

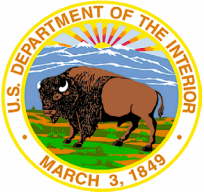
U.S. Department of the Interior Office of Inspector General

Evaluation Report

*OVERSIGHT AND FOLLOW-UP ON
AUDIT FINDINGS AND RECOMMENDATIONS,
PERTAINING TO INSULAR AREA GOVERNMENTS'
USE OF FEDERAL FUNDING*

REPORT NO. 2003-I-0011

FEBRUARY 2003



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Arlington, VA 22203

EVALUATION REPORT

February 28, 2003

Memorandum

To: Deputy Assistant Secretary for Insular Affairs

From: Elaine T. Weistock *Elaine T. Weistock*
Director for Quality Assurance and Management Control Reviews

Subject: Final Evaluation Report on Oversight and Follow-up on Audit Findings and Recommendations Pertaining to Insular Area Governments' Use of Federal Funds (No. 2003-I-0011)

This report presents the results of our evaluation of oversight and follow-up on audit findings and recommendations that pertain to insular area governments' use of Federal funds. The evaluation covered insular area audit report findings that cited monetary amounts or cost exceptions related to Department of the Interior (DOI)-funded programs that were included in audit reports issued pursuant to the Single Audit Act. We conducted this evaluation in response to concerns expressed by DOI officials regarding the large number of audit findings and recommendations that remained unimplemented and unresolved. Appendix 1 provides a discussion of the background and scope of the evaluation.

We found that DOI needs to promote efforts to subject funds that DOI provides to insular area governments to Federal regulations so that DOI can ensure proper use of the funds and resolve audit recommendations and findings pertaining to the misuse of DOI funds. We also found that the Office of Insular Affairs (OIA) needs to improve its processing of insular area external audit report findings that are referred to it for resolution.

In the December 19, 2002 response (Appendix 2) to the draft report, you concurred with the report's three recommendations. Based on the response and additional information provided by OIA, we consider Recommendation 1 resolved and implemented and Recommendations 2 and 3 resolved but not implemented (see Appendix 3). Accordingly, Recommendations 2 and 3 will be referred to the Assistant Secretary for Policy Management and Budget for tracking of implementation.

The legislation, as amended, creating the Office of Inspector General requires that we report to Congress semiannually on all audit reports issued, actions taken to implement our audit recommendations, and recommendations that have not been implemented.

We appreciate the cooperation shown by OIA staff during our review. If you have any questions regarding this report, please call me at (703) 235-1425 extension 110.

Results of Evaluation

Overview

External audit report findings pertaining to insular area governments' use of Federal funds provided by DOI were not adequately addressed. This condition occurred because most of the financial assistance provided to the insular areas by DOI is not subject to Federal control and because DOI has not developed adequate audit follow-up procedures. We reviewed 16 report findings of which 12 findings, with questioned costs of \$25.5 million, were not resolved because the funding was not subject to regulations that govern the use of Federal financial assistance. Also, 4 of the 16 findings that we reviewed (with questioned costs of \$1 million) had \$100,000 of questioned costs that had not been resolved, even though the funding was subject to Federal control.

Processing Single Audit Reports

The OIG receives copies of external (single) audit reports from the Federal Audit Clearinghouse, the organization the Office of Management and Budget designated to receive these reports from Federal award recipients. After receipt, the OIG summarizes and refers findings to the appropriate DOI bureau for audit follow-up action. For insular area findings pertaining to DOI-funded programs, the OIG usually sends reports to the Office of Insular Affairs (OIA), an Office of the Secretary component that has responsibility for fostering the efficiency and effectiveness of insular area governments and for providing technical and financial assistance to these governments. If OIA (or other bureau or office to which the report has been sent) does not resolve the findings, OIG refers the matter to DOI's Management Control and Audit Follow-up officials, Office of Financial Management (under the Deputy Assistant Secretary for Budget and Finance). These officials help resolve findings and monitor and track corrective action implementation.

Entitlement-Type Funding

Findings in 12 of 16 external audit reports¹ reviewed had not been resolved or monitored for corrective action implementation because the findings pertained to the use of entitlement-type

¹ External audit reports included in our review were conducted in accordance with the Single Audit Act. We refer to these audit reports as "external" because they were prepared by independent (non-DOI, Office of Inspector General) auditors. Under the Single Audit Act and Office of Management and Budget Circular A-133, the Federal Government established a "coordinated" approach to the audit of recipients of Federal financial assistance, based on a designated threshold of monetary aid. The Circular provides for independent auditors to review all Federal financial assistance provided to the recipients and to prepare a consolidated audit report.

funding. The 12 sample monetary findings, with questioned costs of \$25.5 million, which were not resolved or monitored for corrective action implementation, included the following:

- Documentation was not maintained on expenditures of \$23,593,062,
- Purchases of \$32,232 had not been properly authorized, and
- Expenses of \$447,172 were unallowable.

Other than sending letters to insular area government officials, inquiring about the status of the findings, we found that OIA took no further action to resolve these 12 findings. OIA said that it had not followed up on these matters because the funding sources cited in the findings were subsidies, compact funds or other types of entitlement-type funding over which OIA had no enforcement authority under Federal financial assistance regulations.

In our opinion, unless legislative provisions and the terms and conditions of financial assistance are changed, there is little value in DOI being held responsible for audit findings and recommendations related to the misuse or inappropriate use of Federal funds over which it has little control. Moreover, with a backlog of about 600 external audit report findings that were unresolved as of May 2002, most of which, we believe, are not subject to Federal control, DOI may experience difficulty in providing oversight to the few audit reports' findings over which it can exercise control. Nonetheless, we believe that OIA, as the DOI organization responsible for "assist[ing] the islands in developing more efficient and effective government," should exercise greater oversight of these findings by encouraging resolution and monitoring corrective action implementation²

OIA officials said that DOI was engaged in negotiations to strengthen the Government's control over Federal financial assistance to the Compact states. If successful, the negotiations should enable DOI to exercise the provisions of 43 CFR Part 12, which provides for the imposition of sanctions for noncompliance with the terms of Federal financial assistance.

In recognition of the prevailing limitations on DOI's control over insular area government use of DOI financial assistance, OIG and DOI's Management Control and Audit Follow-up personnel reviewed open external audit report findings and eliminated from

² The text in quotations was taken from OIA's mission statement in its Annual Performance Plan.

Audit Follow-Up Procedures

DOI's audit tracking system those findings involving funds over which DOI currently has limited enforcement authority.

OIA has not established an effective framework for processing external audit reports and report findings. Although OMB Circular A-50 requires Federal agencies to "maintain a complete record of actions taken" with regard to audit findings and recommendations, OIA did not –

- Establish audit finding and recommendation tracking procedures,
- Adequately document its communications with insular area government officials with regard to requesting report responses and corrective action plans and monitoring corrective action implementation,
- Establish time frames for completing audit follow-up tasks, or
- Clearly define the roles of its audit liaison and program officials with regard to their audit follow-up responsibilities.

Four of the selected findings that we reviewed pertained to Federal funding over which DOI did have authority to resolve and ensure proper use, of which three findings pertained to funds provided by OIA, as follows:

- OIA said that it resolved one report's findings based on documentation submitted by the insular area government. The findings, questioned costs of \$596,151, pertained to insufficient documentation on the award and selection of a contractor. OIA maintained documentation to show the basis for its having considered the findings resolved.
- One finding was closed based on a negotiated settlement related to a questioned cost of \$234,194. The finding pertained to the premature release of a retainer on a construction project, which was not completed. In support of closure, OIA provided a copy of a settlement agreement between the construction project contractor and the insular area government that provided for the payment of the contractor's claim. We considered this finding adequately resolved, even though OIA, in our opinion, should have prepared a summary to explain the resolution in terms of the amount of the questioned cost.

- One report remained open. OIA had communicated with the insular area government regarding resolution; however, OIA had taken no action to recover or offset \$105,835 of \$205,835 of undocumented costs that the Federal Government had reimbursed. OIA had determined that \$100,000 of questioned costs should be reinstated as allowable. Prior to completion of our evaluation fieldwork, OIA had not provided our staff with sufficient documentation on its basis for considering the finding partially resolved.

Our sample transactions did not include cases in which OIA recovered questioned costs. However, an OIA official informed us that his office has taken action to recover DOI funds that were not used for their intended purpose. To illustrate this point, the OIA official provided a copy of correspondence, showing that OIA requested reimbursement from an insular area government for an advance payment for a piece of equipment, which the insular area government did not purchase. The official also provided a copy of a check from the insular area government, which reimbursed the U.S. Treasury for the advance.

Improvements Needed in Single Audit Report Processing, Government-wide

External audit coordinators at all of the other Federal agencies we contacted said that they maintained a system or process for monitoring the resolution and tracking of the implementation of single audit report findings and that they documented their disposition of audit findings. We did not, however, verify that they maintained such systems or that the systems worked effectively.

In the June 2002 report, “Single Audit Actions Needed to Ensure That Findings Are Corrected” (No. GAO-02-705), the General Accounting Office (GAO) discussed single audit report follow-up at the Departments of Education, Transportation, and Housing and Urban Development. GAO concluded that “each agency had procedures for obtaining and distributing the audit reports to appropriate officials for action. However, they often did not issue the required written management decisions or have documentary evidence of their evaluations of and conclusions on recipients’ actions to correct the audit finding. In addition, program managers did not summarize and communicate information on single audit results and recipient actions to correct audit findings to agency management.”

We consider the results of GAO’s review of other Federal agencies’ single audit report follow-up practices to parallel the

results of our review. In general, we found that DOI officials had not adequately documented the basis for their determinations that audit findings had been resolved or summarized the actions taken to monitor and correct audit findings.

Recommendations

We recommend that the Deputy Assistant Secretary for Insular Affairs:

1. Support efforts to strengthen Federal controls over DOI financial assistance provided to insular area governments.
2. In conjunction with the Deputy Assistant Secretary for Budget and Finance and the OIG, develop and implement procedures for monitoring (apart from Office of Management and Budget Circular A-50 tracking and resolution requirements) external audit findings that pertain to Federal funds that are not subject to 43 CFR Part 12 enforcement provisions.
3. Develop and implement procedures for the assignment of responsibility for and the processing of external audit report findings to ensure that appropriate and timely actions are taken and documented.

OIA Response and OIG Reply

In the December 19, 2002, response to the draft report (Appendix 2), the Deputy Assistant Secretary for Insular Affairs concurred with the report's three recommendations.

Based on the response and additional information provided by OIA, we consider Recommendation 1 resolved and implemented, and Recommendations 2 and 3 resolved but not implemented (Appendix 3).

Background

Since 1931, DOI has been assigned certain responsibilities for providing economic and financial assistance to insular area governments, which consist of the territories: the U.S. Virgin Islands, American Samoa, and Guam; the Commonwealth of the Northern Mariana Islands; and the Freely Associated (or “Compact”) States: the Federated States of Micronesia, the Republic of the Marshall Islands, and the Republic of Palau. DOI’s Office of Inspector General (OIG), in particular, has been assigned responsibility for audit oversight of the insular areas. The 1982 Insular Areas Act (Public Law 97-357) transferred to DOI’s OIG audit authority that previously was assigned to Federal Government Comptrollers for the four major insular areas (the territories and the Northern Mariana Islands). Also, under the Compacts of Free Association, DOI’s OIG was designated the Federal Government’s representative with regard to audit oversight of the Compact states. Although DOI has responsibility for maintaining Federal audit oversight and provides funds for purposes such as economic development and technical assistance, the insular area governments are largely self-governing.

Much audit attention has been focused on deficiencies in the financial management practices of the insular area governments. In Budget Justifications and Annual Departmental Reports on Accountability, DOI has acknowledged the “long-standing financial and program management deficiencies” and “poor financial controls” that undermine the economic well-being of insular area governments. Recently, we issued a report “Management Challenges for Insular Area Governments, an Opportunity for Improvement” (Report No. 2002-I-0017) dated March 2002, which catalogued the deficiencies in the insular area governments’ financial management practices that have been identified by the OIG in its audit reports. Based on the report’s findings, the OIG, in its March 2002 semiannual report to the Congress, said, “The state of financial affairs in the Insular Areas is, in a word, disturbing.” The report recommended that the insular area governments implement specific corrective actions to improve overall financial management, enhance revenue collections, control expenditures, and improve general program operations.

In fiscal years 1997 through 2001, the OIG processed 31 insular area external audit reports with monetary findings of \$48.5 million of DOI funds. Although these reports also contained findings pertaining to funding provided by other Federal agencies, we do not know the total amount of monetary findings that is attributable to other Federal agencies because we do not maintain records of findings pertaining to non-DOI funds.

Guidance on Audit Follow-up

Federal regulations provide for the audit of recipients of Federal assistance, establish remedies for the misuse of Federal financial assistance, and require Federal agencies to resolve and assure the implementation of audit recommendations. Specifically:

- 43 Code of Federal Regulations (CFR) Part 12 provides for the audit of Federal financial assistance, such as the grants, loans, and contracts. This Regulation also contains provisions for recipients that “materially” do not comply with the terms of an award of Federal financial assistance. According to the Regulation, an awarding agency can impose sanctions, including temporarily withholding cash payments, disallowing (that is, denying the use of) funds, suspending or terminating the award, or withholding further awards for noncompliance with the terms of the Federal financial assistance. Also, the Regulation states that any funds paid to a recipient of Federal financial assistance, in excess of the amount to which the recipient is entitled, constitutes a debt to the Government and provides for the recovery of such funds.
- The Office of Management and Budget’s (OMB) Circular No. A-50, “Audit Followup,” requires Federal agencies to “establish systems to assure the prompt and proper resolution and implementation of audit recommendations” and requires the systems to “provide for a complete record of action taken on both monetary and non-monetary findings and recommendations.”

Although OMB Circular A-50 provides for audit follow-up, including resolution, corrective action, and corrective action tracking of all audit findings regardless of funding source, it does not authorize DOI to exercise management control over findings attributable to programs funded by other Federal agencies. Also, although 43 CFR Part 12 provides remedies for the misuse of

Appendix 1

Background and Scope

Scope of Evaluation

Federal financial assistance, which might be identified in the course of an audit, the Regulation (Part 12.110 (a)(2)) does not apply to recipients of statutory entitlements or mandatory awards.

The scope of our evaluation included external audit reports with DOI monetary findings that were issued in fiscal years 1997 through 2001. Of 31 such reports with DOI findings of \$48.5 million, we judgmentally selected 16 reports with findings of \$26.5 million for review.

We conducted our evaluation in accordance with the President's Council on Integrity and Efficiency's "Quality Standards for Inspections."

DOI Monetary Amount of External Audit Report Findings

Insular Area	Finding Amount	Sample Amount
American Samoa	\$2,748,455	\$1,214,561
Commonwealth of the Northern Mariana Islands	12,597,246	830,345
Federated States of Micronesia	745,138	614,841
Guam	5,453,333	205,835
Palau	1,718,810	412,428
U.S. Virgin Islands	632,247	0
Marshall Islands	24,569,903	23,177,750
Total	\$48,465,132	\$26,455,760

We reviewed the actions taken by responsible officials to resolve and track implementation of the findings. We also contacted audit and program personnel at the Departments of Transportation, Health and Human Services, Defense, and Agriculture and at the Federal Emergency Management Agency to discuss the manner in which these agencies tracked, resolved, or monitored corrective action implementation of findings that pertained to the use of their agencies' funds.



United States Department of the Interior

OFFICE OF INSULAR AFFAIRS

1849 C Street, NW

Washington, D.C. 20240

December 19, 2002

Deputy Assistant Secretary

Elaine Weistock, Director
Quality Control Division
Office of the Inspector General,
Department of the Interior
1849 C Street, N.W.
Washington, D.C. 20240

Re: Department of the Interior (DOI), Office of Insular Affairs (OIA) Response to Draft Evaluation Report, October 2002, entitled Recommendations pertaining to Federal funding of Insular Area governments, Office of Insular Affairs, Report No. H-IN-OIA-017-02 (Report)

Dear Ms. Weistock:

We appreciate the recommendations set forth in the Report and have found them to be very helpful. The Report makes the following three recommendations, and OIA agrees with each one:

- 1) *We recommend that the Deputy Assistant Secretary (DAS) for Insular Affairs support efforts to strengthen controls over DOI financial assistance provided to Insular area governments.*

We support efforts to strengthen controls over DOI financial assistance provided to insular area governments, subject to the sovereignty of certain insular areas and consistent with Federal policy of encouraging local self-government in the U.S. territories.

The Report states that “unless legislative provisions and the terms and conditions of financial assistance are changed, there is little value in DOI being held responsible for audit findings and recommendations related to misuse or inappropriate use of Federal funds that are provided under entitlement-like conditions.” We agree with this statement, and indeed OIA has taken the lead in drafting new fiscal procedures to provide controls for financial assistance to be provided to the Republic of the Marshall Islands (RMI) and the Federated States of Micronesia (FSM) under the Compact of Free Association (Compact).

- 2) *We recommend that the DAS for Insular Affairs and the Deputy Secretary for Budget and Finance in conjunction with the Inspector General develop and implement procedures for monitoring (apart from the Office of Management and Budget Circular A-50 tracking and resolution requirements) external audit*

findings that pertain to Federal funds that are not subject to 43 C.F.R. Part 12 enforcement provisions.

The Report discusses Interior funds that are disbursed to the freely associated states as mandatory payments not subject to 43 C.F.R. Part 12 enforcement provisions regarding external audit findings. OIA will be happy to work with the Inspector General and the Deputy Assistant Secretary for Budget and Finance on a system to monitor external findings related to Compact assistance.

OIA is currently developing and advocating procedures apart from the Office of Management and Budget Circular A-50 tracking and resolution requirement to be implemented in the anticipated amendments to the Compact. Continued Federal program funding will be made available through a process of “sectoral grants” which will require procedures for monitoring fiscal integrity apart from the Office of Management and Budget Circular A-50 tracking and resolution requirements.

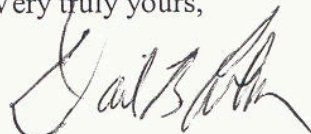
- 3) *We recommend that the DAS for Insular Affairs develop and implement procedures for the assignment of responsibility for and the processing of external audit report findings to ensure that appropriate and timely actions are taken.*

OIA’s Administrative Manual became outdated as a result of office reorganization and downsizing. OIA is rewriting the grants portion of the Administrative Manual to include procedures for assigning responsibility and processing external audit report findings. The revisions to the manual will be drafted by February 28, 2003, and, following consultations with the Inspector General and Deputy Assistant Secretary for Budget and Finance will be completed in final version by March 30, 2003.

We recognize that a number of audit report findings arise as a result of the lack of qualified personnel in insular area governments. This lack of capacity is also at least partially to blame for the failure of insular area governments to respond to audit findings in a timely manner. To address this problem, OIA has provided several technical assistance grants to improve management practices and to assist in the introduction of technical methods designed to improve accountability. Significant improvements have been made in grant management and accountability over the years, and the insular areas continue to participate in an ongoing program of professional staff development.

Please feel free to contact us if you have any questions.

Very truly yours,



David B. Cohen

Appendix 3

Status of Recommendations

Recommendation Reference	Status	Action Required
1	Resolved and implemented.	No further action is required.
2 and 3	Resolved, not implemented.	The recommendations will be referred to the Assistant Secretary for Policy Management and Budget for tracking of implementation.

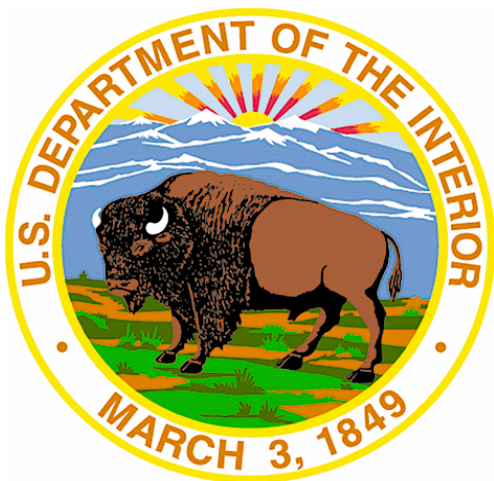
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