discouraging reliance on U.S. payments and subsidies, improving territorial financial conditions, coordinating other Federal agency programs affecting the territories, and improving relations between the U.S. and territorial governments. The Assistant Secretary of the Interior for Territorial and International Affairs is responsible for discharging this new role.

Because of these increases in autonomy, the Federal Government has lost its major "presence" 1/ in the territories. With the popular election of chief executives in the territories, the Governors and Presidents are no longer representatives of the Federal Establishment in their areas. Like their appointed predecessors, they are the heads of the territorial governments; but unlike them, they are not responsible to, and need not be responsive to, the executive branch in Washington. Consequently, the only remaining Federal presence in the territories is the U.S. Government Comptrollers.

Appendix I describes the geographic location, size, population, and governmental structure of the four principal U.S. territories and the Trust Territory of the Pacific Islands. Appendixes II and III are the organization charts for the Department of the Interior and its Office of Territorial and International Affairs.

DUTIES AND RESPONSIBILITIES OF THE COMPTROLLERS

The organic act for Guam and that for the Virgin Islands establishes the position of a Government Comptroller, appointed by the Secretary of the Interior, who shall

> " * * * audit all accounts and review and recommend adjudication of claims pertaining to the revenue and receipts of the government * * * and of funds derived"

1/The term Federal "presence," as defined by the Interagency Policy Review Task Force of U.S. Territories and the Trust Territory, does not relate to or include personnel, military or civilian, who are in the territory to carry out the particular purpose of a Federal agency. The term refers, instead, to officers and employees of the United States charged with administrative or oversight roles relating to the overall functioning of Federal or territorial governments in the territory.

"from bond issues; and he shall audit, in accordance with law and administrative regulations, all expenditures of funds and property pertaining to the government * * * including those pertaining to trust funds held by the government * * *.

" * * * it shall be the duty of the government comptroller to bring to the attention of the Secretary of the Interior and the Governor * * * all failures to collect amounts due the government, and expenditures of funds or uses of property which are irregular or not pursuant to law. The audit activities of the government comptroller shall be directed so as to (1) improve the efficiency and economy of programs of the government * * * and (2) discharge the responsibility incumbent upon the Congress to insure that the substantial Federal revenues which are covered into the Treasury of the government * * * are properly accounted for and audited.

" * * * as soon after the close of each fiscal year as the accounts of said fiscal year may be examined and adjusted, the government comptroller shall submit to the Governor * * * and the Secretary of the Interior an annual report of the fiscal condition of the government, showing the receipts and disbursements of the various departments and agencies of the government. The Secretary of the Interior shall submit such report along with his comments and recommendations to the President of the Senate and the Speaker of the House of Representatives." (48 U.S.C. 1422d and 1599 (1976))

The organic acts also provide that the Comptroller shall make such other reports as are required by the Governor, the Comptroller General of the United States, or the Secretary of the Interior. The acts provide that the activities of the Comptroller shall be subject to review by the Comptroller General, who shall report thereon to the Governor, the Secretary, and the Congress. Furthermore, the acts give the Comptroller access to all records of the territorial government, but state that he or she is not to be a part of any executive department of the government.

In approving the legislation that created the position of Government Comptroller for Guam, the House Committee on Interior and Insular Affairs noted the continuing interest of the Federal Government in the operation of the territorial government, including direct and indirect Federal financial assistance, and the fact that the elected Governor would function without any direct supervision from the executive branch of the Federal Government (H. Rept. 90-1521, June 5, 1968, on H.R. 7329). A similar justification supported the establishment of the position of Government Comptroller for the Virgin Islands. In addition, the committee took the position that the function of the Comptroller is only that of an auditor, and not a policymaker, by specifically stating that the Comptroller is not to interfere with the administration of the executive branch of the territorial government.

Under the provisions of 48 U.S.C. 1681b, the duties and responsibilities of the Government Comptroller for Guam under 48 U.S.C. 1422d are applicable to the Trust Territory of the Pacific Islands and the Northern Mariana Islands.

Secretarial Order No. 3009, issued September 13, 1977, by the Secretary of the Interior, establishes the position of Government Comptroller for American Samoa, to be appointed by the Secretary of the Interior, who shall

> " * * * perform specific and comprehensive audits of all activities, entities, and branches of the Government of American Samoa. These audits shall include but not be limited to financial, compliance, management, organization and program reviews. In addition, other types of audits shall be made as appropriate at the request of the Secretary of the Interior. All transactions of the Government of American Samoa shall be audited in accordance with the U.S. Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions." The Government Comptroller for American Samoa shall make audit reports which will be addressed to the Governor of American Samoa. A copy of all reports will be sent to the Secretary of the Interior, and by him to the appropriate Committees of the U.S. Congress. The Governor of American Samoa shall respond in writing to the findings reported by the Government Comptroller for American Samoa within forty-five (45) days from the date of each report and shall indicate what actions will be taken to correct the deficiencies noted and to comply with the recommendations contained therein.
>
> " * * * as soon after the close of each fiscal year as the accounts of said fiscal year may be examined and adjusted, the Government Comptroller for American Samoa shall submit to the Governor for American Samoa, and to the Secretary of the Interior an annual report of the fiscal condition of the government showing the receipts and disbursements of the various departments and agencies of the government together with his comments and recommendations. The Secretary shall submit such report, along with the Secretary's comments and recommendations, to the appropriate Committees of the U.S. Congress. Interim audits may be performed quarterly so as to complete the annual audit and report on a timely basis and to provide for the early identification of major problem areas."

The Secretarial Order also provides that if the Comptroller finds an expenditure is irregular or not pursuant to law, he may take an exception against the certifying officer. The order gives the Comptroller access to all records of the territorial government. In addition to his other duties, the Comptroller shall, upon request of the Governor, provide advice and assistance to him, particularly in financial matters of Federal interest.

DEPARTMENTAL LINES OF AUTHORITY RELATING TO COMPTROLLERS' ACTIVITIES

The organic acts, other laws, and a Secretarial Order provide that the position of Comptroller shall be under the general supervision of the Secretary of the Interior. However, the Secretary has delegated this authority to the Assistant Secretary of the Interior, Office of Territorial and International Affairs (OTIA).

Under the current OTIA organizational structure, there are Comptroller offices for American Samoa, the Virgin Islands, and Guam. The latter also has a branch office for the Northern Mariana Islands and the Trust Territory of the Pacific Islands. (See app. III, p. 50.) The Comptrollers report to the Director, Office of the U.S. Government Comptrollers, who is responsible for ensuring effective audit operations in the four principal U.S. territories and the Trust Territory of the Pacific Islands. The Director works under the general guidance of the Deputy Assistant Secretary of the Interior for Territorial and International Affairs (Operations), and is responsible for

- --developing an effective Comptrollers organization and staff,
- --reviewing and approving each Comptroller's annual audit work plan and providing a reporting system to monitor implementation and progress,
- --reviewing and approving the draft annual reports on the fiscal condition of each territory,
- --summarizing and transmitting audit reports to the Congress and following up on critical issues,
- --reporting to the Congress on the fiscal condition of each territory, and
- --providing a system to report the actions taken by management to comply with significant recommendations contained in the Comptrollers' audit reports.

Until June 1980, the three Comptroller offices were responsible for auditing the territorial governments in addition to providing them technical assistance--primarily assistance in developing financial management systems. An OTIA reorganization, however, split these responsibilities and created an Office of the U.S. Government Comptrollers and an Office of Technical Assistance. In order to staff the new technical assistance component within each territory, positions in the Comptroller Office were transferred to the Technical Assistance Office. Although the audit and technical assistance staffs are separate and each reports to its respective director in OTIA headquarters, they continue to share physical facilities and administrative support.

STAFFING OF COMPTROLLER OFFICES

Although the total authorized staffing level for the three Comptroller offices is 58 permanent full-time positions for fiscal 1982, only 44 are actually on board. This includes 36 professional audit and 8 support staff. However, the staffing level for each office has fluctuated since fiscal 1979, as the following table illustrates.

	Authorized (note a)				
Office	Fiscal 1979	Fiscal 1980	Fiscal 1981	Fiscal 1982	On Board 5/15/81
American Samoa	7	11	11	11	10
Guam/TTPI/NMI	32	33	26	31	18
Virgin Islands	30	30	27	16	16
Total	69	74	64	58	44

a/Based on Department of the Interior appropriations enacted or requested.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review objective was to evaluate the organization and functions of the Offices of the U.S. Government Comptrollers. Because of our special relationship to internal audit organizations--a relationship mandated by law--we are continually working to improve the Federal internal audit capability, both through issuing principles, concepts, and standards and through periodic reviews of the audit organizations. In the past 6 years, we have issued over 110 reports on internal audit. Furthermore, the Congress has shown great interest in improving internal auditing. Hearings on internal audit problems and requests for our reviews of specific audit organizations are frequent.

We reviewed the legislative history of the organic act for Guam and that for the Virgin Islands to ascertain the Congress' rationale for establishing the position of Government Comptroller in these two territories. We also reviewed the legislative history of 48 U.S.C. 1681b, which provides that the duties and responsibilities of the Government Comptroller for Guam under 48 U.S.C. 1422d are applicable to TTPI and NMI. Furthermore, we reviewed Secretarial Order No. 3009--issued by the Secretary of the Interior--which established the position of Government Comptroller for American Samoa.

Our review was conducted at the U.S. Government Comptroller offices in Pago Pago, American Samoa; Agana, Guam (including the TTPI/NMI suboffice in Saipan, Northern Mariana Islands); St. Thomas, Virgin Islands; and the Department of the Interior, OTIA headquarters, Washington, D.C. The review was made from April through September 1981.

We reviewed the organization and functions of the U.S. Government Comptroller offices in relation to the Comptroller General's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." As part of our evaluation, we used a set of guidance materials for quality reviews of government audit organizations prepared by the National Quality Review Project. This project is sponsored jointly by the National Intergovernmental Audit Forum and the National State Auditors Association. The guides, which have not yet been finalized, are intended to evaluate quality control policies and practices in the performance of financial/compliance audits of government organizations by government auditors. The guides we used were:

--Guide for Review of Quality Control Policies and Procedures.

--Audit Agency Questionnaire.

--Audit Staff Questionnaire.

--Auditee Questionnaire.

We interviewed the Government Comptrollers, Deputy Government Comptrollers, Technical Assistance Chiefs, and most audit and technical assistance staff members to obtain their responses to (1) our questionnaires and (2) questions we raised during our evaluation. We also interviewed OTIA headquarters personnel to obtain pertinent information. We reviewed available agency reports, records, and files at the four U.S. Government Comptroller offices and at OTIA headquarters. In addition, we reviewed 22 randomly selected Comptroller reports, including related workpapers, issued during fiscal 1979 to 1981 to determine the Comptrollers' performance with respect to our examination, evaluation, and reporting standards. The results of the interviews, reviews, and examinations were combined in what we judged to be an accurate evaluation of the Comptrollers' organization and functions.

As part of our review, we met with the Governors of American Samoa, Guam, the Northern Mariana Islands, the Virgin Islands, and the Acting High Commissioner of the Trust Territory of the Pacific Islands to obtain their views on the Comptrollers. We had discussions with the territorial auditors in American Samoa, Guam, and the Virgin Islands to gain information about their operations and their working relationship with the Comptrollers.

We presented our findings to and obtained viewpoints from staff members of the Senate Committee on Energy and Natural Resources, House Committee on Interior and Insular Affairs, Senate Appropriations Subcommittee on Interior, and House Appropriations Subcommittee on Interior.

We provided a draft of this report for comment to the Office of Management and Budget (OMB); the Department of the Interior; the Department of State; and the Governors of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands. Because one of the main issues of the report is audit independence, we also requested comments from the U.S. Government Comptrollers for American Samoa, Guam/TTPI/NMI, and the Virgin Islands; a former U.S. Government Comptroller for the Virgin Islands; Interior's Inspector General; and the High Commissioner of the Trust Territory of the Pacific Islands. (See app. VI, pp. 53-81.) We requested, but did not receive, comments from the Governor of the Northern Mariana Islands.

On December 4, 1981, we testified before the Subcommittee on Insular Affairs and the Subcommittee on Public Lands and National Parks, House Committee on Interior and Insular Affairs, on the major issues addressed in the report.

CHAPTER 2

ACTION NEEDED TO ENSURE THAT A STRONG FEDERAL AUDIT PRESENCE CONTINUES IN THE TERRITORIES

Although the territories have made substantial progress toward self-government in recent years, a strong Federal audit "presence" is still needed. The territories continue to rely heavily on Federal funds to operate their governments, and they still have major deficiencies in their financial management systems.

TERRITORIAL BUDGETS ARE FINANCED PRIMARILY BY FEDERAL FUNDS

The territories depend heavily upon Federal financial assistance to operate their governments, finance their capital improvements, and develop their economies. This assistance comes through direct Interior appropriations, Federal grant programs, and Federal taxes. In fiscal 1981, Federal assistance totaled about $615 million, or 81 percent of the total territorial budget. The table on page 10 illustrates anticipated Federal assistance and territorial revenues for fiscal 1980-1982.

Direct Interior appropriations are provided to the territories to promote their economic, social, and political development. The funds are used specifically for territorial operating expenses, construction and repair of infrastructures, and economic development loans. For example, the funds have been used to construct hospital facilities in the Virgin Islands and develop Guam's fishing and agricultural resources.

The territories also receive funds under myriad Federal grant programs. The grants are for assistance in such areas as public housing, child nutrition, and medicaid. Appendixes IV and V show the 17 Federal agencies that funded programs in the territories and the amounts granted in fiscal 1979 and 1980.

Two of the territories--Guam and the Virgin Islands--are allowed to retain Federal income taxes collected under the U.S. Internal Revenue Code. The Congress allows these territories to collect and retain these taxes so that they can operate their governments.

Furthermore, Guam and the Virgin Islands receive taxes "covered over" by the Treasury Department. In Guam, the funds referred to by this term represent Federal income taxes withheld from U.S. military and civilian personnel stationed on the island. In the Virgin Islands, the funds represent taxes imposed and collected under the U.S. Internal Revenue Code on articles produced in the territory and transported to the United States. Periodically, Treasury transfers payments to the territorial governments.

ANTICIPATED FEDERAL ASSISTANCE
AND TERRITORIAL REVENUES
FISCAL 1980-1982
(dollars in millions)

	American Samoa			Guam			Northern Mariana Islands			Trust Territory of the Pacific Islands			Virgin Islands			Total		
	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982
FEDERAL ASSISTANCE																		
Direct Interior appropriations	$17.3	$25.8	$23.7	$ 10.2	$ 12.0	$ 10.0	$27.1	$24.4	$23.6	$120.0	$ 94.4	$ 72.5	$ 21.0	$ 9.8	$ 18.2	$195.6	$166.4	$148.0
Federal grants	16.9	14.5	15.2	57.3	65.0	55.0	12.7	17.9	18.0	37.8	35.0	30.0	80.0	88.6	60.6	1/204.7	221.0	178.8
Taxes "covered over" by Treasury Department	-	-	-	17.7	18.5	19.5	-	-	-	-	-	-	29.0	36.0	36.0	46.7	54.5	55.5
Income taxes in lieu of Federal taxes	15.5	15.3	15.0	62.9	68.0	70.0	-	-	-	-	-	-	86.2	90.0	93.6	164.6	173.3	178.6
	$49.7	$55.6	$53.9	$148.1	$163.5	$154.5	$39.8	$42.3	$41.6	$157.8	$129.4	$102.5	$216.2	$224.4	$208.4	$611.6	$615.2	$560.9
TERRITORIAL REVENUES																		
Other local taxes and nontax revenues	4.5	4.7	5.0	36.8	45.4	45.8	9.2	10.6	10.9	13.9	14.6	15.6	63.9	65.6	67.3	128.3	140.9	144.6
Total revenues	$54.2	$60.3	$58.9	$184.9	$208.9	$200.3	$49.0	$52.9	$52.5	$171.7	$144.0	$118.1	$280.1	$290.0	$275.7	$739.9	$756.1	$705.5
PERCENTAGE FEDERAL ASSISTANCE TO TOTAL REVENUES	92	92	92	80	78	77	81	80	79	92	90	87	77	77	76	83	81	80

SOURCE: U.S. Department of Interior, Office of Territorial and International Affairs

1/This figure differs from the one in app. V because two information sources were used. The above source used actual and/or estimated financial data obtained from the territorial governments. The app. V source--Geographic Distribution of Federal Funds, which is compiled for the Executive Office of the President by the Community Services Administration--used a statistical formula to predict the most probable distribution of funds because Federal agency accounting systems do not always provide accurate data on the geographic distribution of funds expended.

Guam and the Virgin Islands are requesting additional Federal assistance to eliminate accumulated general fund deficits. During fiscal 1982-1985, these territories are authorized to receive $67.5 million to help cover the deficits. However, to qualify for the funds, the Governors of Guam and the Virgin Islands must submit a plan to implement effective budget and accounting systems, reduce accumulated deficits, and balance their budgets by fiscal 1986.

American Samoa, Guam, and the Virgin Islands also have received about $42.5 million to cover "shortfalls" in income tax collections resulting from Federal income tax reductions. The Virgin Islands is requesting an additional $75 million for anticipated lost revenues in fiscal 1981-1984.

Other territories may request similar assistance. The Northern Mariana Islands incurred a $3.9 million deficit in fiscal 1979. The Acting High Commissioner of the Trust Territory of the Pacific Islands anticipates that the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau are likely to develop deficits; he believes the Federal Government will provide assistance to offset their deficits.

MAJOR DEFICIENCIES EXIST IN TERRITORIES' FINANCIAL MANAGEMENT SYSTEMS

Major deficiencies still exist in territorial financial management systems. A December 1977 report by the Surveys and Investigative Staff, House Committee on Appropriations, identified major problems common to all the systems.

--Monthly fund status reports for monitoring obligations and expenditures in relation to allotments were inaccurate, incomplete, and untimely for management decision purposes.

--Cash reconciliations were not performed regularly.

--Collection of receivables due for taxes and services were generally inefficient and ineffective.

--Adequate accounting controls were not maintained over Federal grant funds.

--Coordination and integration of systems between the central accounting division and the departments were virtually nonexistent because the general ledger control records were not reconciled with the subsidiary records.

According to the Comptroller staffs, OTIA technical assistance staffs, and territorial government officials, many of these problems still exist. For example, the territorial governments are not performing periodic general ledger account reconciliations to ensure that account balances are correct and/or agree with subsidiary ledgers. The lack of periodic reconciliations has resulted in the TTPI not being able to prepare accurate trial balances since fiscal 1977; the Comptroller for Guam/TTPI/NMI has indicated that TTPI's financial affairs are not auditable. Also, the Virgin Islands government is continuing to experience delays in reconciling the cash on deposit with balances shown in the general ledger. Since the government operates on a cash basis, the delay in reconciling bank accounts is a serious problem. In addition, the territorial governments are experiencing problems in eliminating delays in processing financial documents, developing accounting and physical controls over fixed assets, and providing separate accountability for various funds.

The Comptrollers have made major contributions toward improving the efficiency and economy of territorial programs and ensuring the accountability over Federal funds. This has been done mostly through numerous reports disclosing major deficiencies, particularly in the financial management area, that warrant the attention of the Congress, the Department of the Interior, and the territorial governments. For example:

--In the Virgin Islands, the Comptroller reported questionable Department of Public Works procurements amounting to more than $4 million.

--In Guam, the Comptroller disclosed that the Department of Land Management was transferring ownership of government land to private parties without statutory authority, and incurring substantial losses.

--In American Samoa, the Comptroller reported that appropriate expenditure and obligation controls were not practiced by department and agency heads to avoid overobligation of appropriated funds.

From October 1, 1978, to May 30, 1981, the Comptrollers issued 132 audit reports on various aspects of the territorial governments' operations. However, as previously discussed, major deficiencies in their financial management systems continue to plague the territories.

COMPTROLLER'S AUTHORITY WILL TERMINATE IN TRUST TERRITORY OF THE PACIFIC ISLANDS

The Comptroller for Guam/TTPI/NMI will no longer have authority to audit all government accounts of the Trust Territory of the Pacific Islands, which includes the Northern Mariana Islands, when the trusteeship agreement under which the United States administers TTPI is terminated. In view of the substantial Federal assistance which the Northern Mariana Islands and the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau will receive in future years and the serious financial management problems these governments are currently experiencing, we believe that a continued Federal audit presence is needed.

The Congress has already approved a covenant whereby the Northern Mariana Islands will become a U.S. territory and its people U.S. citizens (Public Law 94-241). The covenant will not become fully effective, however, until the trusteeship agreement is terminated, which is expected to happen in early 1983. When the trusteeship ends and the covenant becomes effective, the United States will retain the authority to enact legislation affecting the territory. However, section 503(a)(3) of the covenant provides that certain existing U.S. laws will then become inapplicable. The law providing the Guam/TTPI/NMI Comptroller's audit authority in the NMI (48 U.S.C. 1681b) is among those to terminate; and no provision has been made to continue Federal audit oversight in the territory.

A somewhat different situation exists with regard to the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau. These governments are currently negotiating a Compact of Free Association with the United States whereby, upon termination of the trusteeship agreement, they will be accorded the status of "freely associated states." As such, they will be fully self-governing insofar as domestic and foreign affairs are concerned, while the United States will retain authority over defense and security matters. The freely associated states will not be U.S. territories. Furthermore, an official of the Office of Micronesian Status Negotiations--which is negotiating the terms of the Compact--told us that, unlike the NMI covenant, the United States will not retain authority to enact domestic legislation for the freely associated states. Instead, the Compact will be the basic document regulating the new relationship. As such, section 171 of the Compact provides that application of U.S. laws to the TTPI by virtue of the trusteeship agreement ceases, except as provided in the Compact or its related agreements. The law providing the Guam/TTPI/NMI Comptroller's audit authority in the Trust Territory (48 U.S.C. 1681b) is among those to terminate.

The Compact of Free Association has been negotiated and initialed by the future freely associated states and the United States, but negotiations on a number of subsidiary agreements are not yet complete. With respect to audit, section 233 of the Compact contains a grant of authority from the freely associated states to the U.S. Government to determine and implement procedures for the periodic audit of all grants and other assistance, including funds expended for various Federal services and programs, provided by the United States to the freely associated states under the Compact. The Compact also provides that the audits will be conducted at least annually during the first 5 years following the effective date of the Compact.

The audit authority granted the United States under the Compact relates only to Federal grants and assistance to the freely associated states. It is less extensive than the existing Comptrollers' authority to audit all territorial accounts, which include both Federal and local funds. An Office of Micronesian Status Negotiations official told us that a subsidiary agreement on auditing is yet to be negotiated. We believe an acceptable agreement would, at a minimum, (1) define the Federal audit authority, (2) designate the Federal audit organization that will provide the periodic audit coverage, (3) provide the Federal auditors access to all books, records, and accounts, (4) specify the types of audits to be performed (financial, compliance, economy and efficiency, and program results), and (5) set forth the requirements for accountability over Federal funds.

CONCLUSION

Unless some action is taken, termination of the trusteeship will eliminate the needed Federal audit presence in the Northern Mariana Islands, and it will diminish that presence in the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau.

RECOMMENDATION TO THE CONGRESS

We recommend that, upon termination of the agreement under which the United States administers the Trust Territory of the Pacific Islands, the Congress enact legislation to provide Federal audit oversight in the Northern Mariana Islands.

RECOMMENDATION TO THE PRESIDENT'S PERSONAL REPRESENTATIVE FOR MICRONESIAN STATUS NEGOTIATIONS

We recommend that the President's Personal Representative for Micronesian Status Negotiations, when negotiating the remaining agreements terminating the Trust Territory of the Pacific Islands--specifically the subsidiary agreement on auditing--develop a Federal audit capability with respect to the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau, with authority and responsibilities comparable to those of the U.S. Government Comptrollers.

AGENCY COMMENTS AND OUR EVALUATION

Federal and territorial officials agreed that a strong Federal audit presence is still needed in the territories. The Under Secretary of State for Security Assistance, Science, and Technology did not consider it necessarily true that the Federal audit presence would be diminished if the Federal audit function in the freely associated states is different from that of the U.S. Government Comptrollers. However, he concurred with our recommendation to the President's Personal Representative for Micronesian Status Negotiations. Further, he stated the Office of Micronesian Status Negotiations would consult with us when drafting the subsidiary agreement on auditing. We have incorporated in this report the Under Secretary's suggested phrasing concerning the Northern Mariana Islands.

CHAPTER 3

TRANSFER OF FEDERAL AUDIT FUNCTION

TO INTERIOR'S INSPECTOR GENERAL

WOULD ENHANCE INDEPENDENCE

Our review showed that the independence of the Comptrollers' audit function has been impaired because they do not report to a high enough level in the Department of the Interior and because they are located in a line organization which has management responsibility for the activities being audited. This could be addressed easily by transferring the audit function to the Inspector General, who reports to the Secretary of the Interior.

In addition to organizational impairments to independence, we found that the establishment of close relationships between auditors and territorial officials, and the auditing of programs by the same individuals who provided technical assistance on those programs, may have affected the Comptrollers' ability to work and report findings in an impartial manner. The Comptrollers' independence has been further impaired by external factors, including restricted access to records and information, limited staff resources, and delayed territorial government responses to audit reports. We believe, however, that most of these personal and external impairments would be eliminated and others could be substantially reduced if the Comptrollers' audit function were transferred to the Inspector General.

The degree of independence achieved must be viewed as one of the most important criteria when an audit organization is being evaluated for competence, objectivity, and performance. To this end, generally accepted standards have been formulated for auditing. In the government sector, we have published policies and procedures for auditing government programs and functions. 1/ In the private sector, the American Institute of Certified Public Accountants has issued auditing standards. In both cases the standards prescribe and define the concept of audit independence and its importance to the audit profession. The GAO standard states:

> "In all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, must be free from personal or external impairments to independence, must be organizationally independent, and shall maintain an independent attitude and appearance."

1/"Standards For Audit Of Governmental Organizations, Programs, Activities, And Functions," 1981 revision.

Similarly, the American Institute of Certified Public Accountants standard states:

> "In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors."

These standards place upon auditors and audit organizations the responsibility for maintaining independence. Auditors should consider not only whether they are independent and their own attitudes and beliefs permit them to be independent, but also whether there is anything about their situation that might lead others to question their independence.

ORGANIZATIONAL LOCATION IMPAIRS INDEPENDENCE

The Comptrollers are not organizationally independent because they do not report to the highest possible level within the Department of the Interior and they are not located outside the line management function under audit. Although the organic acts, other laws, and a Secretarial Order place the Comptrollers under the general supervision of the Secretary of the Interior, they report to the Deputy Assistant Secretary of the Interior (Operations), OTIA, through a Director, U.S. Government Comptrollers, who in turn reports to the Assistant Secretary of the Interior, OTIA. OTIA--a line management function--is responsible for territorial matters. On the other hand, the Comptrollers--an OTIA component--are responsible for auditing the territories, whose budgets are more than 20 percent Interior-funded. In contrast, Interior's Office of the Inspector General reports directly to the Secretary of the Interior. (See apps. II and III, pp. 49 and 50.)

During our review, situations were brought to our attention that indicated the Comptrollers' independence has been impaired by their organizational position within OTIA. One of these occurred when OTIA apparently attempted to delay a report on the TTPI National Historic Preservation Program--an Interior grant program. On June 25, 1980, the TTPI High Commissioner wrote OTIA about his dissatisfaction with the Guam/TTPI/NMI Comptroller's report. On July 10, 1980, OTIA requested that the Comptroller not release the report until it could be reviewed. Because OTIA does not have a policy of reviewing draft reports other than annual reports, this attempt by OTIA gives the appearance of organizational impairment. OTIA apparently was not aware that the report had already been released on February 28, 1980.

The Guam/TTPI/NMI Comptroller stated that this example shows the Comptroller does maintain independence since the report was issued only on his decision. He disagreed that the request from OTIA to delay the issuance of the report would jeopardize the auditor's independence. We, however, believe that OTIA's attempt to delay the report would indicate an organizational impairment.

In another incident, the Director of the Office of Territorial Affairs 1/ requested the Comptroller for Guam/TTPI/NMI to redraft TTPI's fiscal 1978 annual report. In a May 23, 1979, letter to the Comptroller, the Director stated:

> "In general, I believe the report is unduly negative * * *. The negative tone of the report contradicts our testimony before the committee to whom we elaborated on the need for technical assistance and on the progress you and we had been making."

The letter requested that the report be rewritten. This was done, but, according to the Comptroller, the report was not changed materially and the Comptroller's independence was not impaired. He further stated OTIA's comments are considered no different than management's comments to draft management audit reports. However, OTIA is a line management activity responsible for the Comptroller's offices. Because of this organizational relationship, we believe OTIA's comments cannot be treated with the same degree of independence as other management comments. Accordingly, the above letter and actions to rewrite the report could indicate to outside parties that OTIA can exert influence upon the Comptrollers.

In American Samoa, the Comptroller's independence has been impaired for over 2 years because of OTIA's failure to correct deficiencies in the financial operations of American Samoa's High Court. In May 1979, after the Comptroller identified widespread mismanagement of Federal funds, OTIA directed the Comptroller to assign an auditor as the High Court's authorizing and disbursing officer. The Comptroller initially accepted the function because (1) there were few alternatives at that time for ensuring proper control and accountability of the High Court's funds and property, and (2) he envisioned the arrangement to be temporary.

After the Comptroller's initial audit efforts, the Department of the Interior's Inspector General initiated an investigation into the High Court's financial operations. On June 5, 1980, the Inspector General issued a report disclosing numerous financial irregularities similar to those identified by the Comptroller.

On June 25, 1980, the Deputy Under Secretary of the Interior for Territorial and International Affairs responded to the Inspector General's report, stating the transfer of the authorizing and disbursing function to the Comptroller was "regarded as a short term solution." He further stated that

> "we have * * * decided to create a new Associate Justice position for the High Court and to vest in that position"

1/Predecessor of the Office of Territorial and International Affairs.

"administrative responsibility for the Court, thereby permitting the Comptroller to cease to perform that role, which we have always agreed is an inappropriate one for him."

In November 1980, the Secretary of the Interior appointed a temporary Associate Justice to the High Court to perform a management review of the Court's accounting and fiscal practices, develop a new administrative system, train personnel in the new system, and supervise the administrative officer.

The Comptroller's office, however, was not relieved of the authorizing and disbursing assignment after the Associate Justice was appointed. On March 11, 1981, the Comptroller wrote OTIA that

> "* * * this assignment has involved my office in day-to-day operations of the Court, which to a knowledgeable third party, could give the appearance of a compromise of our independence and objectivity."

The Comptroller told OTIA that if he had known the arrangement would last so long, he would have officially objected in the beginning.

The Comptroller's independence has been further impaired because of OTIA's failure to take action on the Comptroller's report on the High Court's financial operations. This report, issued in April 1980, identified several weaknesses within the High Court's disbursement function. Although the Comptroller made several recommendations to improve funds management and control, OTIA and the High Court have not implemented the recommendations in an effective or timely manner. In his March 11, 1981, letter, the Comptroller wrote OTIA that "corrective action needs to be taken or initiated on each of the individual findings in the audit" and "procedures need to be drafted for DOI [Department of the Interior] approval to govern administrative and fiscal operations of the Court."

On May 29, 1981, the High Court's Associate Judge wrote to OTIA indicating that corrections had been made in the High Court's fiscal operation. However, not all the problems have been resolved and the Comptroller remains responsible for the High Court's authorizing and disbursing function. In August 1981, an OTIA official agreed that the High Court's financial deficiencies have not been fully resolved.

The respective organic acts, other laws, and the Secretarial Order establishing the Comptrollers' positions also provide an opportunity for territorial Governors and/or the High Commissioner to impair the Comptrollers' independence. The applicable laws provide that the Comptrollers for Guam/TTPI/NMI and the Virgin Islands shall make such reports as may be required by the Governor and/or the High Commissioner. In addition, the Secretarial Order provides that the Comptroller for American Samoa shall provide advice and assistance, upon the Governor's request.

Because of these provisions, the Comptrollers' independence could be impaired by the appearance that they are under the territorial Governors' and/or the High Commissioner's authority. Such would be the case, for example, if the Comptroller were required to report on politically sensitive issues. We believe that the territorial Governors and the High Commissioner should be able to suggest to the Comptrollers potential audit areas and request advice and assistance.

We believe transferring the Comptrollers' audit function to the Office of the Inspector General would eliminate the organizational impairments to the Comptrollers' independence. Under the Inspector General, the audit function in the territories would be performed by a professional audit organization that reports directly to the Secretary of the Interior, rather than to the Assistant Secretary of the Interior, OTIA, which has line management responsibility for the activities being audited. The Inspector General has maximum organizational independence as prescribed by our standards.

In addition, we believe the audit function could be enhanced under the Inspector General. As part of a professional audit organization, the audit function would receive the professional level of technical guidance and direction required to effectively carry out an audit operation. The Inspector General would be able to provide the necessary oversight, review, and assistance in developing comprehensive audit plans; following up on audit findings and recommendations; ensuring compliance with audit standards; determining audit staff resources; providing audit staff training programs; developing audit staff rotation programs; and recruiting audit staff.

Two of the three Comptrollers and Interior's Inspector General concur with our position that the audit function would be more independent and effective if it were under the Inspector General. Our position is further supported by the President's Transition Team report on OTIA, which recommended that the Comptrollers' audit function be transferred to the Inspector General.

APPEARANCE OF PERSONAL CONFLICTS OF INTEREST UNAVOIDABLE

Personal impairments, such as the establishment of close relationships between auditors and territorial officials and the auditing of programs by the same individuals who provide technical assistance on these programs, may have affected the Comptrollers' ability to work and report findings impartially.

One notable example of close relationships with territorial officials was the personnel problems between the Comptroller for the Virgin Islands and several members of the Virgin Islands employees union. The Comptroller was concerned about the potential for a conflict of interest charge against the Comptroller's office by the Virgin Islands Government. At that time the president of the union, who was also a member of the Comptroller's auditing staff, was an active member of the Virgin Islands Central Labor Council--an association of Virgin Island unions.

The mission of the Comptroller's Office and its employees is to audit the Virgin Islands government; obtain and evaluate confidential and sensitive information; and develop, report, and recommend actions on matters that may be subject to dispute within the scope of the collective bargaining relationship between the Virgin Islands government and its organized employees. Because of this, the Comptroller concluded that for the president of the local union and other employees of the Comptroller's Office to be affiliated with the organized employees of the Virgin Islands government was a conflict of interest and, therefore, not appropriate pursuant to Department of the Interior regulations on employee responsibilities and conduct. Moreover, the Comptroller felt, the direct affiliation with the Central Labor Council also may have been contrary to our professional audit standards of conduct.

To remedy the situation, the Comptroller requested, through OTIA, that the Interior Department's Ethics Counselor review several instances which, in the Comptroller's opinion, had impaired the ability of the auditor in question to be impartial. Based on the several instances presented, Interior issued a remedial order precluding the union's president from attending and participating in deliberations of the local Central Labor Council.

Our review also disclosed other situations where auditors have had close relationships with individuals in the organization they audited. For example, an auditor in the TTPI/NMI suboffice was involved in an audit of TTPI's Comprehensive Employment and Training Act (CETA) operation in which his wife was the acting director. According to the auditor in question, he objected to being assigned and was reassigned. The Deputy Comptroller stated that he was initially unable, due to limited staff, to assign anyone else to the job.

The Guam/TTPI/NMI Comptroller stated that since

> "the auditor's initial assignment on the CETA audit was to reference 1/ the draft audit report * * * we did not believe his independence would be affected or could be logically questioned by others, because his duties merely consisted of insuring that information contained in the draft report was supported by the audit workpapers."

This referencing process is a critical stage in the audit process, and we believe the referencer should meet the same standards for independence (e.g., personal relationship) as the other auditors must meet. The referencer is ensuring the accuracy of the report and should be free of any personal involvement in the job.

It should be noted that in the territories, the Comptrollers' offices have auditors who are related to local government employees. This is unavoidable because of the island geography and small

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1/A step in an audit to verify the accuracy of the audit report.

population of the territories. Thus, it is very important that conflicts of interest, or the appearance of conflicts of interest, be prevented.

Again, living in the territories can subject auditors to circumstances that could impair their independence. For example, in American Samoa and TTPI, the local government provides housing and office space to the Comptrollers and their staffs. Because of this arrangement, the Comptroller for American Samoa is reluctant to question the eligibility of certain individuals to occupy local government housing, since he and his staff may also be ineligible. In a memorandum to OTIA dated October 7, 1980, the Comptroller wrote that this condition "tends to cloud our independence and objectivity a bit."

The difficulty of maintaining an independent viewpoint is further compounded by auditors providing technical assistance to the territorial governments they audit. In American Samoa, TTPI, and the Virgin Islands, auditors are maintaining accounting records, reconciling accounting transactions, or preparing financial statements. At each location, many of the auditors who provide such technical assistance subsequently work on the annual report. The Comptrollers told us the situation was unavoidable due to limited staff resources. Nevertheless, the situation exists, and it creates a potential for, and the appearance of, a compromise of the Comptrollers' independence.

Recognizing the potential for compromise, OTIA separated the auditing and technical assistance functions in June 1980--a move we recommended in reports issued in 1978 and 1980. 1/ Technical assistance branches were established in each territory under a Director, Technical Assistance, while the Comptrollers remained under the Director, U.S. Government Comptrollers.

However, according to a May 1981 draft, "Statement of Policy on Auditing Role of the U.S. Government Comptrollers," OTIA proposes recombining the audit and technical assistance functions under one directorship, with both functions vested in the Comptroller offices. We would again question, if OTIA officials approve the current proposal, whether the Comptroller offices will be able to report impartially about inadequate conditions found in areas in which technical assistance was provided. Moreover, we believe that such an arrangement may restrict the Comptrollers' selection of what is to be audited, especially since the Comptrollers' annual audit plans are approved by OTIA. The situation would be conducive to restricting the selection of audit areas in the territories.

1/"American Samoa Needs Effective Aid to Improve Government Operations and Become a Self-Supporting Territory," CED-78-154, Sept. 22, 1978, and "Problems With New Responsibilities of Self-Government in the Northern Mariana Islands," ID-80-20, Mar. 7, 1980.

We questioned the Comptrollers' auditors about their attitudes toward conducting audits of and providing technical assistance to the territorial governments. Many agreed that vesting the Comptroller offices with both the audit and the technical assistance functions could create an awkward situation for the auditors and confusion in the minds of territorial officials.

One of our major concerns about the draft statement on the role of the Comptroller is the fact that the Comptrollers will be responsible for designing, implementing, and initially operating territorial financial management systems. Another concern is about the limitations proposed in the statement outlining the technical assistance role in the territories. The statement reads:

> "To minimize the appearance of conflict, * * * personnel will not audit or review in or near an area where they have provided technical assistance, * * *."

As discussed in chapter 5, more technical assistance should be provided to the territorial governments so they can properly establish effective financial management systems. In our opinion, however, given the limited staff available to the Comptrollers and the extensive audit work needed in the financial management area, the above policy would limit the Comptrollers' ability to fulfill their mandate to audit all accounts, expenditures of funds, and property pertaining to the territorial governments.

As previously discussed, we believe that if the Comptrollers' audit function were transferred to the Inspector General, some of these personal impairments would be eliminated while others could be substantially reduced. Most importantly, auditors would no longer have to audit territorial programs and operations on which they provided technical assistance, because program operating responsibilities are prohibited under the Inspector General Act (5 U.S.C. App. § 9 (Supp. III, 1979)). In addition, close relationships with territorial officials could be substantially reduced by having the Inspector General institute a program of rotating auditors periodically. Such a program would enable the audit staff to broaden their professional auditing experience and training.

EXTERNAL FACTORS ALSO IMPAIR INDEPENDENCE

The Comptrollers' independence has been further impaired by external factors including restricted access to records and information, limited staff resources, and delayed territorial government responses to audit reports.

On several occasions, Virgin Islands officials impeded the Comptroller's access to records and information needed to fulfill his office's statutory duties. For example, in March 1979, the Governor of the Virgin Islands requested the Comptroller to audit certain Law Enforcement Assistance Administration planning grants administered by the Virgin Islands Law Enforcement Planning Commission. The Comptroller agreed to perform the audit and his staff requested the Virgin Islands' Department of Finance to provide certain payroll records to substantiate costs charged to the grants. For 9 weeks, however, the audit was delayed because Department of Finance officials would not provide the needed records. After a letter was sent to the Governor, the Comptroller informed us, the Department of Finance provided the records.

Because of limited staff resources, the Guam/TTPI/NMI Comptroller has had to reduce the scope of audits or eliminate audits entirely. For example, the Comptroller's office initially planned to perform a detailed examination of accounting records during the 1980 annual audit of the Government of Guam's financial operation. However, due to limited staff resources the scope was reduced to a review (as defined on p. 30). The office has not been fully staffed for the last 3 years. As of May 15, 1981, 13 of the 28 authorized auditor positions were vacant.

The independence of the Comptroller for Guam/TTPI/NMI has also been impaired by the territorial governments' delayed responses to audit reports. For example, two recent reports were delayed because it took the territorial government about 5 months to respond in one case, and about 4 months in the other.

We believe most of these external impairments to audit independence would be eliminated if the Comptrollers' audit function were transferred to the Inspector General. For example, access to records and information would be improved because the Inspector General has subpoena authority. Also, quicker territorial government responses to audit reports would be achieved because the Inspector General must report to the Congress semiannually on his audit findings and recommendations. In addition, he must bring the Congress up to date on recommendations made in previous semiannual reports on which corrective actions have not been completed. Our recommendation in chapter 4 would require the territorial Governors to submit a written statement of actions taken on Federal audit recommendations within 60 days of the issuance date of the report.

CONCLUSIONS

Auditors must be organizationally independent and free from personal and external impairments to audit independence. The independence of the Comptrollers' audit function is impaired. We believe transferring the Comptrollers' statutory audit function to Interior's Office of Inspector General would make the audit function not only more independent, but also more effective. As part of a professional audit organization the audit function would receive the professional level of technical guidance and direction required to effectively carry out an audit operation.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend the organic acts for Guam (48 U.S.C. 1422d) and the Virgin Islands (48 U.S.C. 1599), and public laws (48 U.S.C. 1681b) relating to the Northern Mariana Islands and Trust Territory of the Pacific Islands to

--transfer the audit authority and staff from the U.S. Government Comptrollers to the Office of the Inspector General, Department of the Interior, for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight of the governments of Guam, the Virgin Islands, the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, and

--eliminate the provision requiring the U.S. Government Comptrollers to provide reports at the request of the territorial Governors and High Commissioner.

We also recommend that the Congress enact legislation to transfer the audit authority and staff from the U.S. Government Comptroller for American Samoa to the Office of the Inspector General, Department of the Interior, for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight of the government of American Samoa.

AGENCY COMMENTS AND OUR EVALUATION

The Office of Management and Budget; the Department of State; Interior's Inspector General; the U.S. Government Comptrollers for American Samoa, Guam/TTPI/NMI, and the Virgin Islands; a former U.S. Government Comptroller for the Virgin Islands; and the Governors of American Samoa and the Virgin Islands concurred with our recommendation to transfer the audit authority and staff from the U.S. Government Comptrollers to Interior's Inspector General Office, but some raised specific questions and concerns. Interior's Assistant Secretary for Territorial and International Affairs and the High Commissioner of the Trust Territory of the Pacific Islands, however, did not agree with our recommendation. The specific comments are discussed below.

Office of Management and Budget

OMB said that Interior has taken the lead in attempting to resolve audit problems in the Virgin Islands and it seems appropriate that they should continue in this oversight role. OMB stated that this is consistent with our recommendation to transfer the audit function of the U.S. Government Comptrollers to Interior's Inspector General Office.

It should be noted that Interior's "lead in attempting to resolve audit problems in the Virgin Islands" is in reference to the President's Council on Integrity and Efficiency headed by Interior's Inspector General. This task force has recently completed a comprehensive audit of the Virgin Islands Government. A report should be issued in February or March 1982.

Assistant Secretary for Territorial and International Affairs, Department of the Interior

Interior's Assistant Secretary for Territorial and International Affairs disagreed with our recommendation, stressing the current differences in audit authority between the U.S. Government Comptrollers and Interior's Inspector General--specifically the "wider authority" of the U.S. Government Comptrollers to review non-Federal financial accounts of the territories. The Assistant Secretary further stated "Territorial governments and the U.S. Congress would be likely to resist the expansion of the Inspector General's authority to include audit authority over territorial accounts." We did not find such resistance to our recommendation from the territorial governments nor the Inspector General's Office. Our recommendation assumes that the "wider authority" of the Comptrollers would also be transferred.

The Assistant Secretary also expressed a concern that the audit coverage for the territories could be reduced if the auditor positions now located permanently in the territories were reassigned to audit areas with higher departmental priorities. We agree with the Assistant Secretary that there could be a reduction in audit coverage in the territories. We clarified our recommendation by adding that the transfer of the U.S. Government Comptrollers to Interior's Office of Inspector General shall be for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight in the territories.

High Commissioner of the Trust Territory of the Pacific Islands

The High Commissioner stated:

> "We disagree with this recommendation because it would likely lead to a reduction in audit effort in the territories, defeating the principal recommendation of the audit report. This is because the present audit staff of the U.S. Controllers, in relation to dollars to be audited, is considerably greater than that of the DOI [Interior] Inspector General. Although this ratio is justified in our opinion by geographic and political complexities, it is likely that the Inspector General, with department-wide responsibilities, would see otherwise. A better solution is to assure organizational independence of the auditors within OTIA. This can be done by establishing reporting relationships that separate the auditors from those directly responsible for territorial operations. If the two reporting lines merge at the level of the assistant secretary, a Presidential appointee, audit independence should be sufficient for professional standards."

While we do not share the High Commissioner's belief that audit independence could be maintained to meet professional standards under OTIA, we do agree that audit effort in the territories could be reduced. As we noted above in our response to the Assistant Secretary's comments, we have clarified our recommendation.

Inspector General, Department of the Interior

Interior's Inspector General agreed with our recommendation, but he stated that it was unclear whether the Comptroller's office will continue to exist and, if so, what its function will be. He suggested that the recommendation more clearly address the existence, function, and role of the Comptrollers if the Inspector General is given their audit authority and staffing. The legislation we have proposed to the Congress implementing this recommendation will eliminate the Offices of the U.S. Government Comptrollers.

U.S. Government Comptroller for American Samoa

The Comptroller for American Samoa, who agreed with our recommendation, stated that transferring the Comptroller audit function to the Inspector General will not, in itself, solve the problems in American Samoa. He indicated that other steps will be necessary, such as:

(1) "Housing units should be constructed or otherwise acquired which will meet Federal standards and be operated by the Federal government, for all Department of the Interior (DOI) expatriate employees. Commercial rentals generally are not available, and continued reliance on the American Samoa Government (ASG) to provide housing to DOI employees indicates at least tacit approval of the present situation which is perceived as impairing our independence."

(2) "Office space meeting Federal standards, and as far removed as possible from control by ASG, should be procured. The ideal situation would be the construction of a small Federal building in American Samoa to house the several Federal staffs here, including the Office of U.S. Government Comptroller. The present situation, whereby the Comptroller occupies space provided rent-free by ASG, should not continue. The recently initiated effort to get a written lease with ASG is only a superficial solution, as ASG would continue to be our 'landlord' and could subject us to pressures in the future."

(3) "High level support for the Comptroller needs to be demonstrated. ASG can subvert the Comptroller's efforts through non-responsive actions; and, dimunition of the Office's influence can occur if there is a perception that the Comptroller does not have the full support of DOI and the Congress."

We agree with the Comptroller that his three points could strengthen the independence of the audit function; however, approval and funding for construction of housing and an office building would be affected by current reductions to the Federal budget.

U.S. Government Comptroller for Guam/TTPI/NMI

The Comptroller for Guam/TTPI/NMI had no objection to the transfer of the Comptrollers' offices to the Office of the Inspector General. He did not concur, however, with our conclusion that the transfer would increase their independence and effectiveness. Thus he could foresee no appreciable strengthening of the Comptrollers' independence and effectiveness by the transfer.

The Comptroller provided some additional information to support his view that the independence and effectiveness of his office had not been affected by its placement within OTIA. Our position, however, is not to demonstrate that the current Comptroller's office is ineffective and lacks independence, but to indicate the potential for, and the appearance of, the impairment of independence and effectiveness.

Acting U.S. Government Comptroller for the Virgin Islands

The Acting Comptroller for the Virgin Islands agreed with our findings and recommendations. Although he did not feel that the independence of his office is threatened by current management, he indicated that the potential exists for the Comptroller's independence to be impaired by future management. He stated that the transfer of the Comptroller's office to the Office of the Inspector General would be in accord with various standards of independence and would remove the potential for future organizational impairments. Further, he said the transfer to a professional organization would provide a wealth of audit expertise that could be tapped by his office, increasing the quality of audits performed and reports issued.

CHAPTER 4

EFFECTIVENESS OF AUDIT FUNCTION

NEEDS TO BE IMPROVED

In addition to the problems previously discussed regarding the need to (1) ensure a continued Federal audit presence and (2) transfer the audit function to Interior's Inspector General, we also found that the audit coverage was inadequate and needed improvement. The inadequacy stems from the following three problems.

- --A large portion of the limited audit resources available is devoted to preparing a legislatively mandated "annual report of the fiscal condition of the government." We found that the nature and purpose of the report is ill-defined and, since its production is not timely, it is of little value to the users. We believe the annual report should be prepared by the territorial governments and audited by independent auditors, rather than being prepared and audited by the Comptrollers.

- --Very few Federal grant programs in the territories are audited. If OMB designated Interior's Inspector General as the "cognizant Federal audit agency" under the single audit concept, Interior would become responsible for audit coverage of Federal grant programs in the territories.

- --The lack of a formalized system has resulted in infrequent followup on audit recommendations. Establishing formalized audit report followup systems and requiring the territorial Governors to submit a written statement of actions taken on Federal audit recommendations would help the Federal auditors and the territorial governments improve the economy and efficiency of territorial operations and ensure better accountability over Federal and local funds.

REQUIRED ANNUAL REPORT IS NOT CLEARLY DEFINED

From October 1, 1978, to May 30, 1981, the Comptrollers allocated significant audit resources to the preparation of the "annual report of the fiscal condition of the government," as the following table shows.

Office	Percentage of audit resources used (note a)	Number of reports issued (note b)
American Samoa	27	2
Guam	39	2
TTPI/NMI	47	4
Virgin Islands	18	2

a/For the American Samoa, Guam, and TTPI/NMI offices, the percentage represents audit resources used from Oct. 1, 1978, to May 30, 1981, on the fiscal 1978, 1979, and 1980 annual reports. For the Virgin Islands office, the percentage represents audit resources used only on the fiscal 1979 annual report. We could not determine the percentage of audit resources used on the fiscal 1978 annual report, but about 1,200 staff-days were spent. The Virgin Islands' fiscal 1980 annual report review was just starting during our field visit in May-June 1981.

b/The number of reports issued from Oct. 1, 1978, to May 30, 1981, represents the fiscal 1978 and 1979 annual reports.

Although the annual report is required by law and a Secretarial Order, it is not clear what the report is to represent. The organic acts, other laws, and a Secretarial Order pertaining to the territories state that:

> "* * * as soon after the close of each fiscal year as the accounts of said fiscal year may be examined and adjusted the government comptroller shall submit to the Governor [and/or High Commissioner] and the Secretary of the Interior an annual report of the fiscal condition of the government, showing the receipts and disbursements of the various departments and agencies of the government. The Secretary of the Interior shall submit such report along with his comments and recommendations to the President of the Senate and the Speaker of the House of Representatives."

In our review of the legislative histories of the organic acts and other laws, we found no expression of congressional intent in enacting this provision. Thus, there is no legislative guidance on whether the Comptrollers' annual report is to represent

--a comprehensive annual financial report prepared by the Comptroller, which represents the culmination of all budgeting and accounting activities engaged in by the government during the year,

or

--an audit of an annual financial report prepared by the territorial government, which represents an independent auditor's examination and report on whether the government's financial statements are prepared in conformity with generally accepted accounting principles and present fairly the financial condition and results of operations of the government entity.

Furthermore, the Comptrollers' operating manual is also unclear about what the report is to represent. The manual states that the annual report is not an audit report, but a summary of the fiscal condition of the territory. It further states that the report should cover financial trends, the extent to which the territory is self-supporting, and the anticipated need for Federal funds. Fulfilling these requirements would give the report some of the characteristics of a comprehensive annual financial report as defined by the "Governmental Accounting, Auditing, and Financial Reporting" standards, 1980 restatement, issued by the National Council on Governmental Auditing.

On the other hand, according to the Comptrollers' operating manual the annual report should note the extent of the auditor's verification of the source and accuracy of the financial information and statements. Also, the auditor must conform to GAO's auditing and reporting standards. These provisions seem to represent requirements for an audit of an annual financial statement in accordance with generally accepted government auditing standards.

Generally, the Comptrollers report annually on their "review" of the territorial governments' financial statements. However, these reviews consist principally of inquiries of territorial officials and analytical procedures applied to financial data. The scope is much narrower than that required for an "examination" conducted in accordance with generally accepted government auditing standards, the objective of which is to express an opinion on the financial statements taken as a whole. An examination includes such steps as a review of internal controls and tests of financial transactions; however, the Comptrollers usually do not perform these audit steps, primarily because of inadequate recordkeeping by the territorial governments. As a result, they do not and cannot express an opinion on the financial statements presented in their annual reports.

In addition to limiting the scope of the annual "reviews," the Comptrollers have been unable to submit timely reports. As of May 30, 1981, the most recent annual reports were generally not issued until 1 year after the fiscal year ended, as the following table shows.

Annual report for fiscal year ended September 30, 1979	Issuance date
American Samoa	September 1980
Trust Territory of the Pacific Islands	September 1980
Guam	November 1980
Northern Mariana Islands	September 1980
Virgin Islands	April 1981

According to the Comptrollers, the reports were usually late because they were unable to start their reviews until the territorial governments had closed the books. For two territories, that was 6 and 9 months after the fiscal year ended.

Because the reports are late, the data on the current fiscal condition of the territorial governments are not available when the territories' annual appropriation requests come before the Congress. For example, during fiscal 1982 budget hearings, the appropriations committees had only fiscal 1979 annual reports available to them. These reports, of course, did not reflect the most current information on any significant changes, problems, or improvements that may have occurred during fiscal 1980.

In our opinion, the "annual report of the fiscal condition of the government" should be a comprehensive annual financial report as defined by the Governmental Accounting, Auditing, and Financial Reporting standards, 1980 restatement--the representative culmination of all budgeting and accounting activities engaged in by management--and should be prepared by the territorial governments, not by the Comptrollers. Furthermore, the audit of a comprehensive annual financial report form of the "annual report of the fiscal condition of the government" should also be the responsibility of the territorial governments, not the Comptrollers. We believe such an annual report could provide Interior, OMB, and the Congress with the kind of detailed financial and statistical data they need for making informed fiscal decisions affecting the territories. Such data are not presently available in the Comptrollers' annual reports.

The Governmental Accounting, Auditing, and Financial Reporting standards, 1980 restatement, state that at the end of each fiscal year, every governmental unit should prepare and publish a comprehensive annual financial report covering all funds and financial transactions of the unit during the year. The annual report, preferably issued within a reasonable period after the close of the fiscal year, is the major responsibility of the chief financial officer of the governmental entity. This person should make every effort to ensure that the report reflects generally accepted principles of accounting and financial reporting applicable to governmental entities. Although the report is to be formally addressed to the chief executive and governing body of the governmental unit to which it applies, it must also meet the needs of all persons and groups who have a legitimate interest in the government's financial operations. At a minimum, for the territorial governments, this would be Federal and independent auditors, Interior, OMB, and the Congress.

An audit of a comprehensive annual financial report form of "annual report of the fiscal condition of the government" in conformance with generally accepted government auditing standards--which would permit the expression of an opinion on the financial statements--could not be done by the Comptrollers. In our opinion, to meet such audit standards they would need more audit resources than they presently use on their limited reviews. This would further limit the audit resources available to review other significant territorial operations, such as Federal grants.

It is an inherent responsibility of governments to assure the users of their financial statements that those statements fairly present the financial position and results of operations in conformity with generally accepted accounting principles. The territorial governments, therefore, should be responsible for arranging an independent audit of their comprehensive annual financial report. In all the territories, there are independent auditors available to perform such financial audits.

Relieving the Comptrollers of the responsibility for preparing the annual reports, however, is not intended to prevent the Comptroller or other Federal auditors from auditing various financial aspects of territorial operations. In fact, Federal audit resources could be refocused on areas deemed appropriate by the Federal auditors, the Congress, the Department of the Interior, and other Federal agencies to ensure accountability over Federal and local funds.

FEDERAL GRANT AUDITS ARE GENERALLY NOT PERFORMED

As noted from the table on page 10, Federal grants represent a significant amount of the Federal financial assistance provided to the territories. For example, for fiscal 1981 Federal grants totaling $221.0 million made up 29 percent of the $756.1 million in territorial government revenue. Based on our review of audit staff time charged and audit reports issued during October 1, 1978, to May 30, 1981, the Comptrollers have not given Federal grants sufficient audit coverage.

The U.S. Government Comptrollers for the Virgin Islands and American Samoa generally agreed that an inadequate number of Federal grant audits had been performed. The Comptroller for Guam/TTPI/NMI stated that he had performed 26 grant audits during the period. However, the amount of time expended on those audits represented only 12.4 percent of available staff time. The Comptroller for Guam/TTPI/NMI stated that one major problem, which has contributed to some of the deficiencies cited in our report, is a critical staff shortage.

Other audit organizations could review Federal grant programs, but they are limited in their ability to do so for many reasons. Some territorial internal audit groups are unable to perform such audits because of staff limitations and capabilities. In addition, the audit efforts of the Federal grantor agencies' inspector general offices are limited because of travel expenses and other related costs.

We contacted five agencies--the Departments of Agriculture, Health and Human Services, Labor, and Transportation and the Environmental Protection Agency--which provided over 75 percent of the Federal grant assistance to the territories in fiscal 1980. Although these agencies had about 88 programs operating in the territories, we learned that their respective inspector general offices had performed only eight grant audits from October 1, 1978, to August 14, 1981. Inspector general officials told us that travel expenses and related costs prevent them from providing adequate Federal grant audit coverage in the territories, particularly in the Pacific region.

OMB Circular A-102, Attachment P, provides a mechanism for improving the audit coverage of Federal grant programs. The circular requires that all Federal grant audits are to be made organizationwide, rather than grant-by-grant. Such audits are to determine whether (1) financial operations are conducted properly, (2) financial statements are presented fairly, (3) the organization has complied with laws and regulations affecting the expenditure of Federal funds, (4) internal procedures have been established to meet the objectives of Federal grant programs, and (5) financial reports to the Federal Government contain accurate and reliable information.

The circular states that OMB will designate a cognizant Federal audit agency which will have audit responsibility for each major recipient of Federal grants. The cognizant Federal audit agency for the territories, however, has not been designated. We believe Interior's Office of the Inspector General is the logical choice.

FOLLOWUP ON AUDIT RECOMMENDATIONS IS INFREQUENT

While professional audit standards advocate establishing formal procedures to ensure consistent followup on audit report recommendations, the Comptrollers have not done this. The lack of a formalized system has led to infrequent report followup. Accordingly, the Comptrollers do not know whether territorial governments have implemented promised improvements.

The Comptrollers for Guam/TTPI/NMI and the Virgin Islands stated that the lack of report followup was due to limited staff and higher priority work, primarily the annual report and management audits. Although the Comptroller of American Samoa followed up on reports issued during fiscal 1979, he has done no followup since then.

The Comptrollers agreed that formalized audit followup systems should be developed. However, they stated that such systems would be more effective if the territorial governments were required to respond in writing to the audit recommendations within a specified time frame. At present, only the Governor of American

Samoa is required to respond in writing to audit findings and recommendations. Under Secretarial Order 3009, the Governor is required to indicate within 45 days of the report issuance date what action will be taken to correct deficiencies noted and comply with the recommendations.

We asked the Comptrollers, the Governors of the Northern Mariana Islands and the Virgin Islands, and the Acting High Commissioner of the Trust Territory of the Pacific Islands if a legislative provision, requiring the territorial Governors to submit a written statement of actions taken on Federal audit recommendations within a specified time frame to cognizant Federal audit organizations, the Secretary of the Interior, and the Congress, would enhance the capability of Federal auditors and the territorial governments to improve the economy and efficiency of territorial operations and to ensure accountability over Federal and local funds. All the officials agreed that such a provision would be valuable.

CONCLUSIONS

We believe the audit function in the territories would be further strengthened if the legislatively required "annual report of the fiscal condition of the government" and the annual audit of this report were made the responsibility of the territorial governments. Relieving the Federal auditors of the annual report requirement would enable them to increase their audit coverage of territorial programs and operations. In particular, more attention could be given to Federal grant audits. Also, if OMB designated Interior's Inspector General as the cognizant Federal audit agency under the single audit concept, organizationwide audit coverage would be extended to the territories' Federal grant programs.

Formalized report followup systems are needed to monitor corrective actions taken by the territorial governments on the Federal auditors' findings and recommendations. Requiring the territorial Governors to submit a written statement of actions taken on Federal audit recommendations would help the Federal auditors and the territorial governments improve the economy and efficiency of territorial operations and ensure better accountability over Federal and local funds.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress amend the organic acts for Guam (48 U.S.C. 1422d) and the Virgin Islands (48 U.S.C. 1599) and the public laws (48 U.S.C. 1681b) relating to the Northern Mariana Islands and Trust Territory of the Pacific Islands to

--eliminate the provision requiring the U.S. Government Comptrollers to submit an annual report of the fiscal condition of the government to the territorial Governors, High Commissioner, and the Secretary of the Interior; and

--require the Governors of Guam, the Northern Mariana Islands, and the Virgin Islands, and the High Commissioner of the Trust Territory of the Pacific Islands to (1) prepare, publish, and submit a comprehensive annual financial report in conformance with the standards of the National Council on Govermental Accounting within 120 days of the close of the fiscal year to the Secretary of the Interior and the Congress; (2) arrange for an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards for governmental units; and (3) submit to the cognizant Federal auditors, the Secretary of the Interior, and the Congress a written statement of actions taken on Federal audit recommendations within 60 days of the issuance date of the audit report.

We further recommend that the Congress enact similar legislation to require the Governor of American Samoa to

--prepare, publish, and submit a comprehensive annual financial report in conformance with the standards of the National Council on Governmental Accounting within 120 days of the close of the fiscal year to the Secretary of the Interior and the Congress;

--arrange for an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards for governmental units; and

--submit to the cognizant Federal auditors, the Secretary of the Interior, and the Congress a written statement of actions taken on Federal audit recommendations within 60 days of the issuance date of the audit report.

RECOMMENDATION TO THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

We recommend that the Director, Office of Management and Budget designate the Office of the Inspector General, Department of the Interior, as the cognizant Federal audit agency in the territories under the single audit concept.

RECOMMENDATION TO THE SECRETARY OF THE INTERIOR

We recommend that the Secretary of the Interior direct the Inspector General to establish formalized audit report followup systems in Interior's territorial audit offices.

AGENCY COMMENTS AND OUR EVALUATION

Interior's Inspector General, the U.S. Government Comptrollers for American Samoa and the Virgin Islands, the former U.S. Government Comptroller for the Virgin Islands, and the Governors of American Samoa and the Virgin Islands agreed with our recommendations to the Congress. The High Commissioner of the Trust

Territory of the Pacific Islands raised a valid point about the additional cost to the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau for arranging independent audits. No other commenters expressed their viewpoint on those recommendations.

OMB, Interior's Inspector General, the High Commissioner of the Trust Territory of the Pacific Islands, the former U.S. Government Comptroller for the Virgin Islands, and the Governor of American Samoa agreed with our recommendation to OMB. The U.S. Government Comptroller for Guam/NMI/TTPI stated that the position of the Inspector General "gives it no edge" on the single audit, and that the Comptrollers, if given the resources, could do such audits just as well.

Interior's Inspector General, the High Commissioner of the Trust Territory of the Pacific Islands, the U.S. Government Comptroller for the Virgin Islands, the former U.S. Government Comptroller for the Virgin Islands, and the Governor of American Samoa agreed with our recommendation to the Secretary of the Interior. The Assistant Secretary for Territorial and International Affairs also generally agreed with our recommendation. No other commenters expressed an opinion on the recommendation.

Some of the commenters raised specific questions and concerns. They are discussed below.

Office of Management and Budget

OMB stated that it would have no problem designating the Department of the Interior as the cognizant Federal audit agency under the single audit concept. In fact, OMB said that arrangements have been made for Interior to assume responsibility for Federal grant audits of the territorial governments. However, OMB stated, if audit responsibility is not transferred to Interior (we assume OMB is referring to Interior's Inspector General) then it may be more logical for one of the agencies whose grants to the territories are more sizable than Interior's to be the cognizant single audit agency.

Inspector General, Department of the Interior

Concerning the recommendation to OMB, Interior's Inspector General stated that if the audit function and personnel spaces of the U.S. Government Comptrollers are not transferred to the Inspector General, then the cognizant agency assignment under the single audit concept should be based on the predominance of Federal grant funds to the territories. In that case, the Inspector General continued, our recommendation to establish formalized audit report followup systems should be directed to the Assistant Secretary for Territorial and International Affairs, and not to the Inspector General.

U.S. Government Comptroller for American Samoa

While the Comptroller for American Samoa agreed with the recommendation to remove the requirement for the annual report, he added that some additional requirements should be placed upon the Comptroller to report to the Congress on the territory's financial reporting and auditing process, and to provide an opinion on aspects of the territory's operations including budget procedures, program management, effectiveness of the delivery of Federal funds, and other matters of interest to the Congress.

The Comptroller agreed that territorial governments need to respond directly to the Congress on all Federal reports. He noted, however, that such a requirement has been relatively ineffective because the Washington level seldom, if ever, follows through to determine action plans for recommended improvements. The Comptroller can follow up, but any necessary enforcement must come from Washington.

Acting U.S. Government Comptroller for the Virgin Islands

The Acting Comptroller for the Virgin Islands stated that if the annual audit were not required, more time could be devoted to essential duties such as Federal grant audits. He stated, however, that the Comptroller's office would not be able to expand grant audits to an acceptable level because of limitations on staff size.

U.S. Government Comptroller for Guam/TTPI/NMI

The Comptroller for Guam/TTPI/NMI provided several examples of the territorial government's noncompliance with generally accepted standards for financial management as reasons why the Comptroller's office could not express a positive opinion on financial statements or why some grant audits could not be initiated. We believe his comments support the need for the local governments and local public accounting firms to perform annual and grant audits.

The Comptroller also pointed out that we had understated the number of Federal grant audits conducted in his territorial jurisdiction from October 1, 1978, through May 30, 1981. From our analysis of the data, we did, in fact, not recognize certain types of audits that should have been categorized as grant audits and the corrected data are on pages 32 and 33 of this report. However, our analysis did show that only 12.4 percent of available staff time was spent by the Comptroller's office on grant audits. This fact, along with the Comptroller's acknowledgement that his office has a "critical shortage of staff," supports our position that resources are not readily available for grant audits.

Former U.S. Government Comptroller for the Virgin Islands

The former Comptroller for the Virgin Islands generally concurred with our recommendation that the Governors be required to arrange for an independent audit of the comprehensive annual financial report. He expressed concern that the local public accounting firms would not be capable, sufficiently independent, or objective enough to perform such an audit. The U.S. Government might know less about the financial condition of the territory from a local audit than they do now. Therefore, he felt that specific requirements for selecting an audit firm should be added to the recommendation.

High Commissioner of the Trust Territory of the Pacific Islands

The High Commissioner of TTPI raised the question of who should pay the bill for independent audits. Her comments state:

> "For the Trust Territory this would impose a significant new financial burden at a time when operating budgets have been cut sharply. We have no conceptual objection if the function were funded. However, considering that more than 90 percent of governmental budgets in the Trust Territory are Federally funded, it would seem that the primary external audit responsibility would best be continued by DOI [Interior] auditors."
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> * * * * *
>
> "* * * Each of the four new governments has constitutional provisions for public auditors but they are in varying degrees of implementation. Any elimination of external audit support by the DOI auditors should include a transition period long enough to allow the public auditors in each government to be fully functioning. Furthermore, it is not clear in the report whether a fully functioning public auditor 'comparable to the U.S. Government Comptrollers' (page 14) would satisfy the recommendation for an independent audit. If public auditors and outside independent auditors are both required, then the financial burden would be extreme."

We agree with the High Commissioner that public auditors and outside independent auditors could impose a financial burden on the new governments. However, we believe that if these new governments want self-government, then they should assume the responsibility for maintaining a public auditor to audit the internal government operations and arranging for an outside independent audit of their annual financial report.

CHAPTER 5

MORE FEDERAL TECHNICAL ASSISTANCE AND ASSUMPTION OF GREATER RESPONSIBILITY BY THE TERRITORIES WOULD ENHANCE AUDIT EFFECTIVENESS

Although the focus of our review was on the Federal audit function in the territories, it is clear that improved effectiveness of the Federal audit agency alone is insufficient to ensure continued growth in the territories' ability to manage and account for Federal and local funds. They also have a significant need for direct Federal technical assistance to help overcome the financial management problems that continue to plague the territories. We believe such assistance, coupled with the assumption of greater responsibility by the territories for financial management--particularly in establishing audit followup systems and improving the territories' internal audit capabilities--would greatly enhance Federal audit effectiveness.

MORE TECHNICAL ASSISTANCE IS NEEDED

Primary responsibility rests with the territorial governments to ensure that financial management weaknesses are corrected. However, they need Federal technical assistance.

OTIA's technical assistance branch offices represent a permanent local technical assistance capability in the territories. However, as of May 15, 1981, these offices had only 11 staff members working with the territorial governments on financial management problems. While we did not specifically review OTIA's technical assistance activities, the territories' financial management problems as described in chapter 2 are so extensive that we question the sufficiency and effectiveness of OTIA's technical assistance.

Some territorial leaders and financial management officials told us they hoped OTIA would develop a comprehensive technical assistance action plan and provide all the necessary resources--staff and/or funds--so that their territorial governments could establish and maintain effective financial management systems. We believe such assistance should also be provided to the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau. These governments have experienced difficulties under the TTPI financial management system and are considering establishing their own systems.

AUDIT FOLLOWUP SYSTEMS SHOULD BE DEVELOPED

The territorial governments have not instituted audit followup systems to ensure that recommended corrective actions on all Federal and independent auditor reports are implemented and followed through to completion.

On December 31, 1980, the Deputy Under Secretary of the Interior for Territorial and International Affairs wrote the territorial Governors about the need to establish a more formalized followup system for all audit reports issued on their operations. Interior suggested a system that would provide for a designated liaison official to follow up corrective actions on all audit reports and identify any need for additional corrective actions.

The territorial governments, however, have made little response. The Virgin Islands have made no move to establish an audit followup system. American Samoa and Guam have designated liaison officials but the officials are not certain how they should proceed. Only the Northern Mariana Islands government has established an audit followup system. An NMI official stated, however, that the system should place more accountability for corrective action on department heads. He also said he has had difficulty coordinating agencies' actions to correct problems.

INTERNAL AUDIT CAPABILITIES SHOULD BE IMPROVED

All the territorial governments have internal audit groups. However, due to their limited scope of work, staff resources, staff capabilities, or lack of independence, they are presently not capable of fully providing the type of audit coverage needed to supplement, much less substitute for, the Federal audit role in improving the economy and efficiency of territorial operations and ensuring accountability over Federal and local funds.

The territorial governments have established the following internal audit groups:

Territory	Internal audit group
American Samoa	Office of the Territorial Auditor
Guam	Office of the Territorial Auditor
	Internal Audit Section, Bureau of Budget and Management Research
Northern Mariana Islands	Public Auditors Office
Virgin Islands	Internal Audit Division, Department of Finance
Trust Territory of the Pacific Islands	Internal Audit, Bureau of Investigations

Although most of the internal audit groups have broad responsibilities, which include economy and efficiency, operational, compliance, and financial audits, their scope of work is very limited. In American Samoa, Guam, and the Virgin Islands the internal audit groups mainly perform Federal grant audits. Financial audits and audits of government operations and internal controls usually are not performed. American Samoa's internal audit group, however, has recently begun financial, compliance, and operational audits.

Limited staff resources is a major reason for the narrow scope of work. For example, TTPI has only three internal auditors, while Guam has only six. Guam's chief internal auditor stated that since her staff is small, her group is committed to performing Federal grant audits only.

In addition, the staff capabilities of the internal audit groups are limited. Guam and TTPI officials believe that the staff auditors are not able to perform complex operational and financial audits. The TTPI Acting High Commissioner stated that his present internal audit group may be abolished since they are incapable of planning and performing the most basic audits. Guam's chief internal auditor stated that while the staff auditors are beginning to understand compliance audits, none is capable of planning and supervising the work and preparing the final written product.

Limited education restricts the auditors' capabilities. Several auditors do not have adequate college education. For example, only the director and deputy director in American Samoa's Office of the Territorial Auditor have college degrees. The six staff auditors have at most 2 years of college training. Only the director and 2 of the 13 auditors in the Virgin Islands internal audit group have college degrees.

Furthermore, one territorial internal audit group is not organizationally independent. In the Virgin Islands, the internal audit group is part of the Department of Finance, which is responsible for administering the Federal grants that the internal audit group reviews. The Comptroller's annual reports have recommended for a number of years that the Virgin Islands Government establish an independent internal audit group.

CONCLUSIONS

A strengthened Federal audit presence alone is not enough to improve the economy and efficiency of the territorial governments. They need to assume a greater responsibility for establishing and maintaining strong financial management systems to ensure proper control and accountability over Federal and local funds. Although this is primarily the territorial governments' responsibility, they cannot do the job alone; they need Federal technical assistance. In addition, territorial audit followup systems are needed to ensure that all Federal and independent audit report recommendations are identified and corrective actions are implemented and followed through to completion. Furthermore, increasing the size of internal audit staffs, improving staff capabilities, expanding the scope of audit coverage, and ensuring audit independence would clearly assist the territorial and Federal governments in assuming their responsibilities.

RECOMMENDATIONS TO THE SECRETARY OF THE INTERIOR

We recommend that the Secretary of the Interior

--develop and submit to the Congress a comprehensive technical assistance plan, including a determination of what resources are needed, to establish effective financial management systems for the governments of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands and

--report to the Congress on the resources needed to assist the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau in establishing their financial management system requirements.

RECOMMENDATIONS TO THE GOVERNORS OF AMERICAN SAMOA, GUAM, THE NORTHERN MARIANA ISLANDS, AND THE VIRGIN ISLANDS

We recommend that the Governors of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands

--establish an audit followup system to ensure that recommended corrective actions on all Federal and independent audit reports are implemented and followed through to completion and

--strengthen their internal audit function by increasing the size of staffs, improving staff capabilities, expanding the scope of audit coverage, and ensuring audit independence.

AGENCY COMMENTS AND OUR EVALUATION

The Governors of American Samoa and the Virgin Islands agreed with our recommendation to the Secretary of the Interior to develop a comprehensive technical assistance plan. Interior's Assistant Secretary for Territorial and International Affairs, the High Commissioner of the Trust Territory of the Pacific Islands, and the U.S. Government Comptrollers for American Samoa and the Virgin Islands generally agreed with our recommendations. Interior's Assistant Secretary for Territorial and International Affairs expressed a willingness to assist us in our current review of the transition needs of the newly developing Micronesian governments. No other commenters expressed their viewpoint on these recommendations.

The Governors of American Samoa, Guam, and the Virgin Islands agreed with our recommendations that they establish a followup system and strengthen their internal audit functions. However, they note the need for comprehensive technical assistance from the Department of the Interior. The U.S. Government Comptroller for the Virgin Islands also agreed that improving internal audit capabilities is an immediate need of the territory. No other commenters expressed their viewpoint on these recommendations.

Some of the commenters raised specific questions and concerns. They are discussed below.

Assistant Secretary for Territorial and International Affairs, Department of the Interior

The Assistant Secretary for Territorial and International Affairs agreed that increased technical assistance is desirable. However, he felt that transferring the Comptrollers to the Inspector General's Office would not aid in the accomplishment of the desired result. He stated that because the Comptrollers are in the territories, they are available to provide guidance to the territories on their financial management activities. Such guidance from the Comptrollers, however, would lessen audit independence and runs counter to our recommendation in chapter 3 that the audit function and the technical assistance function of the Department of the Interior be separate.

Further, our recommendation is directed toward the establishment of a plan for more effective technical assistance. The need for additional and separate technical assistance resources would be best determined after review of the comprehensive plan we are recommending.

The Assistant Secretary states his belief that technical assistance picks up on audit recommendations to solve problems. The recommendations can be most expeditiously implemented and

> "* * * most efficiently done if the auditors and technical assistance personnel report to the same office (TIA). The extent of compliance with audit recommendations at local levels would be diminished if auditors were not connected to the office directly responsible for the oversight of the territories."

We disagree with the Assistant Secretary on the grounds that such an organizational alignment is in direct violation of our audit independence standards and those of the American Institute of Certified Public Accountants.

U.S. Government Comptroller for American Samoa

Although generally agreeing with our recommendations, the Comptroller for American Samoa stated that increasing technical assistance will not solve the problems without a desire for improvement. The Comptroller further stated that in addition to the Federal Government providing needed technical assistance to improve systems, some better means to enforce good financial management of territorial finances also should be considered.

Governor of Guam

The Governor of Guam agreed that internal audit functions need to be increased; however, financial constraints limit the government's ability to increase the size and capabilities of its staff at this time.

Governor of American Samoa

The Governor of American Samoa agreed that an audit followup system is needed and the internal audit function should be strengthened. He stated that his government has already initiated steps toward those goals.

DESCRIPTION OF PRINCIPAL U.S. TERRITORIES

AND THE TRUST TERRITORY OF THE PACIFIC ISLANDS

The following describes the geographic location, size, population, and governmental structure of the four principal U.S. territories discussed in this report--American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands--as well as the Trust Territory of the Pacific Islands.

AMERICAN SAMOA

American Samoa is an unincorporated and unorganized territory. The most southerly of all lands under the United States' sovereignty, American Samoa comprises the eastern islands of the Samoan group (Western Samoa is independent) and is located approximately 2,300 miles southwest of Hawaii and 1,600 miles northeast of the northern tip of New Zealand.

The seven islands of American Samoa have a land area of 76 square miles. Over 96 percent of the land is owned communally, and its occupancy and use are regulated by Samoan custom. American Samoa's population is about 30,000.

Since 1977, residents of American Samoa have elected their own Governor and Lieutenant Governor. Legislative power is vested in the American Samoan legislature, which is composed of a Senate and House of Representatives. The members of the Senate are elected by the county councils, in accordance with the Samoan custom, while members of the House are elected by popular vote in each district.

GUAM

The island of Guam is an organized, unincorporated territory. It is the southernmost point in the chain of volcanic islands in the western Pacific Ocean known as the Mariana Islands. Guam lies about 6,000 miles southwest of San Francisco and 1,500 miles southeast of Manila.

Guam is the largest and most populous island in the Marianas chain. Its lima bean shape covers 209 square miles and is populated by approximately 100,000 people, over 20 percent of whom are military personnel and Federal employees and their dependents. Guamanians are U.S. citizens.

Guam is administered by a Governor and Lieutenant Governor elected, since 1970, by popular vote. Legislative authority is vested in a 21-member unicameral legislature which is elected biennially. Since 1972, the residents of Guam have elected a nonvoting delegate to the U.S. House of Representatives.

NORTHERN MARIANA ISLANDS

The Northern Mariana Islands comprise 14 islands, with a land area of 182 square miles. The population is estimated at approximately 17,000 with the majority (about 14,600) living on the island of Saipan; 900 live on Tinian and 1,275 on Rota. The remaining islands north of Saipan are, for the most part, uninhabited.

On January 8, 1978, the Constitution of the Northern Mariana Islands became effective in accordance with the "Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America." The Covenant, approved by joint resolution of the U.S. Congress on March 24, 1976, will allow the Northern Mariana Islands to become a commonwealth of the United States when the United Nations Trusteeship Agreement is terminated. At that time its residents will become U.S. citizens.

Under the Constitution, the residents of the Northern Mariana Islands elect their own Governor and Lieutenant Governor. A bicameral legislature composed of a Senate and House of Representatives serves as the legislative authority of the islands.

U.S. VIRGIN ISLANDS

The U.S. Virgin Islands is an organized, unincorporated territory that is part of the curving chain of the Greater and Lesser Antilles separating the Caribbean Sea and the Atlantic Ocean. The islands are located 1,400 miles southeast of New York and approximately 1,000 miles southeast of Miami. More than 50 islands make up the group that is under the sovereignty of the United States, but only three--St. Thomas, St. Croix, and St. John--have a size or population of any significance. Most of the other islands are uninhabited.

The total land area of the U.S. Virgin Islands is approximately 130 square miles, with St. Croix being about twice as large as the other two islands combined. The population of the islands is approximately 115,000, and the residents have been citizens of the United States since 1927.

The U.S. Virgin Islands is administered by a Governor and Lieutenant Governor elected, since 1970, by popular vote. A bicameral legislature composed of 15 Senators elected every 2 years serves as the legislative authority of the territory. Since 1973, the islands have been represented in the U.S. House of Representatives by a nonvoting delegate elected by popular vote.

TRUST TERRITORY OF THE PACIFIC ISLANDS

The Trust Territory of the Pacific Islands comprises more than 2,100 islands and encompasses the island groups of the Marshalls, Carolines, and Marianas (except for Guam and the Northern Marianas). These groups make up most of what is known as Micronesia, or the "land of small islands." The far western boundary of the area is only 500 miles from the Philippines; Hawaii is some 1,800 nautical miles from the eastern border of the territory.

The Trust Territory lies in an expanse of the Western Pacific Ocean equal in size to the continental United States, or 3 million square miles. The land area, however, is approximately 700 square miles, or about one-half the size of Rhode Island. Only about 100 of the islands are inhabited, with a total population of approximately 116,000 (excluding the Northern Mariana Islands).

The United States administers the Trust Territory under a 1947 Trusteeship Agreement with the Security Council of the United Nations. As administering authority, the United States is responsible for promoting the political, economic, and educational development and for improving the health and wellbeing of the Micronesians through better community facilities and services. The chief executive of the Trust Territory is the High Commissioner, appointed by the President.

Since 1947, self government has been gradually assumed in various parts of the Trust Territory depending on the freely expressed wishes of the inhabitants. It is anticipated that the Trusteeship will be terminated in the near future. Ongoing political status negotiations with the Central Carolines (the Federated States of Micronesia), Palau, and the Marshall Islands are focusing on a future political relationship of "free association" with the United States. A negotiated "Compact of Free Association" was initialed by each of the Micronesian entities in November 1980.

On July 12, 1978, the voters in the six districts of the Trust Territory voted on a proposed constitution for the Federated States of Micronesia. The constitution was approved by a majority vote in each of the four central districts but was disapproved in the Marshall Islands and Palau Districts. The enabling legislation provided that the constitution would not become effective in any district that did not approve it. The referendum results, however, accelerated moves for legislative and fiscal separation, and this was accomplished through the issuance of Secretarial Order 3027 on September 29, 1978.

The Government of the Marshall Islands

Following the rejection of a permanent union with the rest of Micronesia, the Marshall Islands established its own constitutional government on May 1, 1979, in Majuro, Marshall Islands. This new government was modeled after the British parliamentary system with a President, in place of a Prime Minister, and a unicameral parliament (Nitijela).

The Federated States of Micronesia

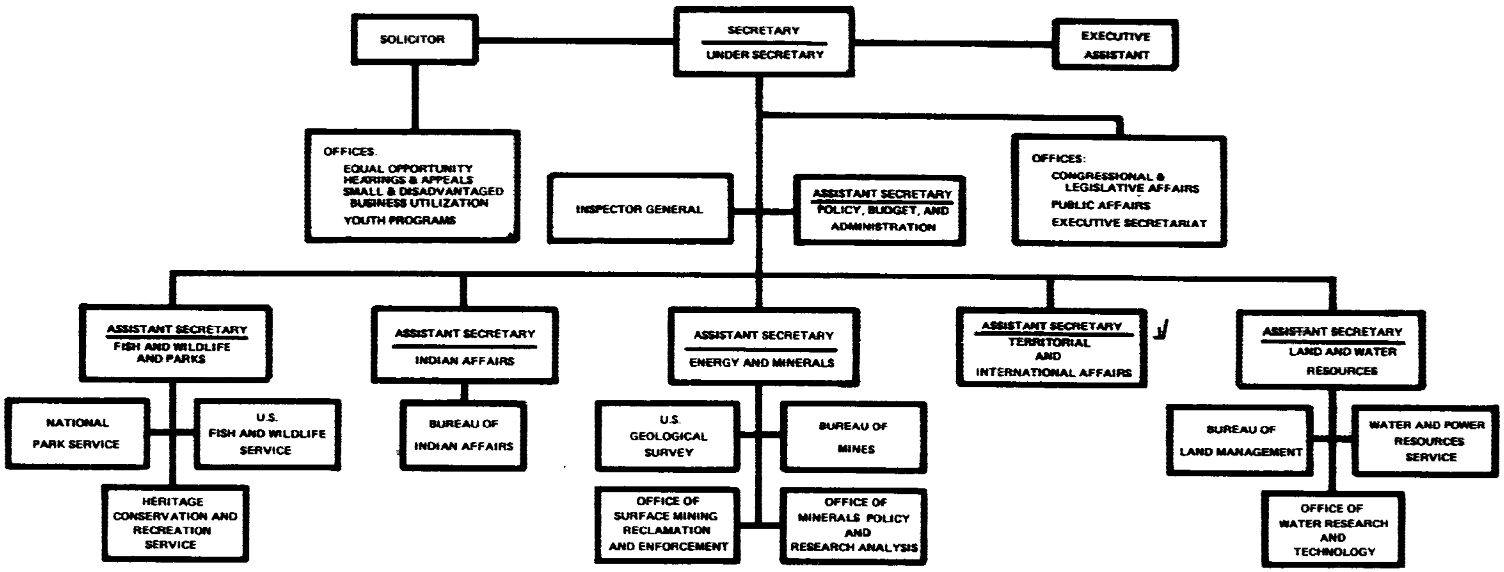
The States of Yap, Truk, Ponape, and Kosrae, forming the central area of the Trust Territory, adopted the Constitution of the

Federated States of Micronesia on July 12, 1978, and made it effective on May 10, 1979. The government of the Federated States, located in Kolonia, Ponape, is headed by a President elected by a 14-member unicameral Congress. Each of the four states has a popularly elected governor as the chief executive of the local state government.

Republic of Palau

Palau adopted its constitution on July 9, 1980, following considerable political activity, including two prior referendums. Constitutional government was installed in Palau on January 1, 1981, with an elected President and a bicameral legislature.

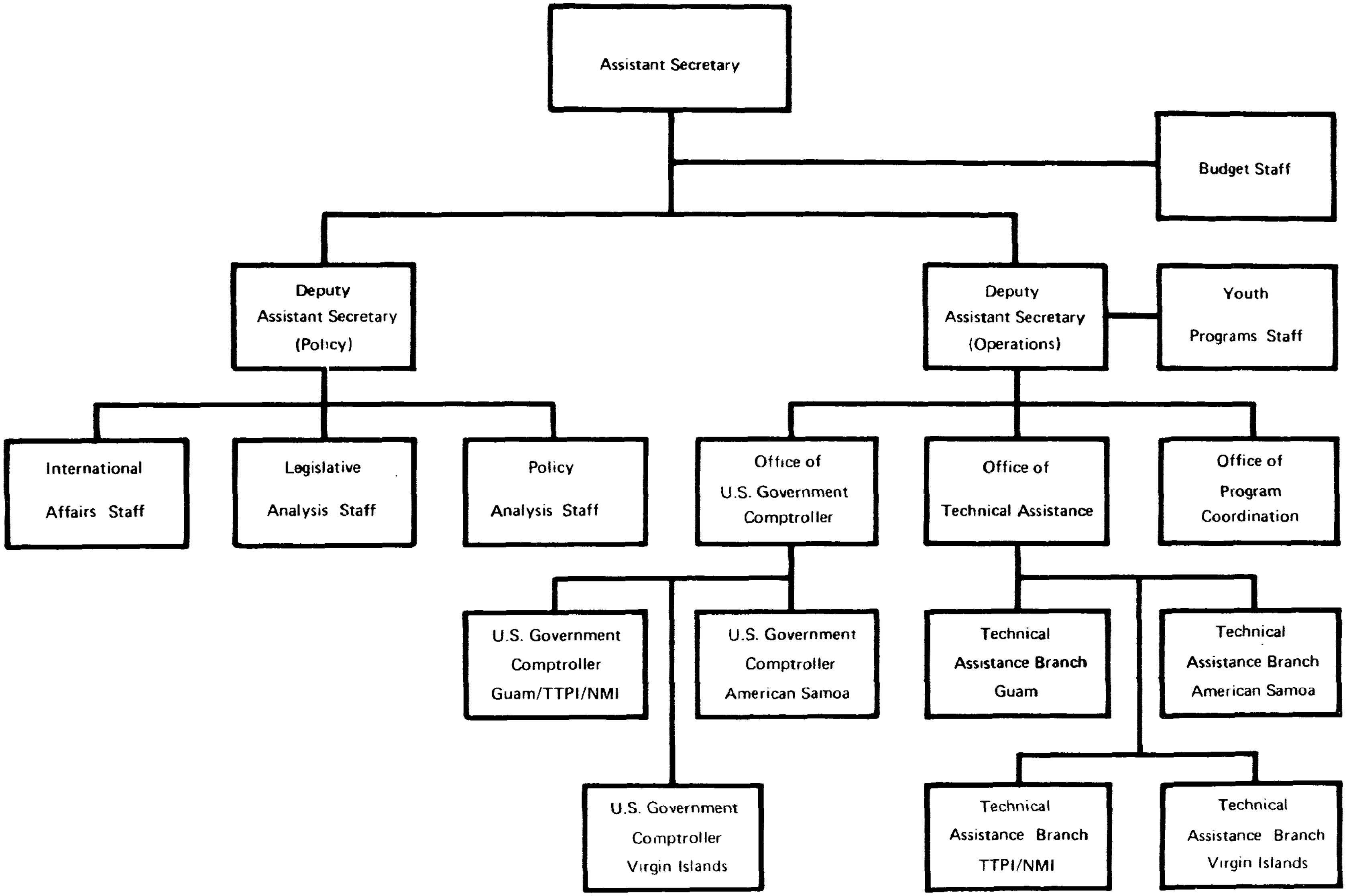
U.S. DEPARTMENT OF THE INTERIOR
ORGANIZATION CHART



1/ See app. III for detailed organization chart.

APPENDIX II

OFFICE OF THE ASSISTANT SECRETARY FOR TERRITORIAL AND INTERNATIONAL AFFAIRS U.S. DEPARTMENT OF THE INTERIOR ORGANIZATION CHART



APPENDIX III

FISCAL 1979 FEDERAL GRANTS

TO THE TERRITORIES

	American Samoa	Guam	Northern Mariana Islands	Trust Territory of the Pacific	Virgin Islands	Total
	(thousands)					
Department of Agriculture	$ 1,882	$12,578	$ 571	$ 3,224	$21,971	$ 40,226
Department of Commerce	397	1,261	-	857	319	2,834
Department of Defense	-	117	-	-	77	194
Department of Energy	-	-	-	-	271	271
Department of Health, Education, and Welfare	6,412	17,110	9,449	1,796	18,059	52,826
Department of Housing and Urban Development	40	681	40	58	2,426	3,245
Department of the Interior	722	1,344	104	616	1,158	3,944
Department of Justice	376	611	183	835	521	2,526
Department of Labor	2,238	7,630	-	4,696	11,032	25,596
Department of Transportation	1,373	5,580	-	4,577	23,628	35,158
Action	-	14	-	-	137	151
Community Services Administration	-	-	-	1,381	798	2,179
Environmental Protection Agency	3,572	5,900	1,616	8,659	3,210	22,957
Equal Employment Opportunity Commission	-	-	-	-	43	43
National Endowment for the Arts	320	317	-	158	391	1,186
Office of Personnel Management	50	70	40	30	67	257
Water Resources Council	-	42	70	-	42	154
Total	$17,382	$53,255	$12,073	$26,887	$84,150	$193,747

SOURCE: "Fiscal Year 1979 Geographic Distribution of Federal Funds in Territories and Other Areas Administered by the U.S.," compiled for the Executive Office of the President by the Community Services Administration

APPENDIX IV

FISCAL 1980 FEDERAL GRANTS

TO THE TERRITORIES

	American Samoa	Guam	Northern Mariana Islands	Trust Territory of the Pacific	Virgin Islands	Total
	(thousands)					
Department of Agriculture	$ 2,256	$18,424	$ 917	$ 3,742	$25,623	$ 50,962
Department of Commerce	272	576	-	-	589	1,437
Department of Education	2,993	8,247	5,530	544	4,971	22,285
Department of Energy	-	89	-	-	-	89
Department of Health and Human Services	2,407	10,520	4,039	1,174	11,932	30,072
Department of Housing and Urban Development	34	26	24	1,361	-	1,445
Department of the Interior	347	898	277	958	908	3,388
Department of Justice	332	504	810	262	1,573	3,481
Department of Labor	1,972	6,111	-	3,444	7,719	19,246
Department of Transportation	1,438	4,221	8	6,387	9,073	21,127
Action	-	2	-	-	173	175
Community Services Administration	-	-	-	929	1,705	2,634
Environmental Protection Agency	2,461	2,036	-	5,553	2,531	12,581
Equal Employment Opportunity Commission	-	-	-	-	35	35
National Endowment for the Arts	320	313	14	10	433	1,090
Office of Personnel Management	60	80	70	50	90	350
Water Resources Council	-	150	174	-	69	393
Total	$14,892	$52,197	$11,863	$24,414	$67,424	1/$170,790

SOURCE: "Fiscal Year 1980 Geographic Distribution of Federal Funds in Territories and Other Areas Administered by the U.S.," compiled for the Executive Office of the President by the Community Services Administration

1/This figure is different from the one in the table on p. 10 because two information sources were used. The above source used a statistical formula to predict the most probable distribution of funds because Federal agency accounting systems do not always provide accurate data on the geographic distribution of funds expended. The p. 10 source--U.S. Department of Interior, Office of Territorial and International Affairs--used actual and/or estimated financial data obtained from the territorial governments.

APPENDIX V

United States Department of the Interior

OFFICE OF THE INSPECTOR GENERAL
WASHINGTON, D.C. 20240

November 25, 1981

Mr. W. D. Campbell
Acting Director
Accounting and Financial
Management Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Campbell:

We have reviewed your draft report "The Federal Audit Function in the Territories Should Be Strengthened" and think the overall recommendations are sound and should, if implemented, improve the audit function in the territories. There are three recommendations which we believe should be clarified. These are as follows:

1. GAO recommends that the Director, Office of Management and Budget (OMB), designate the Department of the Interior's Office of Inspector General as the cognizant Federal audit agency in the territories under the single audit concept.

We agree if the audit function and personnel spaces are transferred to our office. If not, we believe the cognizant agency assignment should be based on the predominance of Federal grant funds to the territories.

2. GAO recommends that the Secretary

-- direct the Inspector General to establish formalized audit report followup systems in Interior's territorial audit offices.

We agree if the audit function and personnel spaces are transferred to our office. If not, the recommendation should be changed to direct the Assistant Secretary for Territorial and International Affairs (TIA) to establish formalized audit report followup systems in Interior's territorial audit offices.

The Office of Inspector General will still oversight the followup systems but TIA would have the management responsibilities if your recommendations are not implemented by Congress.

3. GAO recommends that Congress amend the Inspector General Act and other acts relating to the territories to

-- transfer the audit authority and staff from the U. S. Government Comptrollers to the Department of the Interior's Office of the Inspector General.

We agree with the GAO recommendation, however, it is unclear from the recommendation whether the Comptroller's office will continue to exist and, if so, what their function will be. We suggest the recommendation more clearly address the existance, function and role of the Government Comptrollers if the Inspector General is given their audit authority and staff.

Thank you for an opportunity to comment on the draft report.

Sincerely,

Richard Mulberry
Inspector General

747 Amana St., #1515
Honolulu, HI 96814
November 28, 1981

Mr. Victor L. Lowe
Director, U. S. General Accounting Office
Far East Branch
P. O. Box 50187
Honolulu, HI 96850

Dear Mr. Lowe,

Thank you for the opportunity to comment on your draft report, "The Federal Audit Function in the Territories Should be Strengthened". As a prior U. S. Comptroller for the Virgin Islands I have agonized over the inefficiency and ineffectiveness of the Territories' governmental programs and financial management for several years.

I concur totally with the need for, and intent of, each recommendation in the report. Unfortunately, I do not believe that any material improvement will be realized unless other actions are also taken by the Department of Interior and the U. S. Congress.

Most of the problems outlined in the report are inherent in the political, social and economic structure of the territories. I personally believe that the leaders and managers of the Territories will continue to refuse to recognize or correct those problems unless faced with specific consequences such as the possibility of the withholding of federal funds. This will be the case regardless of the organizational restructuring of the Comptrollers offices. I certainly agree, however, that your recommendations are valid and should be implemented and that every effort should be made to correct the totally unacceptable conditions that have continued for so many years.

The above opinion is expressed with the personal knowledge that the audit operations of the Comptrollers offices have been every bit as independent and professional as that of any Federal Department with which I have been associated throughout my career. This includes adherence to the audit standards established by the Comptroller General of the United States. The biggest problem has been the failure of the U. S. Congress to provide the Comptroller with the necessary authority to insure implementation of audit recommendations.

In summary, it is my feeling that although the detailed findings of the report do not totally support the recommendations, those changes should still be made. They are necessary to conform with the requirements and guidelines of the audit profession and to explore new avenues to solve the existing problems.

Hopefully, the reorganizations recommended will also force the Department of Interior and the U. S. Congress to recognize the need to redefine the role of the U. S. Government in the Territories.

I am concerned about one specific recommendation, however. I feel that a qualification should be added to the requirement for the Govenors to "arrange for an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards for governmental units". In the Virgin Islands I assure you that within those terms a local C.P.A. firm will be engaged. They will be neither capable of or sufficiently independent or objective to perform such an audit. Since the annual report will undoubtedly be materially inacurrate to begin with, the U. S. Government may wind up knowing less about the financial condition of the Territory than they do now. There are specific qualifying requirements for selecting an audit firm that are available throughout the profession. I strongly suggest that such requirements be added to the recommendation.

Again, thank you for the opportunity to express my opinion on this very vital and valuable report.

Sincerely yours,

Darrell E. Fleming

Darrell E. Fleming
U. S. Comptroller for the Virgin Islands (Retired)

GAO NOTE: The commenter also included a handwritten note as part of his reply. Those comments were considered in our evaluation.

 APPENDIX VI

United States Department of the Interior

OFFICE OF THE SECRETARY
U.S. GOVERNMENT COMPTROLLER FOR AMERICAN SAMOA
PAGO PAGO, AMERICAN SAMOA 96799

Serial: 0516
SDJ:mmn

December 1, 1981

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

Dear Mr. Eschwege:

We have reviewed your DRAFT report titled, The Federal Audit Function in the Territories Should be Strengthened. We agree, generally, with your recommendations, subject to the following comments:

1. Appearance of conflict or impaired independence - Transferring the Comptroller audit function to the Inspector General will not, in and of itself, solve the problems in American Samoa. Other steps will be necessary, such as:

    a. Housing units should be constructed or otherwise acquired which will meet Federal standards and be operated by the Federal government, for all Department of the Interior (DOI) expatriate employees. Commercial rentals generally are not available, and continued reliance on the American Samoa Government (ASG) to provide housing to DOI employees indicates at least tacit approval of the present situation which is perceived as impairing our independence.

    b. Office space meeting Federal standards, and as far removed as possible from control by ASG, should be procured. The ideal situation would be the construction of a small Federal building in American Samoa to house the several Federal staffs here, including the Office of U.S. Government Comptroller. The present situation, whereby the Comptroller occupies space provided rent-free by ASG, should not continue. The recently initiated effort to get a written lease with ASG is only a superficial solution, as ASG would continue to be our "landlord" and could subject us to pressures in the future.

CONSERVE AMERICA'S ENERGY

Save Energy and You Serve America!

c. High level support for the Comptroller needs to be demonstrated. ASG can subvert the Comptroller's efforts through non-responsive actions; and, diminution of the Office's influence can occur if there is a perception that the Comptroller does not have the full support of DOI and the Congress.

2. Comptroller's Annual Reports - We agree that the format and content of the reports were not clearly defined, nor consistently presented. Also we agree that each Territorial government should prepare and publish an annual financial report as defined in the GAAFR, and that these reports should be regularly audited by independent public accountants. However, there probably should be some requirement placed upon the Comptrollers to report to the Congress annually on the Comptroller's evaluation of the Territory's financial reporting and auditing process, and his opinions on other aspects of the Territory's operations such as budget procedures, program management, effectiveness of the delivery of the Federal funds, and other matters of interest to the Congress.

3. Response to Federal Audit Reports - Requiring the Territorial governments to respond directly to the Congress on all Federal audit reports is an excellent proposal. As your report states, only in American Samoa is there a requirement for the Governor to respond in writing to Comptroller's reports. But that requirement has been relatively ineffective because there has been little or no follow-up from the Washington level to ascertain the Governor's action plans for improvement. The Comptroller can follow-up, but the only real clout to enforce needed improvements must emanate from Washington.

4. Technical Assistance - Increasing technical assistance will not solve the problems without a desire for improvement. We detect a lack of will - or interest - in getting really good financial management in the territory. After all, the territories have generally received their funding requests in the past even though it was known by DOI and the Congress that financial systems often were in disarray. So, if financial assistance readily comes under a bad system, what is the incentive for a good system. In addition to the Federal government providing needed technical assistance to improve systems, some better means to enforce good financial management of territories' finances also should be considered.

The report is a good one and focuses on what we see as some real problems in Federal oversight responsibilities in the territories. We appreciate the opportunity to offer our comments.

Sincerely,

S.D. Jones, Jr.,
U.S. Government Comptroller
for American Samoa

cc; Vic Lowe, Director
Far East Branch, Intern. Div.
GAO
P.O. Box 50187
Honolulu, Hawaii 96850

APPENDIX VI

United States Department of the Interior

OFFICE OF THE SECRETARY
U.S. GOVERNMENT COMPTROLLER FOR THE VIRGIN ISLANDS
P.O. BOX 7730
CHARLOTTE AMALIE, ST. THOMAS
U.S. VIRGIN ISLANDS 00801

December 4, 1981

Director, Far East Branch
International Division
United States General Accounting Office
P. O. Box 50187
Honolulu, Hawaii 96850

Dear Sir:

Thank you for the opportunity to review and comment on your draft report titled "The Federal Audit Function in the Territories Should be Strengthened". My comments, of course, will be from the viewpoint of a U. S. Government Comptroller in the Virgin Islands and do not necessarily represent the views of the Office of Assistant Secretary, Territorial and International Affairs. This office agrees with the findings and recommendations insofar as they relate to the Office of the U. S. Government Comptroller for the Virgin Islands.

In the early years of this office when both the Government and the population of the Virgin Islands were a fraction of the present size, the audit strength of the Comptroller's Office was more than double present levels. Federal dollars in the Territory were also a fraction of the present total. We had more staff to audit less and there were more frequent visits by auditors from other Federal Agancies. With the present limited staff, there is now only a slight chance that any particular Federal program will be audited. Most of the Federal audits we have done or know about have disclosed serious problems. The comparative rarity of Federal audits is undoubtedly a contributing factor in this situation.

Over the past several years, there has been a continuing dialogue between the various Comptrollers and the Office of the Assistant Secretary, Territorial and International Affairs (formerly Office of Territorial Affairs) concerning independence and conflicts of interest. Organizational changes were made to modify or alleviate potential conflicts of interest resulting from audits of systems developed or installed through the Technical Assistance functions. However, the changes only raised the organization level at which a conflict of interest would arise, but did not address organizational impairments on the independence of the Comptrollers. Although we do not feel that the independence of this office is threatened by the current management (all audit reports are issued without review by Territorial and International Affairs except for the Annual Report on the Territory's Financial Condition), we do recognize that the potential exists for the Comptroller's independence to be impaired by future managers. Transfer of the Comptroller's office to the Office of the Inspector General, as recommended, would be in accord with the various standards of independence applicable to this office and would remove the potential for future organizational impairments.

On the plus side, transfer to a professional audit organization would provide a wealth of audit expertise that could be tapped by this office, increasing the quality of audits performed and reports issued; enhance professional training of the staff by inclusion in the Inspector General's training program and rotational assignments; and alleviate some of the problems when recruiting for new staff members.

In the Virgin Islands Comptroller's Office, the contents of the annual report and its format have been decided by the various Comptrollers. There has been no consensus or direction, that we are aware of, on what information would be most useful to the Department and to the Congress. This confusion, together with the fact that the report is usually more than a year late because of the Territory's accounting problems, engenders the feeling that the report is unnecessary and a waste of resources which would be better used elsewhere. If the annual report was not required, more time would be devoted to more essential duties such as auditing Federal grant programs. Of course, we would not be able to expand grant audits to an acceptable level because of limitations on staff size.

It was the practice of this office to followup on audit recommendations until about four years ago. Followups were suspended because there was resistance to our followups from prior territorial officials and because of mandated work such as the annual report and other assignments of apparent higher priority. Subsequent to your audit, all reports issued have been referenced and procedures are presently being developed to reinstitute followups on all recommendations.

A modern accounting system together with effective internal audit capabilities rank near the top on this Territory's list of immediate needs. However, the Territory lacks the personnel expertise and financial resources to develop these systems. It's not likely they will be accomplished unless the Federal Government augments the meager resources available. The situation presents a golden opportunity for OTIA's technical assistance mission.

Your report, as it relates to this office, is fair and objective and implementation of the recommendations will improve the quality of our work and effectiveness of our reports.

Sincerely,

William C. Caton

William C. Caton
Acting Comptroller

United States Department of the Interior

U.S. GOVERNMENT COMPTROLLER FOR GUAM/TTPI/NMI
238 O'Hara Street
Suite 807, PDN Bldg.
P.O. Box BJ

December 4, 1981

Mr. Victor Lowe
Director, Far East Branch
International Division
General Accounting Office
P.O. Box 50187
Honolulu, Hawaii 96850

Dear Mr. Lowe:

In accordance with Mr. Eschwege's letter dated November 17, 1981, we submit our comments on the draft report entitled: The Federal Audit Function In The Territories Should Be Strengthened.

In summary, we have no objection to the transfer of the Comptroller Offices to the Office of the Inspector General (IG). If, however, Congress wishes to continue the current policy of requiring audit reports prepared and signed by the Comptrollers, we foresee no appreciable strengthening of the Comptrollers' independence and effectiveness by this transfer.

All audit reports are issued and signed by the Comptrollers without OTIA review and approval, except for the annual reports. Annual reports are submitted to OTIA in draft form for its review and comments. Because OTIA's responses to its review are only in terms of comments for the Comptrollers' consideration, they are treated the same as management comments. Accordingly, changes to the annual reports as a result of these comments are only made by the Comptrollers when they improve on the clear, concise, and factual reporting.

We do not concur with the statement that the transfer to the IG will increase the efficiency of the Comptroller Offices. Concerning, the Guam/TTPI/NMI Office, we are professionally competent to manage and conduct all types of audits. We are fortunate to have on our staff two CPAs and one attorney. We operate under an operating manual issued by OTIA, which includes GAO audit policies and principles. Finally, we prioritize our audits according to problem areas.

Our major problem, which is a cause to some of the deficiencies cited in your draft report, is our critical staff shortage. This condition, in turn, is created by the existing hiring freeze, which was placed upon us since April 1980. As a result, our Saipan Office is currently down to two auditors and our Guam Office to eleven auditors.

The following is our detailed comments to the draft report.

1. Page 6, line 1, Departmental Lines of Authority Relating to Comptrollers' Activities.

"Reviewing and approving the draft annual reports...." should be change to "Reviewing and commenting on the draft annual reports...."

This wording is in accordance with the Operating Manual for the Guidance of the U.S. Government Comptrollers, issued by OTIA on October 1, 1979. Page 22 of this manual states "Drafts of Annual Reports required by the Congress shall be submitted to the Office of Territorial Affairs (OTA) for review and comments."

The reason for the foregoing statement is expressed in the minutes of the Comptrollers Conference held at Harpers Ferry in September 1979, as follows:

"Because of this report's importance to current and future policy, and to budget decisions, the Draft needs to be reviewed by OTA before the report is formally released. The purpose of the OTA review is to assure consistency with current Departmental policy, and is not designed to thwart the Comptroller or inhibit his objectivity."

2. Page 6, Staffing of Comptroller Offices.

The reason for the low number of on board professional and support staff at May 15, 1981, for Guam/TTPI/NMI is because there has been no action taken on our Request for Personnel Action, SF Form 52, since April 1980. The last addition to our staff was on March 1980. As of November 30, 1981, our Saipan Office staff was down to two auditors and eleven for Guam. Details are as follows:

Position	Guam	Saipan	Total
Comptroller/Deputy/Auditor	11	2	13
Secretary/Clerk	2	1	3
	13	3	16

It is to be noted that the insufficient on board staff is the major cause of the problems cited in your draft report, concerning Guam/TTPI/NMI.

3. Page 17, Organizational Location Impairs Independence.

We do not agree that a request for a delay in issuing a report would jeopardize the auditor's independence.

Your example of an impairment by citing the TTPI National Historic Preservation Program shows on the contrary that the Comptroller does maintain independence, as the report was issued only on his decision. We are not aware of any instance of a delay in issuing a report, because of OTIA's request.

4. Page 18, Organizational Location Impairs Independence.

We do not agree that our independence was impaired concerning the TTPI FY 1978 Annual Report. As previously stated, the Operating Manual provides for OTIA to only review and comment on the draft annual reports. We, accordingly, considered its comments and made changes as we determined appropriate. We did not revise the entire report as implied in your draft report. Furthermore, we considered OTIA's comments as being no different than management's comments to our draft management audit reports. Changes as a result of management's comments are also made, as we deemed necessary. Therefore, if OTIA comments impair auditor's independence, management comment procedures, which I believe are applied by all Federal audit agencies, also impair auditor's independence. We do not believe that is so, because audit agencies view management comments as an important audit tool to assure a factual and unbiased report.

5. Page 20, Organizational Location Impairs Independence.

We have no objection to the transfer of the Comptroller Offices to the Office of the Inspector General. But we fail to arrive at your conclusion that this move will increase our effectiveness. We see no appreciable change as long as Congress wishes audit reports to be signed and issued by the Comptrollers rather than OTIA or the IG.

Our annual audit plans have been comprehensive. We have informed Congress several years ago that the cyclical audits have been discontinued in favor of audits of problem areas and application of audit priorities. We conduct audits under a written operating manual, which incorporates the audit policies and principles of your office and provides detailed audit procedures. We have written procedures on (1) issuing assignment authorization, assignment biweekly progress report, and biweekly status report on audit assignments; (2) performing the survey and developing an audit program and budget based on the results of the survey; (3) accomplishing the field work; and (4) summarizing the results of the audit and issuing an audit report.

The foregoing procedures have been supplemented with a training program, which has been broad and thorough. In view of the impracticability of participating in stateside training programs, except during home leave at which time we encourage our staff to attend, we developed our own training, centered around the local AGA Chapter Training Program and supplemented by several in-house seminars and workshops. (Note: Our AGA Chapter's recent receipt of a Chapter Competition award from its headquarters was mainly due to its extensive local education program).

In summary, our office has the professional competence to do the things cited on page 20 of your draft report. In instances where we did not meet certain standards it is because we were not given the staff resources to accomplish them, and also we prioritized audit activities without jeopardizing our independence. It is also to be noted that our competence is substantiated by two CPAs and one attorney who are a part of our small staff.

6. Page 22, Appearance of Personnel Conflicts of Interest Unavoidable.

a. Your statement that an auditor who was closely related to an individual employed by an organization being audited was assigned to review the TTPI CETA operation is misleading. The auditor was not assigned responsibility for auditing the TTPI CETA operation. Also the statement that the auditor was assigned despite his request that he not be is incorrect.

The auditor's initial assignment on the CETA audit was to reference the draft audit report. A prerequisite to an objective reference process is for the referencer to not be involved in the field audit work. The auditor was assigned this responsibility because other staff members had participated in the audit field work and he had not. Although we were aware of the auditor's relationship with the Acting CETA Director, we did not believe his independence would be affected or could be logically questioned by others, because his duties merely consisted of insuring that information contained in the draft report was supported by the audit working papers. He was not involved in any field audit work. Moreover, contrary to the implication in your draft report, the auditor did not voice any objections to this assignment.

Unfortunately, there were some differences in the data uncovered during the referencing process. The auditor in question was assigned responsibility for resolving the differences because he was the only staff member available at that time. However, he subsequently reported to his supervisor that he should be relieved of his assignment because the differences could not be resolved without additional field work and discussions with the Acting CETA Director. Contrary to your implication that the auditor was removed after repeated objection, he was reassigned upon the initial notification to his supervisor of potential problems on independence. Responsibility for resolving all differences was thereafter assigned to two other auditors.

In conclusion, the foregoing situation more appropriately relates to a previously discussed staff shortage problem in the Saipan Branch Office and the resultant effect of this shortage.

b. We do not agree that our independence was impaired by undertaking technical assistance. Prior to the reassignment of the technical assistance staff from the Comptroller's Office, staff members who were selected to this task were assigned on a permanent basis to avoid a conflict of interest. Also, they reported directly to the Comptroller.

7. Page 24, External Factors Also Impair Independence.

The reduction of the scope of audit because of the limited staff resources is not correct. Once the scope of audit is determined, normally at the end of the survey phase of the audit, it is reduced when a potential problem area, which was uncovered during the survey phase and subsequently subjected to an indepth review during the verification phase, did not materialize into a reportable finding. The scope is also reduced when it is determined that a review of a lesser number of planned selected documentation is sufficient to substantiate a finding.

8. Page 26, Effectiveness of Audit Function Needs to be Improved.

We do not agree with your statement that if the IG is designated as the cognizant auditor under a single audit concept, there would be an organization-wide coverage of Federal grant programs. During the period of your audit, the IG was the cognizant auditor, who submitted audit requests to our Office. We had acknowledged all of his requests, except in recent months when staffing became critical.

Furthermore, the single audit concept requires a thorough comprehensive audit of the entire organization--greater even in detail than the annual audits done in the past. It requires a great deal of audit resources. Given the IG's responsibilities for programs of billions of dollars in the States, it is unlikely that it would devote substantial resources to single audits of the several territories. The position of the IG gives it no edge on the single audits. Given the staff resources, the Comptrollers could do them as well.

9. Page 30, Required Annual Report Is Not Clearly Defined.

We disagree with the inference that with more audit resources the Comptrollers could have expressed an opinion on the financial statements. No positive opinion could have been expressed on any of the financial statements presented by the three governments under our audit jurisdiction, because certain generally accepted standards were not met. In one instance the general ledger was not closed because of questionable account balances. We would have requested for additional staff, if the financial records were in a condition to render a positive opinion.

10. Page 30, Federal Grant Audits are Generally Not Performed.

a. Your statement that only 10 grant audits were conducted in the four territories from October 1, 1978 through May 30, 1981 is understated. Our office alone performed 26 grant audits during that period. This total does not include the EDLF audits and the comprehensive Federal Grant Management audits for Guam and TTPI. Additionally, your report gave evidence that we did considerable Federal grant audit work, as it refers to two of them on pages 17 and 22.

We did not perform a grant management audit for NMI at the time when the Guam/TTPI audits were conducted, because NMI was a newly established government and the grant management section was only at the organizational stage. Subsequent attempts to perform a management audit of Federal grants for NMI was unsuccessful because of the critical shortage of staff who were assigned to higher priority audits.

b. Your statement that other audit organizations could review Federal grant programs, but they are precluded from doing so for many reasons, contradicts your statement on page 37. You state on page 37 that "Guam's internal auditor...is committed to performing Federal grants only." In fact, while your audit was underway, the internal auditor was performing 36 CETA subgrant audits.

11. Page 31, Follow-up on Audit Recommendations is Infrequent.

We are quoted as saying the lack of report follow-up was primarily due to the requirement to do the annual audit. This is a misquote. We cited higher priority work, but we referred to the management audits rather than the annual. Also, we made a judgemental decision at that time to place a higher priority to audits of significant problem areas than to follow-up audits.

Sincerely yours,

BEN T. FUKUTOME
U.S. Government Comptroller
for Guam/TTPI/NMI

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

DEC 15 1981

Mr. W. D. Campbell
Acting Director
Accounting and Financial
Management Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Campbell:

We have reviewed your draft report, "The Federal Audit Function in the Territories Should Be Strengthened." We concur whole-heartedly with the title, but believe that recommendations contained within that report would not produce the desired results.

The Comptrollers for the Virgin Islands, American Samoa, Guam, the Northern Marianas, and the Trust Territory of the Pacific Islands currently have the authority to audit all accounts of the territorial governments. This fact is an integral aspect of the Federal-territorial relationship, and it is important for the Federal Government, which has a wide range of financial and other interests in the territories, to protect its broad audit capabilities in the territories. Those broad capabilities are protected within current institutional arrangements. We have the following comments on your specific recommendations:

1. GAO recommends that the Director, Office of Management and Budget (OMB) designate the Department of the Interior's Office of the Inspector General (OIG) as the cognizant Federal audit agency in the territories under the single audit concept.

GAO has failed to take into consideration the essential difference between the function of the Comptrollers and the function of the Inspector General. Public Law 95-452 sets forth the departmental audit and investigation responsibilities of the Office of Inspector General, and Public Laws 90-497 and 95-134 set forth the responsibilities of the Government Comptrollers to audit all accounts of the territorial governments. One is a purely Federal function, to audit Federal accounts and investigate the activities of Federal officials; the other is an aspect of the special Federal-territorial relationship in which Federal officials responsible for that relationship can look into non-Federal financial accounts of the territories. The Comptrollers have a wider authority than the Office of the Inspector General, in keeping with the broad base of financial support that is contributed to the territories by the Federal Government.

Territorial governments and the U.S. Congress would be likely to resist the expansion of the Inspector General's authority to include audit authority over territorial accounts. This sensitive type of intrusion into internal territorial affairs can be accomplished effectively only when the auditors report to a Federal official who is responsive to Federal and territorial political concerns. =or a Federal official who has no cognizance over territorial affairs to exert authority in auditing the non-Federal books of the territories would be seen as colonialistic by the territories. If the Inspector General's office tried to handle territorial audits, it would find itself in a number of difficult political situations which it would not be equipped to handle. In the long run, however, it is the Federal relationship to the territories that would be harmed.

Transfer of the Comptrollers from the office of Territorial and International Affairs (TIA) to the Inspector General could reduce the audit coverage in the territories because of the disproportionate number of auditors in the territories versus the remainder of the Department. The Inspector General would be likely to conclude that use of the Comptroller's audit staff elsewhere in the Department would lead to higher "payoff" for the Department as a whole. The Inspector General is required to make these types of decisions in approaching his job.

The Comptrollers, under TIA, are assigned on a permanent basis to monitor funds in the territories as well as to assess the political and social climate of the area. It is unrealistic and impractical to think that this function can be performed adequately by auditors traveling to the territories periodically. Local resentment would be assured against "strangers" coming in for just a short period to pass judgement on the territories activities.

2. GAO recommends that the Secretary of the Interior direct the Inspector General to establish formalized audit report follow-up systems in Interior's territorial audit offices.

We agree that a great deal can be done to improve, and streamline, the reporting functions of the Government Comptrollers. The Inspector General now has the authority to investigate the performance of the Comptrollers, since they are Federal officials. Recommendations made by the Inspector General for improved performance by the Comptrollers should be carried out through their superior, the Assistant Secretary, Territorial and International Affairs. We would be happy to work with the office of the Inspector General in developing guidelines for improving the performance of territorial auditors.

3. The GAO recommends that the Secretary of the Interior develop and submit to the Congress a comprehensive technical assistance plan, including a determination of what resources are needed, to establish effective financial management systems for the Governments of American Samoa, Guam, the Northern Mariana Islands and the Virgin Islands.

TIA agrees with the GAO's recommendations that increased Federal technical assistance is desirable. However, transferring the Comptrollers to the Inspector General's Office would not aid in the accomplishment of the desired result. Because the Comptrollers are in the territories on a full-time basis, they are available to provide guidance to the territories on matters of financial management.

In many cases, technical assistance is a follow-up to the findings of an audit. Technical assistance picks up the recommendations of the audits, and assigns the appropriate experts to deal with solving the problems. In order for technical assistance to be effective, however, there must be ready lines of communication between the auditors and the technical assistance personnel so that recommendations may be implemented as expeditiously as possible. This is most efficiently done if the auditors and technical assistance personnel report to the same office (TIA). The extent of compliance with audit recommendations at local levels would be diminished if auditors were not connected to the office directly responsible for the oversight of the territories.

4. GAO recommends that the Secretary of the Interior report to the Congress on the resources needed to assist the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau in establishing their financial management systems' requirements.

We have consistently offered advice and technical assistance to the governments of Micronesia as they have developed their financial management systems. Because of facilities that are available in Saipan, many of the financial records and most of the accounting of the Micronesian governments are managed in Saipan, through contacts between the governments and Trust Territory headquarters. Until appropriate facilities are in place in the Micronesian capitals, it is likely that financial management will continue to be handled in Saipan. Congress has asked the General Accounting Office to assess the Micronesian government's transition needs, and we will be happy to assist in GAO's study.

Sincerely,

Pedro A. Sanjuan
Assistant Secretary
Territorial and International Affairs

OFFICE OF THE GOVERNOR
PAGO PAGO, AMERICAN SAMOA 96799

PETER TALI COLEMAN
Governor

TUFELE LI'A
Lt. Governor

December 16, 1981

Serial: 1498

Victor L. Lowe
Director
United States General Accounting Office
Far East Branch - International Division
P. O. Box 50187
Honolulu, Hawaii 96850

Dear Mr. Lowe:

This is in reply to your letter of November 17, 1981 inviting comments on the draft of the proposed report by the United States General Accounting Office on the need to strengthen both the Federal audit function and internal audit capabilities in the United States territories.

First, we concur generally with the proposed recommendations to the Congress, Director of the Office of Management and Budget, and Secretary of the Interior concerning the Federal audit function in American Samoa. We have no objections, whether established by legislation or other appropriate means, either to the transfer of the audit authority and staff to the Office of the Inspector General within the Department of Interior; a requirement that a comprehensive annual financial report be submitted as outlined and, if funded by the Federal government (estimated at $100,000 annually) audited independently; or a requirement that written statements of actions on Federal auditor recommendations be submitted within 60 days.

With regard to a comprehensive annual financial report, we point out that we have been developing such a report over recent years and anticipate a report for fiscal year 1981 that, for the first time, conforms for the most part to accounting principles of the Municipal Finance Officers Association and National Council on Governmental Accounting. This report will be the basis for building future statistical and record data as may be required.

We also support and welcome the development by the Secretary of the Interior of a comprehensive technical assistance plan that will enhance the improvement of the financial management system of the American Samoa Government.

We further agree generally with the proposed recommendations on strengthening internal audit capabilities through a followup system to assure corrective action on all audit reports is taken as appropriate, broadened scope of audit coverage, and essential staff size, expertise and audit independence. This Government has already initiated the following steps in these regards.

1. Follow-up System. A liaison officer in the Governor's Office has been designated to ensure that adequate follow-up is taken on all Federal, territorial and independent audit reports that are issued. The liaison officer coordinates with all agencies involved. Findings and recommendations reported are expected to be acted upon within a specified period of time (30 days, with up to a 60-day extension if needed) to correct deficiencies noted. In addition, the Territorial Auditor has provided for some time a similar follow-up system on all audits which his office makes.

2. Scope of Audits. The scope of the audits conducted by the Territorial Auditor has been expanced into three separate areas: operations, financial compliance, and federal grants. Currently, work is being conducted to improve the economy and efficiency of various operational areas and to ensure financial compliance in day-to-day activities of the Government. Federal grants audit utilize the single audit concept of an organization as a whole. This approach will enable the Auditor to eventually produce reports on the internal workings of the entire Government.

3. Staff Size. The Territorial Auditor's staff has been increased by six new positions within the past two years and now includes 14 staff auditors and two secretarial and clerical positions. This increase includes three new supervisory positions in fiscal year 1982, which will enable examination in greater detail of areas of concern within the Government.

4. Education. The Territorial Auditor's staff currently has three auditors with four-year college degrees and four auditors with a two-year college education. At the present time, an effective on-island education program is also in process, in which six staff members are attending the American Samoa Community College on a part-time basis. In addition to this formalized education, regularly scheduled in-house training programs are conducted, utilizing materials offered by the AICPA, CIA, and the Council of State Governments. Both local programs will improve the educational qualifications and professional capability of the staff.

5. Auditor Independence. With respect to auditor independence, no auditor is knowingly assigned to an audit in which independence may be questioned. It is felt that each and every auditor understands the importance and is capable of separating personal and actuality of independence, and we believe the system is functioning very well from this perspective.

Sincerely,

Peter Coleman

PETER TALI COLEMAN
Governor

cc: Director, Administrative Services
Territorial Auditor

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

DEC 22 1981

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

Dear Mr. Anderson:

This letter is in response to the General Accounting Office draft report on the strengthening of the Federal audit function in the territories.

The report recommendation pertaining to the Office of Management and Budget relates to audit cognizance for the U.S. Territories and the Trust Territory of the Pacific Islands. I know that Interior has taken the lead in attempting to resolve audit problems in the Virgin Islands and it seems appropriate that they should continue in this oversight role. Indeed, this is consistent with the recommendation at the beginning of Chapter 3. A number of discussions have been held between OMB and the Department of the Interior and arrangements have been made for Interior to assume responsibility for Federal audits of the territorial governments.

We would, therefore, have no problem designating the Department of the Interior as the cognizant Federal audit agency. If, however, the audit responsibility is not transferred to Interior, it may be more logical for OMB to consider one of the agencies whose grants to the territories are more sizable than Interior's.

We appreciate the opportunity to review the draft report.

Sincerely,

~~Edwin L. Harper~~
Deputy Director

cc: Mr. Victor Lowe

THE VIRGIN ISLANDS OF THE UNITED STATES
OFFICE OF THE GOVERNOR
CHARLOTTE AMALIE, ST. THOMAS 00801

December 22, 1981

Mr. Victor L. Lowe
Director
United States General Accounting Office
Far East Branch - International Division
P. O. Box 50187
Honolulu, Hawaii 96850

Dear Mr. Lowe:

I have received your letter dated November 17, 1981 transmitting for review a draft report on the need to strengthen the Federal audit function in the territories. The report contains the following salient points:

1. Independent internal audit division be improved in terms of manpower and expertise to perform the entire spectrum of audit activities (financial, compliance, audit report follow-up).

2. Remove the federal comptrollers from office of Territorial Affairs to Office of the Inspector General, Secretary of Interior.

3. Prohibit the auditing of non-federal programs by the U. S. Comptrollers. All local government audits, including the Annual Report, to be done by Certified Public Accountants.

4. Require the certified Annual Report to be submitted no later than 120 days after the close of the fiscal year.

5. Require response to audit findings of the U. S. Comptroller no later than 60 days after report is issued.

6. Proposes the Congress enact comprehensive technical assistance plan to assist territories in developing effective financial management systems.

I perceive no problem with the proposed recommendations, so long as item 6 is adopted and includes funds for the retraining of existing and proposed staff of the Internal Audit Division and EDP and Accounting Staff of the Department of Finance.

I support the points outlined in the report on the condition that technical assistance is provided and with adequate federal matching funds to implement the recommendations.

Sincerely yours,

Juan Luis
Governor

APPENDIX VI

-ccc

Territory of Guam

OFFICE OF THE GOVERNOR
AGANA, GUAM 96910
U.S.A.

PAUL M. CALVO
Governor

29 DEC 1981

Mr. Victor L. Lowe
Director
U.S. General Accounting Office
Far East Branch-International Division
P.O. Box 50187
Honolulu, HI 96850

Dear Mr. Lowe:

I have reviewed your draft report on the strengthening of the federal audit fuction in the territories paying particular attention to Chapter 5. My comments are as follows:

1. To concur in the recommendation that an audit follow-up system be established to assure that actions recommended by federal and independent audits are implemented and followed through. This follow-up system would be implemented by our Bureau of Budget and Management Research.

2. I concur in the recommendation that our internal audit function be increased. However, there are financial constraints on the ability of the government to increase the size and capability of its audit staff at this time.

3. I take exception to the statements at page 37 of the draft concerning the lack of capability of Guam's Internal Audit Division to plan and supervise preparation of final audit reports. The Internal Audit Division of the Bureau of Budget and Management Research is fully qualified to perform all necessary government audits.

4. Although in the past our internal audits have been basically limited to federal grants audits, the Bureau of Budget and Management Research, beginning in fiscal year 1982, initiated audits of certain government of Guam operations and will continue to perform audits of local government operations.

Sincerely,

PAUL M. CALVO

January 6, 1982

GAO DRAFT REPORT:
"THE FEDERAL AUDIT FUNCTION IN THE TERRITORIES
SHOULD BE STRENGTHENED"

The Department of State wishes to offer the following comments on the draft report. This response has been coordinated with the Office for Micronesian Status Negotiations. The comments are keyed to the pages of the draft report:

Page i.

In the second paragraph, while it is true that the Federal audit presence in the freely associated states of Palau, the Marshall Islands and the Federated States of Micronesia will be different than the present organization in the Federal Comptroller's Office on Guam, it is not necessarily true that the Federal audit presence will be "diminished".

In the second and third paragraphs, it appears sensible to transfer control of the statutory audit function for the U.S. territories to the Office of the Inspector General of the Department of the Interior. Control of the Federal audit function for the freely associated states will, as noted later in the report, be segregated from the Department of the Interior and will reside with the structure this Administration intends to establish to manage the free association relationship.

Page v.

The Department of State agrees with the recommendation to the President's Personal Representative for Micronesian Status Negotiations and can confirm that the Administration's intentions with respect to the negotiation of a subsidiary agreement implementing Section 233 of the Compact of Free Association are fully consistent with this recommendation. However, the language which recommends the development of "a Federal audit capability in the new governments" might be more accurately phrased as "a Federal audit capability with respect to the new governments."

Page 13.

In the second paragraph, the second sentence should begin by stating that "The Covenant will not become fully effective..." since many of the provisions of the Covenant (PL 94-241) are already in effect.

GAO NOTE: For protocol purposes, we requested comments on our recommendation to the President's Personnel Representative for Micronesian Status Negotiations though the Secretary of State.

Page 15.

The same comment as stated above for page v.

The Department of State considers the draft report a generally excellent document and regrets the delay in the submission of this response. The Department would appreciate receiving a copy of the final version of this report. Finally, the Office for Micronesian Status Negotiations has informed the Department that the GAO will be consulted in the drafting of the subsidiary agreement to Section 233 of the Compact of Free Association.

James L. Buckley
Under Secretary of State for
Security Assistance, Science and Technology

APPENDIX VI

TRUST TERRITORY OF THE PACIFIC ISLANDS
OFFICE OF THE HIGH COMMISSIONER
SAIPAN, CM 96950

CABLE ADDRESS
HICOTT SAIPAN

JAN 21 1982

JAN. 1 2 1982

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

Dear Mr. Eschwege:

We submit herewith our comments on the draft report, "The Federal Audit Function in the Territories Should be Strengthened". Listed below are responses to the major report recommendations, followed by a specific comment applicable to the Trust Territory.

<u>"Federal Audit Presence Should Continue"</u>

We concur.

<u>"Audit Function Needs to be Strengthened"</u>

a. Transfer statutory audit function to DOI Inspector General.

Response to recommendation to transfer auditors to DOI Inspector General:

We disagree with this recommendation because it would likely lead to a reduction in audit effort in the territories, defeating the principal recommendation of the audit report. This is because the present audit staff of the U.S. Controllers, in relation to dollars to be audited, is considerably greater than that of the DOI Inspector General. Although this ratio is justified in our opinion by geographic and political complexities, it is likely that the Inspector General, with department-wide responsibilities, would see otherwise. A better solution is to assure organizational independence of the auditors within OTIA. This can be done by establishing reporting relationships that separate the auditors from those directly responsible for territorial operations. If the two reporting lines merge at the level of the assistant secretary, a Presidential appointee, audit independence should be sufficient for professional standards.

b. Require annual financial statements to be prepared by territorial governments and relieve Federal Comptroller of annual report requirement.

We concur.

c. Require territorial governments to arrange independent audits of the annual financial statements.

For the Trust Territory this would impose a significant new financial burden at a time when operating budgets have been cut sharply. We have no conceptual objection if the function were funded. However, considering that more than 90 percent of governmental budgets in the Trust Territory are Federally funded, it would seem that the primary external audit responsibility would best be continued by DOI auditors.

A principal reason in the draft report for this recommendation is to free up Federal auditors to audit categorical Federal grants, which amounts to an upside down approach to audit emphasis. Federal grants approximate $30 million a year in the Trust Territory. Basic operating grants are $70 to $90 million. The CIP and other special funds, which have earned even less audit scrutiny than Federal categorical grants, total more than $250 million over the five-year plan.

At the same time, we concur in the recommendation to make DOI the cognizant audit agency for Federal categorical grants. This is a cost effective move for both the auditors and the grantee.

Some clarification is needed in the report in respect to the new governments of the Trust Territory. Each of the four new governments has constitutional provisions for public auditors but they are in varying degrees of implementation. Any elimination of external audit support by the DOI auditors should include a transition period long enough to allow the public auditors in each government to be fully functioning. Furthermore, it is not clear in the report whether a fully functioning public auditor "comparable to the U.S. Government Comptrollers" (page 15) would satisfy the recommendation for an independent audit. If public auditors and outside independent auditors are both required, then the financial burden would be extreme.

d. Establish report follow-up systems in the territorial governments.

We concur.

"More Technical Assistance"

We concur.

General Comment Regarding Auditability of TTPI Records

On page 12 of the draft report, it is stated that "the Comptroller from Guam/TTPI/NMI has indicated that TTPI's financial affairs are not auditable." Like most sweeping generalizations, this is not strictly true. TT's Financial Management System consists predominantly of fund ledgers which account for authorizations, obligations, disbursements, accrued expenditures and fund balances by activity in object class detail. These ledgers are auditable and have in fact been frequently audited by Federal auditors of categorical grants. A recent example is the CETA audit conducted by the Comptrollers from Guam/TTPI/NMI. The actual problem in the system has been the lack of reliable balance sheet information. This problem is being corrected currently with the assistance of an outside CPA firm.

Thank you for the opportunity to review and comment on the draft report. In the main it is a constructive and forward looking document.

Sincerely,

Janet McCoy

Janet J. McCoy
High Commissioner

cc: Director, Far East Branch, International Divison

(911532)

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