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

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RESOURCES AND ECONOMIC
DEVELOPMENT DIVISION

JAN 28 1974

B-160759

The Honorable Dixy Lee Ray
Chairman, Atomic Energy Commission



Dear Dr. Ray:

We have surveyed the organization and operation of AEC's audit function. Our survey was conducted at AEC Headquarters and at three AEC field offices--Las Vegas, Nevada; Oak Ridge, Tennessee; and Richland, Washington. We examined policies and procedures, audit reports, and supporting workpapers. We had previously reported on AEC's audit function to the Chairman, AEC, on March 21, 1968 (B-160759).

Our current survey showed that the AEC audit function is, for the most part, being conducted satisfactorily. AEC statistics show that during fiscal year 1973 the AEC audit organization conducted 1,032 audits. Five hundred and thirty-six of these were functional audits, such as payroll, travel, and procurement; the remaining 496 were audits of costs incurred under cost-reimbursement contracts. These audits disclosed 1,330 items needing corrective action and \$14.4 million of questionable contractual costs. In addition, during fiscal year 1973, management took corrective action on 1,166 deficiencies which the auditors had previously identified and \$6.5 million in reimbursed unallowable costs was recovered from contractors.

Certain aspects of the audit function--organizational location of the audit groups assigned to AEC field offices, scope of audit coverage, and timeliness of the evaluations of the work done by the auditors assigned to the field offices--need improvement.

The Assistant General Manager, Controller (Controller), generally agreed with our comments and recommendations and said corrective actions would be initiated on all the recommendations, except the one on the organizational location of the auditors in the field offices. He stated that AEC would consider it further and advise us of its views at a later date.

BACKGROUND

Primary responsibility for AEC's audit activities rests with the Controller, who develops all audit policy. The Assistant Controller for Auditing carries out AEC's audit activities for the Controller.

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AEC's audit function is a combination of a centralized and several decentralized audit groups. The centralized group (Controller's auditors) reports to the Assistant Controller for Auditing and is responsible for reviewing all activities performed by AEC Headquarters and its 11 field offices (eight operations offices, two naval reactors offices, and the Grand Junction Office).

The decentralized audit groups are

- The auditors assigned to the AEC field offices who report to the managers and are responsible for reviewing the activities of AEC's contractors.¹ These auditors are hereinafter referred to as field office auditors.
- The auditors employed by AEC's prime contractors (contractors' auditors).

The distinction between the audits performed by these three groups of auditors is as follows:

1. Controller's auditors:

- Are responsible for auditing all activities of Headquarters and the AEC field offices, including contract administration.
- Evaluate the technical competency and objectivity of the audits conducted by the auditors in the field offices. (The managers of the field offices and the Controller are informed in writing of these evaluations through the medium of periodic evaluation reports issued by the Assistant Controller for Auditing.)
- Develop the audit programs for and direct two AEC-wide audits annually. (The Controller's auditors and the field office auditors actually perform these audits.) The results of these audits are contained in reports to the managers of the AEC field offices and to the contractors responsible for the activities being audited. The significant aspects of these reports are consolidated into a report issued by the Controller through the General Manager to the five AEC Commissioners.

¹There are no auditors permanently assigned to the Grand Junction Office because of its relatively small contracting activity.

2. Field office auditors:

--Are primarily responsible for auditing the activities of AEC's prime contractors, i.e., the cost-type operating contractors at AEC's major production and research facilities.

--Evaluate the technical competency and objectivity of the prime contractors' audit staffs.

3. The contractors' auditors review the prime contractors' activities relating to the AEC contracts and report to their top management.

As of October 1973, there were 28 Controller's auditors, 12 of whom were assigned to Headquarters and 16 of whom were assigned to AEC field locations; about 130 field office auditors; and about 130 contractors' auditors.

AEC's audit structure is an outgrowth of its overall method of operation, under which almost all AEC operating responsibilities are carried out under cost-type contracts, which its decentralized field offices administer. These contractors employ about 95,000⁽¹⁾ persons and AEC employs about 7,600 persons. The decentralized audit groups are an integral part of the AEC audit function.

The Controller's auditors are required to evaluate the work of the field office auditors, who, in turn, are required to evaluate the work of the contractors' auditors. During these evaluations consideration is given to the technical competency, objectivity, and independence of these auditors.

The Controller's audit staffs at the three locations surveyed have, during the past 3 years, spent about 22 percent of their time evaluating the work of the field office auditors. Similar statistics were not available on the time spent by the field office auditors evaluating the contractors' auditors work.

INDEPENDENCE OF FIELD OFFICE AUDITORS

In all matters relating to the audit work, it is important that the audit organization and the individual auditors maintain an independent attitude. The auditors and the audit organization should maintain sufficient independence so that their opinions, conclusions, judgments, and recommendations will be impartial.

¹Does not include 9,700 persons employed by AEC construction contractors.

Although we did not identify any instances of auditors lacking independence, we noted that organizationally the field office auditors are responsible to and under the direction of the finance directors of the field offices. The finance directors are organizationally responsible to the assistant managers for administration, who in turn are responsible to the managers of the field offices.

At the three AEC field offices surveyed, drafts of all audit reports were submitted to the finance directors before the reports were finalized. The final reports were signed by the audit branch chiefs and, for the most part, were addressed to the managers.

In our opinion, the field office auditors are not organizationally as independent as is desirable, since the finance directors, under whom they work, have operating responsibilities, such as the review and approval of contractors' accounting procedures, which are subject to review by the field office auditors. Since the finance directors have the authority to direct all matters pertaining to auditing, a finance director could possibly limit the audit coverage in his areas of responsibility. Also the field office auditors might have to report on matters (1) for which the finance directors have responsibility or (2) which may adversely reflect on decisions made by the finance directors.

Recommendation

Since the existing organizational location of the field office auditors could subject them to policy direction from superiors who are involved directly with the management functions being audited, we recommend that the field office auditors be organizationally located outside the management entity subject to their audit and be directly responsible to, and under the supervision of, the manager.

Agency comments

The AEC Controller agreed with the technical merits of the recommendation. But he pointed out that there were practical aspects in such organizational changes that would have to be considered further and that AEC would advise us of its views at a later date.

AUDIT COVERAGE SHOULD BE EXPANDED

AEC's audit coverage includes:

- Annual audits of the financial transactions of AEC Headquarters, each field office, and AEC's prime cost-type contractors, i.e., operating contractors.

- Periodic audits of AEC and operating contractors' activities, such as payroll, travel, procurement, and management of capital assets.
- Periodic audits of costs incurred by AEC contractors (other than its operating contractors) under cost-reimbursable contracts.
- Two AEC-wide audits annually.

These AEC-wide audits cover a wide variety of activities, such as equipment management and controls over computer resources, and involve a coordination between the Controller's and field office auditors under the overall direction of the Controller. At the conclusion of the work, the managers of the AEC field offices and the operating contractors responsible for the activities being audited are advised of the results of the audits. Copies of the audit reports are forwarded to Headquarters for consolidation into overall AEC-wide audit reports which the Controller issues through the General Manager to the five AEC Commissioners.

AEC's audit coverage has not included overall assessments of major AEC programs, such as waste management, operational safety, and nuclear materials security, to determine whether these programs are (1) being conducted in line with authorized objectives and (2) making reasonable progress in accomplishing such objectives. Rather, its audit coverage has been concerned with the economical, efficient, and effective conduct of the functional aspects of its major programs; e.g., travel, procurement, and equipment management.

The full scope of an audit of a governmental program, a function, an activity, or an organization should encompass not only an examination of financial transactions, accounts, and reports and a review of efficiency and economy in using resources, but also an inquiry into the results or benefits achieved and whether programs are meeting objectives. While each individual audit need not be of such extensive scope, we believe that the full scope of audit work for major governmental programs should be accomplished over a period of time. Such coverage will better serve AEC management.

Recommendation

Therefore, we recommend that the Controller plan for making, from time to time, assessments of AEC's major programs and projects.

Agency comments

The Controller stated he agreed with our recommendation and would adopt it. He pointed out, however, that manpower limitations and the priority of other work in the foreseeable future would limit, more than he would like, the extent to which he will be able to implement our recommendation.

DELAYS IN MAKING EVALUATIONS
OF FIELD OFFICE AUDITORS

Pursuant to AEC audit policy, the Controller is responsible for evaluating the work of the field office auditors. This responsibility is carried out for the Controller by his auditors assigned to the AEC field locations.

The Controller's auditors review and report to the finance directors on individual audits performed by the field office auditors. According to the Assistant Controller for Auditing, on occasion, the Controller's auditors have discussed, with the field office managers, the adequacy of certain audits performed by the field office auditors. AEC's auditing procedures require the Controller's auditors to issue biennial evaluation reports to the managers, which contain overall assessments of the adequacy of audits performed by the field office auditors.

In addition, each year AEC's Assistant General Managers, including the Controller, orally advise the General Manager on the performance of the AEC field offices in their areas of responsibility. The Controller's appraisal includes the auditing function of the field offices. According to the Controller, the General Manager uses this appraisal in individual discussions with each field office manager. The Controller said it has been his experience that the discussion of the results of appraisals at this management level has been particularly effective. He pointed out, however, that these appraisals are not intended to substitute for the biennial reports.

Although the Controller's auditors were regularly reviewing and reporting to the finance directors on individual audits performed by the field office auditors, the required biennial evaluation reports to the managers had not been made within the required time frame by 8 of the 10 field offices which have auditors, as shown in the table on the following page.

<u>Controller's audit staff</u>	<u>Office location</u>	<u>Evaluation reports</u>		
		<u>Date of last report</u>	<u>Months since last report</u>	<u>Months overdue</u>
		(as of October 31, 1973)		
Albuquerque (note a)	Albuquerque	7-72	15	--
Chicago (note a)	Chicago	5-69	53	29
Nevada	Nevada	5-72	17	--
	San Francisco	3-71	31	7
Oak Ridge	Oak Ridge	5-69	53	29
	Savannah River, South Carolina	6-68	64	40
Pittsburgh (note a)	Pittsburgh	6-68	64	40
	Schenectady	1-69	57	33
Richland	Richland	6-68	64	40
	Idaho	5-70	41	17

^a Although we did not visit these offices, statistics on the biennial evaluation reports were available at AEC Headquarters.

The Assistant Controller for Auditing told us that the workloads of the Controller's auditors prevented them from conducting the overall evaluations within the required time frame. However, he pointed out that, over the last 2 years, he has held general discussions with the field office managers about the performance of the field office auditors.

The biennial evaluation reports prepared by the Controller's auditors represent the only written communication to the managers on the overall acceptability and reliability of audits performed by the field office auditors. These biennial evaluations have pointed out to the managers such weaknesses as:

- Audit staffing level insufficient to provide complete audit coverage.
- The need for insuring that audit findings are acted upon.
- The need for improving the planning of audits and the reviewing of workpapers.

Recommendation

We recommend that the Controller (1) expedite the performance of the evaluations of the audits of the field office auditors which are overdue and issue the related reports thereon to the managers of the AEC field offices and (2) establish procedures which will promptly bring to his attention those evaluations which are not made within a reasonable period after such evaluations are due.

In implementing the above recommendations, the Controller should consider whether there is a need for either additional staffing or the rearrangement of audit priorities to insure compliance with the AEC requirement.

Agency comments

The AEC Controller told us that he agreed with these recommendations and that corrective action would be taken.

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We appreciate the courtesies and cooperation extended to our representatives during the survey. Please advise us of any actions planned or taken with respect to the matters discussed in this report.

We are sending copies to the Director, Office of Management and Budget; the Chairman, Joint Committee on Atomic Energy; and the Chairmen of the House and Senate Appropriations and Government Operations Committees.

Sincerely yours,

Henry Eschwege

Director, Resources and
Economic Development Division