

By Ken Stier

When Securities and Exchange Commission (SEC) staff attorney Gary Aguirre wanted to question John Mack, a Wall Street titan, now CEO and chairman of the investment bank Morgan Stanley, about some suspicious trading activity flagged by the New York Stock Exchange, Aguirre's supervisors were supportive — until they weren't. A flurry of targeted calls from a posse of defense attorneys to more senior SEC offices led to the abrupt change, Aguirre claims, in an account largely corroborated by a yearlong Senate Finance and Judiciary Committees investigation report released in August 2007.

The upshot: What might have been a blockbuster insider-trading case that could help curb one of the most important abuses in U.S. capital markets was effectively derailed. (Mack would be questioned a year later, as the SEC finished out an investigation, but circumstances led many to wonder if it was not with diminished zeal.) Aguirre was fired soon afterward, and the Senate investigation determined this was “closely connected to his objections to the special treatment afforded John Mack,” Sen. Charles Grassley, ranking member of the Senate Finance Committee, said in releasing the report. But when Aguirre brought these serious allegations to the SEC's Office of the Inspector General (OIG), there was “no attempt to conduct a serious, credible investigation,” Grassley noted. “The Inspector General merely interviewed SEC management, accepted their side of the story, and closed the case. This is unacceptable. It is the role of the Inspector General to be an independent finder of fact, not a rubber stamp of management.”

It is just one of many recent examples of the highly uneven — many would say deteriorating — performance of this critical component of the country's civil service, which was created to ensure the efficient and impartial functioning of the federal bureaucracy. The system of inspectors general was created by Congress in 1978 to provide independent oversight of Cabinet departments and major federal agencies, initially 30, extended to 34 more through a 1998 amendment.

The law contained strong provisions for ensuring independence, a seven-day letter response requirement, robust investigative powers, including subpoena authority, and a ban on secretarial interference, provisions that “clearly make the IG the most independent, unfiltered voice below the secretary in any federal department,” said Eleanor Hill, the Defense Department IG from 1995 to 1999, in recent congressional testimony. Key to the IG's

unique role is its hybrid reporting function — internally to the agency head, and externally to Congress — which stokes the critical tension between the executive and legislative branches. All in all, it was a “stroke of congressional brilliance,” Hill said.

The IGs created by the 1998 amendment differ in several key respects from the original cohort of IGs. The latter are appointed by agency heads, while those in the original group are appointed by the president, with Senate confirmation. While charged with the same responsibilities, they cannot initiate criminal investigations. In practice, the newer IGs (see lists of both) are more “closely aligned to independence standards for internal auditors” than those for external auditors, explained the Government Accountability Office (GAO).

This system is not window dressing. There are close to 12,000 employees working with a combined budget of US\$1.9 billion, up from US\$1.5 billion in 2002. (Although the Central Intelligence Agency has an IG, neither the size of its staff nor its budget is made public.) The IGs seem to be a very good investment for taxpayers. Collectively they recovered US\$6.8 billion for the public coffers from fines, settlements or recoveries, and investigations. The investigations also yielded 8,400 successful prosecutions, 7,300 suspension or debarments, and 4,200 personnel actions, all in a single year (2006), according to the most recent report from the President’s Council on Integrity and Efficiency, a supervisory board chaired by the deputy director of the Office of Management and Budget.

An additional US\$9.9 billion in potential savings has been identified through audit recommendations. “These performance levels are consistent with previous years’ efforts: IGs have been and continue to be a primary means by which we identify and eliminate waste, fraud and abuse,” OMB Deputy Director Clay Johnson III told a Senate oversight committee in July. “The IGs play a critical role in identifying mismanagement of scarce taxpayer dollars,” added David M. Walker, U.S. comptroller general. “As we enter a period where great transformation will be needed in the way government does business [because of escalating deficits and limited resources], it will be increasingly important to consider the IGs’ role in this process, and to take advantage of the opportunities to make the IG offices more efficient and effective.”

But rather than investing in these “profit centers” OIGs are generally under-funded, particularly when compared with the growth of their agencies, the multiplying complexity they face and their increased reporting demands. The Justice Department, for instance, has grown about 30

percent in the last 15 years, from 83,000 employees to 110,000, but the OIG there has essentially remained the same – with about 400 staff rather than the 520 it would have if it were keeping pace. “I am concerned that inadequate resources can affect both the thoroughness and timeliness of projects that are, by necessity, staffed more thinly than warranted...[and] that our employees may be burned out when we continually ask them to do more with less,” Glenn Fine, the Department of Justice’s inspector general, told Congress recently.

In this context, it is usually an indication of problems when an IG moves to cut his own staff. The administrator of the General Services Administration (GSA), Lurita Doan, moved to make significant staff cuts after the IG, Brian Mill, started investigating procurement practices. Doan proposed to have external contractors perform “surveys” instead. The EPA’s IG, Bill Roderick, moved to slash his own staff by 60, out of 360 positions, even while his budget increased. This has led some to advocate allowing OIGs to submit their budget requests directly to Congress and the OMB rather than having them controlled by the agency heads.

Another problem is the sometimes serious mismatches between the size and budget of the IG’s office compared to the agencies it is meant to oversee, or to its overall importance. At the SEC, for instance, which has a critical role overseeing U.S. capital markets, there is an OIG of just 10 staffers, which is smaller than its counterpart at the Library of Congress (17), the National Archives and Records Administration (16) and the Smithsonian Institution (14). The SEC’s IG office is expected to expand with a new IG; the last one retired the day the critical Senate Finance Committee report came out. He had been the SEC’s first and only IG.

The biggest concern, though, for this highly sensitive layer of the civil service is the increasingly political nature of key appointments, which sabotages the IGs’ mission of disinterested service to the public. This was particularly apparent in the Bush administration, which, until the Republican Party lost control of Congress in 2006, did not have to worry about Senate approvals. More than 60 percent of IGs appointed by President Bush had prior political experience (either at the White House or as Republican congressional staff), while fewer than 20 percent had prior audit experience, the House Committee on Oversight and Government Reform reported in 2005. During the Clinton years, more than 60 percent of IG appointees had prior audit experience. Even this is low considering that enabling statutes require IGs be selected “without regard to political affiliation, and solely on the

basis of integrity and demonstrated ability in accounting, auditing, financial analysis, law, management analysis, public administration or investigations.”

Clearly the system of IGs — which turns 30 next year — is due for some rejuvenation. This may explain the recent percolation of activity by congressional committees, the GAO and elsewhere in the capital’s financial audit and accountability community, whose reports have provided the basis for this review. A survey of recent IG performances should be a warning of what further neglect may bring.

Perhaps the most blatant instance of IG partisanship was the tenure of Janet Rehnquist, daughter of the late Supreme Court judge William Rehnquist, at the Department of Health and Human Services (DHHS). DHHS has 1,445 IG staffers and a budget of US\$222 million, making it the largest OIG in the system, just ahead of the Department of Defense’s. Rehnquist faced a number of charges of mismanagement, including forcing out senior staff, hiring outside civil-service procedures and questionable travel expensing. More serious was the charge that she delayed the audit of a state pension fund until after an election at the request of the top aide of Florida Gov. Jeb Bush. A number of the allegations were substantiated by investigations by the GAO and an IG supervisory board, including the shredding of potentially relevant documents, which helped lead to her resignation in 2003.

Another alarming allegation of top-level interference took place at the Department of Homeland Security (DHS) when it was headed by its first secretary, Tom Ridge. In response to IG reports highlighting critical shortcomings at the new agency — failures to detect weapons at airports and to consolidate multiple-agency terrorist lists, as well as excessive executive bonuses and extravagant employee award ceremonies — Ridge allegedly complained to IG Clark Kent Ervin. Ridge tried to “intimidate me, to stare me down, to force me to back off, to not look into those areas that would be controversial, not to issue critical reports,” recounted Ervin in media accounts after he was forced out in 2004.

Another category of problems is when IGs themselves do not appreciate or respect their true mission. This has led a number of IGs to shield their agencies from outside scrutiny. A congressional inquiry into whether Defense Department IG Joseph Schmitz blocked criminal investigations of senior Pentagon officials led to his resignation in 2005. Schmitz’s office colleagues reportedly used code names to refer to people under investigation for

fear that their boss would tip off the targets of these probes; he was also suspected of having given a report to the White House before it was issued.

The concept of inspector general goes back to 17th century Europe, first deployed within militaries, where there have been myriad opportunities for illegal enrichment. Congress nodded to the verity of war profiteering when it created the Special IG for Iraq Reconstruction in 2004 and empowered it with a US\$34 million budget and staff of 155, making it the second largest of the agency-appointed IGs, headed by Stuart Bowen. A series of scathing reports about extensive waste, abuses and fraud by U.S. government employees and private contractors led to so far unsuccessful efforts, some involving subterfuge, to terminate the ad-hoc office.

The latest, and perhaps the most egregious, alleged OIG abuse to come to light is what has taken place at the State Department under Howard Krongard. He is alleged to have repeatedly thwarted investigations into contracting fraud within the US\$3.6 billion spending that the State Department has overseen in Iraq and Afghanistan. He also is accused by seven former and current staffers of censoring politically embarrassing reporting. "One consistent element in these allegations is that you believe your foremost mission is to support the Bush administration, especially with respect to Iraq and Afghanistan, rather than act as an independent and objective check on waste, fraud and abuse on behalf of U.S. taxpayers," said a 14-page letter from Rep. Henry Waxman, chairman of the House Committee of Oversight and Government Reform, which has an ongoing investigation. "Your strong affinity with State Department leadership and your partisan political ties have led you to halt investigations, censor reports and refuse to cooperate with law-enforcement agencies," the letter added. One example of the consequences: Tests of kitchen facilities at the new US\$600 million embassy in Baghdad short-circuited the electrical system; wires were found to be "counterfeit," reducing State Department employees to eating MREs.

Particularly problematic is the classic conundrum of who should be "the guardians of the guardians." As Eleanor Hill noted, "If the system is to have any credibility, the public must be assured that those who enforce high ethical standards on others are themselves held to those same standards. There must be a clear and convincing answer to the question "Who's watching the watchdog?"

The current answer is two supervisory councils. The President's Council on Integrity and Efficiency (PCIE)

oversees the presidentially appointed IGs, while the others are supervised by the Economic Council on Integrity and Efficiency (ECIE). Both councils are headed by the deputy director of the OMB, which many consider too political a position to ensure impartiality. To improve oversight, an Integrity Committee was established in 1996, chaired by the FBI assistant director of investigations and staffed by career FBI agents, three IGs and the directors of the Office of Government Ethics and the Office of the Special Counsel, along with a staff advisor from the Justice Department's Public Integrity Unit.

This is still no guarantee against unfortunate stalemates, such as the case of NASA IG Robert Cobb, who is alleged to have suppressed investigations and unfairly penalized staff for doing their jobs. A six-month investigation by the Integrity Committee determined that Cobb had indeed compromised his authority by alerting the NASA administrator to audits and even search warrants being issued by the FBI. This "created an appearance of a lack of independence," according to a redacted 1,000-page committee report that recommended disciplinary action "up to and including removal." That was enough for both congressional oversight committees to call for Cobb's resignation, but so far NASA has been circled the wagons, denying there were any violations.

For "both agency heads and OMB to ignore these investigative findings mocks the mission of the President's Council on Integrity and Efficiency, and sends a clear message that these agencies are unconcerned with preserving the integrity of the system of inspectors general," charged Danielle Brian, executive director of the Project on Government Oversight (POGO), an independent watchdog group, in a letter to OMB's Johnson.

The standoff highlights the fact that however well-structured the IG system is, it critically depends on the quality of the people staffing those positions. "While statutory protections are very important, it goes without saying that IGs also have to be comfortable with their independence, fully understand its importance, be willing to exercise it, and be prepared to defend it, if necessary," explained Hill, who is now a lawyer in private practice.

Effective, functioning IGs also need sensible counterparts running key government agencies. Both must have a deep respect for the vital role IGs play and they must find a professional working relationship that allows that function to be carried out. Congress could do a more robust job of making sure, during the confirmation process, that department and agency heads understand and fully accept

the mission of inspectors general and the statutory independence upon which that rests — and then remain vigilant to their performances.