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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-114802

JUN 19 1976

HEAD OF AUDIT AGENCY

We have made a survey of the extent and frequency of internal audits of financial reports that Federal departments and agencies (agencies) were required to submit to the Department of the Treasury and the extent that internal auditors reviewed accounting systems producing the financial reports.

In our survey, we sent questionnaires to 28 of 49 members of the Federal Audit Executive Council. The 28 council members were heads of internal audit staffs in the executive agencies of the Government. (See enc. I.) Because the Treasury submitted 9 completed questionnaires--1 for each of its separate internal audit staffs--a total of 36 completed questionnaires were received.

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In sending our questionnaires, we advised you and other council members that we would prepare and distribute a summary of the results of our survey. The responses to the questionnaire showed that the majority of the respondents:

- Audited only a small number of agency financial reports submitted to Treasury.
- Reviewed accounting systems producing the reports occasionally but not regularly.
- Emphasized audits of program results and economy and efficiency rather than audits of agency financial reports.

The agencies included in our survey had fiscal year 1975 gross obligational authority totaling about \$401.5 billion--about 90 percent of the total gross obligational authority for the Government. These agencies, other than the U.S. Postal Service, maintained 258 of 286, or about 90 percent, of the accounting systems identified in the Comptroller General's

FGMSD-76-43

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Report to the Congress on "Status, Progress, and Problems in Federal Agency Accounting During Fiscal Year 1975" (FGMSD-76-13, Oct. 23, 1975).

RESPONSIBILITIES FOR ACCOUNTING
SYSTEMS AND INTERNAL AUDIT

The Budget and Accounting Procedures Act of 1950 makes the head of each executive agency responsible for establishing and maintaining adequate systems of accounting and internal control. These systems must conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General in accordance with that law.

The purposes of accounting systems, as specified in the 1950 act, include providing full disclosure of the results of financial operations; adequate financial information needed in the management of operations and the execution of the budget; effective control over income, expenditures, funds, property, and other assets, including appropriate internal audit; and suitable integration with the central accounting of the Treasury from which consolidated reports of the Government are developed. The 1950 act assigned the responsibility for preparation of consolidated financial reports of the Government to the Secretary of the Treasury.

As stated in GAO's statement of basic principles, standards, and concepts of "Internal Auditing in Federal Agencies" (August 1974), the work of the internal auditor should include examination and testing of accounting and other records and the related procedures underlying the agency's management information system to establish the reliability of the data used by management for internal purposes and for external reports.

The 1950 act requires that, in determining the audit procedures to be followed in our reviews of accounting systems, we consider, among other things, the adequacy of internal audit and controls. We were, therefore, interested in obtaining general information on the extent and frequency of internal audits of (1) financial reports that agencies are required to submit to the Treasury and (2) the accounting systems which produce the reports.

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A summary of the responses to our questionnaire follows.

EXTENT OF AUDITS MADE OF
AGENCY FINANCIAL REPORTS

The questionnaire listed 16 financial reports (see enc. II) that agencies were required to submit to Treasury throughout the fiscal year. For the 16 financial reports listed in enclosure II, reporting entities were required to submit a total of about 2,000 financial reports 1/ for fiscal year 1974.

We asked the respondents to identify audits they made during the 2-year period ended June 30, 1974, which included coverage of the financial reports listed in the questionnaire. The following table summarizes the number of financial reports included in these audits.

<u>Fiscal year audited</u>	<u>Financial reports included in audits</u>	
	<u>Number</u>	<u>Percent of total reports submitted (note a)</u>
1974	64	3.20
1973	79	3.95
1972	26	1.30
1971 and prior	<u>7</u>	.35
Total	<u>176</u>	

a/Computed on the basis of 2,000 reports for each fiscal year.

The number of reports audited by a single respondent ranged from zero to 20 out of 176 financial reports.

1/No agency was required to submit all 16 reports, but some made similar reports for separate entities within the agency. Reports submitted more frequently than annually are included only once.

RESPONDENTS' POLICIES REGARDING
AUDITS OF AGENCY FINANCIAL REPORTS
AND ACCOUNTING SYSTEMS

Each respondent was asked to indicate his current policy regarding:

- The frequency of audits of agency financial reports submitted to Treasury.
- The reporting of results of audits of agency financial reports to Treasury.
- The extent of reviews made of accounting systems.

The following table summarizes the questionnaire responses concerning the audit policies of the respondents.

<u>Audit policies</u>	<u>Responses</u>	
	<u>Number</u>	<u>Percent</u>
Auditing agency financial reports submitted to Treasury:		
On a cyclical basis	8	22
Occasionally but not regularly	15	42
Did not audit	<u>13</u>	<u>36</u>
	<u>36</u>	<u>100</u>
Reporting to Treasury results of audits of agency financial reports:		
Reported results of all audits	3	8
Reported identified adjustments	2	6
Did not report results of audits	18	50
Did not audit	<u>13</u>	<u>36</u>
	<u>36</u>	<u>100</u>
Reviewing accounting systems:		
On a cyclical basis	10	28
Occasionally but not regularly	24	66
Did not review	<u>2</u>	<u>6</u>
	<u>36</u>	<u>100</u>

Although the responses showed that it was the policy of 23 of 36 respondents to audit agency financial reports, only a small number of required reports was being audited each fiscal year. (See table on p. 3.)

The respondents who reported that audits of financial reports were made on a cycle basis (22 percent of the responses) indicated they used the following cyclical periods.

<u>Cycle</u>	<u>Number of responses</u>
Annually	3
Every 2 years	2
Every 3 years	1
Every 3 to 4 years	1
Every 7 years	1

Of the responses, 34 out of 36 showed that it was the respondents' policy to review accounting systems cyclically or occasionally. Of these, 10 responded that it was their policy to make reviews on a cyclical basis, as follows:

<u>Cycle</u>	<u>Number of responses</u>
Annually	4
Every 3 years	1
Every 4 to 5 years	2
Every 5 years	1
Every 7 years	1
Cycle not specified	1

The other 24 respondents stated that accounting systems were reviewed occasionally.

RESPONDENTS' PLANS TO CHANGE THEIR AUDIT POLICIES

We asked the respondents to tell us of any planned changes to their audit policies regarding agency financial reports. Of the responses, 9 out of 36, or 25 percent, showed that they planned to change their audit policies and to audit more agency financial reports in one or more of the following ways.

- Emphasize financial management audits at computer centers.

- Make surveys of the accuracy of internal reports used to prepare Treasury reports.
- Audit the Yearend Integration of Agency-Treasury Data report once every 5 fiscal years.
- Establish an audit program for headquarters operations, which will include a review of some reports submitted to Treasury.
- Audit agency financial reports submitted to Treasury on a cyclical basis.

WHY AGENCY FINANCIAL REPORTS
HAVE NOT BEEN AUDITED

If respondents did not audit their agency's financial reports during fiscal years 1973 and 1974, we asked them to indicate their reasons. The following table summarized their responses, some of which included more than one reason.

<u>Reasons for not auditing agency financial reports</u>	<u>Number of responses</u>
Primary emphasis placed on program results and economy and efficiency audits	21
Lack of manpower	13
Cycle review not scheduled in the 2-year period ended June 30, 1974	8
Question not answered	<u>1</u>
	<u>48</u>

CONSIDERATIONS IN PLANNING FUTURE AUDITS OF
ACCOUNTING SYSTEMS AND FINANCIAL REPORTS

In addition to the results of our survey, I would like to bring to your attention the following matters for consideration in planning future audits of accounting systems and financial reports.

The fact that GAO continues to report major deficiencies in accounting systems (such as overobligation of appropriations, failure to account for property and other assets, improper expenditures, and inadequate control over receipts)

emphasizes the need for an evaluation of internal audit coverage of the financial management area.

3 Further, the need to insure that adequate accounting controls and sound financial reporting exist in the Government was pointed out recently by Arthur Andersen & Co. in its inquiry into accounting controls and financial reporting of the Government. Referring to Government accounting systems in its booklet, 1/ Arthur Andersen & Co. stated that:

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"The accounting system should contain internal checks and balances to assure reliability of the data produced. Such internal controls should be supplemented by annual financial audits."

9 Treasury Secretary William E. Simon, in his statement before the House Committee on Appropriations on January 27, and 28, 1976, said that Treasury planned to publish accrual statements on a consolidated basis for the Federal Government as a whole. This action, we believe, highlights the need to insure through audit that the statements submitted to Treasury for consolidation are accurate. The date for the first of these publications--for the fiscal year ending September 30, 1977--is early in 1978.

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CONCLUSIONS

The responses to our questionnaire and other considerations set forth above indicate a need for increased emphasis on audits of agency financial reports required by Treasury and reviews of accounting systems that produced the reports, to provide more effective control over, and accountability for, all funds, property, and other assets for which agencies are responsible. Further, Treasury's plan to publish accrual statements on a consolidated basis makes this increasingly important.

Because we did not perform a detailed review of the internal audit function at the agencies responding to our questionnaire, we are not making any recommendations at this time, but will be inquiring into this and other questions resulting from the questionnaire responses during our

1/"Sound Financial Reporting in the Public Sector, A Prerequisite to Fiscal Responsibility," Sept. 10, 1975.

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reviews of Federal agency internal audit systems. As you know, a number of these reviews are already underway.

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We are sending copies of this letter to the Fiscal Assistant Secretary of the Treasury; the Director, Office of Management and Budget; the Chairman, Federal Audit Executive Council; and the 36 participating respondents.

We thank you for your cooperation in completing the questionnaire. We shall appreciate receiving your comments on the matters discussed in this letter.

Sincerely yours,

A handwritten signature in cursive script that reads "D L Scantlebury". The signature is written in dark ink and is positioned to the left of the typed name.

D. L. Scantlebury
Director

Enclosures - 2

LIST OF DEPARTMENTS AND AGENCIESWHOSE INTERNAL AUDIT STAFFSSUBMITTED COMPLETED QUESTIONNAIRES

1. Department of the Air Force
2. Department of Agriculture
3. Department of the Army
4. Department of Commerce
5. Department of Defense
6. Department of Health, Education, and Welfare
7. Department of Housing and Urban Development
8. Department of the Interior
9. Department of Justice
10. Department of Labor
11. Department of the Navy
12. Department of State
13. Department of Transportation
14. Department of the Treasury
 - a. Office of the Secretary
 - b. Bureau of Alcohol, Tobacco, and Firearms
 - c. Customs Service
 - d. Bureau of Engraving and Printing
 - e. Bureau of Government Financial Operations
 - f. Internal Revenue Service
 - g. Bureau of the Mint
 - h. Bureau of the Public Debt
 - i. U.S. Secret Service
15. ACTION
16. Civil Aeronautics Board
17. Environmental Protection Agency
18. Federal Power Commission
19. General Services Administration
20. Interstate Commerce Commission
21. National Aeronautics and Space Administration
22. National Science Foundation
23. Small Business Administration
24. Smithsonian Institution
25. U.S. Civil Service Commission
26. U.S. Information Agency
27. U.S. Postal Service
28. Veterans Administration

FINANCIAL REPORTS LISTED IN QUESTIONNAIRE

Code or form number (note a)	Title of report	Report frequency	Reporting entities for fiscal year 197.	
			Description	Quantity
SP 220	Statement of Financial Condition	(b)	Revolving, general, and special funds	176
SP 221	Statement of Income and Retained Earnings	Semi-annually	Revolving and business-type funds	90
SF 224	Statement of Transactions	Monthly	Activities for whom Treasury disburses	993
SP 225	Report on Obligations	Monthly	Activities exceeding \$1 million	67
SF 1219	Statement of Accountability	Monthly	Accountable officers	63
SF 1.20	Statement of Transactions	Monthly	Activities which do their own disbursing	51
DD 1323M	Statement of Transactions	Monthly	Department of Defense	3
DD 1363	Statement of Transactions and Accountability (Military)	Monthly	Department of Defense	7
DD 1400M	Statement of Transactions	Monthly	Department of Defense	3
GFO 2106	Year-end Integration of Agency-Treasury Data	Annually	All agencies	110
BA 5727	Report of Selected Balances for Stating Budget Results on the Accrual Basis - Appropriations and Fund Accounts	Quarterly	All agencies	146
BA 6728	Report of Selected Balances for Stating Budget Results on the Accrual Basis - General, Special and Trust Fund Receipt Accounts	Quarterly	All agencies	146
A	Federal Aid to States	Annually	Activities providing aid to States	35
B	Annual Report on Unfunded Foreign Currency Reservation Accounts	Annually	Agencies having foreign currency activities	15
C	Report on Overseas Expenditures and Foreign Currencies Available for Conversion	Annually	Agencies having foreign currency activities	47
D	Report of Estimated Foreign Currency Collections	Annually	Agencies having foreign currency activities	47

c/ 1,999

a/Form numbers were not established for reports identified with a letter code.

b/Semiannually for revolving funds and business-type funds and annually for regular governmental activities.

c/Each reporting entity was required to submit a final report for each fiscal year.