

GAO

United States General Accounting Office

Report to Congressional Committees

March 1995

FINANCIAL AUDIT

Expenditures by Three Independent Counsels for the Six Months Ended September 30, 1993



Accounting and Information
Management Division

B-259353

March 31, 1995

Congressional Committees

This report presents the results of our audits of expenditures reported by three independent counsels for the 6 months ended September 30, 1993. Independent counsels and the Department of Justice are required under 28 U.S.C. 594 to report on expenditures from a permanent, indefinite appropriation established within Justice to fund independent counsel activities. We are required under 28 U.S.C. 596 and Public Law 100-202 to audit those expenditures. We found that the statements of expenditures presented in appendixes I, II, and III for independent counsels Arlin M. Adams, Joseph E. diGenova, and Lawrence E. Walsh were reliable in all material respects.

Further, our audits included limited tests of internal controls and compliance with laws and regulations that disclosed

- a material weakness in internal controls over reporting of expenditures and
- no material noncompliance with laws and regulations we tested.

The following sections provide background information, outline each conclusion in more detail, and discuss the scope of our audits.

Background

The independent counsel provisions of the Ethics in Government Act of 1978 (28 U.S.C. 591-599) established a process for the appointment of independent counsels so as to preserve and promote the accountability and integrity of public officials and of institutions of the federal government. The law provides for the judicial appointment of temporary, special prosecutors¹ when the Attorney General determines that reasonable grounds exist to warrant further investigation of high-ranking government officials for certain alleged crimes. The independent counsel law expired on December 15, 1992; however, the law's provisions allowed the three independent counsels serving in that position on that date—Mr. Adams, Mr. diGenova, and Mr. Walsh—to continue their work until completed.

On June 30, 1994, and subsequent to this audit period, the Independent Counsel Reauthorization Act of 1994 (Public Law 103-270) was enacted,

¹In 1983, the title of these positions was changed from special prosecutor to independent counsel.

reauthorizing the independent counsel law for an additional 5 years. The act contains various amendments aimed at addressing problems identified in our prior independent counsel reports.² For example, these amendments require added cost controls over independent counsel expenditures and designate specific responsibilities to the Administrative Office of the United States Courts (AOUSC) for independent counsels' administrative support.

The independent counsel law directs the Department of Justice to pay all costs relating to the establishment and operation of independent counsel offices. In 1987, Public Law 100-202 established a permanent, indefinite appropriation within Justice to fund expenditures by independent counsels. Independent counsels are required to report their expenditures from the appropriation for each 6-month period in which they have operations. We are required to audit expenditures from the independent counsel appropriation and to report our findings to appropriate committees of the Congress.

Independent counsels may also incur costs that are paid from appropriations other than the permanent, indefinite appropriation established to fund independent counsel activities. These costs arise, for example, from the use of detailees from other federal agencies, such as the Federal Bureau of Investigation (FBI). While independent counsels are not required to and do not include the cost of all their activities in reported expenditures, the nature of these other costs is identified and discussed in the notes to the statements of expenditures presented in the appendixes to this report.

Opinion on Statements of Expenditures

The statements of expenditures for independent counsels Arlin M. Adams, Joseph E. diGenova, and Lawrence E. Walsh present fairly, in all material respects, the respective expenditures of these independent counsel offices for the 6 months ended September 30, 1993. The statements of expenditures and related notes regarding bases of accounting and additional pertinent information are provided in appendixes I through III.

Consideration of Internal Control Structure

For this audit period, the internal controls we considered for each of the three independent counsels and for AOUSC regarding the administrative

²Financial audits of expenditures by independent counsels (GAO/AFMD-93-1, October 9, 1992; GAO/AFMD-93-60, April 21, 1993; and GAO/AIMD-94-76, April 15, 1994).

support and accounting services it performs for independent counsels were those designed to

- safeguard assets against loss from unauthorized use or disposition;
- assure the execution of transactions in accordance with management authority and with laws and regulations; and
- properly record, process, and summarize transactions to permit the preparation of expenditure statements in accordance with applicable bases of accounting.

With the exception of Independent Counsel Walsh, independent counsels and AOUSC continued to have a material weakness in internal controls over reported expenditures. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low risk that errors or irregularities in amounts that would be material to the expenditure statements may occur and not be detected promptly by employees in the normal course of performing their duties.

In 1986, Justice entered into an agreement with AOUSC to transfer the processing of payments for independent counsel expenditures from Justice to AOUSC, and Justice periodically disburses lump-sum payments to AOUSC for this purpose. Independent counsel offices typically submit payment vouchers, payroll information, and supporting documentation to AOUSC. On the independent counsels' behalf, AOUSC expends funds and records the expenditures in its payroll and accounting systems. AOUSC also prepares monthly summarized expenditure reports and submits them to independent counsels.

Independent counsels have generally fulfilled their financial reporting requirements by using the summarized expenditure reports prepared by AOUSC. During this audit period, and as discussed in our prior reports,³ AOUSC expenditure reports have had errors, thus requiring us to propose—and independent counsels to accept—audit adjustments.

During this audit period, Independent Counsel Walsh's office maintained its own separate accounting system and performed procedures to reconcile AOUSC reports to its own records, enabling it to identify any errors in the AOUSC reports. The other two independent counsels during this audit period continued to rely almost solely on AOUSC reports in

³Financial audits of expenditures by independent counsels (GAO/AFMD-93-1, October 9, 1992; GAO/AFMD-93-60, April 21, 1993; and GAO/AIMD-94-76, April 15, 1994).

reporting expenditures. We believe that independent counsels may continue to experience problems reporting their expenditures until AOUSC establishes effective internal controls for accurately summarizing independent counsel expenditures.

In our prior reports, we identified other internal control weaknesses at independent counsel offices and AOUSC including, for example, inadequate segregation of duties and inadequate procedures to ensure compliance with applicable laws. We attributed many of the problems regarding independent counsels' noncompliance with certain laws and regulations to a lack of comprehensive guidance, either in the independent counsel law or elsewhere, on the financial management structure and operation of independent counsel offices. In response to our prior reports, independent counsels and AOUSC officials acknowledged that corrective action was needed and have taken steps to improve internal controls through greater segregation of duties, increased interaction between independent counsel and AOUSC employees, and the ongoing development of handbooks and other written guidance.

Also, since the issuance of our prior reports, and subsequent to this audit period, the Congress addressed many of the problems we found by passing the Independent Counsel Reauthorization Act of 1994. The act amends the independent counsel law by requiring independent counsels to generally comply with the established policies of the Department of Justice regarding expenditure of funds and by establishing additional restrictions on the compensation and travel expenses paid to independent counsels or their employees.

Compliance With Laws and Regulations

Our tests for compliance with selected provisions of laws and regulations disclosed no material instances of noncompliance during the 6 months ended September 30, 1993.

Objectives, Scope, and Methodology

In order to carry out their financial operations and to ensure accountability, independent counsels are responsible for

- preparing statements of expenditures,
- establishing and maintaining internal controls and systems to provide reasonable assurance that the internal control objectives previously mentioned are met, and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether the statements of expenditures reported by independent counsels are reliable (free of material misstatement and presented fairly in accordance with the bases of accounting described in accompanying notes). We are also responsible for considering the internal control structure in order to determine our auditing procedures for expressing an opinion on the statements of expenditures, not to provide assurance on the internal control structure. In addition, we are responsible for testing compliance with selected provisions of laws and regulations.

In order to fulfill these responsibilities, for each independent counsel, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the statement of expenditures and notes thereto, except items indicated as unaudited;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the statement of expenditures;
- obtained an understanding of the design of relevant internal control structure policies and procedures, determined whether they had been placed in operation, assessed the associated control risk, and conducted limited tests of relevant internal controls, including those over expenditure authorizations and financial reporting; and
- tested compliance with certain aspects of selected provisions of the independent counsel provisions of the Ethics in Government Act of 1978 (28 U.S.C. 591-599), 5 U.S.C. Chapter 55, and implementing regulations, relating to pay administration.

It is important to note that because of inherent limitations in any internal control structure, losses, noncompliance, or misstatements may nevertheless occur and not be detected. Also, projecting any evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate. As a result of the material internal control weakness over reported expenditures previously discussed, we extended our substantive testing in order to opine on the expenditure reports presented in the appendixes to this report.

We obtained, but did not audit, information on costs that were not paid from the permanent, indefinite appropriation established to fund independent counsel activities. We obtained information on these costs

from the independent counsel offices; the Department of Justice, including the FBI; the Internal Revenue Service; and the Office of Inspector General of the Department of Housing and Urban Development.

We discussed the results of our work with the three independent counsels or their representatives and with representatives of AOUSC and incorporated their comments where appropriate.

We performed our audits in accordance with generally accepted government auditing standards. We completed our audit work on February 23, 1995.

We are sending copies of this report to the Attorney General, the Director of the Administrative Office of the U.S. Courts, the three independent counsels included in our audit, and other interested parties. Copies will be made available to others upon request.



David L. Clark
Director, Legislative Reviews
and Audit Oversight

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Abbreviations

AOUSC	Administrative Office of the U.S. Courts
FBI	Federal Bureau of Investigation

Statement of Expenditures for Independent Counsel Adams

ARLIN M. ADAMS

Office of Independent Counsel

Statement of Expenditures
(Cash basis)

Six Months Ended September 30, 1993

Personnel compensation and benefits	\$1,441,509
Travel	104,082
Rent, communications, and utilities (note 3)	308,390
Contractual services (note 4)	816,614
Supplies and materials	13,242
Acquisition of capital assets	9,518
Administrative services (note 5)	<u>110,779</u>
Total expenditures	<u>\$2,804,134</u>

The accompanying notes are an integral part of this statement.

**Appendix I
Statement of Expenditures for Independent
Counsel Adams**

ARLIN M. ADAMS

Office of Independent Counsel

Notes to Statement of Expenditures

Note 1 - Accounting policies

Reporting entity: The accompanying statement of expenditures presents the expenditures of the Office of Independent Counsel - Arlin M. Adams (OIC-Adams) for the 6 months ended September 30, 1993. The statement of expenditures includes only expenditures made from the permanent, indefinite appropriation for the offices of independent counsel that are processed through the Administrative Office of the U.S. Courts (AOUSC) and the OIC. Mr. Adams was appointed on March 1, 1990, to investigate the administration of various programs of the Department of Housing and Urban Development from 1983 to 1989. OIC-Adams' investigation is ongoing.

Basis of accounting: The accompanying statement of expenditures was prepared principally on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under this method, except for payroll and employee benefits, expenditures are recorded when the funds are disbursed by AOUSC or, for noncash transfers, when charged by AOUSC. Most payroll and related employee benefits are recorded at the end of the pay period when earned. The cost of retroactive retirement coverage discussed in note 2 is to be recorded when paid. The cost of purchased capital assets, which principally consist of office equipment and furniture, is recorded in the statement of expenditures when paid. These assets will remain with the federal government when they are no longer needed by the OIC.

Note 2 - Contingency

Under the laws governing federal employee retirement coverage and the regulations implemented by the Office of Personnel Management, federal employees appointed for periods exceeding 1 year generally are covered by federal employee retirement programs. Certain employees of the office of independent counsel with qualifying appointments were erroneously not provided retirement coverage. In August 1992, AOUSC determined that these employees should be retroactively provided retirement plan coverage and has been reviewing individual employee personnel files to determine specific coverage requirements. In December 1992, qualified employees, then employed by the OIC, became members of the retirement plan and began receiving current retirement coverage. The cost of providing retroactive retirement contributions for current and former OIC employees is estimated to be \$250,000 and will be recorded in the period paid.

**Appendix I
Statement of Expenditures for Independent
Counsel Adams**

Note 3 - Rent, communications, and utilities

Approximately \$239,000 in office rent is included in rent, communications, and utilities.

Note 4 - Contractual services

Contractual services primarily consists of court reporting services and outside consulting services in support of litigation.

Note 5 - Administrative services

AOUSC receives an administrative fee equal to 3 percent of OIC expenditures for performing disbursement and accounting functions for OIC-Adams. Payment of these fees generally occurs in the fiscal quarter following the services.

Note 6 - Other operating costs (unaudited)

Certain costs relating to employees assigned to work with the OIC by the Federal Bureau of Investigation (FBI), Internal Revenue Service (IRS), and Inspector General of the Department of Housing and Urban Development (HUD IG) were financed through funds appropriated to these agencies and, accordingly, are not included in the statement of expenditures. These agencies are not reimbursed for these costs. The schedule below shows the estimated costs (unaudited) of the assistance provided to the OIC during the 6-month period, based on information provided by officials of these agencies.

	Costs (unaudited)
FBI	\$332,000
IRS	7,000
HUD IG	<u>98,000</u>
	<u>\$437,000</u>

Statement of Expenditures for Independent Counsel diGenova

JOSEPH E. diGENOVA

Office of Independent Counsel

Statement of Expenditures
(Cash basis)

Six Months Ended September 30, 1993

Personnel compensation and benefits	\$367,606
Travel	4,448
Rent, communications, and utilities (note 2)	100,351
Contractual services (note 3)	20,041
Supplies and materials	3,907
Acquisition of capital assets	50,351
Administrative services (note 4)	<u>15,123</u>
Total expenditures	<u>\$561,827</u>

The accompanying notes are an integral part of this statement.

**Appendix II
Statement of Expenditures for Independent
Counsel diGenova**

JOSEPH E. diGENOVA

Office of Independent Counsel

Notes to Statement of Expenditures

Note 1 - Accounting policies

Reporting entity: The accompanying statement of expenditures presents the expenditures of the Office of Independent Counsel - Joseph E. diGenova (OIC-diGenova), for the 6 months ended September 30, 1993. The statement of expenditures includes only expenditures made from the permanent, indefinite appropriation for the offices of independent counsel that are processed through the Administrative Office of the U.S. Courts (AOUSC) and the OIC. Mr. diGenova was appointed in December 1992 to investigate a preelection search of passport files. OIC-diGenova's investigation is ongoing.

Basis of accounting: The accompanying statement of expenditures was prepared principally on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under this method, except for payroll and employee benefits, expenditures are recorded when the funds are disbursed by AOUSC or, for noncash transfers, when charged by AOUSC. Most payroll and related employee benefits are recorded at the end of the pay period when earned.

Note 2 - Rent, communications, and utilities

Approximately \$61,000 in office rent is included in rent, communications, and utilities.

Note 3 - Contractual services

Contractual services primarily consists of court reporting services and outside consulting services in support of litigation.

Note 4 - Administrative services

AOUSC receives an administrative fee equal to 3 percent of OIC expenditures for performing disbursement and accounting functions for OIC-diGenova. Payment of these fees generally occurs in the fiscal quarter following the services.

**Appendix II
Statement of Expenditures for Independent
Counsel diGenova**

Note 5 - Other operating costs (unaudited)

Certain costs relating to employees assigned to work with the OIC by the Federal Bureau of Investigation (FBI) were financed through funds appropriated to the FBI and, accordingly, are not included in the statement of expenditures. The FBI is not reimbursed for these costs. The estimated cost (unaudited) of the other assistance provided to the OIC during the period, based on information provided by FBI officials, was \$122,000.

Statement of Expenditures for Independent Counsel Walsh

LAWRENCE E. WALSH

Office of Independent Counsel

Statement of Expenditures
(Modified-cash basis)

Six Months Ended September 30, 1993

Personnel compensation and benefits	\$1,329,366
Travel	74,970
Rent, communications, and utilities (note 3)	394,309
Contractual services (note 4)	258,766
Supplies and materials	10,505
Acquisition of capital assets	9,654
Administrative services (note 5)	<u>87,216</u>
Total expenditures	<u>\$2,164,786</u>

The accompanying notes are an integral part of this statement.

**Appendix III
Statement of Expenditures for Independent
Counsel Walsh**

LAWRENCE E. WALSH

Office of Independent Counsel

Notes to Statement of Expenditures

Note 1 - Accounting policies

Reporting entity: The accompanying statement of expenditures presents the costs of the Office of Independent Counsel - Lawrence E. Walsh (OIC-Walsh) for the 6 months ended September 30, 1993. The statement of expenditures includes only expenditures made from the permanent, indefinite appropriation for the offices of independent counsel that are processed through the Administrative Office of the U.S. Courts (AOUSC) and the OIC. Mr. Walsh was appointed on December 19, 1986, to investigate allegations of crimes relating to the sales of arms to Iran; the diversion of funds to, and other support of, the Nicaraguan Contras; and the prosecution of any indictments stemming from the investigation.

Basis of accounting: The accompanying statement of expenditures was prepared on a modified-cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under this method, most expenditures for goods and services are recorded when invoices are received and certified for payment. Certain major expenditures such as rent, utilities, and administrative fees, are accrued on a monthly basis. No accrual is made for salaries and benefits earned but not yet paid at the end of the reporting period. The cost of retroactive employment coverage discussed in note 2 is to be recorded when paid. The cost of purchased capital assets, consisting of office furniture and equipment, is expensed and no provision is made for depreciation. These assets will remain the property of the federal government after they are no longer needed by the OIC.

Note 2 - Contingency

Under the laws governing federal employee retirement coverage and the regulations implemented by the Office of Personnel Management, federal employees appointed for periods exceeding 1 year generally are covered by federal employee retirement programs. Certain employees of the office of independent counsel with qualifying appointments were erroneously not provided retirement coverage. In August 1992, AOUSC determined that these employees should be retroactively provided retirement plan coverage and has been reviewing individual employee personnel files to determine specific coverage requirements. In November 1992, qualified employees, then employed by the OIC, became members of the retirement plan and began receiving current retirement coverage. The cost of providing retroactive retirement contributions for current and former OIC employees is estimated to be approximately \$1,000,000 and will be recorded in the period paid.

**Appendix III
Statement of Expenditures for Independent
Counsel Walsh**

Note 3 - Rent, communications, and utilities

Office rent, including heating, ventilation, and air conditioning during regular business hours, totaled about \$216,000 during the 6-month period. Also included in rent, communications, and utilities are additional charges of approximately \$84,000 for utility usage during evenings and weekends.

Note 4 - Contractual services

Contractual services consists primarily of outside consulting services in support of litigation, protective services, equipment maintenance, and court reporting services.

Note 5 - Administrative services

AOUSC receives an administrative fee equal to 3 percent of OIC expenditures for performing disbursement and accounting functions for OIC-Walsh. These fees are generally recorded in the period when the services are rendered.

Note 6 - Other operating costs (unaudited)

Certain costs relating to employees assigned to work with the OIC by the Internal Revenue Service (IRS) and the Federal Bureau of Investigation (FBI) as well as other assistance provided by the Department of Justice were financed through funds appropriated to those agencies and, accordingly, are not included in the statement of expenditures. These agencies were not reimbursed for these costs. The schedule below shows the estimated costs (unaudited) of the other assistance provided to the OIC during the 6-month period, based on information provided by agency officials.

	Costs (unaudited)
FBI	\$30,000
Other Justice	27,000
IRS	<u>37,000</u>
	<u>\$94,000</u>

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