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BY THE COMPTROLLER GENERAL

# Report To The Congress

OF THE UNITED STATES

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## GAO Findings On Federal Internal Audit--A Summary

Although Federal internal audit organizations save the Government billions of dollars each year, recent GAO reviews of such organizations disclosed some problems, including insufficient

- financial auditing,
- computer auditing,
- grant and contract auditing, and
- quality testing of audits and grantee records.

In addition, followup on audit findings has been poor and fraud identification was for many years a low priority. Lack of adequate staff contributed to most of these problems.

Legislation creating Offices of Inspector General has upgraded the audit organizations of most major departments and agencies. GAO is summarizing the results of its reviews of internal audit organizations made during the past 4 years so that the new Offices of Inspector General and other internal audit organizations can improve their audit activities.



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COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report summarizes our experiences over the past 4 years in reviewing Federal internal audit organizations and discusses their need for more staffing and management attention. Our review was made to give internal audit organizations and the new Offices of Inspector General in the executive branch a broad perspective on the status of internal auditing in the Government.

We are sending copies of this report to the Director, Office of Management and Budget, and to the heads of departments and agencies having Inspector General Offices or major internal audit organizations.

*Thomas B. Steitz*  
Comptroller General  
of the United States



D I G E S T

Federal internal audit organizations save the Government billions of dollars each year. However, not all their work is as effective as it could be, and internal audit problems have kept the Government from realizing the full benefit of their work. During the past 4 years, GAO has issued 70 reports on these problems. This report summarizes these problems so that the new Inspector General Offices and other internal audit organizations can improve their audit activities.

Problems in Federal audit organizations included

- low priority on preventing and detecting fraud,
- insufficient financial auditing,
- inadequate and insufficient audits of grants and contracts,
- a need for more computer auditing,
- poor followup on findings, and
- insufficient staff.

LOW PRIORITY ON  
FRAUD PREVENTION AND DETECTION

Fraud and abuse in Federal programs has increased sharply in recent years and has heightened the need for internal auditors to act as deterrents in fighting this problem.

Before legislation creating Offices of Inspector General in most major departments and agencies, fraud prevention and detection

received little attention by Federal audit organizations. To meet the increased challenge of detecting fraud and abuse that the new legislation poses, auditors and investigators need better training. (See ch. 2.)

#### INSUFFICIENT FINANCIAL AUDITING

Financial audits of the Government's assets, liabilities, revenues, and expenses have been inadequate. Federal units with annual funding exceeding \$20 billion told GAO they had not received financial audits during fiscal 1974-76 although 58 of these reported they had received nonfinancial audits. Also, some agencies spend most of their audit time on grants and contracts. As a result some internal coverage, particularly financial, has not been adequate. (See ch. 3.)

#### INADEQUATE AND INSUFFICIENT GRANT AND CONTRACT AUDITING

Federal grant and contract funds are particularly susceptible to exploitation through various means, such as false claims, bribery, and collusion. Even though grant audits have received more emphasis than internal audits, recent GAO reports indicate that many Federal grants and contracts are either unaudited or are audited in an uncoordinated, ineffective, and inefficient manner, an approach that costs both time and money.

The Government can lose millions of dollars through gaps in audit coverage, and unnecessary costs result from duplication of effort and from too frequent audits of grants too small to warrant more than occasional audits. Numerous audits also unnecessarily disrupt the grantee's staff. (See ch. 4.)

#### NEED FOR MORE COMPUTER AUDITING

None of the Federal agencies has adequately audited computer systems. This is a serious deficiency since the Government spends over \$10 billion annually to operate over 10,000 computers. These computers annually issue unreviewed payments and initiate other actions involving billions of dollars in

Government assets. This lack of audit can cost the Government huge amounts. (See ch. 5.)

#### POOR FOLLOWUP ON AUDIT FINDINGS

Hundreds of millions of dollars may be lost each year because Federal agencies too often delay or take no action to resolve audit findings. Although the actual number of unresolved findings is unknown, one recent GAO report noted that findings from nearly 14,000 audit reports involving \$4.3 billion in 34 agencies had not been resolved. The difficulty of resolving findings varies widely. Although some delays are unavoidable, in most agencies this process is taking too long. Both agency management and internal auditors have important roles in resolving findings. (See ch. 6.)

#### INSUFFICIENT STAFFING

GAO has been issuing reports since 1966 advocating more staffing for internal audit organizations; although the staffs increased significantly in the 1970s, there has been a strong trend for internal auditors to perform mostly external audits. The result is inadequate coverage of Federal programs. During fiscal 1974-78, agency audit organizations frequently were unsuccessful in obtaining more staff, thereby hampering the efforts of two Offices of Inspector General and probably creating problems for others. Additional staff was unobtainable because

- agencies drastically reduced or did not approve requests for more audit staff,
- the Office of Management and Budget (OMB) and the Congress reduced certain agency requests for audit staff, and
- agencies decreased their audit staffs in response to overall OMB ceiling reductions.

Recently OMB requested more staffing for the Inspectors General in the 1981 budget--which would result in an aggregate increase of 20 percent above fiscal 1979 levels, although

the amounts for individual agencies vary. We cannot now predict how the freeze on Government hiring will affect the planned increase. (See ch. 7.)

### CONCLUSIONS

The establishment of the Inspector General Offices and other recent improvements have the potential to strengthen Government auditing, but it is too early to say whether their efforts will correct all deficiencies. (See ch. 8.)

GAO will continue to work with internal audit and Inspector General organizations and will advise the Congress of any further actions needed to solve the problems discussed in this report.

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ABBREVIATIONS

GAO            General Accounting Office  
HEW            Department of Health, Education, and Welfare  
HUD            Department of Housing and Urban Development  
OMB            Office of Management and Budget

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## CHAPTER 1

### INTRODUCTION

In recent years the role of Federal internal auditing has been the subject of widespread congressional concern, culminating in the passage of Inspector General legislation in 1976, 1977, 1978, and 1979 which combined the audit and investigation activities within 15 Federal agencies for the purpose of detecting fraud, waste, and abuse. This concern was generated by the public's demand for better Government and an end to waste in Federal programs.

Federal executive agencies have offices throughout the United States and abroad which employ nearly 5 million people and manage scores of programs. Effective management of such operations requires a system of internal control, including internal audit. An agency's internal audit organization, when given adequate staff, organizational independence, and authority to review all agency functions, can furnish management with information, analyses, appraisals, and recommendations for improving operations.

Federal internal auditing also includes so-called "external" auditing of Federal grants, loans, and contracts which may be done by Federal auditors or by State and local auditors or independent public accountants under the direction of Federal auditors.

Each Government agency is required by Federal law to have an internal audit organization, and for many years we have emphasized the importance of strong internal audit systems. The need for internal audit in Federal agencies was first recognized by the Congress in the Accounting and Auditing Act of 1950, which required each agency head to establish and maintain systems of internal control, including appropriate internal audit. The same act required the Comptroller General to prescribe principles and procedures for internal audit. The principles and procedures which were developed encouraged auditors to identify opportunities for minimizing unnecessary or wasteful practices and to review agency programs and activities to determine whether they are meeting established objectives.

Because of our special relationship to internal audit organizations--a relationship mandated by law--we are continually working to improve the Federal internal audit capability, both through issuing principles, concepts, and standards and through periodic reviews of the audit organizations. In the past 4 years, we have issued 70 reports on internal

audit. <sup>1/</sup> This report brings together the major findings, conclusions, and recommendations from those reports.

### BENEFITS OF INTERNAL AUDITING

Federal internal audit organizations are important management resources and often save the Government billions over the costs of their operations by reducing or eliminating unnecessary or wasteful practices and identifying potential cost reductions. At present, there are 14,946 internal auditors in the Government. These auditors prevent and detect fraud; provide audit coverage to internal financial operations, Federal assistance programs, and computer systems; and follow up on unresolved audit findings. Appendix II shows the number of auditors in Federal internal audit organizations during fiscal 1979.

### GAO EFFORTS TO IMPROVE INTERNAL AUDITING

In 1975 we began a series of reviews concentrating heavily on (1) managing the internal audit function, (2) financial auditing, (3) audit staffing and use, (4) computer auditing, and (5) audit effectiveness. About the same time there was a corresponding resurgence of interest shown by the Congress in internal audit. Hearings on internal audit problems and requests for our reviews of specific audit organizations became more frequent. In recent years the Congress has requested evaluations of the Army, Navy, Air Force, Defense Contract Audit Agency, Defense Audit Service, Small Business Administration, Federal Bureau of Investigation, and Internal Revenue Service audit operations. It has also asked for special reviews, such as its request for information on who performs financial audits for all executive branch units.

This report summarizes the status of our recent efforts in the Federal internal audit area. It highlights existing problems so the new Offices of Inspector General and other internal audit organizations can improve their activities.

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<sup>1/</sup>Appendix I lists these reports, some of which are discussed in subsequent chapters.

## CHAPTER 2

### INTERNAL AUDITORS ARE BECOMING MORE ACTIVE

#### IN COMBATING FRAUD

Fraud and abuse in Federal programs has increased sharply over the past few years and has emphasized the need for Federal internal auditors to act as deterrents in fighting this problem. Although no one knows the extent of fraud in the Federal Government, losses resulting from it are estimated to be substantial. Department of Justice officials believe that fraud ranges from 1 to 10 percent of Federal program expenditures and have reported that in every instance where they have looked for fraud in Federal programs, they have found it. In 1978 we reported that the Government lacked leadership, guidance, and commitment in handling fraud. The situation has improved with creation of 15 Offices of Inspector General. This chapter discusses the Federal responsibility and the role of the internal auditor in controlling this problem.

#### THE FEDERAL GOVERNMENT HAD NOT BEEN FULFILLING ITS RESPONSIBILITY TO CONTROL FRAUD

In the past the Federal Government had used a passive approach in identifying fraud, even though the extent of fraud in Government programs was significant. Even the low side of Justice's estimate of fraud, 1 percent, would total \$2.5 billion annually. While substantial in itself, this amount is more significant when considered in terms of the goods and services it could provide at current funding levels--enough to (1) fund the school lunch program for over 1 year, (2) increase the number of jobs provided under the Comprehensive Employment and Training Act programs, (3) increase nearly 5-fold the grants for cancer research, or (4) increase nearly 20-fold the grants for air pollution control.

Clearly the impact of fraud, both financially and socially, is formidable. Federal agencies' effectiveness and credibility in dealing with social and economic problems may depend largely on their success in dealing with fraud. Until recently, however, agencies gave fraud detection a low priority. This led to passiveness regarding potentially fraudulent situations.

The Federal Highway Administration, for instance, generally viewed contract violations as honest mistakes without considering the reasons for the violations or potential fraud.

The Department of Labor regarded questionable personnel and training cost reports submitted by prime sponsors as possible funds to be recovered rather than possible fraud. The Department of the Interior did not make a concerted effort to detect fraud and abuse but relied primarily on complaints and allegations--a reactive approach.

Federal agencies generally are becoming more aware of the amount of fraud which may be occurring in their programs. A former Department of Health, Education, and Welfare (HEW) Secretary estimated in 1978 that fraud and abuse in the Medicaid program alone totaled \$750 million. HEW's Office of Inspector General estimated that fraud, waste, and abuse in HEW programs was as much as \$6.3 billion in fiscal 1977. The Department of Commerce estimated that fraud in the Office of Minority Business Enterprise amounted to 10 percent of the program, or about \$5.3 million annually. Identifying the extent, nature, and frequency of these illegal acts, together with strong internal controls and effective audit coverage, are first steps to combating and preventing them.

INTERNAL AUDITORS HAVE NOT  
EFFECTIVELY DETERRED FRAUD

Although internal auditors should not be expected to be insurers against fraud, they are responsible for serving as deterrents to it. They must be alert to the possibility of fraud and devote some effort to fraud detection. Once identified, all indications of fraud should be referred to the proper authorities. In addition, when fraud is discovered, the auditor is responsible for determining why it happened and for recommending changes to strengthen management controls to prevent similar frauds.

In a September 1978 report, we recommended that Federal agencies adopt a more organized approach to identifying fraud, which included:

- Developing information on the most likely types and methods of fraud and the magnitude of fraud in agency programs.
- Giving fraud detection a higher priority.
- Making employees more aware of the potential for fraud and alert to the need for reporting irregularities promptly.
- Fixing responsibility for identifying fraud.
- Providing fraud training to agency investigators.

The auditor's traditional role of concerning himself or herself with fraud only when it comes to his or her attention is not enough. At this time when auditors are being required to rethink their fraud detection role, we believe a more positive, systematic role in fraud detection is needed. This rethinking of responsibilities may significantly affect the extent of the work that internal auditors, independent public accountants, and other auditors will have to do to identify fraud.

#### COMPUTERS MAKE DETECTING FRAUD EVEN MORE COMPLEX

Computers can make fraud even more difficult to detect, and often internal auditors are unaware of crimes committed in systems over which they have audit responsibility. Detecting computer fraud is often more difficult because computer systems usually provide fewer written records of transactions. These systems naturally concentrate processing in fewer hands and make proper separation of duties more difficult. Furthermore, the concentration of asset information in easily changeable form increases the potential for loss.

Auditors need better information on computer crimes to insure good audit planning and to enable them to respond to the needs of management and their organizations. Auditors should analyze computer crimes to pinpoint the internal control weakness that may have facilitated them and recommend action to strengthen agency operations and procedures. A more systematic approach to preventing and detecting crimes in computer systems than was necessary for manual systems is needed. This necessitates better internal control and more effort to see that the systems are operating as designed.

#### AUDITORS AND INVESTIGATORS NEED BETTER TRAINING IN IDENTIFYING FRAUD

Unfortunately agency auditors and investigators often do not have the background, experience, and training needed to effectively detect fraud. Our 1978 report stated that about 70 percent of agency investigators had no experience in investigating fraud and about 80 percent had no formal training in this area. When investigators had such training, it was generally limited to procurement fraud. Most investigators also lacked the education in finance and accounting often needed to identify fraud.

Audit staffs need at least basic training in recognizing and preventing fraud. Agencies should develop in-house programs or identify existing programs that provide such training. During our 1978 review, many investigative officials

and investigators indicated a need for more training in such areas as (1) what fraud is, (2) where and how it occurs, and (3) the types and extent of evidence needed to prove fraud.

Since fraud against the Government usually involves financial matters, auditors and investigators need additional expertise in this area. Our 1978 report noted that the qualifying requirements for the criminal investigator position generally included a bachelor's degree or several years of related experience or an equivalent combination of education and experience. However, none of these criteria required experience or training in investigating fraud or knowledge of subject matter often necessary to investigate fraud, such as finance and accounting.

## CHAPTER 3

### MANY FEDERAL PROGRAMS LACK ADEQUATE

#### FINANCIAL AUDIT COVERAGE

The time spent by Federal agencies on internal financial audits is often insufficient to adequately cover their assets, liabilities, income, and expenses.

#### OBJECTIVE OF FINANCIAL AUDITING

According to the Accounting and Auditing Act of 1950, the objective of financial auditing in the Federal Government is internal control. The internal auditor should examine financial transactions to the extent necessary to determine whether:

- The agency is effectively controlling revenues, expenditures, assets, and liabilities.
- It is properly accounting for its resources, liabilities, and operations.
- Its financial reports contain accurate, reliable, and useful data and are fairly presented.
- It is complying with laws and regulations.

The internal auditor should evaluate the agency's policies and procedures and the internal controls related to its financial operations, including accounting and financial reporting. He or she should be particularly concerned with the agency's assets--whether they are fully accounted for and whether procedures are being followed to adequately protect them from loss, deterioration, or misuse. Appendix III specifies financial areas that should be reviewed, as applicable, by an agency's internal audit staff.

#### MORE FINANCIAL AUDITING IS NEEDED

In May 1977 Senator Lee Metcalf, then Chairman of the Subcommittee on Reports, Accounting and Management, Senate Committee on Governmental Affairs, asked us to obtain information on financial audits of each organizational unit of the executive branch of the Federal Government. Specifically, he wanted to know who had audited each unit during fiscal 1974-76.

In response, we reported in June 1978 that 133 Federal units with annual funding exceeding \$20 billion had told us

they had not received financial audits during fiscal 1974-76, although 58 had reported they had received nonfinancial audits. Although some of these funds were budgeted for Federal assistance programs which are often audited at State or local levels, the Federal disbursing units involved were not included in these audits.

Our reviews during fiscal 1976-78 concerning the extent of internal financial auditing in seven major agencies disclosed that the Departments of Housing and Urban Development (HUD) and Agriculture were generally providing adequate audit coverage of internal financial operations. For various reasons, the other five agencies lacked such coverage. We found:

- The Department of Labor's auditors had provided virtually no internal financial coverage because external audits of grants under the Department's Comprehensive Employment and Training Act Program had been given primary emphasis.
- Veterans Administration auditors had focused on audits of the agency's hospitals and had not adequately covered all internal financial operations. They had provided only sparse coverage to the multibillion-dollar veterans benefit programs, which constituted 74 percent of the Veterans Administration's fundings.
- The Department of the Interior's auditors, except for audits of the Bureau of Land Management and the Bureau of Reclamation, had not provided sufficient coverage of the Department's internal financial operations.
- The National Aeronautics and Space Administration's audit staff had provided virtually no coverage to headquarters operations or to several field centers and component installations.
- The Department of Justice had placed primary emphasis on financial audits of the Federal Prison System and only limited financial audit coverage had been provided in the other program areas.

The lack of financial audit coverage in most instances stemmed from a lack of audit personnel. In addition, decisions on establishing audit priorities have resulted, in some cases, in the shift of limited staff to external audits. For example, Labor officials told us they had emphasized external audits because of the significant dollar amounts appropriated to such programs. The Director of Justice's Internal Audit Staff stated that his office's concentration on Federal Prison System audits had stemmed from the fact that for the first

4 years of its existence, his office had to depend almost entirely on reimbursement from the groups it audited to fund its operations. Thus, about 65 percent of its reports were on the Federal Prison System, which provided the largest share of the reimbursement during that period. The Veterans Administration's concentration on hospitals also stemmed partially from the fact that its Internal Audit Service had not developed its universe of programs to be audited and had not filed its plans for auditing that universe with OMB. Lacking a defined universe and a formal plan, the Service had been following a longstanding policy of concentrating on hospitals.

#### EXTERNAL AUDITING HAS RECEIVED MORE EMPHASIS

Many agencies are spending most of their audit effort on external audits of grants and contracts. As a result, some internal audit coverage, particularly financial coverage, has not been adequate. The trend toward more external auditing was pointed out in our 1976 report. It stated that HEW spent 80 percent of its audit time on external audits; HUD, 64 percent; and the Department of Transportation, more than 70 percent.

Although we recognize the need for adequate external audit coverage and the problems experienced in attaining it--as discussed in chapter 4--we believe the resulting lack of emphasis on internal financial auditing represents a serious weakness.

## CHAPTER 4

### FEDERAL GRANTS AND CONTRACTS DO NOT RECEIVE

#### ADEQUATE AUDIT COVERAGE

Federal grants and contracts are exploited through various means, such as false claims, bribery, and collusion, and many of our recent reports show that they are not being adequately audited. The Federal Government relies on audit to assure that funds are spent as the Congress intended and to prevent unauthorized expenditures and loss of funds from fraud and abuse.

#### A WIDE RANGE OF PROBLEMS REDUCES THE EFFECTIVENESS OF CONTRACT AUDITS

Several factors adversely affect the performance of contract audits. The purpose of contract auditing is to help procurement and contract administration management achieve the objective of prudent contracting by giving them financial information and advice on proposed or existing contracts and contractors. Over the past 4 years, we have reported on the contract audit practices of the Defense Contract Audit Agency, the National Science Foundation, and the Departments of Agriculture and Labor. The following summarizes our findings in these agencies.

- The Defense Contract Audit Agency lacked adequate audit planning and coordination and needed to broaden the scope of its audits and minimize delays and disruptions. It also lacked sufficient coverage to assure that contractors complied with cost accounting standards, rules, and regulations. Finally, the Agency was not given sufficient time to perform effective audits, was not allowed access to contractor records, often did work that was unnecessary or could have been re-assigned, and did not conduct enough pricing reviews.
- Many National Science Foundation audit reports questioning costs charged to National Science Foundation grants and contracts were closed by the Foundation without action, or else actions taken were untimely.
- The Department of Agriculture had been unable to obtain adequate grant and contract audits for many years due to lack of funding, hiring freezes, and personnel ceilings. This lack of staff has resulted in the inability of the Department's audits to cover compliance with laws, regulations, and agency procedures or provide enough specifics so that Agriculture

agencies could file claims against institutions that had improperly used Department funds.

- The Department of Labor's Comprehensive Employment and Training Act program encouraged duplicative financial audits of contractors and subgrantees by not adopting a policy fostering the acceptance of audits done at the direction of subgrantees and contractors.

#### GRANT AUDITING INVOLVES OF A MAZE OF PROBLEMS

Federal grant auditing has been uncoordinated, ineffective, and inefficient. With the amount of Federal assistance expected to increase to almost \$89 billion in fiscal 1980, it has become more and more difficult to adequately cover Federal grants involving various programs and administrative structures.

Our review of the audit experience of 73 grantees during fiscal 1974-77 disclosed that about 80 percent of the grant funds in our sample had not been audited by or on behalf of Federal agencies while others had been audited repeatedly because each agency audited its own grantees without coordinating coverage with other funding agencies. Only 1 grantee received a single comprehensive audit, and the number of times a recipient was audited varied from no audits to over 50.

This disorganized approach costs time and money. The Government can lose millions of dollars through gaps in audit coverage. Unnecessary costs result from duplication of effort and from too frequent audits of grants too small to warrant more than occasional audits. Also, numerous audits unnecessarily disrupt the grantees' staffs.

#### Responsibility for Auditing Grants

Each agency that provides Federal money to a grantee must see that the grantee's records or activities are appropriately audited. These audits may be done by Federal auditors, State and local auditors, or certified public accountants. The purpose of such audits is to assure the agencies and ultimately the Congress that grantee reports are reliable, operations are complying with laws and regulations, and Federal funds are not subject to fraud or embezzlement and are being used for authorized purposes.

Although the ideal in auditing grant programs is to have a single audit of a recipient, this ideal is far from being

achieved despite attempts to attain it. 1/ In general, agencies have been auditing only their own grants. They have not been completely reviewing grantees' financial controls and generally have paid little attention to how a recipient's grant management practices affect other Federal grants, even those of much larger amounts. Under this narrow approach, auditors have been unlikely to detect improper charges or transfers of funds and equipment among grants.

#### Methods for Auditing Grants Were Disorganized

Methods for auditing Federal grants were disorganized and did not afford grants the full protection of audits or optimize the use of audit resources. Coverage of Federal grantees ranged from nonexistent or insufficient to excessive. Overall, we found that 2/

- although most grantees received audits, they had been narrow in scope and had not given either the Federal Government or the grantees a meaningful overview of the grantees' financial controls and grant management capabilities;
- many recipients had received far less coverage than seemed appropriate--either no audits had been made or coverage had suffered major gaps; and
- some grantees were being audited much too often.

#### Duplication of Audit Effort Has Been a Problem

Although Federal policy seeks to have each audit satisfy the needs of as many agencies as possible, most auditing of grantees has not been done with an eye toward minimizing duplication. Frequently, several organizations audit the same grant to satisfy the specific requirements of only one agency while paying little attention to the recipient's grant management practices and how they affect all Federal grants.

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1/Three OMB Circulars, A-73, A-88, and A-102, provide guidance for single audits of Federal grant programs. In addition, we have issued an audit guide (see p. 14) for insuring a single audit approach for these programs.

2/The following groupings are not mutually exclusive; some recipients are in more than one category.

This piecemeal approach both provides little assurance that Federal funds are properly safeguarded and causes duplication of effort. Piecemeal auditing has two drawbacks. First, auditors frequently do not detect inequitable charges or improper transfers of funds and equipment to the Federal grant when they do not see the total picture, and second, auditors cannot determine how improper practices affecting one grant may affect other grants and programs.

#### MANY GRANTS RECEIVED INSUFFICIENT COVERAGE

Because of gaps in audit coverage, the ability of audits to insure the proper expenditures of hundreds of millions of dollars in Federal funds was either limited or nonexistent. For example:

- No Federal audit coverage was provided an Ohio grantee receiving \$52.5 million from HEW and Labor during fiscal 1974-77.
- No audits were made of a Washington State grantee that had received about \$5.5 million from five Federal agencies under 23 grants.
- Almost no Federal audit coverage was provided a Washington State grantee receiving \$15 million in Federal funds from ACTION and HEW during a 4-year period. Only \$126,000 of \$1.6 million in ACTION funds were audited, and HEW grant funds of \$13.4 million were not audited.

#### CROSS-SERVICING HAS SELDOM BEEN USED

In September 1973 the General Services Administration issued Federal Management Circular 73-2 (now OMB Circular A-73) requiring the Federal agency with the principal financial interest in a multifunded grantee to study the feasibility of one agency conducting audits for the other grantor agencies. This approach is often called cross-servicing.

This circular established a framework for accomplishing the purpose of cross-servicing, which is to conserve staff resources, promote efficiency, and minimize the disruption of audits on grantees. However, in 1977 we reported that Federal agencies were not using this arrangement to the extent possible. This can result in duplicate audit effort, a waste of time and money, and the interruption of program personnel work.

Several barriers inhibit additional cross-servicing. These include (1) lack of Federal-wide funding information on grantees, (2) limited Federal audit staffs, (3) lack of reimbursements procedures, (4) the large number of Federal programs, and (5) the lack of a standard audit guide covering multiple programs and funding sources.

With regard to this latter problem, we issued "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" in October 1978 to serve as a guide for insuring a uniform audit approach and uniform documentation procedures for financial audits of organizations receiving funds from several Federal agencies or under several federally assisted programs. This guide was updated and reissued in January 1980. Moreover, in October 1979 OMB issued attachment P to Circular A-102, which directed Federal departments and agencies to improve audit coordination with regard to Federal assistance by requiring the use of these guidelines and to increase their reliance on audits by State or local governments. The attachment established audit requirements for State and local governments and Indian tribal governments receiving Federal assistance to insure that audits are made on an organizationwide basis rather than a grant-by-grant basis.

The adverse effect of insufficient cross-servicing was illustrated in our 1978 report on internal auditing in the Department of Agriculture. A large part of the shortfall in the Department's audit coverage involved programs administered by State and local governments and educational institutions. Much of this shortfall would be eliminated if States and local governments made those audits now required by Federal regulations and if other Federal agencies provided adequate audit coverage of those Department activities for which they had cognizance under existing cross-servicing arrangements.

BETTER MONITORING OF ASSISTANCE FROM  
INDEPENDENT PUBLIC ACCOUNTANTS IS NEEDED

Federal internal auditors increasingly have been relying on the work of independent public accountants to carry out their requirements for audits of grant and other federally funded programs. However, such audits must be reviewed. These reviews require a certain expenditure of staff time by the internal audit organization. Moreover, Federal internal auditors often reserve for themselves some part of the audit universe to maintain better control over the program or entity being audited.

We reviewed the financial opinion work done by public accountants auditing HUD's low-rent housing program in 1976. The accountants performed this work satisfactorily in most cases, although some of their work may not have always met American Institute of Certified Public Accountants standards. In addition, Department reviews revealed that five audits by a public accountant, whose work we had not reviewed, appeared to be below standard.

Our review showed that HUD was not effectively monitoring the performance of the independent public accountants, contrary to its own procedures. As a result, HUD accepted audit reports containing obvious errors or not meeting HUD audit requirements and did not identify deficiencies in the public accountants' workpapers.

#### AUDIT COVERAGE OF GRANTS AND CONTRACTS FOR HIGHER EDUCATION IS INADEQUATE

HEW is responsible for auditing Federal funds provided to 2,500 colleges and universities. This support is in the form of grants and contracts for research and development, facilities and equipment, and fellowships and traineeships. During fiscal 1974-76, these grants and contracts totaled about \$14.4 billion, which was provided by 14 agencies, including HEW, Agriculture, Defense, Energy, the National Science Foundation, and the National Aeronautics and Space Administration. Under a cross-servicing arrangement, HEW is responsible for auditing the funds and providing the results to funding agencies.

In July 1979 we reported on HEW's audit coverage of these grants and contracts. We reviewed HEW's audits at 20 institutions that had received the most Federal support during fiscal 1975 and concluded that HEW was trying to do too much with too few audit resources. As a result, audits were not conducted often enough and were omitted entirely at some institutions. Because the shortage of audit resources had significantly contributed to the shortfall in coverage, we recommended that the Inspector General reassess his staffs' priorities to see if more effort could be devoted to university audits.

#### QUALITY TESTING IS TOO SUPERFICIAL

In July 1979 we reported that Federal agencies' procedures for examining the work of independent public accountants in auditing grantees' financial and other operations were too superficial. We recommended that more effort be devoted to quality testing of audits of grantees' records because without effective audits, the Federal Government has little

ability to detect and recoup Federal funds spent for unauthorized purposes and the Government's ability to identify and get correction of weaknesses in grantees' controls over cash and other assets is also impaired.

We examined the quality testing procedures of the Departments of Commerce and HEW and the Community Services Administration and found these procedures ineffective in identifying low quality work. We reviewed 12 audits that had been through the agencies' review processes; 8 lacked one or more attributes necessary for a quality job. All three agencies claimed that their audit groups had more responsibilities than resources to carry them out.

A shortage of Federal audit staff contributes to the quality testing problem, although a complete and balanced approach to quality testing would be feasible without greatly expanding audit resources. Such an approach would rely on testing a statistically sound sample, which could then be projected to all audits done by public accountants for an agency. We recommended that the Director, OMB, require Federal grantmaking agencies to develop and implement complete and balanced quality testing processes for identifying substandard work. We also recommended that the Secretaries of Commerce and HEW and the Director of the Community Services Administration reassess the priorities for their auditors to see if more time could be devoted to the quality testing of audits.

## CHAPTER 5

### MORE AND BETTER COMPUTER AUDITS

#### ARE NEEDED IN FEDERAL AGENCIES

Although many Federal agencies have made excellent progress in internal auditing, none has adequately audited automated data processing systems. This is a serious deficiency since the Government spends over \$10 billion annually to operate over 10,000 computers. These computers annually issue unreviewed payments and initiate other actions involving billions of dollars in Government assets. These actions are often wrong and can cost the Government huge amounts.

#### IMPACT OF COMPUTERS

Many Federal agencies use computers to support their functions. Annually, more than a billion actions, involving billions of dollars, in directives to act, to make payments, to issue orders for material, and to bill for amounts owed are initiated. They also issue millions of notifications to people outside the Government. In our April 1976 report on automated decisionmaking by computers, we stated that Federal agency computers processed more than 1.7 billion payments and other actions a year without anyone reviewing their correctness. Many agencies use computers in this way. At a minimum, Government computers issue annually:

- Unreviewed authorizations for payments or checks (excluding payroll) totaling \$26 billion.
- Unreviewed bills totaling \$10 billion.
- Unreviewed requisitions, shipping orders, repair schedules, and disposal orders for material valued at \$8 billion.

According to audit reports we reviewed, undetected data and programming errors cost the Government many millions of dollars annually and can impede agency mission achievement.

In addition, computers have added a new dimension for potential crime. Our 1976 report on computer-related crimes in Federal programs indicated that information on computer crimes was difficult to obtain because the crimes frequently were not classified as such by investigative agencies. Even so, we learned of 69 crimes or other incidents resulting in losses of over \$2 million. In addition, some crimes violated the privacy of individuals about whom computerized records were kept. Because computers are used so extensively in

managing Federal programs, Federal internal auditors should place proper emphasis on audits of computer systems.

#### SOME INTERNAL AUDITORS ARE CONTRIBUTING TO IMPROVED COMPUTER AUDITING

Some Federal internal audit groups are conducting critical and searching analyses of computer resources, determining their effectiveness, and assessing their adequacy in meeting users' needs. Some groups have made significant contributions to their agencies' computer management. Millions of dollars have been saved, and the effectiveness of programs has been significantly enhanced.

We reached these conclusions in our September 1977 report which provided the results of our review of the activities of internal audit groups in 12 Federal agencies to identify examples of audit involvement in automatic data processing.

#### IMPROVED AUDIT COVERAGE IS NEEDED

Although some internal audit organizations are doing good work in the computer field, others pay little attention to computers. Within the Department of Defense, for example, which had over 5,500 computers as of September 30, 1978, and many wide-ranging automated data systems applications, the limited expertise and need for more training in the computer area are pronounced. According to a February 1977 Senate staff study, the Deputy Assistant Secretary of Defense for Management Systems reported that of a total Defense-wide professional audit staff of 2,264 only 234 (about 10 percent) had extensive computer training and expertise. 1/

When the magnitude of automated systems and their far-reaching impact on agency operations, programs, and resources are considered, the adequacy of coverage by internal audit staffs is questionable and, in our view, a much greater computer audit capability is needed in many agencies.

#### Many Audit Organizations Have Avoided Computer-Related Audits

There is a long history of audit organizations' aversion to work involving computers and computer-based applications. This situation was reflected in many of our reports issued during fiscal 1975-1977. For example, we found that:

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1/Staff Study of Computer Security in Federal Programs, Committee on Government Operations, United States Senate, Feb. 1977, p. 177.

- The Veterans Administration Internal Audit Service had not evaluated the adequacy of controls over computer processing in the Veterans Administration's compensation and pension system.
- The HUD Office of Inspector General had made limited audits of the automated portions of HUD's payroll system. Its audits concentrated on evaluating the controls over preparing and entering information for computer processing and over computer outputs. It did not, however, thoroughly test controls in programs used to compute pay amounts.
- The Department of Commerce Office of Audits had made limited reviews of the automated parts of the Department's payroll system. The Office did not participate in designing and developing automated systems and did not review the systems on a continuing basis after they became operational.
- The Postal Service's Office of Audits had limited capabilities in the computer area because it had only one specialist knowledgeable in the design of computer systems and the Office had not actively participated in designing and modifying computer programs. Thus, the Office could not assure itself of adequate internal controls and complete audit trails in these programs.

Large sums are involved in the systems discussed in the above examples, and the need for auditors to assess the adequacy and effectiveness of control is obvious. All the agencies cited have taken action to correct the specific control deficiencies we found. Conversely, during our review of computer auditing in 12 Federal agencies, several audit staffs said that they simply did not have the technical competence to perform auditing in the computer environment. Consequently, they simply tried to avoid all contact with automatic data processing.

#### Auditors Need To Improve Their Analysis of Computer Errors

Internal auditors should analyze computer errors to determine if a pattern of deficiencies in data or programming exists. Computer applications need to be closely scrutinized, because the reliability of the information generated and the resultant management decision depend on effective automated systems.

According to our April 1976 report on managing automated decisionmaking, certain types of stocks in an automated inventory system at a naval installation were building up due to a quirk in the computer program which had the effect of double counting requests for parts and supplies. As a result, the computer ordered replacements automatically to accommodate this apparent increase in the need for such parts and supplies. Prior to our examining these cases, we learned that the agency had assumed that the computer's actions were correct and no one had questioned their output.

Our review made us begin to wonder how frequently similar situations might exist where a computer's input was resulting in actions being taken automatically with no review by human beings. We reviewed the reports of other Government internal audit agencies to find out whether similar situations existed elsewhere and were surprised to discover that it was rather common for internal auditors to encounter automated systems turning out errors which were not being detected by operators and users.

In each case reviewed, internal auditors detected the error and had corrective actions taken but they treated each case on an individual basis when, in fact, there was a pattern of errors. Eventually we were able to attribute these similar cases to ineffective programming, poor data, or a combination of the two. These factors, together with almost unquestioning acceptance of the outputs of computers as correct, had resulted in losses amounting to hundreds of millions of dollars through erroneous payments, ordering of unneeded items, incorrect eligibility determinations, and the like.

By establishing that this pattern existed rather generally throughout the Government and in disclosing the magnitude of the errors, we convinced OMB of the need to issue specific directives to all Federal departments and agencies directing them to take broad corrective action.

#### Auditors Need To Examine Computer System Weaknesses That Facilitate Crime

Chapter 2 emphasized that computer crimes in Federal programs were cause for growing concern. During our 1976 review, we obtained information from various investigative offices on 69 cases of improper use of computers totaling over \$2 million in losses. Furthermore, these cases did not represent all the computer crimes involving the Federal Government, since agencies do not customarily differentiate between computer and other crimes. Moreover, many crimes may have not yet been detected or reported.

We reviewed 12 of these cases in detail. In each case the incidents were directly traceable to weaknesses in system controls. These weaknesses resulted from deficient systems designs, improper implementation of controls by operating personnel, or a combination of both. Moreover, the weaknesses were in basic management controls, such as separation of duties and physical access control over facilities. Weaknesses in system controls existed primarily because management failed to recognize the importance of controlling systems. This lack of emphasis affected both the way systems were designed and the extent to which operators enforced controls.

Managers can use internal auditors as an important part of management control. But internal audit groups vary greatly in how they review computer systems. Although we could not say that audits of controls would have detected or prevented all 69 incidents, such audits were recognized as an important part of good overall management control. Some agency officials told us of specific plans to review systems procedures and controls, and some had been reviewing them regularly. Others had not, and overall audits of controls were either inadequate or ineffective. Auditors can identify control weaknesses that may result in criminal activity, but they must have adequate training and they should evaluate controls as systems are being designed as well as reviewing systems in operation.

#### Auditors Need Technical Competence for Conducting Computer Audits

Effective audits of computers and applications require technical competence beyond that required of auditors in the past, and the time is long gone when auditors could both ignore computers and successfully discharge their responsibilities. Managers and auditors need to continually monitor computer operations and determine whether an effective and reliable system is functioning. Without such evaluations, computer operations are vulnerable to undetected error, misuse, and fraud.

## CHAPTER 6

### AUDIT FINDINGS ARE NOT BEING PROPERLY RESOLVED

Hundreds of millions of dollars may be lost each year because Federal agencies too often delay or take no action to resolve audit findings. Although the actual number of unresolved findings is unknown, our October 1978 report noted that \$4.3 billion in audit findings, contained in nearly 14,000 audit reports of 34 agencies, had not been resolved.

#### ROLES OF MANAGERS AND AUDITORS IN RESOLVING FINDINGS

The difficulty of resolving findings varies widely, and although some delays are unavoidable, in most agencies this process is taking too long. Both managers and auditors have important roles in resolving findings, as discussed below.

Management's overall responsibility for resolving findings is spelled out in OMB Circular A-73. In addition, OMB Circulars A-88 and A-102 provide specific guidance on audit followup for Federal assistance programs. Circular A-73 requires that managers promptly decide what should be done and complete corrective measures as necessary on findings. The circular requires agencies to (1) determine agency action on audit recommendations within 6 months after they are made and (2) periodically evaluate their followup systems.

The internal auditor's role is stated in GAO's Policy and Procedures Manual for Guidance of Federal Agencies, which has similar requirements. The manual also states that auditors should participate in the followup activities to see if their findings have received serious management consideration and whether satisfactory corrective action has been taken. It further states that when operating officials disagree with auditors' findings, a decision should be made at a higher management level.

#### FACTORS CONTRIBUTING TO THE LACK OF PROMPT OR EFFECTIVE ACTION

Although established procedures require agency administrators to promptly and effectively resolve audit findings, our 1978 report stated that they often had not done so because:

- Administrators were busy with other duties and resolving findings had low priority. Department and agency heads generally did not emphasize to employees the importance of audits as a means of safeguarding funds and improving Government operations.

- Administrators rejected findings and recommendations without suitable justification and did not always seek needed legal or other expert advice.
- Agency efforts to recover funds and realize savings were not aggressive. Basically they did not insure collection action by establishing accounting and collection control over amounts to be recovered from grantees and contractors.
- Agency systems for tracking and resolving findings were deficient.
- Deficiencies in auditors' work sometimes made prompt and effective action difficult. Also, auditors could have done more to see that action was taken on their findings. More specifically, they did not always (1) fully develop findings, (2) issue prompt reports, and (3) verify or question the adequacy of administrators' corrective actions.

#### Systems for Tracking and Resolving Findings Are Inadequate

Most agencies were not complying with OMB requirements, and few had adequate systems for tracking and resolving findings. In addition to our 1978 review, other audits over the past 4 years have addressed aspects of this problem repeatedly.

We have issued several reports in recent years pointing out that agencies have often failed to establish formal followup systems. Examples follow.

- The Naval Audit Service did not have a formal system to effectively track the progress of findings and recommendations after reports had been issued. The Audit Service's large number of repeat findings indicated the inadequacy of both management's implementation of recommendations and its followup procedures.
- Because of its limited staff, the Small Business Administration did not conduct specific followup reviews.
- The Department of Defense contracting officers did not provide required feedback on recommendations, nor did they always use Defense Contract Audit Agency findings when negotiating contract prices. Action taken on 22,500 audit reports was unknown.

- The National Science Foundation did not follow up on its recommendations, and many were not resolved or the actions taken were untimely.
- The Defense Audit Service was not using a systematic method for following up on recommendations, and there was no assurance that followup would be accomplished even on significant matters.
- The General Services Administration's followup system needed considerably greater management emphasis--by the agency and OMB--and more prompt and systematic review by internal auditors to provide any assurance that promised corrective actions were actually taken or that the reported problems were otherwise satisfactorily resolved.

Agencies allowed findings to go unresolved because their systems did not track resolutions to final settlement. Management and audit officials often remove findings from control records and consider them resolved when grantees or contractors agree with them and promise to take corrective actions. In addition, administrators often forget or overlook final settlement when findings are prematurely dropped from tracking systems, and top managers assume that the findings were completely resolved when sometimes they were not. In some cases proper resolution of findings could have been facilitated if agency auditors had reported complete findings, issued prompt reports, and determined and questioned the adequacy of management's corrective actions.

## CHAPTER 7

### INTERNAL AUDITING IS IMPAIRED BY

#### INADEQUATE STAFFING AND LACK OF INDEPENDENCE

Our past reports have pointed out numerous weaknesses in the staffing of internal audit groups. We have long supported a strong Federal internal audit capability in recognition of the important role it plays in preventing and detecting fraud, waste, and abuse.

#### INADEQUATE STAFFING IS A WIDESPREAD, PERSISTENT PROBLEM

We have been issuing reports since 1966 on the need for increased staffing for internal audit groups, and although audit staffs increased significantly in the 1970s, there has also been a strong trend for internal auditors to do mostly external audits. As a result, even with increased staffs, internal auditors are still not adequately covering Federal programs.

In 1976 we reported that several agencies had not established internal audit staffs whereas others had staffs which were too small. We reported in 1979 that agency audit organizations frequently had been unsuccessful in obtaining more staff and that this situation was hampering the efforts of two Offices of Inspector General during fiscal 1978 and would probably create problems for others. Agencies could not obtain more staff during fiscal 1974-78 primarily because

- agencies drastically reduced or did not approve requests for more audit staff,
- OMB and the Congress reduced certain agency requests for audit staff, and
- agencies decreased their audit staffs in response to overall OMB ceiling reductions.

This lack of resources adversely affects many areas in the internal audit function. For example, in most instances when we found a lack of financial audit coverage, it stemmed from a lack of personnel. In 1977 we reported that limited staffing was a barrier inhibiting the implementation of additional cross-service auditing. In addition, our recent report on grant auditing cited the shortage of audit resources as the principal reason given by Federal agencies for insufficient grant audit coverage. Federal auditors also stated

that too few audit resources prohibited them from performing effective quality testing of audits and grantee records.

### Most Agencies Are Affected

The majority of Federal audit organizations have inadequate internal audit staffs. For example, our reports on the General Services Administration, the Small Business Administration, the Army Audit Agency, the Department of Commerce, and HEW all disclosed that these agencies had insufficient staffs. Also, the Department of the Interior and the Veterans Administration lacked the staffs to provide adequate internal financial audit coverage, and the Defense Audit Service could not provide coverage to high level Defense offices for this reason. For many years the Department of Agriculture has lacked staff to conduct grant and contract audits, and the Community Services Administration, the Department of Commerce, and HEW not only had too few auditors to make their own audits, but they also did not have enough staff to test the quality of audits by independent public accountants.

Some of our recent reviews of agency staffing have resulted in the addition of staff. Our reviews of the Veterans Administration and the Department of Labor resulted in the addition of 205 and 40 auditors, respectively. Our review of proposed cutbacks in the staffing of the Defense Audit Service resulted in the rescinding of a proposed 25-percent reduction.

### DEPARTMENT OF DEFENSE AUDIT ORGANIZATIONS HAVE INCREASED THEIR INDEPENDENCE

Several of our past reports indicated that internal auditors did not have the degree of independence from certain operations and activities subject to their review as would be desirable. The positions of internal auditors in an organization should be independent of the officials responsible for the operations the auditors review. To provide an adequate degree of independence, internal auditors should be responsible to the highest practical organizational level, preferably to the agency head or to a principal official reporting directly to the agency head. In particular, we reported that internal audit groups within the Army, Navy, and Air Force did not have their audit functions placed high enough in the organizations to grant auditors maximum independence. We also reported that these Departments could obtain greater benefits by having their audit organizations headed by qualified civilians and that more civilians should be appointed to staff positions held by military internal auditors to the extent possible. The Army, Navy, and Air Force all did appoint civilian heads to their internal audit organizations.

## CHAPTER 8

### RECENT ACTIONS TO IMPROVE INTERNAL AUDITING

Efforts are underway to correct some of the problems discussed in this report. A significant step was taken on March 19, 1979, when the administration announced its Financial Priorities Program. This comprehensive program, developed to direct top management attention to needed improvements in agency financial systems, consists of nine areas selected for priority attention. These are accounting systems, internal control, cash management, audit followup, outlay estimating, debt collection, overtime, grant financing, and grant accountability. Each agency will be responsible for making the improvements needed in each area. Among other things, the program emphasizes full implementation of OMB Circular A-102 and the proper resolution of audit findings. This chapter discusses other recent corrective actions taken by OMB and the Inspectors General.

### CURRENT EFFORTS TO COMBAT FRAUD ARE IMPROVING

A shortage of experience, guidance, and resources has hampered efforts by Inspectors General to prevent and detect fraud. Nonetheless, recent actions by Inspectors General to (1) establish fraud abatement programs, (2) develop and coordinate audits and investigation policy and initiate joint audit-investigative reviews and joint reviews among Inspectors General Offices, and (3) develop new methods for extending audit procedures for detecting fraud will greatly improve their fraud prevention and detection capabilities. Another positive step has been the provision of training to several Inspectors General staff members in fraud detection and white collar crime and cross-disciplinary training for auditors and investigators.

### THE STATUS OF FINANCIAL AUDITING IS UNCLEAR

At present the adequacy of actions taken to improve internal financial audit coverage of Federal departments and agencies is difficult to determine, particularly since the Inspectors General have not been in office long enough to determine their effects. Some Inspectors General have reported problems in attaining adequate internal financial audit coverage brought on by a lack of staff. In future reviews we plan to monitor developments relating to financial audit coverage.

## GRANT AUDITING IS CHANGING DRASTICALLY

Since our recent reports were issued, major corrective measures have been initiated to improve grant auditing. As mentioned on page 14, OMB issued attachment P to Circular A-102 which incorporated our standard audit guide, (Guidelines for Financial and Compliance Audits of Federally Assisted Programs) and explained how it should be used. Attachment P also established a system that allows one Federal agency to act for all agencies in auditing a single grantee.

OMB is now taking several measures to implement the concept of a single, coordinated audit on a Government-wide basis called for in attachment P. Their next step will be to work with the Intergovernmental Audit Forum and our Office on its implementation, an effort that will require extensive coordination. OMB is also assigning Federal agency cognizance over major State and local government grantees and Federal agency recipients that have established indirect cost rates. OMB is developing major compliance items for about 60 Federal programs that together constitute about 90 percent of total Federal assistance, the purpose of which will be to determine whether grantees have spent Federal funds for authorized purposes. Finally, OMB has requested the Inspectors General to identify legal requirements that are inconsistent with the audit provisions of Circular A-102 and is conducting a limited number of pilot tests to determine the workability of the single audit concept.

### University Audits Are Being Improved

HEW and OMB have both taken recent actions to improve audits of Federal grants and contracts administered by institutions of higher education. OMB issued a revision to Circular A-88 that (1) continues the policy of relying on a single agency to act for all agencies in auditing universities and in negotiating their indirect cost rates and (2) adds to those duties the responsibility to follow up on audits by assuring correction of system deficiencies and negotiating monetary recoveries. HEW's Inspector General reported that a major program of reform was underway to close the accountability gap created by university systems. This program includes (1) simpler Federal regulations, (2) improved procedures for audit resolution, (3) early audit reviews of proposed changes in institutions' accounting systems, and (4) sanctions against institutions and individuals when corrective actions are not taken in a reasonable time.

## Substandard Audit Work is Being Addressed

We are now involved in two efforts with the American Institute of Certified Public Accountants aimed at resolving the problem of substandard certified public accountant work affecting Federal programs. We are working with the Institute's Ethics Subcommittee to determine the extent of substandard work involving Federal programs. Institute representatives plan to review certified public accountant reports prepared under various grant programs for indications of substandard work. The other effort is a project involving the Institute and our Office designed to explore and recommend solutions to problems in the procurement and performance of certified public accountant services for federally assisted programs.

## SOME INSPECTORS GENERAL HAVE IMPROVED COMPUTER AUDITING

Some Inspectors General have made recent improvements in their coverage of computer operations. Because long-term training is required, however, providing adequate coverage to computer systems will require time. Inspector General Offices have recently tried to provide audit coverage and computer auditing training and to develop security programs for computer systems. For example, the Department of Agriculture's Inspector General Office recently reviewed computer security and corrected conditions that had resulted in 6,400 unauthorized accesses to computer files during one 12-month period. Although these measures are encouraging, computer auditing is still far from adequate. For example, the Inspector General of the Department of the Interior recently reported that his Office had 89 sensitive computer applications which should have been audited on a 3-year cycle but that their current cycle exceeded 30 years.

## UNRESOLVED FINDINGS ARE BEING ADDRESSED

Since our October 1978 report on the need for more effective resolution of audit findings, OMB and the Inspectors General have tried to address this problem. In October 1978 OMB requested department and agency heads to immediately review their audit followup systems to bring them into compliance with Circular A-73. In December 1978 OMB requested descriptions of their existing systems so that OMB could work with agencies to assure that individual systems were consistent with the circular and that the unresolved findings were promptly and properly settled.

OMB has recently issued guidance to improve agency followup systems. In October 1979 it issued attachment P to

OMB Circular A-102, which provided guidance for followup relating to Federal assistance programs. In November 1979 the Office revised Circular A-73 to establish a 6-month limit on audit resolution, establish procedures for resolving major disagreements between audit and program officials, require semiannual reports to agency heads, and require periodic evaluations of followup systems. In addition, OMB also revised Circular A-88 in November 1979 to provide for audit followup on Federal grants to educational institutions.

Several Inspectors General have recently established procedures and tracking and reporting systems for open recommendations and designated key officials to review the status of open recommendations. A few Inspectors General have also developed policies for conducting postaudit reviews to assess progress on prior recommendations.

#### STAFFING PROBLEMS ARE NOT RESOLVED

OMB and Federal agencies have addressed the staffing problems of internal audit organizations. OMB gave special attention to audit staffing levels in developing the President's 1981 budget. The Office recently made its customary reviews of individual agency staffs and also made a special review of Inspector General Offices to assure consistency in the agency-by-agency determinations. As a result, OMB requested more staffing for Inspector General Offices in the 1981 budget. This request amounted to an aggregate increase of 20 percent above the fiscal 1979 level, although the amounts for individual agencies varied.

However, most Inspectors General have stated that they still lack staff resources and that this prohibits them from accomplishing their workloads and from fulfilling the requirements of the Inspector General Act. The severity of this problem continues to be emphasized in their most recent reports to the Congress.

## CHAPTER 9

### CONCLUSIONS

Our reviews of Federal internal audit organizations disclosed a number of problems, including

- low priority efforts to identify fraud,
- insufficient financial auditing,
- problems involving audits of grants and contracts,
- a need for more computer auditing,
- poor followup on findings, and
- insufficient staff.

These problems can lead to the loss of billions of dollars if the trend is not reversed because they result in lack of effective control over the Government's assets, liabilities, revenues, and expenses. They also create uncertainty as to whether Federal departments and agencies and their grantees are complying with laws and regulations.

The establishment of the Inspector General Offices could be a significant step toward solving internal audit problems by consolidating existing auditing and investigative resources to more effectively combat fraud, abuse, waste, and mismanagement. However, the potential of these Offices has not been fully realized because Federal agencies have frequently been unsuccessful in obtaining additional qualified staff. According to OMB, more staffing for Inspectors General has been requested in the 1981 budget. This request amounts to an aggregate increase of 20 percent above the fiscal 1979 staff level, although the amounts for individual agencies vary. We cannot at this time predict how the freeze on Government hiring will affect the planned increase.

Other recent improvements include the provision of new guidance on audit followup in OMB Circular A-73 and on grant auditing in Circular A-102. The latter circular and our "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" promote the single audit concept, which can result in staff resources being conserved, enhanced efficiency, and better audit coverage of grantees.

These efforts, some of which are part of the President's Financial Priorities Program, have improved Government auditing, but it is too early to say whether they will correct

all the deficiencies. The new Offices of Inspector General still have problems to iron out, including the training and coordination of effort of their auditors and investigators, as well as the staffing problem. Moreover, we do not know how much effort Inspectors General will devote to financial auditing and computer auditing as opposed to fraud, waste, and abuse reviews. We also do not know what, if any, problems may arise in implementing the single audit concept.

In summary, many actions have been initiated, but their ultimate success cannot be predicted. We will continue to work with internal audit and Inspector General Offices and will advise the Congress of any further actions needed to solve the problems discussed in this report.

GAO REPORTS ISSUED ON  
INTERNAL AUDIT SYSTEMS OF FEDERAL  
AND FEDERALLY ASSISTED PROGRAMS  
SINCE JUNE 1, 1975

<u>Report number</u>	<u>Date</u>	<u>Title</u>
FGMSD-75-31	6/18/75	"Need for Improvements in the Automated Payroll System of the Department of Housing and Urban Development"
FGMSD-75-22	6/25/75	"Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs" - General Services Administration
ID-75-81	7/25/75	"Review and Evaluation of the Office of the Inspector General of Foreign Assistance" - State Department
FGMSD-76-3	11/10/75	"Need for More Effective Controls Over Computerized Payroll-Processing Operations" - Commerce Department
MWD-76-90	2/06/76	Letter report to the Veterans Administration on the Compensation and Benefit Payment System
PSAD-76-35	3/01/76	"Operations Auditing by the Defense Contract Audit Agency--Accomplishments, Problems, and Actions To Improve"
RED-76-89	4/12/76	"Opportunities for Improving Internal Auditing" - Transportation Department
FGMSD-76-5	4/23/76	"Improvements Needed in Managing Automated Decisionmaking by Computers Throughout the Federal Government"
FGMSD-76-27	4/27/76	"Computer-Related Crime in Federal Programs"

<u>Report number</u>	<u>Date</u>	<u>Title</u>
FGMSD-76-67	6/25/76	"Need for Greater Audit Coverage of Internal Financial Areas" - Labor Department
EMD-76-2	7/16/76	"Auditing of Political Advertising by Electric Utilities and Gas and Oil Companies" - Federal Power Commission and Internal Revenue Service
GGD-76-90	7/30/76	"Revenue Sharing Act Audit Requirement Should Be Changed" - Treasury Department
CED-76-136	8/12/76	Letter report on insufficient audit coverage - Environmental Protection Agency
GGD-76-74	8/23/76	"Management Control Functions of the Small Business Administration--Improvements Are Needed"
CED-76-133	8/25/76	"Using Independent Public Accountants To Audit Public Housing Agencies--An Assessment" - HUD
ID-76-83	8/27/76	"Followup Review of the Office of the Inspector General of Foreign Assistance" - State Department
FGMSD-76-81	8/27/76	"Need To Avoid Duplicative Financial Audits of the Comprehensive Employment and Training Act Subgrantees" - Labor Department
FGMSD-76-84	10/08/76	"Audit Coverage of Internal Financial Operations" - Agriculture Department
FGMSD-76-83	10/19/76	"Opportunities To Improve Audit Operations" - HUD
FGMSD-77-3	11/19/76	"Greater Audit Coverage of Internal Financial Operations Is Needed" - Veterans Administration
FGMSD-76-50	11/29/76	"An Overview of Federal Internal Audit" - Government-wide

<u>Report number</u>	<u>Date</u>	<u>Title</u>
FGMSD-77-11	1/27/77	"Actions Needed To Strengthen the New Defense Internal Audit Service"
PSAD-77-80	3/09/77	"Increased Costs to Government Under the Department of Defense Program To Reduce Audits"
GGD-77-37	3/15/77	"Review of the Postal Service Payroll System"
FGMSD-77-28	5/13/77	"Internal Audit Coverage of Financial Matters in the Department of Justice"
FGMSD-77-26	5/31/77	"Potential for Improvement of Internal Audit Function" - Interior Department
CED-77-58	6/01/77	"Reporting, Staffing, and Other Changes Would Change the Internal Audit Function" - Commerce Department
PSAD-77-125	6/08/77	Letter report on Department of Defense compliance with cost accounting standards, rules, and regulations - Defense Contract Audit Agency
FGMSD-77-52	7/14/77	Letter report to the Chairman of the House Government Operations Committee on the authority and resources of the Deputy Assistant Secretary of Defense
FGMSD-77-49	7/26/77	"Why the Army Should Strengthen Its Internal Audit Function"
CED-77-115	8/05/77	Letter report on actions of the Department of Agriculture's Office of Audit and Office of Investigations on Farmers Home Administration Activities in Maine
FGMSD-77-55	9/26/77	"Need for More Effective Cross-Service Auditing Arrangements" - Government-wide

<u>Report number</u>	<u>Date</u>	<u>Title</u>
FGMSD-77-82	9/28/77	"Computer Auditing in the Executive Departments: Not Enough Is Being Done"
HRD-77-11	10/25/77	"Ways the Department of Health, Education, and Welfare Can Increase Benefits From Auditing"
FGMSD-78-02	10/31/77	"Staffing Shortages Within the Defense Audit Service"
FGMSD-78-05	11/11/77	"The Naval Audit Service Should Be Strengthened"
FGMSD-78-04	11/11/77	"The Air Force Audit Agency Can Be Made More Effective"
LCD-77-444	11/23/77	"Review of the Government Printing Office's Internal Audit Program"
FGMSD-78-12	12/27/77	"Need for Additional Internal Audit Coverage in the National Aeronautics and Space Administration"
CED-78-20	1/06/78	Letter report on expenditures charged by the Governor's office of the State of Connecticut to grants made by the New England Regional Commission - Commerce Department
LCD-78-304	1/06/78	Letter report to Senator Charles Percy on General Services Administration audit of alleged violations of procurement regulations (Region I)
CED-78-28	2/09/78	"Opportunities for Improving Internal Auditing in the Department of Agriculture"
LCD-78-315	2/16/78	Letter report to the Administrator of General Services on operations of the Office of Audits
FGMSD-78-25	4/12/78	"Internal Audit of Financial Operations in the Department of Housing and Urban Development"

<u>Report number</u>	<u>Date</u>	<u>Title</u>
FGMSD-78-36	6/06/78	"Financial Audits in Federal Executive Branch Agencies" - Government-wide
FGMSD-78-42	6/29/78	"Is the Air Force Inspection System Effective: GAO Was Denied Access to Pertinent Records"
HRD-78-131	9/05/78	Letter report on contract and grant audits by Defense Contract Audit Agency at Rochester University - HEW and Department of Energy
GGD-78-62	9/19/78	"Federal Agencies Can and Should Do More To Combat Fraud in Government Programs"
HRD-78-147	10/03/78	"The National Science Foundation Needs a Formal System for Followup on Audit Reports" - HEW/National Science Foundation
FGMSD-79-3	10/25/78	"More Effective Action Is Needed on Auditors' Findings--Millions Can Be Collected or Saved"
HRD-78-158	1/09/79	"Problems in Auditing Medicaid Nursing Home Chains" - HEW
GGD-78-93	1/17/79	"The FBI Can Improve Its Management Control Over Operations by Providing Effective Internal Audit" - Justice Department
FGMSD-79-11	1/19/79	Letter report on internal financial audit operations - Transportation Department
FGMSD-79-25	5/10/79	"The Effectiveness of the Defense Contract Audit Agency Can Be Improved"
FGMSD-79-37	6/15/79	"Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling"

<u>Report Number</u>	<u>Date</u>	<u>Title</u>
FGMSD-79-38	7/19/79	"Quality Testing of Audits of Grantees' Records--How It Is Done by Selected Federal Agencies and What Improvements Are Needed"
FGMSD-79-44	7/19/79	"Need for More Effective Audits of Federal Grants and Contracts Administered by Institutions of Higher Education"
FGMSD-79-43	7/27/79	"Federal Civilian Audit Organizations Have Often Been Unsuccessful in Obtaining Additional Staff"
FGMSD-79-51	8/28/79	"A Look at the Air Force Inspector General's Inspection System"
CED-80-4	10/24/79	"Improving Interior's Internal Auditing and Investigating Activities--Inspector General Faces Many Problems"
FGMSD-80-1	10/30/79	"The Army Inspector General's Inspections--Changing From a Compliance to a Systems Emphasis"
GGD-80-8	11/09/79	"The Office of the Comptroller of the Currency's Internal Auditing Needs Strengthening" - Treasury Department
EMD-80-29	11/28/79	Letter report on evaluation of the Department of Energy's Office of Inspector General
FGMSD-80-20	12/20/79	"The Marine Corps Inspection System Should Use Resources More Efficiently"
FGMSD-80-23	12/26/79	"The Navy Inspector General's Inspection System--Some Improvements Are Needed"
FGMSD-80-24	12/27/79	"The Defense Logistics Agency Inspector General Needs To Change From a Compliance to a Systems Approach"

<u>Report number</u>	<u>Date</u>	<u>Title</u>
GGD-80-31	1/4/80	"Internal Auditing Needs More Support in the National Credit Union Administration"
CED-80-20	1/18/80	"Essential Management Functions at the Federal Maritime Commission Are Not Being Performed" - Commerce Department
FGMSD-80-21	2/19/80	"Improved Grant Auditing and Resolution of Findings Could Save the Law Enforcement Assistance Administration Millions" - Justice Department
GGD-80-46	3/4/80	"Opportunities To Strengthen Internal Auditing in the Federal Deposit Insurance Corporation"

STAFF SIZES OF FEDERAL INTERNAL AUDIT  
ORGANIZATIONS AND INSPECTOR GENERAL OFFICES

<u>Organization</u>	<u>Fiscal 1979 audit and investigation staff size</u>
ACTION	13
Agency for International Development	130
Agriculture, Department of	920
Central Intelligence Agency	(a)
Civil Aeronautics Board	33
Commerce, Department of	113
Maritime Administration	41
Community Services Administration	
Internal Audit Division	55
Department of Defense	
Air Force Audit Agency	1,044
Army Audit Agency	823
Corps of Engineers	150
Defense Audit Service	369
Defense Contract Audit Agency	2,910
Marine Corps Field Audit Service	112
Naval Audit Service	552
District of Columbia Government	
Office of the D.C. Auditor	10
Office of Inspector General	25
Energy, Department of	86
Environmental Protection Agency	131
Equal Employment Opportunity Commission	6
Federal Communications Commission	1
Federal Deposit Insurance Corporation	34
Federal Emergency Management Agency	28

<u>Organization</u>	<u>Fiscal 1979 audit and investigation staff size</u>
Federal Home Loan Bank Board	14
General Services Administration	303
Government Printing Office	12
Health, Education, and Welfare, Department of Office of Child Support Enforcement	1,337 145
Housing and Urban Development, Department of	462
Interior, Department of the	163
International Communications Agency	27
Interstate Commerce Commission	82
Justice, Department of Federal Bureau of Investigation Law Enforcement Assistance Administration	58 92 103
Labor, Department of	355
Library of Congress	5
National Aeronautics and Space Administration	86
National Credit Union Administration	4
National Endowment for the Arts	6
National Endowment for the Humanities	8
National Science Foundation	15
Nuclear Regulatory Commission	29
Office of Personnel Management Office of Personnel Management - Compensation	29 43
Pension Benefit Guaranty Corporation	4
Small Business Administration	115

## APPENDIX II

## APPENDIX II

<u>Organization</u>	<u>Fiscal 1979 audit and investigation staff size</u>
Smithsonian Institution	10
State, Department of	68
Tennessee Valley Authority	53
Transportation, Department of	481
Treasury, Department of the	850
U.S. Postal Service	2,068
Veterans Administration	<u>333</u>
Total	<u>14,946</u>

a/The Central Intelligence Agency refused to release information concerning its staff resources.

MAJOR AREAS OF FINANCIAL INTEREST FOR  
REVIEW BY INTERNAL AUDIT ORGANIZATIONS

Cash

General:

- Internal control procedures
- Adequacy of records and procedures
- Cash accounts identified by appropriation and/or fund
- Periodic or surprise cash counts
- Reconciliation of cash with Treasury Department  
fund balances
- Compliance with laws and regulations
- Reports

Collections:

- Physical control
- Cash recorded immediately after receipt
- Timely deposit of cash receipts
- Excessive funds on hand
- Cash in transit--cutoff dates

Disbursements:

- Preaudit prior to approval for disbursement
- Disbursement recorded promptly in records
- Disbursement in transit at time of cutoff

Imprest funds:

- Compliance with fund restrictions
- Advances
- Reimbursements--service provided
- Adequacy of invested capital

Other:

- Investments

Receivables

Internal control procedures  
 Compliance with laws and regulations  
 Receivables identified by appropriations and/or fund  
 Classification of receivables:  
   Interagency/fund  
   External  
 Price established on documentation for:  
   Actual cost  
   Estimated cost  
 Accounts reviewed, delinquent accounts identified  
 Provisions for doubtful accounts  
 Control--adjustments and writeoffs  
 Collection and liquidation of receivables

Advances

## Travel:

Internal control procedures  
 Administrative control over travel  
 Compliance with travel regulations  
 Control over Government travel regulations  
 Timely settlement of employees' travel advances  
 Authorized expenses

## Contractors:

Liquidation--services provided/returned

## Grantees:

Liquidation--services provided/returned

Property

Internal control procedures  
 Policy, procedures, and recordkeeping  
 Integrated property and financial records  
 Account classification:  
   Furniture/fixtures  
   Equipment  
   Plant and equipment  
   On assignment--to others  
   On assignment--from others  
   Supplies and materials

Property (cont.)

Property valuation established on documentation for:

- Cost
- Estimated
- Salvage

Compliance with laws and regulations

Physical control:

- Acquisition
- Removal
- Utilization of property
- Excess property
- Identification

Timely recording in the property/financial records

Control over losses/writeoffs

Reconciliation of physical inventories with property/  
financial records

Depreciation/obsolescence

Evaluation of maintenance costs and economic value

Liabilities

Internal control procedures

Account classification:

- Accounts payable
- Contract provisions
- Accruals
- Intergovernmental/fund
- Advance payments
- Contingencies
- Unfunded
- Long-term debts

Timely recording of liabilities

Accounts identified by appropriation/fund

Liquidation of liabilities

Support/pricing of liabilities

Administrative control of funds

Internal control procedures

Separation of accounts by appropriation/fund:

- Apportionment
- Subdivision of funds
- Obligations
- Reporting

Compliance with laws/regulations

Incurrence of obligations:

- Authority
- Availability of funds:

- Precertification
- Commitment accounting

Administrative control of funds (cont.)

Compliance with 1311 criteria 1/  
 Timely recording  
 Policy and procedures  
 Liquidation and recoupment of excess obligations  
 Use of "M" accounts  
 Reprograming/transfer of funds  
 Accounting for proceeds  
 Status of funds reports

Revenues

Internal control procedures  
 Revenue accounts identified by appropriation/fund:  
   Fees, fines  
   Reimbursements to appropriations  
 Authorized services  
 Established fees:  
   Total costs--supported by accounting records  
   Estimated/negotiated  
   Statutory  
 Timely recording of billings  
 Adjustments/writeoffs  
 Compliance with laws and regulations  
 Comparison amounts billed/cost of services provided

Costs

Internal control procedures  
 Timely recording in accounts  
 Separation of costs:  
   Pay and allowance  
   Direct  
   Indirect  
   Depreciation  
   Contracts/grantees  
   Unfunded  
 System integrated with financial records  
 Basis for costs  
 Cost reports--full disclosure and useful to management  
 Comparison of costs to standards of measurement  
 Compliance with laws and regulations  
 Allocation of costs

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1/Section 1311 of the Supplemental Appropriations Act of 1955 (31 U.S.C. 200) requires Federal agency heads to certify the the validity of their obligations at the end of each fiscal year.

Reports

Full disclosure of financial condition  
Compliance with laws and regulations  
Supported by accounting system  
Usefulness to management  
Timeliness of reports  
Accurate, reliable, truthful  
Comparison of budgeted/programed costs with actual  
Footnoted as required

Other

Approved systems implemented  
Followup on prior recommendations

(911510)





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