ACCOUNTABLE GOVERNMENT

Improving Oversight and Accountability One Island at a Time

by Deborah A. Milks

Governments from the U.S. affiliated insular areas tackle audit issues with the help of the Graduate School.

Challenges are nothing new to islanders. Living on small dots of land in the vast Pacific and the Caribbean Oceans, the people of the U.S.-affiliated insular areas have been caught in the path of typhoons, hurricanes, tsunamis, wars, and the ups and downs of tourism-based economies.

While Guam, American Samoa, and the Virgin Islands have been territories of the United States for some 100 years, they did not have self-governing elections until the 1970s. In the 1980s, the insular group expanded to include the Commonwealth of the Northern Mariana Islands, and the freely associated governments of the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), and the Republic of Palau (ROP).

In the government-accounting world, these U.S.-affiliated island governments operate in many ways like a state or municipality of the United States. They use the U.S. dollar, receive U.S. federal grants, and must comply with Generally Accepted Accounting Principles (GAAP), Governmental Accounting Standards Board (GASB), and the Single Audit Act. The U.S. Department of Interior's (DOI's) Office of Insular Affairs (OIA) administers federal policy in the territories and has the responsibility to administer and oversee U.S. federal assistance provided to the freely associated States.

But unlike a typical U.S. jurisdiction, the insular government's administration and accounting responsibilities include all the services that are typically handled by a state, county, and city and sometimes a country, as is the case of the FSM, RMI and ROP, which are independent countries. Such services include schools, public safety, roads, airports and seaports, hospitals, utilities, retirement plans, development authorities, tourism boards, and immigration, to name a few. All this from remote locations with small populations (for example, the 2000 census has Guam as the largest with a population of 175,000 and Palau as the smallest with a population of 20,000) and a wide range of budgeted general fund revenues (in fiscal year 2008, RMI budgeted just over $34 million, and the Virgin Islands budgeted more than $650 million).

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The problem of brain drain adds to the challenge of multiple and complex responsibilities. The best and the brightest of island citizens often immigrate to the U.S. mainland for higher paying jobs. The pool of college-trained accountants in many affiliated insular areas is shallow, and several of the insular governments' core finance operations are staffed by high school graduates. For instance, in the Micronesia region of the northern Pacific Ocean where nine of the 11 U.S.-affiliated governments are located there are no more than five CPAs working in the public sector.

Improving Accountability

Historically, foreign and U.S. grantors did not expect too much accountability from the island governments, and the islands tended to rely on outside contracted expertise to solve their accounting issues. Unless a federal agency required the government to repay a specific cost in question, little action was taken on audit results. It's fair to say that the audits were not highest on the priority list of the insular governments.

By FY2002, the 11 insular governments' audits (the FSM has four states as well as a national government) were on average over one year late and in total had more than 90 opinion qualifications, a backlog of 600 findings, and $25 million in-question costs. The DOI had been cited by its own auditors for lack of oversight for grants to the insular governments. Something had to change.

At a regular meeting of the Island Government Finance Officers Association (IGFOA) in December 2003, OIA director Nikolao Pula challenged the group to improve the status of their audits. That challenge led to the Audit Improvement Project and a completely different picture of the status of the audits for FY2009. Except for one, all the insular governments are current with their single audit. Six received unqualified opinions, and all eliminated or drastically reduced the number of audit findings. How did the turnaround occur?

As with most successful projects, all the members of the team pulled in the same direction. The OIA provided consistent leadership and clear expectations. The Graduate School's International Institute provided training, guidance, and the financial tools to address the issues and highlight the results. Most importantly, the government finance officers fully accepted the challenge and communicated the expectations to their staff and their governments.

Office of Insular Affairs' Strategic Shift

The emphasis that OIA places on the results of the audits is best summed up by a quote from a letter sent by OIA to the governments in 2004. "Why is OIA now focusing so intently on Single Audit Act compliance, including resolution of findings? One reason is DOI's new strategic plan, developed in response to requirements of the 1993 U.S. Government Performance and Results Act (GPRA). The strategic focus for the islands is to increase self-sufficiency through concentrated efforts to foster economic development and greater accountability of island governments."

The letter continued by noting that audits are the most fundamental and universally recognized measure of financial management and that good audits aid in economic development. The OIA supported its strategic plan with definitive actions:

- adding insular grant managers to staff
- creating an Accountability Section staffed by an accountability and insular policy specialist who assists insular governments on issues related to audit findings and qualifications
- establishing compliance with Single Audit Act requirements as one of the threshold criteria necessary to receive awards for capital improvement projects for U.S. Territories
- including results of the insular area audits as one of their own performance measures.

Outside Assistance

The difficulty of monitoring and accounting for U.S. funds in the insular areas prompted OIA to contract with the Graduate School in 1991. For the past 19 years, the School's Pacific Islands and Virgin Islands Training Initiatives (PITI-VITI) have provided training and other forms of technical assistance to all the U.S. affiliated insular governments in an effort to increase the level of accountability and transparency in the region. The OIA used the PITI-VITI program to manage the Audit Improvement Project. The project had two principle goals:

1| focus resources on the insular government systems for the resolution and closure of audit findings and exceptions

2| develop strategic project plans for each government to address the causes of the most significant findings based upon analyses of that government's specific problem areas.

The OIA recognized that the basic island infrastructure was in place to support the project tasks. There was little to be gained by sending in an outside team to clear audit findings. Thus, there was a decision to take a less top-heavy approach to resolving audit issues and developing audit improvement plans. The approach allowed the islands to build capacity on what was already in place: improved financial management systems, trained staff, and the local public audit offices.

The approach also recognized that each government has a different organization structure and cultural process. Each government was able to internalize the importance of the audit and audit results in its own unique way. The OIA would shine a bright light on the issue, and the Graduate School would provide the forum and structure for reporting results. In the end, however, it was still the responsibility of each insular government to make it happen.

The semi-annual IGFOA meetings became the primary forum for the island finance officers to develop action plans and to report to colleagues on their government's audit improvement progress. The Graduate School contracted expert practitioners to offer best practice ideas and assist with tools and techniques to better handle specific issues. Between IGFOA meetings, an effort was made to help finance offices maintain their focus on audit improvement action plans.

Action Planning

The action planning that came out of the first IGFOA meeting concentrated on three areas:

1| getting out of the permanent state of audit

2| recognizing and improving the flaws in the entire audit process

3| identifying and prioritizing the issues underlying the audit findings.

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Closing Out Audits

The first step was to close out audits and get current. The habit of focusing on the audit findings and questioning costs long after the close of the fiscal year had resulted in a permanent state of audit. The finance offices would attempt to resolve draft findings or develop corrective action plans for issues that may have occurred two or three years in the past and did not relate to current processes. This tended to keep the audit years open and delay the audit report beyond the point where it was a useful document.

Improving the Audit Process

The second planning step focused on the audit cycle, starting with negotiating and contracting with the external auditors. Multiyear contracts, mutual responsibilities, communications, interim deadlines and progress payments, and agreement on the presentation of audit findings became part of the audit contract negotiations.

To avoid log jams during the audit, each government set up an audit liaison who would monitor the audit process, prepare reports of unresolved audit findings, and maintain documentation and correspondence for audit resolution. Some governments assigned that role to a finance office staff person; some used their Public Auditor's office; and others involved another government office.

Tackling the Underlying Audit Problems

The governments' most challenging planning task was to tackle the underlying and actual causes for multiple and repeated findings. The Graduate School developed a simple reporting tool for the governments to categorize and track audit findings. The standard compliance requirements were expanded to include more specific causes.

Being able to easily visualize the number of the audit findings by cause and by department, the governments could then prioritize issues and work on their internal action plans for the high priority areas. By consolidating the tracking sheets and presenting a picture of overarching issues needing attention, improvement efforts could target the areas most in need of technical assistance.

Managing Improvement

At each succeeding IGFOA meeting, the audits showed improvement. The finance officers shared their ideas, continued with action planning, and reported their progress. Although the governments tended to consider the finance office the owner of the audit and the finance officers had taken on the primary responsibility to manage the audit and resolve findings, it became increasingly apparent that the finance offices were not as successful at improving underlying problems in areas where it did not have direct authority. The light needed to shine out beyond the finance offices.

In 2007 a joint meeting was held with IGFOA and the public auditors from each government. Participants discussed strategies where the public audit offices could assist with audit issues, without undermining the independence of their offices. Monitoring the progress of the audits for the government's component units was one example where the public auditor could help ensure the timeliness of the government-wide financial statements.

Another way to highlight the audit status of each insular government was to use a financial monitoring tool referred to as the Performeter. Since FY 2002, members of IGFOA have used the Performeter to report the financial health of their governments. The Performeter presents over time and by-year financial statement analysis data in a format easily understood by non-accountants.

As it was widely being used by local legislators and chief executives of the insular governments, adding an audit status report to the Performeter made sense. Aptly named the A.F.T.E.R. report (audit findings, timeliness, and exception resolution), users are able to easily see trends in audit report qualifications, audit submission dates, the number of audit findings, and the number of repeated findings.

The success of the project and the results of the OIA challenge have been encouraging. As of the FY 2009 audit, six of the 11 governments have unqualified financial statement opinions and several of the governments have zero questioned costs. The other five governments have significantly decreased their number of qualifications, findings, and questioned costs.

Improved Accountability in Guam

Guam offers a good example of improved accountability as a result of the Audit Improvement Project. For FY 2003, Guam had nine financial statement qualifications, seven financial statement findings, six component unit qualifications, $1.2 million in current year questioned costs, and $43 million in cumulative questioned costs.

Flash ahead six years to FY 2009. Guam's Single Audit has zero financial statement qualifications and findings, zero component unit qualifications, zero current year questioned costs, and only $4.6 million of cumulative questioned costs yet to be resolved. Guam has shown an improvement of 90 percent in the amount of unresolved questioned costs over FY 2003.

"When we first started the Audit Improvement Project, I never envisioned the significant progress Guam and the rest of the insular governments would make in improving the timeliness and effectiveness of all the government's audits," said Lourdes Perez, Guam's director of administration and former IGFOA president. "Guam never received an unqualified audit report, nor was the audit ever on time. The FY 2009 financial statements and single audit received unqualified reports with zero questioned costs."

Perez added, "It just goes to show what can occur when all parties work together for some common purpose. The DOI had the foresight and resources to suggest the initiative, IGFOA and each government had the willpower to make positive improvements in financial management systems of their respective governments, and the Graduate School had the training and technical assistance infrastructure to assist. I can only hope the insular governments keep up the momentum and do not fall back to old tendencies."

Bottom Line

What lessons did we learn from the Audit Improvement Project? The first lesson was to recognize that friendly competition among the insular governments is a motivating factor to improve performance, even with audits.

A harder lesson was to not expect to solve all the problems at once. Progress was made by resolving at least one difficult high-priority area at a time and adding some easier wins each year. We learned that highlighting the problems went a long way toward motivating everyone to solve the issue. The most critical success factor was having everyone involved focus their attention, support, and expectations on improvement.

Where does the island government Audit Improvement Program go from here? For the governments that have achieved timely and clean audits, they work to maintain that status and avoid backsliding. Other insular governments will continue to improve their audit status.

But that is not enough; the IGFOA has begun work on a new challenge. Recognizing the need for continual improvement, the finance offices have started a project to establish and report performance measures for their finance office operations: new tools, techniques, and challenges.

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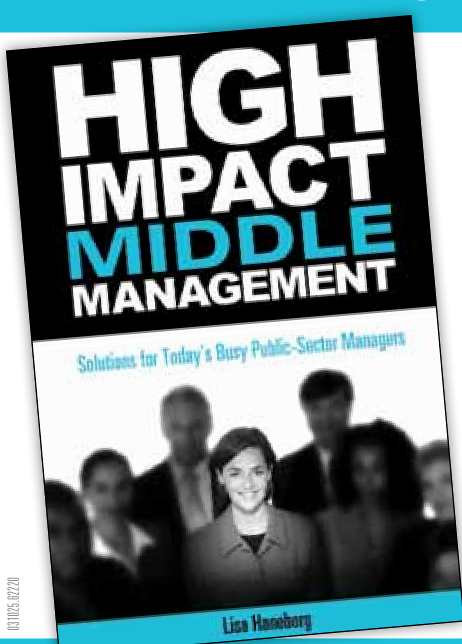

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