



***Internal
Auditing
in
Federal
Agencies***

UNITED STATES GENERAL ACCOUNTING OFFICE

**INTERNAL AUDITING
IN
FEDERAL AGENCIES**

A statement of basic principles and concepts

**UNITED STATES
GENERAL ACCOUNTING OFFICE
1968**

FOREWORD

The need for effective internal auditing systems in the Federal agencies has been recognized by Congress 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, the Comptroller General, in carrying out his audit responsibilities, is required to prescribe principles, procedures, rules, and regulations for carrying out such work, giving

*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.*

The General Accounting Office issued a statement of basic principles and concepts for internal audit in 1957 to assist in carrying out the principles enunciated in the act and to provide guidance to the agencies in developing internal audit organizations and procedures.

As a result of substantial experience gained since that time, a revised statement has been prepared. In

its preparation, we have had the benefit of extensive discussions with representatives of agencies, staff members of congressional committees, and individuals outside of Government with experience in private industry and other public and private organizations.

We have also profited greatly from the follow-up hearings of congressional committees interested in this subject, particularly the Government Activities Subcommittee of the House Government Operations Committee, which has taken a highly active interest in internal audit activities and which issued an important and constructive statement on the subject in June 1963. A copy of the pertinent excerpts from the Committee's report are included in this booklet as an attachment.

The General Accounting Office has issued a number of reports to the Congress appraising the effectiveness of internal audit in individual agencies. In carrying out our statutory responsibilities, we expect to make additional reports from time to time bearing upon the adequacy of the internal auditing in all Federal agencies.

As contemplated in the Budget and Accounting Procedures Act of 1950, it is essential that significant internal audit findings be made available directly to each agency head, and that he assure himself of the adequacy of staffing and the scope of internal audit arrangements in his agency. Evaluation of the adequacy and effectiveness of these arrangements will continue to be an important part of our reporting to the Congress in this area.



**Comptroller General
of the United States**

October 1, 1968

CONTENTS

| | |
|--|-----------|
| MANAGEMENT CONTROL | 1 |
| ROLE OF INTERNAL AUDITING | 1 |
| Nature of internal auditing | 1 |
| Benefits of internal auditing | 2 |
| Congressional interest | 3 |
| SCOPE OF INTERNAL AUDIT WORK | 3 |
| Appraising performance | 4 |
| Evaluating efficiency and economy | 5 |
| Testing the reliability and usefulness of records and reports | 6 |
| Examining financial transactions | 6 |
| Other factors affecting scope of work | 6 |
| LOCATION IN THE ORGANIZATION | 7 |
| Responsibility of management officials | 7 |
| Independence and reporting level | 7 |
| Centralization | 8 |
| Audit staffs in subordinate organizations | 9 |
| RELATIONSHIP TO OTHER INTERNAL REVIEW ACTIVITIES | 9 |
| PERSONNEL | 10 |
| MANAGEMENT OF THE INTERNAL AUDIT FUNCTION | 11 |
| INTERNAL AUDIT REPORTS | 11 |
| Distribution | 12 |
| Reporting standards | 12 |
| FOLLOW-UP | 13 |
| RELATIONSHIP OF INTERNAL AUDITING TO OTHER AUDITS PERFORMED BY AGENCIES | 14 |
| Organizational location | 14 |
| RELATIONSHIP OF INTERNAL AUDITING TO GENERAL ACCOUNTING OFFICE AUDIT RESPONSIBILITIES | 15 |
| APPENDIX | |
| Excerpts from Report by the House Committee on Government Operations on "Survey of Selected Activities (Part 1 - Efficiency and Economy in the Department of Commerce)" | 19 |

INTERNAL AUDITING IN FEDERAL AGENCIES

A STATEMENT OF BASIC PRINCIPLES AND CONCEPTS

MANAGEMENT CONTROL

Management control begins with delegated authority and planned operations and continues through performance and reporting on performance. A well designed system of management control assures efficiency, economy, and adherence to programmed performance. Such a system includes providing carefully devised and frequently updated standards of comparison in accordance with which activities are designed and carried on, and against which their output, whatever its form or stage of completion, can be measured.

The essence of management control is the action which adjusts operations to conform with prescribed or desired standards or requirements. To take this action, management needs timely and adequate information on performance.

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.

Benefits of internal auditing

Management has found that services rendered by the internal auditor in the form of constructive recommendations supported by unbiased, relevant information have aided in meeting many of the problems of both large scale and decentralized operations. The numerous, complex administrative problems of large organizations impose on management the necessity of delegating a large degree of operating authority within the organizational structure. Management must keep informed on what is happening in the organization at its various levels. Internal auditing has become an important means by which management can provide itself with such information and related evaluations.

Management also benefits from timely information on problems on which remedial measures can be taken before the functioning of the organization is impaired. These problems, once they have been examined and appraised, often lead to opportunities for achieving lower costs, increased efficiency, and faster ways of getting things done.

Internal auditing can be of special benefit to the management of smaller organizations, or of small segments of large organizations, where the customary division of duties among employees is not always economical or practical. The internal auditor can often provide additional internal checks and controls required for effective management.

By reason of his knowledge of management policies and procedures and his contacts with officials and employees at all

organizational levels, the internal auditor can render a valuable service by promoting better communication within an agency. He can obtain first-hand observations on the usefulness or effectiveness of the policies and procedures and he can bring to top management's attention those needing modification, explanation, and interpretation. This type of service can contribute materially to good management control.

Congressional interest

The Congress recognized the role and usefulness of internal auditing when it passed the National Security Act Amendments of 1949, the Post Office Department Financial Control Act of 1950, and the Budget and Accounting Procedures Act of 1950. The last named act placed responsibility for the institution of this element of internal control on top agency management by providing (in section 113) that:

*The head of each executive agency shall establish and maintain systems of accounting and 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 ****

The Government Activities Subcommittee of the House Government Operations Committee has taken a strong and active interest in this function in the Federal Government, urging all agencies to adopt effective internal audit systems.¹

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

¹House Report No. 456, 88th Congress, 1st Session (1963). See excerpts from Committee's report in appendix (p. 19).

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.

The scope of internal auditing should include the following general types of work and areas of inquiry.

Appraising performance

A necessary function of management is to establish and prescribe policies, plans, and procedures for carrying out programs and activities in pursuit of the objectives of the organization and to establish organizational or management systems for review of operations.

The internal audit function can provide a highly valuable service to management by reviewing, appraising, and reporting on the extent and nature of internal compliance with management's policies, plans, and procedures as well as with applicable legal and external regulatory requirements.

The internal auditor's work should include the review of the operation of the whole system of management controls over operations and resources to ascertain whether they are functioning in accordance with their design and are functioning effectively. In organizing his work, particularly in large agencies, he should consider making comparative examinations of similar functions which are performed in the various organizational components of the agency.

In making such examinations, the internal auditor should be alert to possibilities for improving operations and identifying opportunities for bringing about greater efficiency and economy.

As a result of his familiarity with management plans and policies, intra-agency relationships, and procedures and with the manner in which they are working out, the internal auditor should also report observations as to their adequacy and effectiveness in relation to top management objectives together with such recommendations for improvement he considers appropriate.

Evaluating efficiency and economy

The internal auditor should be concerned at all times with minimizing unnecessary or wasteful practices in the use of the agency's resources. He should be watchful for and report on such possibilities as:

- Procedures, whether officially prescribed or merely followed, which are ineffective or found to be more costly than justified.
- Duplication of effort by employees or between organizational units, which, if eliminated, could increase overall efficiency.
- Performance of work which serves little or no useful purpose.
- Inefficient or uneconomic use of automatic data processing equipment.
- Overstaffing in relation to work to be done.
- Faulty buying practices.
- Procurement and accumulation of unneeded or excess quantities of property, materials, or supplies.
- Wasteful use of property.

Where functional staff groups exist in an agency which are regularly concerned with such matters as organizational efficiency and personnel utilization and the making of related studies, the internal auditor should recognize such work and avoid any duplication of effort. However, he should communicate to such groups any observations he may have which are related to their responsibilities.

The operations of such functional staff groups should be subject to the same degree and type of audit as obtain for other parts of the organization.

Wherever practicable, the internal auditor should suggest ways of remedying the weaknesses that he finds; in some cases, he may recommend remedial studies by technical personnel.

The internal auditor should be particularly concerned with assets for which the agency is accountable: whether they are fully accounted for and whether procedures being followed adequately protect them from loss, deterioration, or misuse. In examining into these matters, he should be alert to the possibility of active fraud and dishonesty and to opportunities and

practices which could lead to fraud, dishonesty, or loss. The existence of separate groups within the organization concerned with fraud or other forms of irregularity should not inhibit the auditor from giving close attention to such matters in his work. Whenever he does encounter such matters, the internal auditor should bring them without delay to the attention of the management.

Testing the reliability and usefulness of records and reports

The work of the internal auditor should include repeated examination and testing of accounting and other records, and the related procedures underlying the agency's management information system in order to establish the reliability of the data used by management for internal purposes and for external reports.

The purpose and usefulness of internal reports should be reviewed by the internal auditor as one means of keeping reports responsive to the real needs of users, of avoiding the production of repetitive reports that no longer serve any useful purpose, and of avoiding the distribution of reports to persons having no use for them. He should also make sure that changing activities or circumstances are considered in the internal reporting operations.

Examining financial transactions

The internal auditor should examine financial transactions, including both the receipt and the disbursement of public funds, to the extent necessary to evaluate:

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

The work of the internal auditor should include examination into whether all revenues and receipts arising from the activities of the agency are collected and fully accounted for. The internal auditor should consider whether the agency's procedures result in prices, rates, or fees that conform to the requirements of applicable laws, regulations, and program objectives and whether they promote efficiency and economy in administration.

Other factors affecting scope of work

In all of his work, the internal auditor should strive to determine the underlying causes of the errors or adverse conditions he encounters and to formulate recommendations for preventing similar occurrences in the future.

The internal auditor should not be assigned the responsibility for developing and installing methods, systems, or procedures. He should, however, call attention to problem areas and possible improvements and he should be consulted on proposed corrective actions.

The internal auditor should be kept informed of proposed major changes in methods, systems, and procedures, particularly those involving computer applications so that he can contribute suggestions on them before they are put into effect. Consultation between the systems/computer technicians and the internal auditor during the systems development phase, helps to assure that adequate controls are established and adequate audit trails are provided in the system so as to avoid costly changes after a new system has been installed.

LOCATION IN THE ORGANIZATION

Responsibility of management officials

Internal auditing does not in any way relieve other persons of the responsibilities assigned to them. An internal auditor should not replace established lines of operating authority, and his operations do not eliminate the need for continuing organizational and functional supervision.

Operating officials should be vested with full responsibility for compliance with prescribed policies and procedures, for protection and use of the resources of the agency, and for action in the correction of deficiencies or unsatisfactory conditions coming to their attention including those reported by the internal auditor.

Independence and reporting level

The position of the internal auditor in the organization should be such that he is independent of the officials who are directly responsible for the operations he reviews. To provide an adequate degree of independence, the internal auditor should be responsible to the highest practical organizational level, preferably to the agency head or to a principal official reporting directly to the agency head.

Internal auditing cannot be fully effective unless the official to whom the internal auditor reports is a strong supporter of the function, has direct access to the agency head, and has made arrangements to supply all significant audit findings directly to the agency head.

Where the internal auditor does not report to the head of the agency, the function should be placed under the direction of a principal official who does report directly to the agency head so as to assure recognition of its stature and importance in the control system. Also, where the internal auditor does not report to the head of the agency:

- The agency head should satisfy himself that the official to whom the internal auditor reports not only permits but encourages the internal auditor to exercise latitude in setting the scope of work and in reporting on results of his audits. The internal auditor should be sufficiently independent to be able to make impartial appraisals of the operation of agency programs and activities, including those under the official to whom the internal auditor reports.
- The head of the agency should concern himself with the scope and effectiveness of the internal audit function and its staffing and with the adequacy of attention paid to audit findings and recommendations.
- The internal auditor, when he deems it necessary to the fulfillment of his responsibilities, should have direct access to the head of the agency.

Centralization

The establishment of a single internal audit organization reporting to the agency head or to a principal official reporting directly to the agency head:

- Provides the advantages of greater independence.
- Fosters a broad viewpoint on the interrelationship of organizations and functions within an agency.
- Places the internal auditor in a better position to make systematic and independent evaluations of and reports on all agency programs, activities, and operations.

A single audit organization also facilitates the attraction and retention of better managerial and staff capability, more effective staff utilization, and increased coordination of audit

effort and interrelated findings. In addition, under unified direction and supervision, a single audit organization permits the devotion of a greater portion of total staff time to specific audit assignments and provides greater opportunities for tailoring staff assignments to the talents and experience of staff members.

Audit staffs in subordinate organizations

A separate internal audit staff should not be attached to a component bureau or similar organization unless management needs and the size and nature of the bureau's activities are such as to justify an internal audit staff of sufficient size to attract and retain qualified personnel and to make possible the productive and flexible use of staff resources. Decisions on the establishment of such staffs should be made by or be subject to approval by the agency head.

Where an organizational component of an agency maintains its own internal audit staff, the central internal audit activity of the agency should be accountable for furnishing general policy direction and coordinating the efforts of such staff.

The audit coverage by a subordinate audit staff should be included in the scope of the internal audit activity provided for top management. The work of such an organization should be used to the extent practicable in carrying out internal audit work of the top audit group and the effectiveness of the audit work at the lower level should be evaluated as are other control functions.

An internal audit group at the bureau level should be accountable to an official occupying a sufficiently high position to assure its access to any activity of the organization and adequate consideration of and action on its findings and recommendations.

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.

PERSONNEL

Carrying out the type of internal audit described above requires an adequate staff of competent, experienced personnel. The degree to which internal auditing can aid management is proportional to the capabilities of the audit staff and the freedom with which it operates. A program of continuous training and development is essential.

Broad responsibilities and a wide range of services require that the internal auditor be well informed on such matters as his agency's purposes, objectives, programs, policies, operations, activities, and related basic legislation; its budget, fiscal, and accounting procedures and those of the Government generally; legal and regulatory requirements; accounting and auditing principles and procedures; and management practices common to all organizations.

Within the scope of his assigned responsibility, he should be capable of making reviews and evaluations at various operating levels from the standpoint of management. He should be able to recognize problem areas and contribute workable suggestions for improvement. Academic courses in management policies and practices, budgeting, accounting, auditing, and allied subjects will aid the auditor in acquiring some capability in these matters, but much of the ability to perform his function effectively must be acquired by experience.

Internal auditors must be knowledgeable in statistical sampling, computer applications, management information systems, economics, operations research, and other facets of modern management practices. While an audit staff may consist mostly of individuals with training and experience in accounting and auditing, it should also include a considerable degree of expertise in mathematics, computer operations, engineering, and other appropriate specialties when warranted by the nature of an agency's programs and activities.

The nature of his work requires that the internal auditor deal successfully with all classes of employees and be able to communicate with them and others both orally and in writing. He must be tactful and maintain always a good appearance and a professional bearing.

In the course of their examinations, internal auditors have opportunities for becoming acquainted with agency problems and personnel. The investment of talent and time in internal auditing can also make a material contribution to the development of potential management personnel.

MANAGEMENT OF THE INTERNAL AUDIT FUNCTION

A manual should be developed outlining the objectives of internal auditing in the agency, the policies to be followed, the general scope of work to be performed, and standards of performance.

Forward planning of audit work is essential to identify the areas to be covered and to permit systematic scheduling of work and the best use of manpower. However, audit plans should be sufficiently flexible to permit special examinations as new needs or changing circumstances require, thereby making possible the best service to management.

Professional standards of performance, adequacy of work done, and timeliness of reporting should be constantly stressed. Work performed should at all times meet high standards of competence, reliability, and objectivity.

Workpapers prepared during audit work should be so designed as to clearly support the conclusions reached and supply the basis for any recommendations made. The audit scope should be sufficient to keep specific findings of deficiencies in perspective. Audit managers should regularly review the status of audit work in process and, if necessary, guide audit efforts into areas more closely related to current management needs.

To keep pace with changing conditions, internal audit programs should be reappraised from time to time, especially their coverage and their relationship to changes in the agency's policies and programs. Auditing policies and procedures must be modified as necessary to remain responsive to management's current interests.

INTERNAL AUDIT REPORTS

The preparation of audit reports is an important part of the internal audit process since it is through reports primarily that the auditor communicates his observations, findings, conclusions, and recommendations.

Distribution

All significant audit findings should be brought to the attention of the agency head in such form as to facilitate his effective use of the information.

Internal audit reports should be submitted to:

- Management officials who are responsible for the operations or activities reviewed and for making decisions as to actions to be taken on reported findings and recommendations.
- The official to whom the internal auditor is functionally responsible.
- Other officials in the agency who may benefit from the information in the reports.

Top management's role is essential here. By its inattention or inaction, much of the constructive benefit of the internal auditor's work can be lost. On the other hand, its interest in and use of his findings and recommendations can contribute much to the recognition of the importance of his work at all management levels.

Reporting standards

To be effective, audit reports must be carefully prepared in accordance with the following standards:

- Factual matter must be accurately, completely, and fairly presented.
- Findings must be presented objectively and in language as clear and simple as the subject matter permits. Findings must be adequately supported by the audit working papers.
- Reports must be concise but complete enough to be readily understood by the users.
- Information on underlying causes of deficiencies reported should be provided so as to assist in implementing proposals for or devising corrective action.
- Reports should place primary emphasis on improvement of operations rather than on criticism of the past;

critical comments should be placed in balanced perspective with any unusual difficulties or circumstances faced by the operating officials concerned.

- Reports should point up issues and questions needing further study and consideration by the internal auditor or others.
- Reports should recognize noteworthy accomplishments particularly where management improvements in one place may have applicability elsewhere in the agency.

Except where the possibility of fraud or other compelling reason may require a different treatment, the auditor's tentative findings should be discussed with the responsible operating officials whose activities are being reviewed. Their views should be obtained and given recognition so that the report can become a vehicle for constructive action in which the operating officials play an important role. Where possible without undue delay, operating officials' views should be obtained in writing.

FOLLOW-UP

Primary responsibility for action and follow-up on audit recommendations rests with management. A good control system will include procedures under which management officials will evaluate the effectiveness of actions taken on audit recommendations.

A desirable procedure is to have regular status reports prepared for the information of management officials and the internal auditors, as to actions taken on audit recommendations. Also, provision should be made for regular inquiry into whether proposed corrective actions have in fact been taken and their effectiveness. The responsibility for such follow-up should be that of management officials, but the internal auditors should participate.

Where operating officials disagree with the internal auditor's recommendations, a mechanism should be established to reconcile the differences or to call for a decision at a higher management level.

Thus, reporting a finding, observation, or recommendation should not end an internal auditor's concern with the matter. From time to time he should ascertain whether his recommendations have received serious management consideration and whether satisfactory corrective action has been taken.

Agency internal auditors should also concern themselves with the audit findings of the General Accounting Office and related recommendations as to actions to be taken by the agency. They should incorporate, in their follow-up procedures, inquiry into the nature and effectiveness of those actions.

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.

RELATIONSHIP OF INTERNAL AUDITING TO GENERAL ACCOUNTING OFFICE AUDIT RESPONSIBILITIES

The adequacy of the system of internal control, including internal audit, of each Federal agency is of importance to the General Accounting Office in carrying out its statutory audit responsibilities. The Budget and Accounting Procedures Act of 1950 states the duty of the General Accounting Office to consider agency internal auditing as follows:

Sec. 117. (a) Except as otherwise specifically provided by law, the financial transactions of each executive, legislative, and judicial agency, including but not limited to the accounts of accountable officers, shall be audited by the General Accounting Office in accordance with such principles and procedures and under such rules and regulations as may be prescribed by the Comptroller General of the United States. In the determination of auditing procedures to be followed and the extent of examination of vouchers and other documents, the Comptroller General shall give due regard to generally accepted principles of auditing, including consideration of the effectiveness of accounting organizations and systems, internal audit and control, and related administrative practices of the respective agencies.

Although there are numerous areas of common interest between the General Accounting Office and an agency's internal auditors, certain basic objectives and responsibilities differ. Internal auditing is an integral part of an agency's system of management control. In its audits, the General Accounting Office reviews the entire control mechanism within an agency, including the various arrangements made by the management for internal audits and other forms of inspection, appraisal, and evaluation. If warranted by its evaluations, the General

Accounting Office will rely on such work and make full use of it in conducting its examinations.

The General Accounting Office is interested in the degree of agency management concern and interest in the work of the internal auditor and particularly in his reported findings and recommendations. The actions taken by management officials on internal audit recommendations are reviewed by General Accounting Office auditors.

The General Accounting Office uses the same techniques of testing and analyzing, to satisfy itself as to the adequacy of internal audit work, as those used in the review of any other function in a Federal agency. This includes a review of work programs and working papers and their adequacy in relation to what was reported. The review may cover some of the same transactions and procedures as those examined by the internal auditor--a procedure essential in testing the quality of the internal audit work.

Normally there is little duplication of the work of the internal auditor. 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 systems, including internal audit. It makes every effort to keep abreast of the planned work programs of the agency's internal auditors, to consider them in planning its own work, and to avoid, wherever possible, conflicts in audit schedules.

Free and unrestricted access to working papers, records, and reports prepared in connection with internal audit work and other internal review activities is essential in order that General Accounting Office auditors can effectively review and evaluate their propriety and adequacy. Ready access to such records is also necessary in order that all significant information pertinent to any matter being reviewed by the General Accounting Office may be considered. Such information is necessary in order that, to the extent possible, General Accounting Office findings and reports will be complete, accurate, and objective and thus of maximum usefulness to the Congress and to agency and other Government officials.

APPENDIX

**Excerpts from Report by the House Committee on
Government Operations on "Survey of Selected Activ-
ities (Part 1 - Efficiency and Economy in the Depart-
ment of Commerce)"**

**House Report No. 456, 88th Congress,
1st Session (1963)**

Findings and Conclusions

1. Internal audit

Every organization must have an effective system of internal management control. The so-called internal auditing system, as recommended by the Comptroller General in August 1957, constitutes an effective means for the average Federal agency to obtain this essential management function. Unfortunately, this internal audit system has not been adopted on a Government-wide basis. In too many instances, internal audit functions are compromised by inadequate staffs, improper organizational requirements or limits in scope of service. All Federal agencies should review internal management control systems and place them in compliance with the Comptroller General's 1957 recommendations and with the criteria established in this report.

* * * * *

Need for Effective Internal Audit Systems

* * * * *

In the larger Federal agencies, the most promising means of obtaining management control has been the establishment of effective internal audit systems. The Comptroller General in 1957 issued a statement of basic principles and concepts for departments and agencies to follow in the establishment of such systems. For years the Comptroller General and those on his staff working on a day-by-day basis with executive officials have continuously stressed the need for

effective internal management controls. The head of a large executive department or agency must have his own "eyes and ears" within the organization, responsible solely to him, independent of operations and with unlimited jurisdiction to review any and all functions wherein waste or inefficiency might exist. *** However, especially in the larger departments or agencies employing thousands of individuals, involving scores of programs, and having offices located throughout the United States and possibly abroad, if the agency head wants to maintain policy control and achieve economy and efficiency, he has no choice but to institute an effective management control system.

Today, there are internal audit groups sprinkled throughout the agencies and departments of Government. The term is well recognized. Unfortunately, recognition of the *need* for effective internal audits has not always been translated into the *establishment* of such systems. While many exist, there is considerable room for general improvement.

The committee has established certain fundamentals relating to internal audit operations patterned after the 1957 recommendations of the Comptroller General, with certain refinements reflecting deficiencies in operations uncovered during the hearing:

1. There must be a central internal audit system in every large department or agency organized independent of department or agency operations.
2. The personnel assigned to this management function must have the highest qualifications and the complete confidence of the department or agency head. An accounting background and auditing experience is preferred.

3. All reports and recommendations of the internal audit staff must be submitted in full directly to the agency or department head.

4. The scope of review of the internal audit staff must be unlimited.

5. Personnel assigned to the internal audit function must be protected from recriminations and arbitrary personnel action resulting from the adverse effect their reports might have upon other department or agency employees.

6. The reports and recommendations of the internal audit staff must remain available to the Comptroller General and appropriate congressional committees.