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*UNITED STATES  
GENERAL ACCOUNTING OFFICE*

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**Greater Audit Coverage Of  
Internal Financial Operations  
Is Needed**

**Veterans Administration**

The Veterans Administration audit effort is directed primarily toward audits of hospitals and does not provide adequate coverage of all internal financial operations as required by the Accounting and Auditing Act of 1950.

The Internal Audit Service needs to fully identify all programs within its audit universe and implement a plan to provide coverage for those programs.

Also, a determination needs to be made as to the appropriateness of the size of the audit staff and its location within the agency. Among Federal audit organizations, the Internal Audit Service ranks last in the ratios of auditors to agency employees and auditors to agency appropriations and is farthest removed organizationally from its agency head.



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

DIVISION OF FINANCIAL AND  
GENERAL MANAGEMENT STUDIES

B-160759

The Honorable Richard L. Roudebush  
Administrator of Veterans Affairs  
Veterans Administration

Dear Mr. Roudebush:

The Accounting and Auditing Act of 1950 (31 U.S.C. 66a) requires the head of each agency to establish and maintain systems of internal control, including appropriate internal audit, to provide effective control over and accountability for all funds, property, and other assets for which the agency is responsible. The act further contemplates that the head of each agency will assure himself of the adequacy of staffing and the scope of internal audit arrangements in his agency.

We reviewed the Veterans Administration's (VA's) internal audit operations for fiscal years 1973 through 1976 to determine the extent to which financial audits are made to insure that VA is maintaining effective control over revenues, expenditures, assets, and liabilities and that its financial reports contain accurate, reliable, and useful data. We did not consider whether internal audits of economy and efficiency of operations or effectiveness in achieving program objectives were being adequately performed. Appendix III lists the areas of audit concern included in the scope of our review.

We have found that the primary audit emphasis has been at the field level of operations, primarily hospitals and regional offices where both management and financial audits were made. The management audits were undertaken by a staff of management analysts, and the financial audits were the responsibility of a staff of fiscal auditors. The VA audit staff issued 341 audit reports during fiscal years 1973 through 1976, of which 97 were management audits and 244 were financial audits. The 244 financial reports were made on 128 hospitals, 42 regional offices, 24 centers (combinations of hospitals, domiciliarys, and regional offices), 36 State homes, and 14 miscellaneous activities.

Our review of a sample of the 244 financial reports and the corresponding audit programs showed that the VA fiscal auditors were providing extensive coverage of financial areas in their reviews of hospitals, including various aspects of cash, receivables, travel, liabilities, property, and payroll. However, these hospital reviews and reviews of other VA medical programs were directed toward an area which represented about \$3.8 billion, or only 21 percent, of VA's \$18 billion appropriation for fiscal year 1976.

Disbursements under VA's benefits programs, including its Mortgage Loan, Educational Benefits, and Compensation and Pension programs, were reviewed at the VA regional offices, but to a decidedly lesser extent than the hospitals. The benefits programs represented about \$13.7 billion, or 74 percent, of VA's fiscal year 1976 appropriation.

In addition, when financial areas of the benefits programs were reviewed, the audits generally did not provide coverage of the corresponding financial management systems. Because of this limited scope of audit coverage, the Internal Audit Service staff did not identify for correction many of the basic causes that contributed to the financial deficiencies it reported. Examples of such matters were reported by us in two recent reports on education assistance overpayments (MWD-76-109, Mar. 19, 1976) and controls over compensation and pension benefit payments (MWD-76-90, Feb. 6, 1976).

We also found that significant financial areas, such as accounting systems, financial statements, and administrative control of funds, have not been subjected to the important internal control which can be provided by an independent audit. Consequently, opportunities to reduce or eliminate unnecessary or wasteful practices may have been lost and potential cost reductions may not be realized.

The concentration of audit effort on hospitals appears to stem, in part, from the fact that the Internal Audit Service has not developed its universe of programs to be audited and has not filed with the Office of Management and Budget its plans for auditing that universe, as required by Federal Management Circular 73-2. Lacking a defined universe and a formal plan, the Internal Audit Service had been following a longstanding policy of concentrating its audit efforts on hospitals.

The Director of Internal Audit Service told us that he recognized the need to increase the internal audit coverage of financial operations. In January 1976 he reorganized

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his staff along functional lines to broaden the audit coverage, report on trends, and provide better followup on management's actions on reported findings.

A major portion of the reorganization was directed toward consolidating the fiscal audit function with the management audit group to provide better utilization of the staff. However, at the time of the reorganization, the Director elected to continue the policy of emphasizing audits of hospitals and regional offices until he had the opportunity to implement his organizational plan, train his staff, and increase his staff in proportion to the demands of the audit workload.

In our opinion, the recognition of the need to increase the internal audit coverage and the alignment of work along functional lines are steps in the right direction. However, we believe the effectiveness of these actions will depend upon the development of the VA's audit universe and plan. This will give the Director of Internal Audit Service a firm basis for planning and scheduling audits and for making a more effective determination of the appropriateness of the size of his audit staff. Of the 49 major and minor audit agencies in the Government, VA ranks last, in both the ratio of auditors to agency employees (1 to 2,600) and the ratio of auditors to agency appropriations (1 to \$238 million). (See app. II.)

We also believe that attention should be given to the location of the Internal Audit Service within the VA. Of the 49 Federal audit organizations, the Internal Audit Service is farthest removed organizationally from the agency head. Most of the audit directors (41 of 49) report directly to the agency head or one level below. The Director of Internal Audit Service reports to the Assistant Administrator for Planning and Evaluation, who is three levels removed from you.

The Internal Audit Service's present manner of operating is not fulfilling the internal audit requirements of the Accounting and Auditing Act of 1950 insofar as internal financial operations are concerned. We believe changes should be made in the internal audit coverage of the funds, property, and other assets for which VA is responsible.

We recommend that you assess the audit function to determine what actions should be taken concerning the planning, staffing, and location of the Internal Audit Service within VA, to provide effective coverage of VA's internal financial operations. Details of our review are included in appendix I.

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Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving copies of these statements.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen of the House and Senate Committees on Government Operations; the Chairmen of the House Committee on Appropriations and the Senate Subcommittee on HUD-Independent Agencies, Committee on Appropriations; the Chairmen of the House and Senate Committees on Veterans Affairs; the Chairmen of the House and Senate Committees on the Budget, and the Assistant Administrator for Planning and Evaluation and the Director of Internal Audit Service, Veterans Administration.

We appreciate the courtesies and cooperation extended to our representatives during our review. We are looking forward to receiving your comments concerning matters discussed in this report.

Sincerely yours,



D. L. Scantlebury  
Director

GREATER AUDIT COVERAGE OFINTERNAL FINANCIAL OPERATIONS IS NEEDEDCRITERIA FOR AUDIT COVERAGE  
OF INTERNAL FINANCIAL OPERATIONS

Our statements of basic principles and concepts regarding internal audits of financial operations provide that the internal auditor should examine financial transactions to the extent necessary to determine whether:

- The agency is maintaining effective control over revenues, expenditures, assets, and liabilities.
- The agency is properly accounting for its resources, liabilities, and operations.
- The agency's financial reports contain accurate, reliable, and useful financial data and are fairly presented.
- The agency is complying with the requirements of applicable laws and regulations.

Our statements provide that, in carrying out this work, the internal auditor should evaluate the adequacy of the agency's prescribed policies and procedures and the internal controls related to the agency's financial operations, including the accounting and financial reporting. In addition, our Policy and Procedures Manual for Guidance of Federal Agencies provides a basis for each agency to properly plan its internal audit operations to insure adequate coverage.

Appendix III to this report identifies specific financial areas that should be reviewed, as applicable, by an agency's internal audit staff.

ORGANIZATION OF VA

VA administers the laws authorizing benefits for former members of the Armed Forces and for dependents and other beneficiaries of deceased former members of such forces. Benefits are provided through three major appropriations; Benefits, Medical, and Construction. These appropriations support programs to provide compensation for service-connected disability or death; pension for non-service-connected disability or death; educational and training assistance; insurance; housing and other credit assistance; and health services.

Fiscal year 1976 legislation relating to veterans benefits and services authorized funding in excess of \$18 billion. The classification and appropriations of the individual programs by the three major areas are listed in the table on the following page.

SUMMARY OF  
FISCAL YEAR 1976 APPROPRIATIONS  
BY PROGRAMS

	<u>Percent</u>	<u>Fiscal year 1976</u>
Benefits programs:		
Compensation and Pensions		\$ 7,699,700,000
Readjustment Benefits (primary educational assistance)		5,414,475,000
Veterans Insurance and Indemnities		6,600,000
Loan Guaranty Revolving Fund		<u>550,000,000</u>
	74	<u>13,670,775,000</u>
Medical programs:		
Medical Care		3,666,711,000
Medical and Prosthetic		95,000,000
Medical Administration and Miscellaneous Operating Expense		38,528,000
Grants for Construction of State Extended-Care Facilities		10,000,000
Grants to the Republic of the Philippines		2,100,000
Assistance for Health Man- power Training Institutions		<u>30,000,000</u>
	21	<u>3,842,339,000</u>
Construction programs:		
Major		297,464,000
Minor		<u>106,426,000</u>
	2	<u>403,890,000</u>
General operation expenses	3	<u>462,450,000</u>
	100	<u>\$18,379,454,000</u>

The VA conducts its activities on a decentralized basis through its Central Office in Washington, D.C., and at 269 field stations located throughout the United States and in the Republic of the Philippines. The field stations consist of regional offices, insurance centers, data processing

centers, hospitals, domiciliaries, outpatient clinics, supply depots, a prosthetics center, a marketing center, and a records processing center.

#### INTERNAL AUDIT

Prior to January 1976 the VA audit capability was split between fiscal auditors, who primarily performed financial and compliance audits at VA hospitals and regional offices, and management analysts, who made operational audits primarily for the same entities, but not simultaneously.

In January 1976 the Internal Audit Service was reorganized to broaden audit coverage, report trends, and provide better followup on management's actions on reported findings. As part of the reorganization, the management and fiscal audit functions were combined, and the Contracts and Special Audits Division was created to evaluate the increasingly important area of contracts and grants. In addition, the Automated Data Processing Evaluation Division was established to provide indepth audit coverage of transactions involving automatic data processing.

At the end of fiscal year 1976, the audit staff, including clerical support, totaled 76 positions. These positions are classified as follows:

<u>Classification</u>	<u>Numbers</u>
Management	5
Management analysts	39
Fiscal accountants--auditors	20
Computer systems analysts	5
Clerical	<u>7</u>
	<u>76</u>

The Director of Internal Audit Service indicated in a budget estimate submitted in June 1975 that his audit operations would require a staff of 135 by fiscal year 1977, 139 by fiscal year 1978, and 144 by fiscal year 1979.

An increase of 11 positions to a ceiling of 87 was authorized for fiscal year 1977, but funding was provided for only 4 additional positions for the year. The Director has received approval to request 10 additional positions in the fiscal year 1978 budget.

## APPENDIX I

## APPENDIX I

On a comparative basis with 49 major and minor audit organizations in the Government, VA ranks last, in both the ratio of auditors to agency employees (1 to 2,600) and the ratio of auditors to agency appropriations (1 to \$238 million). (See app. II.)

Compared with the same 49 audit organizations, the Internal Audit Service is farthest removed organizationally from its agency head. Most audit directors (41 of 49) report directly to the agency head or to an individual one level below the agency head. The VA audit director reports to an individual who is three levels below the agency head. The Director of Internal Audit Service reports to the Assistant Administrator for Planning and Evaluation, who reports to the Associate Deputy Administrator, who reports to the Deputy Administrator, who reports to the Administrator.

FINANCIAL AREAS AUDITED

At the time of our review, the Internal Audit Service had not developed and filed its audit plans and policies with the Office of Management and Budget as required by Circular 73-2, Audit of Federal Operations and Programs in Executive Branch Agencies. An initial identification of the audit universe had been made, but it had not been fully developed as a basis for planning.

According to the Director of Internal Audit Service, the primary direction of audit efforts has been audits of the VA field installations, such as hospitals and, to a lesser degree, the regional offices because these facilities provide direct services to veterans, and their operation has a high degree of VA management interest. The Internal Audit Service staff issued 341 audit reports during fiscal years 1973 through 1976, of which 244 were financial compliance audits and 97 were management-type audits. A summary of the various reports issued follows.

<u>Classification</u>	<u>Financial</u>	<u>Management</u>	<u>Total</u>
Hospitals	128	54	182
Regional offices	42	7	49
Centers (includes combination of hospitals, domiciliarys, and regional offices)	24	4	28
State homes	36	-	36
Data processing center	3	-	3
Special studies	-	9	9
Other	<u>11</u>	<u>23</u>	<u>34</u>
	<u>244</u>	<u>97</u>	<u>341</u>

The financial audits were performed by headquarters staff who worked independently of the management review staff. Our review of the basic audit program and a sample of the above 244 financial audit reports showed that the VA auditors were auditing a wide range of financial areas during their reviews of hospitals, including some that we consider among the most significant in our approval of accounting systems and our reviews of systems in operations. These areas included various aspects of cash, receivables, travel, liabilities, property, and payroll. However, these hospital reviews and reviews of other VA medical programs were primarily directed toward an area which represented \$3.8 billion, or only about 21 percent, of VA's fiscal year 1976 \$18 billion appropriations.

Disbursements under VA's benefits programs, such as Mortgage Loan, Educational Benefits, and Compensation and Pension, were also being reviewed at VA regional offices, but to a decidedly lesser extent than the hospitals. The benefits programs represented about 74 percent of VA's fiscal year 1976 appropriations.

GREATER AUDIT COVERAGE OF  
INTERNAL FINANCIAL AREAS IS NEEDED

Although the Internal Audit Service's audits have included a wide range of financial coverage, the audit effort does not provide for reviews of the financial management systems from the highest level of management downward to the lowest level of operations. Because the audit coverage has been limited primarily to hospitals and regional offices, the Internal Audit Service staff has been unable to evaluate the significance of the financial deficiencies noted at these field installations in relation to the overall programs.

Each review has been undertaken at a separate organizational entity, but the results have not been compared with similar audits to help management solve its operational problems. The work at the hospitals and regional offices has been primarily on a transaction basis to ensure that established policies and procedures have been properly executed.

For example, the internal audit effort disclosed numerous individual overpayments, but it did not show the significant overall problem of overpayments in the educational assistance programs for veterans and their dependents. Overpayments to veterans had been steadily increasing during the past 9 years, and, as of December 31, 1975, they amounted to almost \$1.4 billion. We reported this matter to the Congress in a report dated March 19, 1976

(MWD-76-109). No comparable audit report has been issued by the Internal Audit Service.

Also we reported in February 1976 on the audit coverage provided to the Compensation and Pension program at the VA's Data Processing Center in Hines, Illinois, which made \$7.4 billion in payments in fiscal year 1975 (MWD-76-90). Despite the large sums involved and the vulnerability to undetected errors, misuse, and possible fraud, the Internal Audit Service had not evaluated the adequacy of controls over computer processing in the compensation and pension system at the time of our review. The Internal Audit Service internal auditor in residence at the Hines center said such controls had not been reviewed due to a shortage of personnel.

We also noted that there were no audits of agency-level financial operations conducted at the VA Central Office. In our opinion, periodic reviews should be scheduled to evaluate the financial controls, compliance with legal restraints, and whether or not the financial reports make full disclosure of the VA's financial conditions and are supported by the financial records.

In addition, increased audit effort is required at the six data processing centers to ensure that the accounting and management systems provide the necessary controls over data processed. Many of VA's accounting systems were approved over 10 years ago, and it is reasonable to assume that, with the passage of time and the introduction of sophisticated data processing equipment, changes have occurred reducing the effectiveness of GAO approved controls. Of the six VA data processing centers, only three have been assigned audit personnel, one each at the Data Processing Centers in Philadelphia, Pennsylvania; and Austin, Texas; and two at Hines, Illinois. At these three locations there are about 58 systems subject to audit. The other three centers with no audit personnel have 70 systems subject to audit.

Many of the other areas which deserve consideration in conducting future audits of financial operations are listed in appendix III. Although it may not be feasible for the Director to provide audit coverage in each of the areas, in view of operational audit requirements and present staffing levels, the appendix provides a framework for future consideration of audits of financial operations.

COMMENTS OF THE DIRECTOR  
OF INTERNAL AUDIT SERVICE

The Director of Internal Audit Service said that one of his primary concerns when appointed Director in September

1974 was the direction and emphasis given to the internal audit operations. As a result of his evaluation, he reorganized his operations to provide broader coverage and to be more responsive to management's needs. He agreed that the Internal Audit Service had not fully developed its universe of programs to be audited, nor had it filed with the Office of Management and Budget its audit universe and plans for auditing the universe. He decided, as an interim measure, to continue the reviews at hospitals and regional offices until he had the opportunity to implement his organizational plan, train his staff, and increase his staff in proportion to the demands of the audit workload.

The Director concurred in our findings that the scope of financial audits should be expanded, that basic problems should be identified, and that the necessary followup work should be done. He also stated that, until the size of his staff is increased, it will not be possible to provide the audit coverage required by the Accounting and Auditing Act of 1950.

#### CONCLUSIONS

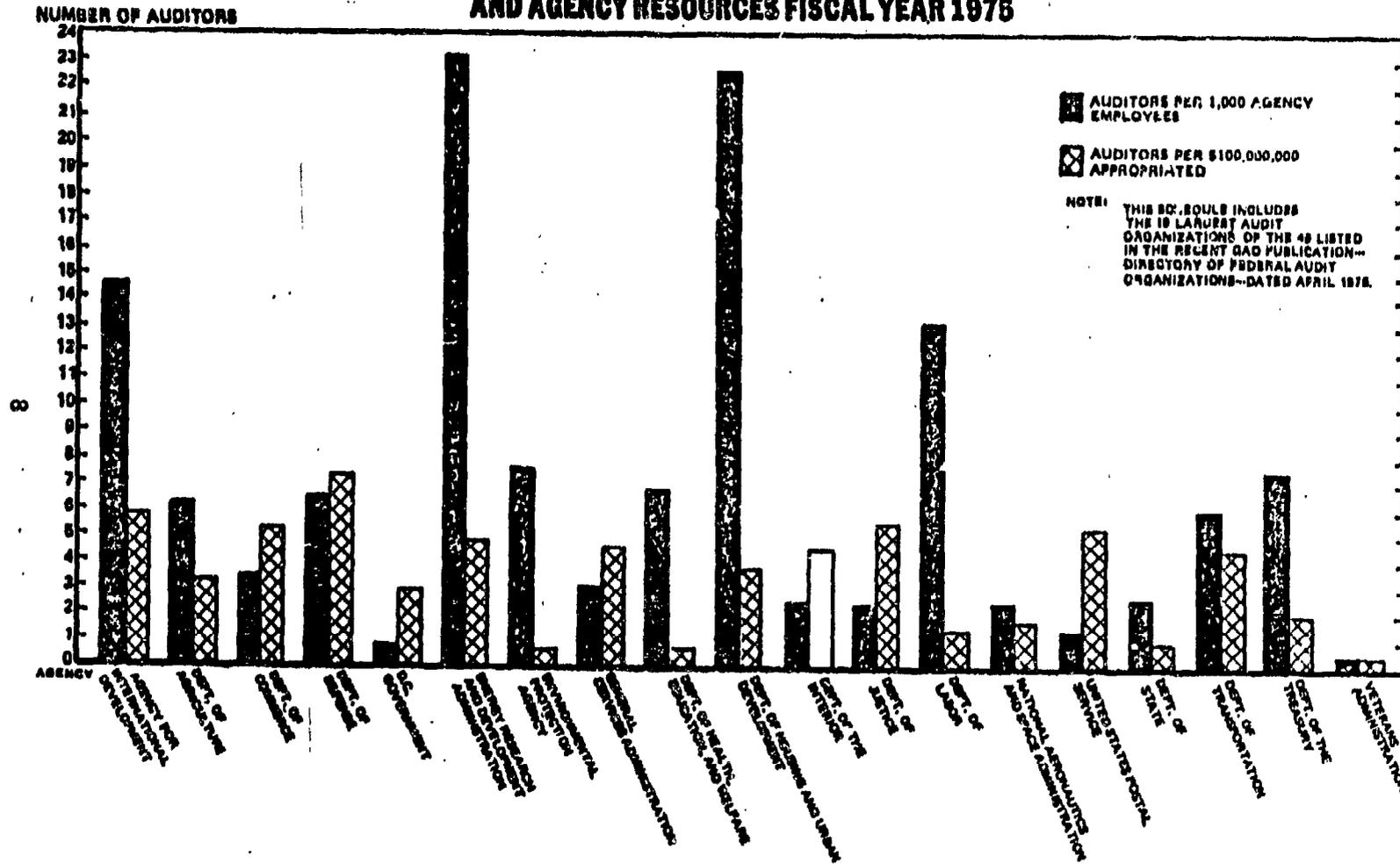
We believe that the reorganization of the Internal Audit Service to improve its audit coverage was a step in the right direction. However, the effectiveness of the reorganization cannot be determined at this time. Since the Internal Audit Service had not fully developed its universe of programs to be audited, it does not have a firm basis for planning and scheduling an overall audit program. As a result, many significant financial matters may not be subjected to the benefits of an independent audit.

The Internal Audit Service's present manner of operating is not fulfilling the internal audit requirements of the Accounting and Auditing Act of 1950 insofar as internal financial operations are concerned. We believe changes should be made in the internal audit coverage of the funds, property, and other assets for which VA is responsible.

#### RECOMMENDATION

We recommend that you assess the audit function to determine what actions should be taken concerning the planning, staffing, and location of the Internal Audit Service within VA, in order to provide effective coverage of VA's internal financial operations.

## COMPARATIVE ANALYSIS OF SELECTED AUDIT STAFF PERSONNEL AND AGENCY RESOURCES FISCAL YEAR 1976



APPENDIX II

APPENDIX II

SUMMARY OF MAJOR AREAS  
OF FINANCIAL INTEREST FOR REVIEW AND  
EVALUATION BY AGENCY 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 the 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 appropriation and/or fund

Classification of receivables:

- Interagency/fund
- External

Price established on documentation for:

- Actual cost
- Estimated cost