

**GAO VIEWS ON
INTERNAL AUDITING
IN THE FEDERAL AGENCIES**



UNITED STATES GENERAL ACCOUNTING OFFICE

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COMPTROLLER GENERAL OF THE UNITED STATES
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The contents of this booklet summarize our views on the organization and operation of the internal auditing function in the Federal departments and agencies.

These views are based on our examinations of internal auditing operations in the Federal Government during the past several years.

A handwritten signature in cursive script that reads "Elmer B. Staats".

Elmer B. Staats
Comptroller General
of the United States

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GAO VIEWS ON INTERNAL
AUDITING IN THE FEDERAL
DEPARTMENTS AND AGENCIES

IMPORTANCE OF STRONG INTERNAL AUDIT SYSTEMS

For many years the General Accounting Office has emphasized the importance of strong internal audit systems. The effectiveness with which this function is discharged by the departments and agencies has a direct bearing on our own auditing and accounting work. Thus, it is of special interest to us quite aside from its value for management purposes. We have strongly advocated the establishment of an internal audit function where we found it lacking and have made recommendations for its improvement where necessary.

The Congress has also stressed its importance and has specifically provided for it in a number of laws, particularly the National Security Amendments of 1949, the Post Office Department Financial Control Act of 1950, and the Budget and Accounting Procedures Act of 1950.

Under the Budget and Accounting Procedures Act of 1950, we are required to prescribe the principles, procedures, rules, and regulations for carrying out our audit responsibilities and, in doing so, to give

"due regard to generally accepted principles of auditing, including consideration of the effectiveness of *** internal audit and control, and related administrative practices of the respective agencies."

That act further requires the head of each agency to establish and maintain systems of

"internal control designed to provide *** effective control over and accountability for all funds, property, and other assets for which the agency is responsible, including appropriate internal audit."

As contemplated by the 1950 Act, we give particular consideration to the internal audit work which has been done in the programs and activities that we examine. To the extent possible, we utilize the internal audit work rather than performing work directly ourselves, although this requires some testing and evaluation of that work for its acceptability and usefulness for our purposes. We also recommend that internal audit attention be given to significant areas or subjects which we find have not been audited.

Various committees of the Congress have also expressed their interest in internal audit systems, and this has been of great benefit in promoting the cause of internal audit throughout the Government. The Government Activities Subcommittee of the House Committee on Government Operations has taken an active interest. It followed up its June 1963 report on the subject (House Report No. 456, 88th Cong., 1st Sess.) with requests to the various Government agencies to furnish information on their internal audit systems. This information was made available to us, and we were requested to undertake reviews of the internal audit systems in various executive departments and agencies to permit an informed judgment on the effectiveness of these systems.

The General Accounting Office first issued a comprehensive statement of principles and concepts on this subject in 1957 to assist Federal agencies in developing internal audit organizations and procedures.

As a result of substantial experience gained since 1957, a revised statement was prepared and issued October 1, 1968. In preparing this statement we had the benefit of extensive discussions with representatives of agencies, staff members of congressional committees, and individuals outside of the Government with experience in private industry, and other private and public organizations. The revised statement of principles places greatly increased emphasis on the usefulness of internal auditing to strengthen management systems and on the very essential role the heads of Federal departments and agencies must play to make internal audit systems function effectively.

ROLE OF INTERNAL AUDIT AND RELATIONSHIP TO
OTHER REVIEW FUNCTIONS

The role of the internal audit organization, the scope of its activities, and its relationship with external and management review groups are set forth as follows in our current statement of basic principles and concepts.

* * * * *

ROLE OF INTERNAL AUDITING

Information needed by management may come from direct observation; from routine and periodic operating, accounting, statistical, and analytical reports; and from functional or staff reviews. Another important source of information is the internal audit organization which conducts independent examinations and makes reports on its findings and appraisals of operations and performance. The internal audit function uniquely supplements routine management checks through its independent approach and methods of review. This function is one of the essential tools of management, complementing all other elements of management control.

Nature of internal auditing

The overall objective of internal auditing is to assist agency management in attaining its goals by furnishing information, analyses, appraisals, and recommendations pertinent to management's duties and objectives, whether self-imposed or prescribed by law or by outside authority.

Internal auditing is a staff and advisory function, not a line operating function. Thus, the internal auditor should not have authority to make or direct changes in his agency's procedures or operations. His job is to make independent and objective analyses, reviews, and evaluations of existing procedures and activities; to report on conditions found; and, whenever he deems it necessary, to recommend changes or other action for the consideration of management and operating officials.

An internal auditor should not be given line-operation responsibilities. Rather, he should be expected to concern himself primarily with the performance of others, to retain an independent outlook in all of his work, and to direct particular attention to matters requiring corrective action. His function is to present his views and suggestions constructively in such a manner that action on his suggestions can be taken by others.

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SCOPE OF INTERNAL AUDIT WORK

To be of maximum usefulness, the scope of the internal auditor's activity should not be restricted.

The duties of the internal auditor should be clearly stated by the head of the agency and information concerning these duties should be disseminated throughout the agency so as to assure full recognition of the nature of his functions at all levels.

Internal auditing should extend to all agency activities and related management controls. Although it should include the audit of accounts and financial transactions, its scope of operation should not be restricted to accounting and financial matters. The internal auditor should also review operations and activities in order that he may provide management with information on the effectiveness, efficiency, and economy with which they are being carried out.

The needs of management officials for assistance of the kind that internal auditors can provide vary from agency to agency because of differences in nature of operations, organizational structure, location of activities, qualities and competence of officials and employees, and concepts of management control held by top agency officials. An internal audit program should be structured to meet the needs of top management and also be designed to serve the needs of subordinate management levels.

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RELATIONSHIP TO OTHER INTERNAL REVIEW ACTIVITIES

In view of the wide range in the size of Federal agencies, the variety and nature of their programs and activities, the geographical location of their operations, and their organizational concepts and operating methods, no single pattern for internal review activities can be specified. The organization for these activities is a matter for top management decision and should be based on the agency's particular needs and problems.

Many agencies have other internal review activities, such as inspection, appraisal, investigation, organization and methods, and management analysis. These activities are often in the nature of management services, and in varied ways they assist management currently in supervising, advising, and reviewing designated functions. Whether these activities are organized separately at the departmental or the bureau level, maximum cooperation and a common understanding among them and with the internal audit organization are essential to prevent duplication of effort. A practical and continuing program of coordination of effort and work results should be established to avoid conflicts and promote the use of work performed by others.

Top management itself should evaluate from time to time the internal audit and other review activities, in order to determine whether they are meeting current needs satisfactorily, with minimum interference with operating activities, without duplication of effort, and at a reasonable cost.

* * * * *

RELATIONSHIP OF INTERNAL AUDITING TO OTHER AUDITS PERFORMED BY AGENCIES

Auditing of the performance and records of third parties such as contractors, grantees, or borrowers is an essential aid to the administration of contracts and of grant and loan programs. The degree of interrelationship between such auditing and internal auditing will vary depending upon the nature, size, and scope of agency programs.

Contract auditing by an agency serves the purpose of determining whether the contractor is complying with contract requirements for the goods or services being supplied to the agency. In the award and administration of negotiated contracts, it is usually necessary to make examinations of requests for cost reimbursement; of the currency, completeness, and accuracy of cost and pricing data used in pricing negotiations; and of activities generating costs to the extent an agency's interests are affected. This type of auditing enables the agency to appraise a contractor's financial responsibility to the Government and to provide information necessary to contract negotiation and administration. It is an essential part of an agency's system of control to achieve its purposes in an efficient and economical manner.

Similarly, the records and performance of grantees or borrowers are subject to audit by the responsible agency as a means of ascertaining whether there has been compliance with the terms and objectives of the agreements under which Federal funds are granted or loaned. Such auditing, like contract auditing, is an integral part of an agency's system of control in achieving its purposes in an effective and efficient manner.

Organizational location

The location in the organization of the audit staff responsible for auditing third party records and performance should be such as to assure that the function effectively serves the program operating officials directly concerned as well as top management and that available audit staff resources are effectively used.

A separate organization of such auditors will be appropriate in many cases because of the size of the organization required to carry out the function; the high degree of specialized knowledge required; or the special need for a close association between program management personnel and the audit staff. In other cases, a single integrated organization of all agency auditors may be desirable.

Regardless of the form of organization adopted, provision should be made for independent internal review of the external audit work in the same manner as other operations are reviewed, to ascertain whether it is being carried out properly and efficiently.

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GAO REVIEWS OF INTERNAL AUDIT ACTIVITIES

Because of the importance of internal auditing to effective management and of the observed need for improvement in Government activities, as well as the specific interest of the Government Activities Subcommittee of the House Committee on Government Operations, the General Accounting Office, over the past several years, has reviewed the internal audit activities and organizations in most of the departments and major independent agencies in the Executive Branch.

This work was in addition to our review and consideration of the internal auditing which may or may not have been applied to the activities being examined by us. During the period from July 1, 1966, to May 31, 1970, we issued 42 reports dealing with internal audit activities (see appendix). Of these, 20 were sent to the Congress, 6 to congressional committees, and 16 to the heads of agencies.

CIVIL DEPARTMENTS AND AGENCIES

In the civil departments and agencies, reviews of the internal audit functions were made in nine departments and in nine major independent agencies, as follows:

Departments

- Department of Agriculture
- Department of Commerce
- Department of Health, Education, and Welfare
- Department of Housing and Urban Development
- Department of the Interior
- Department of Justice
- Department of Labor
- Post Office Department
- Department of the Treasury

Independent agencies

- Atomic Energy Commission
- General Services Administration
- National Aeronautics and Space Administration
- National Science Foundation
- Panama Canal Company

Independent agencies (continued)

Railroad Retirement Board
Small Business Administration
U.S. Civil Service Commission
Veterans Administration

In addition, we made reviews in the District of Columbia Government, the Government Printing Office, The Army Corps of Engineers, and two constituent agencies of the Department of Transportation.

Location in Organization

In each of these reviews, we examined the organizational arrangements under which internal audit activities are carried out. We considered both whether such arrangements assured a high degree of independence of the internal auditor from the operations or activities which should be subject to internal audit, and whether the degree of centralization or decentralization of internal audit responsibility appeared to be consistent with the effective and efficient conduct of the internal audit function in terms of the utilization of available manpower resources and service to the top levels of management.

In most instances, we felt that the organizational arrangements were such that the internal auditor did not have the degree of independence from certain operations and activities subject to his review as would be most desirable. In most of these cases, the internal auditor was responsible to an official at the assistant secretary level--in most cases the assistant secretary for administration--or in the case of independent agencies, to an official having duties similar to those of an assistant secretary for administration. In general, such officials, whether designated assistant secretaries for administration, controllers, or some other title, carried responsibilities for such matters as budgeting and accounting, automatic data processing operations, and other activities, as well as, for the conduct of internal audit. Under these circumstances, the internal auditor could find himself in the position of reporting matters which reflect adversely on activities or operations which are carried out within the responsibility of his immediate superior.

In some instances we found that the internal auditor reported to officials lower in the organizational structure than those at the assistant secretary or comparable level.

Where we found that the existing organizational arrangements were such as to potentially compromise the internal auditor's independence, we suggested alternative organizational arrangements for assignments of responsibility. Our suggestions were in consonance with our view that the greatest degree of independence can be achieved where the internal auditor is responsible directly to the head of the department or agency.

We recognize, however, that in many cases the department or agency head, in the interest of keeping the number of persons reporting directly to him to a minimum or for other reasons, has chosen to place the internal audit function within the responsibility of one of his principal assistants. Where this has been done, we have suggested the need for the department or agency head to assure himself that the internal auditor is free to direct his efforts to the review of activities of operations within the responsibility of his immediate superior, that the audit is of proper scope and effectiveness, staffing requirements are provided and appropriate attention is given to audit findings, and that the internal auditor has the right of direct access to the department or agency head whenever, in his opinion, such access is desirable.

In general, the departments or agencies did not, following our reviews, choose to elevate the position of internal auditor to one reporting directly to the department or agency head. They did, however, assure us that the internal auditor would be afforded the freedom to carry out his responsibilities objectively and in a manner responsive to the need of the department or agency head. In those cases where the principal internal audit organization reported to an organizational level below that of an assistant secretary or comparable official, the departments or agencies were generally receptive to elevating the internal audit function to at least that level.

Centralization

In several departments and agencies, we made recommendations directed to greater centralization of internal audit activities. In certain of these cases, for example the Department of Commerce, Justice, and Treasury, we found that internal audit activities were being carried out by a number

of groups located at the departmental level and in the several constituent agencies of the departments. Many of the organizations or groups were quite small and there existed some evidence that the fragmentation of the audit function and the small size of the component groups adversely influenced the ability to attract, retain, and develop auditing staff and made difficult the utilization of available staff resources in a manner most conducive to serving the needs of top management.

In general, we found the departments and agencies quite receptive to our suggestions for centralization. This was done by the Department of Commerce. The Treasury Department, however, has taken the position that the objectives of internal audit can best be accomplished under the present arrangements. It believes that decentralization of the internal audit function is consistent with the assignments of responsibility to the heads of constituent agencies in that internal audit, as a management tool, should be responsive to the needs of the officials having direct management responsibilities. In the light of the Treasury Department's position, we have suggested several steps designed to strengthen the Department's internal audit system within the present organizational structure.

The Veterans Administration had two agencywide audit groups--one in the Office of the Controller responsible for the audit of fiscal activities and one in the Office of Management and Evaluation responsible for reviewing all activities, including fiscal activities. In response to our recommendation that the two groups be consolidated, the Administrator of Veterans Affairs has directed that the fiscal audit function be transferred from the Office of the Controller to the Office of Management and Evaluation and combined with the Internal Audit Service. In addition, the administrator changed, organizationally, the location of the Office of Management and Evaluation so that it now reports directly to the Deputy Administrator of Veterans Affairs rather than to the Associate Deputy Administrator.

Although the Department of Justice expressed agreement with our recommendation for centralization, it has not yet made the necessary changes in this organization. The Department's inaction has been due, at least in part, to the fact that its requests for funds to staff a central internal audit organization had not been acted upon favorably by the Congress.

In the Department of Transportation, the Office of the Secretary is responsible for establishing guidelines for the four internal audit groups in the Department. We have reviewed internal audit activities in the Federal Aviation Administration and the Federal Highway Administration, but we have not made an overall review of the internal audit function in the Department. However, in May 1970, officials of the Department informed us that they plan to centralize internal auditing at the departmental level during the early part of the fiscal year 1971.

Direction of Effort

In addition to reporting the results of our examinations and recommendations concerning organizational arrangements, we made numerous suggestions or recommendations relating to the direction of audit effort by the various internal audit organizations. Our suggestions were designed principally to broaden the scope of the internal auditor's work in order that it might be more responsive to the needs and interest of top management and carried out in a manner which would provide to top management more useful information.

Staffing

With respect to the internal audit staffs of the various departments and agencies, we gave consideration to their qualifications and to the numbers of staff members in relation to the breadth of their internal audit responsibilities. In general, the question of what size an internal audit staff should be is one which involves a great deal of judgment and one for which there is never one correct answer. It must be determined on the basis of a number of factors including the types of agency operations and activities involved, the effectiveness of other management controls and processes, and the way in which the department or agency head wishes the internal audit staff to operate.

The question of staff qualifications is also one which is difficult to assess. In general, as one would expect, staff members of the various internal audit organizations tend to be persons whose education and/or experience has been in the fields of accounting or financial auditing. In some cases, however, such staff members are drawn from other disciplines

such as engineering, economics, mathematics, or law. The degree to which the nonaccounting or financial auditing disciplines are represented on internal audit staffs depends, at least in part, on the nature of the activities or operations carried out by the department or agency and on the views of the head of the internal audit organization or his superiors as to the need for and the usefulness of staff members drawn from other disciplines in carrying out the internal audit work.

Because of the judgmental nature of such assessments, we restricted our observations and suggestions to those cases where it appeared to us that either the size of the internal audit staff or the qualifications of its members were not commensurate with the responsibilities involved.

For example, with respect to the Department of Labor, we proposed that the Secretary of Labor take action to substantially augment the internal auditing activities in the Department more in line with current needs and establish an effective continuing program of internal audit for periodic audit coverage of all the Department's operations. In this case we found that the Department had only five auditors assigned to the internal audit function. We found also that many of the Department's activities and programs had never been subjected to any regular program of internal auditing and that other important activities and programs had been given only limited internal audit coverage. Considering the magnitude, complexity, and decentralized nature of the Department's activities, we believed that the internal audit staff was entirely too small to perform anything approaching adequate coverage. In this case, the Secretary agreed that the size of the internal audit staff should be increased and is taking steps in that direction.

In the Department of Justice, we found that the internal audit organization that was responsible for reviews of U.S. Attorney and U.S. Marshall activities was made up largely of attorneys who did not appear to be well qualified either by experience or training to perform financial-type reviews. Although it is probable that legal training would be helpful in reviewing activities of the type concerned, we believe that persons with accounting and auditing backgrounds would be more suited to the review of the financial and administrative activities of the offices concerned.

Other Matters

We also considered several other aspects relating to the manner in which internal audit activities were carried out and made suggestions for improvement. These related to the adequacy of follow-up action on recommendations made by the internal audit organization and the adequacy of reporting by the internal audit group in terms of whether the reports provided information sufficient to apprise the recipient of the basis for stated findings and recommendations and of the need for corrective action suggested. We also considered whether the reports were being made available to officials having a legitimate interest in the subjects covered or who would be responsible for acting on the internal auditor's findings and suggestions.

INTERNATIONAL DEPARTMENTS AND AGENCIES

We have reviewed the internal audit activities of the Department of State, Agency for International Development (Washington), and the United States Information Agency. We also examined into the August 1967 reorganization of the Peace Corps. The examination of the State, AID, and USIA audit systems included evaluating the effectiveness of internal auditing as a means of providing top management with information on the effectiveness, efficiency, and economy of the activities for which it was responsible. The review of the Peace Corps was part of our continuing efforts to assist that agency in developing an effective financial management system.

Department of State

In the State Department we found that

- There was a need for the internal audit to direct its attention to substantive program management rather than confining it to functional or housekeeping-type activities.
- The independence and stature of the internal audit suffered from its organizational location and method of funding.
- The scope of examination and size of staff needed expansion.

- Internal audit reports should be directed to higher levels.
- Internal audit recommendations should be followed up.
- More effort should be directed to internal review as opposed to grant and contract audit.
- Better work plans and audit programs were needed.

The principal general problem involved in strengthening of internal audit systems in the Department of State is the need to inculcate at the decision making level a recognition of the need for and benefits to be derived from an adequate internal audit system. However, the Department's letter to us of March 23, 1969, indicates that there is a limited concept of the utility and value to management, of an enlightened, independent and effective internal audit.

In our report issued to the Congress (B-160759 dated December 16, 1969), we stated that the Department was receptive to our views as to the need for more internal review effort and better work plans and audit programs. We stated also that the Department did not agree with our other findings, such as the need to improve the independence and stature of the internal audit function because of its organizational location and method of funding, and that audit recommendations should be followed up. To date, we have not received a formal reply from the Department on the report issued to the Congress, nor has the Department sent comments to the Bureau of the Budget as required by BOB Circular No. A-50.

AID and USIA

Both AID and USIA were receptive to our views and major recommendation that there was a need to raise the internal audit activities organizationally in the agency. In June 1969 AID established a single integrated organization for all auditing and investigating forces under the direction of an Auditor General who reports directly to the Administrator. USIA, in May 1969, established a new Office of Research and Assessment that included the inspection and audit staff headed by an associate director who reports to the Director and Deputy Director of USIA.

These agencies were also receptive to our views for a broader and more balanced audit coverage, as well as a need for vigorous recruitment efforts to fill authorized positions. We believe that the actions taken will assist in providing for more effective internal audits in these agencies.

Peace Corps

With respect to the Peace Corps, we were of the opinion that while the reorganization in August 1967, placing the audit staff under a Division of Administrative Support and Review, would strengthen administrative efforts, it would divert effort previously devoted to internal review and leave that function limited both in scope and independence. We recommended reconsideration of the reorganization, and on July 31, 1969, the Peace Corps announced the establishment of the internal audit function as a separate organizational entity reporting directly to the Deputy Director.

DEPARTMENT OF DEFENSE

In March 1968, we issued a report to the Congress entitled "Internal Audit Activities in the Department of Defense," (B-132900). This report presented information on the audit responsibilities; organization; personnel; general approach and distribution of audit effort, including the extent of audit work performed to evaluate how well contracting personnel discharge their responsibilities relating to the implementation of "The Truth in Negotiations Act," (Public Law 87-653). The report also reviewed the preparation, processing, and distribution of audit reports and audit plans of the five internal audit organizations in the Department of Defense (the United States Army Audit Agency; the Naval Audit Service; the Auditor General, United States Air Force; the Auditor General, Defense Supply Agency; and the Deputy Comptroller for Internal Audit, Office of the Assistant Secretary of Defense (Comptroller)).

On the basis of our review, we concluded that the organization, audit policies, directives, plans, and operations of the internal audit organizations complied substantially with the requirements for an effective internal audit system and that they had performed their prescribed audits in a generally satisfactory manner.

We expressed the opinion, however, that special consideration and continued attention should be given to the following matters:

1. Increasing the audit effort on management-type reviews of significant programs, activities, and operations and directing these reviews to important objectives.
2. Channeling greater audit effort into reviews of the discharge of responsibilities and accountabilities related to the costly programs in the research and development areas.
3. Intensifying the coordination of the total audit effort of the numerous separate organizations performing management reviews and increasing the amount of audit effort directed to broad significant objectives.
4. Substantially increasing the attention and effort to determine the manner in which contracting officers are discharging their responsibilities and accountabilities under Public Law 87-653 and implementing the related portions of the Armed Services Procurement Regulation.
5. Vigorously pursuing current plans to evaluate the activities of the Defense Contract Audit Agency.
6. Continuing efforts to increase the capabilities of the limited number of available auditors and maximize the use of their talents so that greater audit coverage of operating activities, functions, and programs can be attained.

Improvements

A number of actions have been taken by the audit organizations and by the Office of the Assistant Secretary of Defense (Comptroller) which are responsive to our observations and are contributing to the improvement of the internal audit function in the Department of Defense.

Since the report was issued, the audit organizations have given increased emphasis to management-type reviews of significant programs or activities including such areas as research and development and the manner in which contracting officers are discharging their responsibilities and accountabilities under Public Law 87-653. For example:

Air Force Auditor General management audit efforts of significant programs, activities, and operations have increased significantly since the establishment of a separate central audit planning group in July 1968. A number of significant centrally directed audits such as the management of major intercontinental ballistic missile and communications programs and systems have been completed or are in process. Also, the Air Force Auditor General, through his program of systems audit appraisals has worked closely on a concurrent basis during the development stage with managers and systems designers and programmers to assure that new management systems--usually utilizing automatic data processing equipment and techniques--are capable of doing the job for which they are intended.

During fiscal years 1968 and 1969, the Naval Audit Service conducted (1) 15 major management-type studies or reviews on matters or problems of special interest or significance, and (2) more than 20 activity audits of major significance, all of which were conducted in accordance with the "mission-oriented" concept. During fiscal year 1970 the effort in both categories of assignments has been greatly expanded--30 major management studies and 93 mission oriented audits have been performed.

The Auditor General, Defense Supply Agency, has conducted major significant management-type audits which bear on activities of major interest to congressional committees. A comprehensive audit of agency actions subject to the provisions of Public Law 87-653 for the entire Defense Contract Administration Services and all procurement centers of the agency was completed. An evaluation of the management of industrial plant equipment in the hands of contractors has been made which has resulted in significant improvements in the management of these resources and related programs.

The Army Audit Agency has continued to devote a significant portion of its audit effort to management-type reviews. In fiscal year 1969 and 1970, the Army Audit Agency devoted nearly 90 percent of its available manpower resources in performing management-type audits--about 65 percent in comprehensive audits of Army installations and about 25 percent in Army/command-wide audits.

The scope of management-oriented reviews of significant areas was broadened in fiscal year 1968, through the introduction of an "interservice audit" concept whereby programs or activities which cross departmental or agency lines are reviewed on a Defense-wide basis. These reviews are initiated by the Deputy Comptroller for Internal Audit, Office of the Assistant Secretary of Defense (Comptroller). That organization establishes objectives and audit guidelines, and either performs the audit itself or arranges for audit assistance by the other audit agencies within the Department of Defense. Findings are assembled in a consolidated report for appropriate management action at the Office of the Secretary of Defense or military department levels.

The Deputy Comptroller for Internal Audit also has completed comprehensive, management-oriented reviews of such activities as the Defense Contract Audit Agency, family housing, and unobligated and unliquidated funds in procurement and research, development, test, and evaluation appropriations. Many other broad reviews of major defense programs and systems are currently in progress.

In addition, DOD instructions have been issued or revised to provide expanded policy guidance and standards on such matters as audit frequency, audit reports, training, career development, auditor qualifications, and audit supervision.

Other Review Groups in DOD

One of the observations in our March 1968 report on "Internal Audit Activities in the Department of Defense" was that attention should be given to intensifying the coordination of the total audit effort of the numerous separate organizations performing management reviews in DOD. We had suggested that the Secretary of Defense initiate studies of the

management review functions of all internal audit, internal review, and surveillance organizations in DOD. In response to this suggestion, the Assistant Secretary of Defense (Comptroller) stated that he doubted whether such a study would be productive.

Subsequently, we undertook a review ourselves of the structure and activities of such groups, which include the formal internal audit organizations, inspectors general, procurement management review groups, and "in-house" internal review and other evaluative groups which assist managers.

In our report¹ to the Congress we concluded that:

"The number and dispersal of groups engaged in reviewing and evaluating activities in DOD is strong evidence of the importance placed upon this requirement by DOD managers at all levels. However, the number, dispersal, and overlapping in the authorized areas of activity of these groups also exemplifies the need for effective coordination and guidance of their activities in order to avoid undesirable duplications and to obtain the maximum benefits from the total review and evaluation effort.

"The magnitude of the review and evaluation activity in DOD demands, we think, (1) a comprehensive and effective program for coordinating the work of the many varied review and evaluation groups and (2) effective guidance and, where necessary, training of personnel of in-house groups, to maximize the benefits obtainable from their total efforts."

We recommended:

*** that the Secretary of Defense initiate action to establish a system to ensure effective

¹"Need for Better Coordination Among, and Guidance of, Management Evaluation Groups in the Department of Defense," January 2, 1970, B-132900.

coordination among the groups that provide the review and evaluation services and also to furnish them with guidance and, where necessary, with training, in order to maximize the benefits obtainable from the total review and evaluation efforts."

GAO USE OF INTERNAL AUDIT WORK

Civil departments and agencies

In our audits of civil agency programs and activities, we give particular consideration to the internal audit work which has been done in the areas under audit. To the extent feasible, we utilize the internal audit work rather than performing work directly ourselves. To enable us to do this, however, we made some tests of the acceptability and usefulness of such work for our purposes. Normally, there is little duplication of the work of internal auditors by GAO. The internal auditor performs his work as part of management's pattern of operation and control. The General Accounting Office review is part of the independent appraisal it makes for the Congress of the manner in which Federal agencies discharge their responsibilities and of the effectiveness of their control system, including internal audit.

The cognizant GAO audit group ordinarily maintains a close working relationship with the agency internal auditors. The typical arrangement provides for GAO receiving copies of internal audit work plans and internal audit reports. GAO, in turn, furnishes information, in general terms, on the areas in which it plans work.

When GAO undertakes a review of an agency program or activity, one of the first steps is to review the work done or planned in the area by the internal auditors. For example, during our review of the test program being conducted by AEC's Nevada Operations Office for the SAFEGUARD Antiballistic Missile System, we considered the results of various internal audits made by AEC and limited the scope of our review accordingly. We noted several of the internal audit findings in our classified report to the Joint Committee on Atomic Energy.

Our report to the Congress issued May 8, 1970, on Federal grants awarded for constructing waste treatment facilities which benefit industrial users, includes statistics and specific examples developed by the Department of the Interior's internal auditors for their report on the Federal Water Quality Administration's policy of awarding grants for the construction of facilities which process industrial wastes solely or

primarily. The inclusion of the information developed by the internal auditors, to supplement the information developed by us, helped emphasize the significance of the problem dealt with in our report to the Congress.

Another example occurred during the past year when we deferred work on a planned departmentwide review of ADP activities in the Department of Commerce because the Department's Office of Internal Audits is making a comprehensive review of ADP in all Commerce agencies.

In the area of examining financial transactions, including payrolls, and the accounts of accountable officers, it is the responsibility of the agency head to maintain appropriate accounting and internal controls. The internal auditor should examine financial transactions, including both the receipt and disbursement of funds, to the extent necessary to evaluate:

- The adequacy of the agency's prescribed policies and procedures related to such transactions.
- The adequacy of related internal controls.
- Compliance with prescribed agency policies and procedures and applicable laws and regulations.

In recognition that the basic responsibility for proper accounting and internal control is that of each agency, in our examination of financial transactions and the audit of the accounts of accountable officers, we place our major emphasis on the adequacy and effectiveness of the accounting and internal controls. To test the adequacy of agency procedures and the work of the internal auditors, our audits include selective examinations of individual transactions. The extent of our examinations of individual transactions is, of course, dependent on the circumstances in each agency.

For instance, in the Veterans Administration we find that extensive fiscal audit work is performed by the Administration's Internal Audit Service. We have found its work to be very helpful and have been able to limit the extent of our audit work. We have generally made favorable comments on its work in our settlement audit reports issued to VA station directors.

Thus, the internal auditors, in addition to their primary role of serving management, play a very important role in both our program reviews and examinations of financial transactions.

Department of Defense

In all of our audit work in the Department of Defense, we consider the extent and adequacy of coverage by internal audit activities of the subject under review. For example, we made extensive use of the results of internal audit work in a review we recently completed pertaining to petroleum, oil, and lubricant activities in Southeast Asia. We reviewed reports issued by the Army Audit Agency and the Air Force Auditor General pertaining to controls over the receipt and distribution of these commodities, particularly for the period 1966 to 1968 since related records and knowledgeable personnel were no longer available.

We found that the audits, which sometimes covered vast areas of activity in relatively short periods of time, appeared to have been well executed. Consequently, we gave appropriate consideration to the extent and scope of this internal audit work in making our review.

Recently the Army Audit Agency reported on its review of research and development program activities in one of its major commands. Prior to initiating the review agency officials met with us to explore matters pertaining to planning and programming the assignment. Certain areas we suggested were included for review in the audit and were the subject of subsequent findings. In our view this Army Audit Agency review has been very helpful to the managers of Army research and development programs.

Our review of the findings and recommendations of the audit of the activities of the Defense Contract Audit Agency by the Deputy Comptroller for Internal Audit, OSD, indicates that it was well planned and executed and that the findings were objective. Effective action on the findings and recommendations should increase the effectiveness of the work of the agency and possibly contribute to more effective pricing of contracts.

In connection with our audit and settlement work, it has been the practice of our Defense Division for many years to examine into the audit reports issued by the internal audit agencies of the respective military services either on a service-wide or individual installation basis, as appropriate.

In our opinion the proper discharge of agency responsibilities in the settlement of accountable officers' accounts includes:

Adequate administrative procedures for systematically examining disbursement and collection transactions to verify their legality, propriety, and correctness at the point in time when any needed preventive or corrective action can be most effectively taken.

The conduct of systematic internal reviews independent of accountable officers to assure that effective controls are maintained over disbursements, collections, and balances for which accountable officers are responsible; and that appropriate administrative actions are taken to obtain any necessary corrective action required.

Our continuing selective examinations of individual transactions in the accounts of accountable officers being made at each of the military finance centers and our recent limited review of the military leave system of the Army at selected Army installations indicate continuing ineffective internal audits and agency controls to reduce the numbers and types of erroneous payments. Erroneous payments, involving several millions of dollars each year, are still being made in the administration of military pay and allowances, leave, and travel.

Even in those cases where the internal audit work has been rather narrow in scope, we have found that work to be useful when our audit concerned matters within the areas covered by internal audits. One of our basic procedures is to ascertain the internal audit coverage which has been provided when we begin inquiry into an area of an agency's activity. When the internal audit coverage has been good, the extent of our work can be reduced accordingly. In some cases, we have advocated that the coverage be extended to that area or that the internal audit work be improved as found to be necessary.

GENERAL PROBLEM AREAS

One of the more general problems in further development of the internal audit function in the Government departments and agencies is the scarcity of qualified and experienced manpower. The intensified interest in internal audit in the Government and in the private sector, as well as the broadening of the areas to which internal auditors are expected to direct their attention, has resulted in shortages both in the numbers of personnel and in the skills required of them. These shortages have necessitated heavy reliance on the graduating classes of our institutions of higher learning and on an intensification of training efforts in the particular work the staff is to perform. As a practical matter, most of the increased staff resources required has had to be developed from graduates in the disciplines desired and through in-house and external training and experience on the job.

Among the Government agencies, the overall restrictions on numbers of personnel and fund limitations have also been problems. Although in some agencies the required reductions in personnel have been made in areas other than internal audit, the overall requirement for reduction has been cited as precluding or slowing down needed increases in the internal audit staffing.

To a more limited extent, one of the obstacles to improved internal audit has been the lack of recognition by the higher levels of management of the benefits to be derived from effective internal audit. Unfortunately, such recognition is hard to develop without experiencing the benefits available from a highly qualified, broad-gauge internal audit staff--yet the development of such a staff is most difficult when there is a lack of support and recognition from top management.

Despite these problems, however, we believe that both the scope and quality of internal audit in the Government are improving, and there is increasing recognition of its value.

U.S. GENERAL ACCOUNTING OFFICE

REVIEWS OF INTERNAL AUDIT ACTIVITIES

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<u>Department or agency and report title or description</u>	<u>Addressee</u>	<u>Reference no.</u>	<u>Date of report</u>
Department of Agriculture: Review of activities of the Office of the Inspector General	Congress	B-160759	5-8-68
Department of Commerce: Review and appraisal of efficiency and effectiveness of audit activities	Congress	B-160759	7-12-67
Department of Defense: Need for better coordination among, and guidance of, management evalu- ation groups in the Department of Defense	Congress	B-132900	1-2-70
Internal audit activities	Congress	B-132900	3-8-68
Review of organization and operations of internal audit activity in the Office of the Secretary of Defense	Chairman, Government Activities Subcommittee, House Committee on Government Operations	B-132900	7-7-66
Review of the internal audit system of the Defense Supply Agency	Chairman, Government Activities Subcommittee, House Committee on Government Operations	B-132900	8-12-66
GAO observations relative to the or- ganization, staffing, programs, re- porting process, and general objec- tives of the Army Audit Agency	Chairman, Government Activities Subcommittee, House Committee on Government Operations	B-132900	10-14-66
Information relating to the survey of implementation by the military audit agencies of audit plans for Vietnam	Chairman, Subcommittee on Mil- itary Construction, House Com- mittee on Appropriations	B-159451	10-7-66
Use of internal auditors to audit non- appropriated fund activities, Depart- ment of the Army	Secretary, Department of De- fense	B-159150	7-1-66
Audits and reviews of military pay and allowances made at various levels within Department of the Army	Secretary, Department of De- fense	B-125037	12-30-66
Department of Health, Education, and Wel- fare: Observations on development and status of the audit function	Congress	B-160759	5-9-69
Department of Housing and Urban Develop- ment: Report on review of the placement of audit functions in the organizational structure	Secretary, Department of Hous- ing and Urban Development	B-160759	10-16-69
Report of effectiveness of internal audit work relating to financial statements for fiscal year 1966	Secretary, Department of Housing and Urban Development	B-114860	3-21-68
Department of Justice: Need to improve internal audit	Congress	B-160759	12-26-67
Department of Labor: Need to expand and relocate internal audit function	Congress	B-160759	6-6-68

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LIST OF REPORTS ISSUED

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Department of Labor (continued): Need for more effective action to correct conditions disclosed by internal audits, Bureau of Employment Security	Congress	B-133182	1-17-67
Post Office Department: Review of internal auditing and related activities	Congress	B-160759	4-12-68
Department of State: Proposals for improving internal audit in the Department of State	Congress	B-160759	12-16-69
Agency for International Development: Review of Washington internal audit activities of the Agency for International Development	Congress	B-160759	1-17-69
Information concerning delays in finalizing audit reports by auditors assigned to the Mission of the Agency for International Development in Vietnam	Chairman, Subcommittee on Foreign Operations and Government Information, House Committee on Government Operations	B-159451	10-4-66
Survey of internal audits and inspection relating to U.S. activities in Vietnam	Congress	B-159451	7-18-66
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Survey of certain audit activities of the Federal Highway Administration	Administrator, Federal Highway Administration	B-160759	7-30-68
Department of the Treasury: Review of internal audit activities in the Department of the Treasury	Congress	B-160759	10-13-69
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Atomic Energy Commission: Review of the Internal audit system	Chairman, Atomic Energy Commission	B-160759	3-21-68
Civil Service Commission: Review of internal auditing activities	Congress	B-160759	3-20-67
Corps of Engineers, Department of the Army (Civil Functions): Review of disposition of findings disclosed by internal reviews	Chief of Engineers, Corps of Engineers	-	11-9-67
District of Columbia Government: Review of internal auditing	Commissioner, District of Columbia Government	B-160759	2-20-68
General Services Administration: Review of Central Office's direction of internal audit activity	Administrator, General Services Administration	B-160759	3-10-67

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LIST OF REPORTS ISSUED

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<u>Department or agency and report title or description</u>	<u>Addressee</u>	<u>Reference no.</u>	<u>Date of report</u>
Government Printing Office: Examination of financial statements of the Government Printing Office	Congress	B-114829	8-29-66
National Aeronautics and Space Adminis- tration: Review of internal audit activities	Administrator, National Aero- nautics and Space Administra- tion	B-160759	7-12-67
National Science Foundation: Review of Internal audit activities	Director, National Science Foundation	B-160759	6-17-69
Panama Canal Company: Review of internal audit activities	Secretary, Department of the Army	B-160759	1-15-68
Peace Corps: Limited examination into a reorganiza- tion involving the internal audit function	Director, Peace Corps	B-160759	12-27-67
Railroad Retirement Board: Review of the Railroad Retirement Board's internal review system	Chairman, Railroad Retirement Board	B-114817	2-10-70
Small Business Administration: Organization and operation of the in- ternal audit function	Administrator, Small Business Administration	B-160759	6-30-67
United States Information Agency: Review of internal audit activities	Congress	B-160759	4-8-69
Veterans Administration: Need to improve and relocate internal audit activities in the Veterans Administration	Congress	B-160759	10-3-69
Multi-agency: Survey of extent of audits of food donation programs administered by nonprofit voluntary relief agencies, Agency for International Development, Department of Agriculture and Depart- ment of State	Congress	B-159652	3-7-67
Review of audit and inspection programs conducted by U.S. agencies in Vietnam during 1966, Agency for International Development, Department of Defense and Department of State	Congress	B-159451	5-4-67
Survey of implementation by the military audit agencies of their audit phases for Vietnam, Agency for International Development, Department of Defense, and Department of State	Chairman, Subcommittee on Mil- itary Construction, House Com- mittee on Appropriations	B-159451	1-9-67

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