

7-2/538

091047

Relationship Between Internal Auditors and Independent Auditors

Over the years, GAO has repeatedly stressed the importance of internal auditing in Federal agency management systems. The following remarks were delivered at the ceremony for presentation of certified internal auditor certificates, Washington, D.C., chapter of the Institute of Internal Auditors, October 15, 1973.

Internal auditors are—or they should be—an important part of the management control system of the organization they serve, providing independent evaluations of performance of all kinds within the organization for the benefit and use of management officials.

In nongovernment organizations they are also important to owners, investors, directors or trustees, creditors—and even to taxpayers, whether they know it or not.

Finally they are important to independent auditors. Practicing CPAs make good and full use of the work of internal auditors as a simple matter of generally accepted auditing procedures.

GAO, as an independent audit agency in the legislative branch of our Government, has as its biggest job the responsibility for auditing the affairs of almost all Federal agencies and providing the Congress with information on how well Federal agencies are carrying out their financial, management,

and program responsibilities. Carrying out this responsibility in this day and age of a \$270 billion Federal budget can be no slight task. A very important factor in our decisions on specific audits to be made—and the extent of the audits made—is the adequacy of the internal auditing being performed in the many Federal agencies.

Internal auditing in the Federal Government—like the girl in the cigarette ads—has come a long way since the 1940s when the first great strides toward modernization of the Government's financial management system were taken. The caliber of internal audit staffs and their stature within their agencies have vastly and steadily improved. Their constructive contributions to improved management and increased efficiency across the wide spectrum of Federal Government operations are numberless and immeasurable but substantial nevertheless.

Many factors have contributed to this progress—such as enlightened management concepts, legislative

expressions, congressional committee interest, and the aggressiveness and persistence of individual practitioners. Another important factor has been the almost constant drumming of GAO for stronger and stronger internal audit systems in all Federal agencies.

Examples of GAO Support

This activity began in earnest with the modernization of the accounting and auditing operations of GAO which began right after the ending of World War II.

Some examples can best show the nature and degree of persistence of this activity—and here I delve into some history.

- One of the first major GAO reports sent to the Congress under Government corporation audit legislation enacted in 1945 was on the old Reconstruction Finance Corporation. This report—a modest 10 volumes—highlighted a lot of problems as GAO then saw them in the way this corporation was being managed and operated and one of them was the internal audit system. In language much less polite and restrained than we use nowadays, the report stated that the internal auditing

was administered unaggressively, without adequate imagination, and with considerably less useful over-all result than the Corporation would have been justified in expecting.

We urged a major redirection of the internal auditing effort and it did take place.

- Another of the big Federal corporations of that era—and still going strong—was the Commodity Credit Corporation. GAO's first audit report on this corporation under the 1945 legislation chided it for immersing its internal auditors in administrative details. One result was that they spent too little time on checking operating and accounting procedures and the system of internal control and, as the report stated, they gave "scant attention" to finding out whether "program activities were being carried out in accordance with the intent of the board of directors."
- 1949 was the year the Joint Financial Management Improvement Program was launched by Comptroller General Lindsay C. Warren, Secretary of the Treasury John Snyder, and Director of the Bureau of the Budget James Webb. The basic philosophy of this program has always included recognition of the principle that a good accounting system must be subject to internal audit review in order to check compliance with established policies and procedures, evaluate reliability of financial reports, and identify improvement possibilities. This concept is still a vital part of this cooperative program.
- In 1950, the Comptroller General's comprehensive report on the old Maritime Commission came out. Among the many management problems described was the complete lack of internal au-

diting. The report emphasized that

the internal auditors must possess the inherent ability to appraise the adequacy and effectiveness of the internal records and procedures and to appraise performance under the Commission's policies, plans, and procedures.

- In 1952, the Comptroller General published an important circular to the heads of Federal agencies on the contribution of accounting to better management. Among the basic tenets stated was this one: A broadly constituted internal audit program provides the administrator and his subordinates not only with the auditor's findings on financial transactions but also with objective views of the manner in which policies and procedures, whatever their nature, have been carried out along with recommendations for improvements.
- In 1953 occurred one of the little known and now almost forgotten incidents involving GAO's strong support of an internal audit organization. It occurred soon after the first Eisenhower administration took office in January 1953. The then new Secretary of Agriculture, Ezra Benson, asked that GAO make an audit of all of the corporations and lending agencies of the Department of Agriculture as of January 31, 1953—representing about the date of change-over in administrations. He listed nine different organizations in the Department whose assets were measured in the billions of dollars.

This was an impossible task for GAO to perform with the re-

sources then available and because of other audit responsibilities. We took the position that the assurances that the Secretary was looking for could be just as satisfactorily obtained if he used the not inconsiderable internal audit resources of his own Department. We told him frankly that in carrying out our audits we placed great reliance on the work done by the Department's own audit and investigative staffs. We pointed out that we had found such reliance generally to be justified and that one of our major criticisms was that management officials did not always take proper advantage of the findings reported to them by their auditors and investigators.

The Secretary accepted our alternative suggestion that the auditing he wanted done be done by departmental internal auditors, with some GAO oversight. We have been told that this incident helped greatly in improving the stature of internal auditing in this Department, which subsequently developed into one of the best internal audit organizations in the Federal Government.

- In 1957, during the tenure of Comptroller General Joseph Campbell, GAO published a comprehensive statement of basic principles and concepts of internal auditing in Federal agencies. This statement was widely distributed and used within the Federal Government in training programs

and in acquainting management officials, Members of Congress, and internal audit staff members with the elements of strong internal audit systems.

In 1963 the House Committee on Government Operations came out with a vigorous call for a further strengthening of Federal agency internal audit systems, endorsed the 1957 GAO statement, and stated its own version of the fundamental requirements of satisfactory internal auditing.

- In 1968, the GAO statement of basic principles and concepts for internal auditing in Federal agencies was substantially revised to reflect the experience gained in the 10 years since the original statement was published.
- From 1966 to 1969, during the first years of the term of the present Comptroller General, Elmer B. Staats, GAO made special reviews of all major internal audit systems in the Federal Government. One review covered five of the major internal audit organizations of the Department of Defense and the report concluded that these systems were generally satisfactory. All in all, a total of 35 formal reports on this work during this period were prepared and almost all of these contained recommendations of one kind or another for improvement.
- Right now, in 1973, we are in the midst of a major survey of the adequacy of internal audit and other internal review systems of

all of the principal departments and agencies who make grants of Federal funds. This work is nearing completion and reports will be published within the next few months. A major purpose of this survey is to provide the Congress with up-to-date and evaluated information about these systems and their capacity to provide effective audit services in programs which involve grants of Federal funds of around \$40 billion a year.

Auditing Standards

Last year—in 1972—another landmark statement on auditing by the Comptroller General was released. This one dealt with standards for auditing governmental operations irrespective of who makes the audits or what level of government is being audited.

The statement is not prescriptive but it does point the way to the future of governmental auditing, including internal auditing, particularly with respect to the scope and objectives of audit. In brief, it calls for audits not only of financial operations including compliance with legal requirements, but evaluations of the efficiency and economy with which operations are carried out and of progress or accomplishments in achieving established objectives. These standards have been integrated into our earlier statement on internal auditing concepts and a new version will be published in the near future.

GAO Use of Internal Audit Work

Our interest and concern with the quality and usefulness of internal auditing in all Federal agencies has to be unflagging, if we in GAO are to do our job properly. As a matter of our own audit policy, we keep in close touch with internal audit organizations to keep abreast of their plans and programs, their findings and recommendations, and their problems. We use the results of their work when appropriate and by referring to it in published reports we add visibility not only to the existence of internal auditors (whose reports are seldom made public) but to the concept that they are an important part of a management control system.

Some recent examples:

- In June 1973, the Comptroller General reported to the Congress on progress and problems in achieving the objectives of the School Lunch Program—an important nationwide program administered by the Department of Agriculture and involving annual Federal expenditures of well over \$1 billion. The report referred to findings of the Department's Office of Inspector General a year earlier on the limited efforts being made by the Department to extend the School Lunch Program to private schools.
- In July 1973, a GAO report to the Secretary of Health, Education, and Welfare on the need for better management of health research equipment by grantees described earlier findings by the

HEW Audit Agency on inadequate monitoring of grantee property control systems.

- Also in July 1973, the Comptroller General's report to the Congress on the foreign aid program in Brazil mentioned a report by the AID Inspector General which recommended suspending U.S. loans for school construction until the borrower assured a satisfactory level of performance.

Not always do we find internal audit performance to be all that we judge it should be. And true to our place in the scheme of things, we can usually be depended upon to say something about what we found and to make recommendations for improvement. A couple of examples:

- Earlier this year, in auditing the financial operations of the National Bureau of Standards, we found that there had been no recent internal audits of payroll operations and, with one minor exception, no audits of accountable officer functions. We regard these omissions as serious and in this case we suggested to the Director of the Bureau that the management participate more actively in the internal audit planning to provide better assurance that internal auditors would cover all Bureau activities and thus be a more effective part of the Bureau's management control system.
- Our report on the audit of the Student Loan Insurance Fund for 1971 and 1972 contained somewhat of a rarity in audit opin-

ions. It stated that the financial statements did *not* present fairly the financial position and results of operations of the Fund. The reasons were many as were our recommendations for improvement. We also suggested that the HEW Audit Agency be directly involved in resolving the problems encountered and advise on progress being made to improve, provide technical assistance, and propose recommendations on additional financial and operational matters where improvements were called for.

Suggestions for Internal Auditors

We in GAO never quite leave the subject of internal auditing for very long. Before leaving it for now, however, I would like to register a few suggestions for internal auditors to include in their long list of concerns.

- They should make sure, as best they can, that they really have the ears of the top management and that they are given every opportunity to participate in planning their audit program. In addressing the Society of Experimental Test Pilots not long ago, the Comptroller General called attention again to this most important point. He remarked that the internal auditor must have the ear of his company president—or the top man in his government agency—if his information and advice are to be effective.

- Although independence of operation is essential, the internal auditor must not be so detached as to be above constructively helping officials at all levels to improve their performance. The name of the internal audit game is to provide *constructive* as well as protective assistance to the organization and management served.
- Internal auditors should take a dim view of waste and inefficiency and ineffectiveness in any form in the organization served.
- They must not overlook the need to provide a constant check on financial operations, on the adequacy of accounting systems and related control procedures, and on the reliability of financial and other reports used by managers in conducting their affairs. These are all important grist for the internal auditor's mill.
- Internal auditors should develop all the necessary technical proficiency to review the use and operation of electronic computer systems. The notorious Equity Funding Life Insurance Company scandal, which involved over 60,000 bogus insurance policies, would probably not have gone undiscovered so long if the auditors, both internal and external, had really checked out how the computer system was being used.

The Federal Government is a large user of computers and has many large, complex systems. They must be no less subject to expert audit testing for adequacy

of controls and propriety of use than other types of systems.

These suggestions definitely are not a complete inventory of all the matters that internal auditors must worry

about. But to me they stand out as special concerns for all internal auditors—and particularly for those who are adding the mantle of certified internal auditor to their other distinctions and accomplishments.

Good Reason for Agency Program Evaluation

Certainly, Government executives can refine their techniques for performance budgeting, and any new over-all management system must include the concept of management by objectives. A chapter to the HEW handbook on Operational Planning System might be added to provide for use of economic analysis in determining alternatives to accomplish objectives. Another chapter could be added to provide for independent evaluation. Otherwise, some day a GAO report might shock the Secretary into realizing that his Bureau and Agency heads did not tell him the complete story.

William O. Harris

**"Improving Federal Program
Performance,"**

**Government Executive,
September 1973**