
BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Administrator Of Veterans Affairs

First-Year Implementation Of The Federal Managers' Financial Integrity Act In The Veterans Administration

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through annual agency self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by VA in its first year of experience with this new act. The report focuses on VA's evaluation of internal controls, reviews of accounting systems, and the improvements being made as a result of identified problems.



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

HUMAN RESOURCES
DIVISION

B-202205

APRIL 27, 1984

The Honorable Harry N. Walters
Administrator of Veterans Affairs

Dear Mr. Walters:

This report presents the results of our review of the Veterans Administration's (VA's) efforts to implement the Federal Managers' Financial Integrity Act of 1982. Our review was part of a General Accounting Office assessment of 22 federal agencies' efforts to implement the act during the first year.

The Financial Integrity Act establishes a government-wide framework for improving and monitoring the effectiveness of financial management in federal agencies. The act requires you to report annually to the President and the Congress on whether VA's systems of internal accounting and administrative control are in compliance with the Comptroller General's standards. VA's internal control evaluation was conducted in accordance with Office of Management and Budget (OMB) internal control guidelines.

The OMB guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the required evaluation: organizing the internal control evaluation process; segmenting the agency to create an inventory of assessable units; conducting vulnerability assessments to determine the risk of waste, loss, unauthorized use, or misappropriation; planning and performing internal control reviews and other actions to determine the adequacy of internal controls and document weaknesses and planned corrective actions; taking corrective actions; and reporting on the adequacy of internal controls and plans for corrective action.

We reviewed VA's efforts to implement the act in accordance with the OMB guidelines. We focused on the activities of six major departments and offices that accounted for over 99 percent of VA's budget. We also coordinated our work with a similar review you requested the Inspector General to conduct.

VA has made progress in establishing its internal control evaluation program. Top level managers have given this program their personal attention and commitment. These managers responded to VA's instructions to segment their respective organizations into programs and administrative functions and to develop inventories of their assessable units. Then the managers conducted vulnerability assessments and have performed or planned internal control reviews in their most vulnerable areas. VA has required its department and office heads to incorporate internal control responsibilities into subordinate managers' performance plans and to ensure that the accomplishment of these responsibilities is reflected in performance appraisals. VA has established reporting systems to monitor internal control activities, and is developing an automated follow-up system.

Our review disclosed the following aspects of the internal control evaluation process which need improvement to provide a basis for a more meaningful conclusion as to whether VA has reasonable assurance that its internal controls meet the objectives of the act and are in conformance with the Comptroller General's standards (our specific findings are in app. I):

--VA did not develop a comprehensive inventory of assessable units or assign responsibility to assess cross-cutting and common functions. As a result, some areas--such as medical care eligibility and telecommunications--were not assessed while other areas--such as automatic data processing, travel, and time and attendance--were not consistently assessed agency-wide. In addition, some field managers who are responsible for programs and functions did not participate in the process though their expertise could be useful in determining vulnerabilities and their involvement could help sensitize them to the need for adequate internal controls. VA plans to address the need for its components to consider all significant functions and will assign responsibility to assess functions which cut across organizational lines in its revised internal control directive which is in process. In addition, VA recognizes the need for field participation and will continue to emphasize it in subsequent internal control activities. VA's Management Control Staff, which has primary responsibility for monitoring and coordinating the results of VA's internal control activities, agreed to address the need for VA components to include field participation in VA's revised internal control directive.

- The vulnerability assessments generally did not provide adequate information as to the bases for the vulnerability ratings or adequate evidence as to whether existing and potential weaknesses had been identified. For example, little or no information was provided to explain how the evaluation of the factors considered in the assessment process resulted in the conclusion reached. Furthermore, when assessable units were considered highly vulnerable, information was generally not provided to indicate whether a specific weakness had been identified during the assessment or whether the conclusion was based solely on inherent risk associated with the activity. VA plans to require its components, when conducting vulnerability assessments, to document weaknesses identified through the assessment process and to provide information on how key factors which affect internal control are considered in reaching conclusions on overall vulnerability.
- The internal control reviews generally did not analyze the processes used to perform activities being reviewed (event cycles) or the adequacy of internal control objectives and techniques. In addition, the reviews often did not test controls to assure that they were functioning as intended and did not involve adequate field participation. For example, only 4 of the 16 reviews we examined involved testing of controls. Two of the four reviews that tested controls listed event cycles and one listed control objectives. The remaining 12 reviews were limited in scope and were subjective assessments which did not analyze event cycles, control objectives and techniques, or test any controls. VA plans to issue further guidance for conducting more effective internal control reviews.
- VA did not specify the extent and type of training that should be provided to personnel performing and reviewing internal control evaluation activities. As a result, some personnel involved in the performance and review of vulnerability assessments and internal control reviews did not receive training. Although the Department of Medicine and Surgery provided training to its personnel conducting vulnerability assessments, other major components provided little or no training. VA plans to continue to encourage its components to provide training for personnel involved in internal control evaluation activities as needs are identified. The Management Control Staff has agreed to address the need for VA components to provide training in VA's revised internal control directive.

The act also requires that your annual statement to the President and the Congress include a report on whether VA's accounting systems conform to the Comptroller General's principles, standards, and related requirements. VA was able to report on its accounting systems by identifying six systems and comparing the policies of each system with these principles and standards. VA also reviewed audit reports and the annual accounting certifications from its field organizations to detect weaknesses in its accounting operations. As a result of these steps, no significant discrepancies were discovered.

VA limited its accounting systems review to an analysis of the policies of each system, and it did not evaluate the operations of any system to determine whether they conform to the Comptroller General's principles and standards. Although VA indicated in its annual statement that it plans to expand its accounting systems review efforts during 1984 to evaluate the operations of its systems, it has not established policies and procedures on how to conduct these evaluations. VA plans to establish policies and procedures to conduct evaluations of its accounting operations that provide for the assignment of responsibilities, the documentation required to support the evaluations, the quality assurance over the process, the type of training for personnel conducting the evaluations, and the participation of field organizations.

In commenting on a draft of this report, VA generally agreed with our findings, conclusions, and proposed corrective actions and indicated that it is taking actions as discussed above to address our concerns (see app. III). Therefore, we have not included any recommendations in this report, but we plan to monitor VA's progress in these areas as part of our continuing reviews of federal agencies' implementation of the Financial Integrity Act.

As VA makes further progress in implementing the internal control and accounting system requirements of the act and in correcting known weaknesses, and as it makes the improvements it has planned in response to our proposed corrective actions, VA should have a more meaningful basis for concluding as to whether its internal controls and accounting systems meet the objectives of the act.

We appreciate the assistance we received from your officials and hope that this cooperative spirit will continue during the future implementation of this important legislation. We encourage you to continue to devote the resources necessary to implement this act.

We are sending copies of this report to the Director, Office of Management and Budget; and the Chairmen and the Ranking Minority Members of the House Committee on Government Operations, the Senate Committee on Governmental Affairs, and the House and Senate Appropriations and Veterans' Affairs Committees.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Richard L. Fogel". The signature is fluid and cursive, with the first name "Richard" and last name "Fogel" clearly distinguishable.

Richard L. Fogel
Director

11

C o n t e n t s

	<u>Page</u>
APPENDIX	
I	
VETERANS ADMINISTRATION'S FIRST-YEAR IMPLEMENTATION OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT	1
Introduction	1
Overview of VA's first-year efforts to implement the act	2
Organizing the process	3
Segmenting the agency	4
Vulnerability assessments	4
Internal control reviews	4
Follow-up systems	5
OIG role	5
Accounting systems conformance	5
Year-end report	6
Objective, scope, and methodology	6
Enhancements needed in subsequent years' efforts to evaluate and improve internal controls	8
Need to refine the segmentation process	8
Need to improve the vulnerability assessment process	11
Internal control reviews need to be improved	13
Training could improve vulnerability assessments and internal control reviews	15
Improvement needed in efforts to assess conformance with accounting principles and standards	16
Policies and procedures are needed for the accounting systems evaluations	16
Evaluate accounting systems in opera- tion	17
II	
MATERIAL WEAKNESSES	19
III	
LETTER DATED APRIL 4, 1984, FROM THE ADMINISTRATOR OF VETERANS AFFAIRS	20

ABBREVIATIONS

ADP	automatic data processing
GAO	General Accounting Office
ODM&T	Office of Data Management and Telecommunications
OIG	Office of the Inspector General
OMB	Office of Management and Budget
VA	Veterans Administration

VETERANS ADMINISTRATION'S FIRST-YEAR
IMPLEMENTATION OF THE FEDERAL
MANAGERS' FINANCIAL INTEGRITY ACT

INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls, the Congress in August 1982 enacted the Federal Managers' Financial Integrity Act (31 U.S.C. 3512(b) and (c)). The act was enacted for the purpose of strengthening the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control in order to provide effective control over, and accountability for, all funds, property, and other assets for which the agency is responsible (31 U.S.C. 3512(a)(3)).

The General Accounting Office (GAO) believes that full implementation of the Financial Integrity Act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and provide a systematic framework upon which to develop an effective management control system and a sound financial management structure for their agency. To achieve these ends the act requires:

- Each agency to establish and maintain its internal accounting and administrative controls in accordance with the standards prescribed by the Comptroller General, so as to reasonably assure that: (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are properly recorded and accounted for.
- Each agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify the material weaknesses involved and describe the plans for corrective action.

- Each agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards, and related requirements prescribed by the Comptroller General. The Comptroller General issued a statement of accounting principles and standards in April 1983.
- The Office of Management and Budget (OMB) to issue guidelines for federal departments and agencies to use in evaluating their internal accounting and administrative control systems.
- The Comptroller General to prescribe standards for federal agencies' internal accounting and administrative control systems. The Comptroller General issued internal control standards in June 1983.

OMB issued Circular A-123 on internal control systems in October 1981, prior to passage of the Financial Integrity Act. The circular prescribed policies and standards to be followed by federal departments and agencies in establishing and maintaining internal controls in their programs and administrative activities. In February 1982, OMB issued draft guidelines as an aid in implementing the circular. As required by the act, final guidelines to evaluate internal accounting and administrative controls were issued in December 1982. OMB also updated the circular and reissued it in August 1983.

This report on the Veterans Administration (VA) is 1 of 22 reports on federal agencies' efforts to implement the act during the first year.

OVERVIEW OF VA'S FIRST-YEAR EFFORTS TO IMPLEMENT THE ACT

The OMB guidelines provide a basic approach for evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to evaluate and report on internal controls:

- organizing the process to ensure that it can be effectively managed;
- segmenting the agency to create an inventory of assessable units;
- conducting vulnerability assessments to determine the risk of waste, loss, unauthorized use, or misappropriation;

- developing plans and schedules for performing internal control reviews and other actions;
- reviewing internal controls to determine if they are functioning as intended;
- taking corrective actions for improving controls on a timely basis; and
- reporting on the adequacy of internal controls and plans for corrective action, as required by the act.

Organizing the process

VA has made progress in establishing its internal control evaluation program. Top level managers have given this program their personal attention and commitment. On March 2, 1982, in response to the initial OMB circular, the Administrator of Veterans Affairs assigned overall responsibility for VA's internal control efforts to top management officials. He appointed the Deputy Administrator as the chief official responsible for VA's internal control activities and designated the deputy's office as the focal point for establishing policies and procedures related to internal control. The Associate Deputy Administrator for Information Resources Management and his Management Control Staff were also assigned to provide administrative support to the Deputy Administrator in his internal control responsibilities. The Management Control Staff is primarily responsible for monitoring and coordinating the results of VA's internal control efforts.

In April 1982, VA issued an internal control directive to implement the OMB circular. The directive outlined the basic responsibilities for conducting VA's internal control effort and provided a timetable for completing vulnerability assessments and submitting internal control review plans. The directive required VA component heads to evaluate, establish, and maintain adequate controls and to designate internal control officers to oversee the internal control evaluation process in their respective organizations. In July 1983, VA issued a revised directive establishing more specific policies and procedures for improving its internal control evaluation efforts and complying with the requirements of the act. The revised directive also requires component heads to incorporate internal control responsibilities into subordinate managers' performance plans and to ensure that the accomplishment of these responsibilities is reflected in performance appraisals.

Segmenting the agency

VA segmented the agency into components by paralleling its central office organizational structure. The components consist of the Office of the Administrator, 3 offices of associate deputy administrators, 3 departments, and 17 offices. These 24 components divided themselves along organizational and/or functional lines into 146 programs and administrative functions. To conduct vulnerability assessments, some components further subdivided their programs and administrative functions resulting in a total of 361 assessable units. Many small components were assessed as a single assessable unit, while large components were divided into numerous units based on the size, scope, needs, and intricacies of the individual component.

Vulnerability assessments

VA started to conduct vulnerability assessments of its assessable units in April 1982. The assessments and plans for internal control reviews were generally completed and submitted to VA's Management Control Staff by October 1982 as required by the agency directive. Each component designed and conducted its own assessments in accordance with the guidance contained in a February 1982 draft of OMB's guidelines. The assessments generally were performed by mid-level managers and followed the approach outlined by OMB. They generally included an evaluation of the general control environment, inherent risk, and existing safeguards, and an overall assessment of vulnerability.

Internal control reviews

As a result of the vulnerability assessments, VA's components scheduled internal control reviews for all areas that were assessed as highly vulnerable and for some areas rated as low or moderately vulnerable. The reviews for highly vulnerable areas should be conducted at least once a year as provided by the VA directive. Reviews for areas rated less than highly vulnerable should be conducted within 4 years. As of September 30, 1983, four of the six components we examined had conducted 16 reviews. The two largest components--Department of Medicine and Surgery and Department of Veterans Benefits--had not completed any reviews as of February 1984, although their budgets accounted for over 97 percent of the funds appropriated to VA. However, the two major components plan to conduct reviews during 1984.

Follow-up systems

Beginning in January and September 1983, VA required quarterly and annual internal control activity reports, respectively, from its components to provide information on planned and completed vulnerability assessments, internal control reviews, and corrective actions. The Management Control Staff uses these reports to track the progress of the internal control evaluation. The Management Control Staff also works with the components in an effort to assure that vulnerability assessments and internal control reviews are performed, and it is developing an automated follow-up system to monitor VA's internal control activities. Additionally, deviations from the accounting principles and standards and the status of corrective actions will be tracked in a follow-up system maintained by the Office of Budget and Finance. The progress made in correcting significant deviations will be reported to the Management Control Staff and included in its follow-up system.

OIG role

At the request of the Administrator, the Office of the Inspector General (OIG) performed a review to determine if VA's internal control efforts had been conducted in a reasonable and prudent manner. The OIG review included the three departments and six offices' efforts to organize, create inventories of assessable units, conduct vulnerability assessments, and take corrective action in accordance with OMB's guidelines. These components accounted for over 99 percent of VA's budget. On November 30, 1983, the OIG reported to the Administrator on the results of the review. The report stated that adequate documentation is needed to support the internal control evaluation process and that more training is needed for personnel performing internal control activities. The report concluded that considering the complexities of the agency and the internal control evaluation process, VA's first-year efforts represent a reasonable program. Additionally, the OIG has incorporated provisions for increased coverage of internal control issues into its audit plans.

Accounting systems conformance

The act also requires a report on whether an agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General. VA was able to report on its accounting systems by identifying six accounting systems and comparing the policies of each system to the Comptroller General's statement of accounting principles

and standards issued in April 1983. GAO and OIG reports were studied to detect either weaknesses in or nonconformance with accounting policy directives. Annual accounting certifications from field facilities were also examined to identify any weaknesses in operating policies as they apply to operations. As a result of these steps, no significant discrepancies were discovered.

Year-end report

On December 29, 1983, VA issued to the President and the Congress its year-end report required by the act. The report included a description of the internal control evaluation process and identified 10 material weaknesses (see app. II) that indicated the potential for improving policies and controls in the medical fee basis program, veterans benefit programs, medical facility construction program, and supply system. For each of the material weaknesses, information was also provided on the management improvement actions taken or being implemented. According to the report, greater emphasis will be placed on conducting reviews during fiscal year 1984. With regard to accounting systems conformance, the report stated that no significant discrepancies were discovered as a result of VA's review of the policies of each accounting system and that increased emphasis will be placed on the operation of its accounting systems in future evaluations.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate VA's progress in implementing the Financial Integrity Act and reporting on the status of its internal controls and accounting systems. Because our first-year review was limited to an evaluation of the implementation process, we did not attempt to independently determine the status of VA's internal control systems or the extent to which VA's accounting systems conform with the Comptroller General's principles and standards.

Our work was performed at VA's central office and initially included all organizational components identified by VA during its efforts to organize the internal control process and segment its components into programs and administrative functions. To evaluate VA's performance of vulnerability assessments and internal control reviews, we then focused our review on six major organizational components. The six components selected were the Department of Medicine and Surgery, Department of Veterans Benefits, Office of Data Management and Telecommunications, Office of Construction, Office of Procurement and Supply, and Office of

Budget and Finance. These components accounted for over 99 percent of VA's budget and contained 81 percent of VA's assessable units. The Office of Budget and Finance was selected because it is performing the work necessary to fulfill the requirements of the act relating to accounting systems. VA's vulnerability assessments were performed primarily between April and October 1982. Regarding internal control reviews, our examination covered 16 reviews that were completed by four of the six components between October 1982 and September 1983.

VA's initial efforts to evaluate its internal controls were carried out under draft OMB guidelines dated February 1982. Final guidelines were issued in December 1982. The initial efforts did not include the GAO standards for internal control which were issued in June 1983. As a result, VA had completed organizing the process, segmenting the agency, and conducting vulnerability assessments prior to OMB and GAO issuing their final guidelines and standards, respectively. VA issued subsequent guidance in July 1983 that incorporates the GAO standards and provides additional guidance consistent with the final OMB guidelines.

The methodology for our examination involved reviewing guidance, instructions, vulnerability assessments, internal control reviews, quarterly and annual reports, and other records which documented the internal control evaluation process. We reviewed VA's internal control directives issued in April 1982 and July 1983, as well as various memorandums from top level VA officials which provided guidance and instructions on implementing OMB Circular A-123 and the Federal Managers' Financial Integrity Act. Additionally, we reviewed records compiled by OMB in late 1982 on VA's efforts to implement the act. We also reviewed information on VA's mission, functions, structure, employment levels, and budget to determine if VA included all of its programs and functions in the internal control evaluation process. Documents that were prepared after the agency segmented and conducted its assessments in 1982, such as the July 1983 directive, were reviewed to identify improvements that were made by VA.

We also reviewed records related to VA's efforts to review its accounting systems. These records included policies and procedures for accounting systems, annual accounting certifications from field activities, and other documents related to VA's review of its accounting systems.

We interviewed officials in the six major components to determine how the internal control evaluation process was conducted. We also interviewed officials in the Office of Budget and Finance to determine what efforts they had undertaken to determine if VA's accounting systems are in conformance with the principles and standards prescribed by the Comptroller General. In addition, we interviewed officials in the OIG and the Management Control Staff to determine how they participated in the process.

We performed our work in accordance with generally accepted government auditing standards.

ENHANCEMENTS NEEDED IN SUBSEQUENT YEARS' EFFORTS
TO EVALUATE AND IMPROVE INTERNAL CONTROLS

VA has made progress in evaluating its systems of internal accounting and administrative control during its first-year efforts. Improvements are needed, however, to provide VA with a more meaningful basis for concluding as to whether its internal controls meet the objectives of the act. Details on areas in the internal control evaluation process in which problems were encountered and the actions planned by VA to improve its efforts are presented in the following sections.

Need to refine the
segmentation process

VA's segmenting of the agency did not ensure that all programs and administrative functions were subject to the internal control evaluation process. The basic goal of segmentation, according to the OMB guidelines, is to develop an agency-wide inventory of assessable units. This inventory should provide complete coverage of all programs and administrative functions. In VA, the segmentation process did not result in a comprehensive inventory of assessable units. Moreover, the responsibility for assessing certain functions was not clearly assigned. As a result, some areas--such as medical care eligibility and telecommunications--were not subjected to vulnerability assessments, while others--such as automatic data processing, travel, and time and attendance--were not consistently assessed throughout the agency. In addition, the participation of VA's field managers in the process was not defined. Therefore, some of the officials who are responsible for managing VA's programs and functions did not participate in the process.

Each VA component was required to provide the Deputy Administrator with an inventory of areas in which it planned to conduct vulnerability assessments. Although these listings were provided, a comprehensive inventory was never developed. Our discussions with the Management Control Staff indicated that some VA components only listed those areas which they believed to be the most important, not all programs and administrative functions as required by the OMB guidelines. At least two major areas were not included by the responsible components in the evaluation process--eligibility for medical care in VA facilities and telecommunications. VA medical care programs cost about \$7 billion in fiscal year 1982. The programs include various eligibility requirements to assure that medical treatment costs are incurred only when appropriate. The telecommunication activities cost was estimated at \$130.1 million in fiscal year 1982. Such activities include telephone systems, data transmission systems, security surveillance and patient monitoring systems, and records upgrading systems.

These two areas represent major expenditures of time and resources by VA and thus are areas where potential material weaknesses could exist and not be identified. In this regard, the OIG issued a report in September 1983 concerning eligibility problems in VA's outpatient treatment program.¹ The program cost about \$1.1 billion in fiscal year 1982. The Department of Medicine and Surgery has acknowledged that some problems exist but it is not sure of their significance. By assuring that this activity is included in the internal control evaluation process, VA would be in a better position to assess the extent to which internal control improvements could be made.

On October 3, 1983, the Deputy Administrator sent a memorandum to component heads regarding the conduct of vulnerability assessments. The memorandum stated that although the assessments indicated that coverage is generally adequate, areas exist where internal control systems were not assessed or were not properly documented. It also stated that components may be looking only at areas where they have direct or primary responsibility and may overlook items for which they have oversight, advisory, or other types of indirect responsibility. According to the memorandum, this problem may occur in functional areas which overlap organizational boundaries--for example, budgeting, contracting, personnel, safety, construction, equal employment opportunity, automatic data processing (ADP), mail, and travel.

¹Outpatient Eligibility for Treatment, Veterans Administration, Office of the Inspector General, September 28, 1983.

We found that this problem occurred in some areas. For example, 10 of VA's 24 components were assessed as single units and they did not independently assess functional areas, such as travel and time and attendance. As a result, the assessments generally did not indicate whether the vulnerabilities of common functions had been considered. Perhaps the most important area which was not consistently addressed by responsible components was ADP.

VA operates a large number of ADP systems which handle vast amounts of information. Our discussions with VA officials indicated there was some uncertainty over which components should be involved in assessing the internal controls associated with the ADP systems. VA's guidance for the internal control process did not address how functions which cut across agency lines--such as ADP--should be addressed and what offices would be responsible. The Office of Data Management and Telecommunications (ODM&T) is responsible for operating the agency's ADP systems for the various components' (users') automated activities. ODM&T conducted vulnerability assessments on the users' systems but it generally did not involve the users. ODM&T is not always aware of the users' control problems, nor is it required to involve users' participation in the assessment of ADP systems. As a result, ODM&T may not adequately assess a system's internal controls. For example, the Department of Medicine and Surgery assessed the Civilian Health and Medical Program of the Veterans Administration as having inadequate ADP controls to prevent ineligible individuals from receiving medical care. ODM&T assessed this program's ADP functions as satisfactory.

Several of VA's components have extensive activities located throughout the country. As the internal control evaluation process was developed, VA did not provide specific policy or guidance regarding the participation of field managers in the process. When the components conducted their vulnerability assessments, they generally considered field activities but did not always include the field managers or their staffs responsible for managing the agency's programs and functions. The Office of Procurement and Supply and the Office of Budget and Finance obtained some field participation in their vulnerability assessments. Other major components--Department of Medicine and Surgery, Department of Veterans Benefits, Office of Construction, and ODM&T--did not obtain input from field managers for the vulnerability assessments. Only 1 of the 16 internal control reviews we examined involved any participation by field managers.

OMB and VA guidance state that internal control is the responsibility of the individuals who are managing the programs and functions. We believe that the participation of field managers is important because (1) they are directly responsible for, and in many cases probably most knowledgeable of, the function being assessed, and (2) involvement in the process could help sensitize these managers to their internal control responsibilities.

Our draft report proposed that VA develop a comprehensive inventory of assessable units, assign responsibility to assess functions which cut across department and office lines, and take steps to obtain greater field participation in the internal control evaluation process. In the agency comments dated April 4, 1984 (see app. III), VA stated that its segmentation process involved assessable units with both functional and organizational names which do not always reflect the full range of functional areas covered by the units. However, VA agreed that some of its components did not adequately document and may not have adequately considered some significant functional areas within their assessable units. Therefore, VA stated that it plans to address the need for its components to consider all significant functions and that it will assign responsibility to assess functions which cut across organizational lines in its revised internal control directive which is in process.

VA recognizes the need for field participation in the internal control evaluation process. VA stated that time constraints precluded meaningful field participation during the conduct of initial vulnerability assessments. However, VA indicated that personnel conducting these assessments had knowledge of field operations. In addition, VA stated that its major components have systematic review processes in the field that already provide for many of the requirements of OMB Circular A-123. Finally, in a subsequent discussion with the Management Control Staff, it agreed to address the need for VA components to include field participation in the internal control evaluation process in VA's revised internal control directive.

Need to improve the vulnerability assessment process

Our review of VA's initial vulnerability assessments indicated that they did not provide an optimum level of assurance that the components had determined the appropriate level of vulnerability. Many of the assessments did not document weaknesses that may have been disclosed during the assessment process or provide information to support the overall vulnerability rating.

We believe that improvements in the vulnerability assessment process would provide VA management with greater assurance that (1) the assessments will identify existing and potential weaknesses and (2) internal control reviews or other subsequent actions focus on those issues which were the bases for the vulnerability ratings.

VA had not developed guidance to conduct its initial vulnerability assessments, and therefore, it used the OMB guidelines. OMB's guidance for internal control activities indicates that the vulnerability assessments should provide information on the methods used, the key factors considered, and the conclusions reached. The guidelines also indicate that this type of information is useful to agency managers for reviewing the validity of conclusions reached, evaluating the performance of individuals involved in the assessments and reviews, and performing subsequent assessments and reviews.

VA's assessments usually did not provide adequate information as to the bases for the vulnerability ratings. The process generally consisted of evaluating several factors based on OMB's guidelines. Often the only information provided on the assessment documents was the ranking assigned to each factor and identification of the overall degree of vulnerability. Little or no information was provided to explain how the evaluation of those factors resulted in the conclusion reached. Further, particularly when assessable units were considered highly vulnerable, information was generally not provided to indicate whether a specific weakness had been identified during the assessment or whether the conclusion was based solely on inherent risk associated with the activity.

Our discussions with the Management Control Staff indicated that had the assessments provided information on how key factors were considered and how overall ratings were arrived at, the Staff's responsibility for assuring quality in the internal control evaluation process could have been more easily fulfilled. In our opinion, this type of information would also provide VA management with further assurance that the assessment process has identified weaknesses that warrant immediate corrective action and that internal control reviews or other subsequent actions are focused on those issues which were the bases for concluding which activities were most vulnerable.

Our draft report proposed that VA require its components, when conducting vulnerability assessments, to document existing and potential weaknesses identified through the assessment process and to provide information on how key factors which affect

internal controls are considered in reaching conclusions on overall vulnerability. In the agency comments, VA agreed to implement our proposal regarding the conduct of vulnerability assessments in its revised internal control directive.

Internal control reviews
need to be improved

VA's initial 16 internal control reviews completed in four of the six components we examined were generally not performed in accordance with OMB's recommended process. VA has taken an initial step to improve the quality of the reviews and plans to concentrate on this area in 1984. However, additional guidance is needed to ensure that subsequent internal control reviews or other appropriate actions fully determine whether controls are operating effectively.

OMB's draft and final guidelines state that reviewing internal controls involves (1) determining whether adequate control objectives have been established and control techniques exist and are functioning as intended and (2) developing recommendations to correct weaknesses in either the design or functioning of the internal control system. OMB's recommended approach for evaluating internal controls provides that after completion of the vulnerability assessment process, plans should be developed for reviewing internal controls in selected activities based on the results of such assessments.

The approach also includes a six-step process for conducting an internal control review which OMB defines as a detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner. The six recommended steps are--identification of the event cycles, analysis of the general control environment, documentation of the event cycle, evaluation of controls within the cycle, testing of controls, and reporting the results. As with other steps in the internal control evaluation process, OMB points out that adequate documentation of the internal control reviews is important to management for verifying conclusions reached and performing subsequent reviews.

Our review of VA's 16 initial internal control reviews showed that the approach recommended by OMB was generally not followed. Only 4 of the 16 reviews involved testing of controls. Two of the four reviews that tested controls listed event cycles and one listed control objectives. The remaining 12 reviews were limited in scope and were subjective assessments

which did not analyze event cycles, control objectives and techniques, or test any controls. Moreover, the reviews provided little evidence of the scope and methods that were used and the resulting conclusions and planned actions.

OMB's internal control guidelines recognize that in addition to a detailed internal control review, other courses of action may be appropriate, such as requesting an audit or establishing increased or improved monitoring procedures. VA's second internal control directive issued in July 1983 also recognized that alternative courses of action may be appropriate. However, the directive does not contain specific guidance regarding the conduct of internal control reviews or criteria for selecting alternative actions. The directive simply requires the components to conduct internal control reviews reflective of the vulnerability assessment findings and to consider other actions that may be appropriate within the components or by other independent parties.

In response to numerous inquiries from VA managers concerning the conduct of internal control reviews, VA distributed, also in July 1983, guides developed by the Department of Housing and Urban Development for conducting "preliminary reviews" and detailed internal control reviews. As defined by one of the guides, a preliminary review is a diagnostic process for analyzing the results of vulnerability assessments. The results of the preliminary review can be used to determine if an internal control review is appropriate. When the guides were distributed, the reviews that we examined had been started or completed. VA stated that it would consider issuing final guides after the guides developed by Housing and Urban Development have been tested and evaluated. As of February 1984, VA had not issued them.

Our review of VA's initial internal control reviews confirms the need for such guidelines as VA plans to issue. In addition, VA needs to specify the extent to which these reviews should contain information on the scope, the methodology used, the conclusions reached, and the corrective actions that are planned. Moreover, our discussions with VA officials involved with internal control reviews indicate uncertainty over how to conduct a review and when a detailed review is appropriate as opposed to some other course of action. Such a decision is important because of the need to obtain definitive information on the effectiveness of internal controls.

Our draft report proposed that VA issue further guidance on conducting internal reviews and appropriate alternatives in

accordance with OMB's guidelines. In the agency comments, VA stated that it will address the conduct of internal control reviews, selection of other appropriate alternatives, and minimum requirements for information on the scope, methodologies, conclusions, and planned actions in its revised internal control directive. VA also stated that it will issue final guides to conduct "preliminary reviews" and detailed internal control reviews.

Training could improve vulnerability assessments and internal control reviews

VA needs to improve its training of personnel involved in vulnerability assessments and internal control reviews. Although some of the key personnel involved in the evaluation process, such as internal control officers, received some training, most personnel involved in performing assessments and internal control reviews received little or no training.

OMB's guidelines state that to assure quality, agencies should consider providing orientation and training to explain the objectives of and procedures for performing vulnerability assessments and internal control reviews. VA did not establish an agency-wide policy for training to ensure that personnel involved in performing these activities received training. Each component decided on the extent and type of training to provide its personnel. For example, the Department of Medicine and Surgery provided training to its personnel involved in conducting vulnerability assessments, while other major components provided little or no training. An Office of Procurement and Supply official informed us that he felt formal training was not necessary because vulnerability assessments were not to be in-depth evaluations.

The OIG's November 30, 1983, report on internal controls stated that more training is needed for personnel performing internal control evaluation activities. Considering the issues discussed previously regarding the performance of vulnerability assessments and internal control reviews, we believe that additional training is needed to ensure a better understanding of the steps involved in evaluating internal controls.

Our draft report proposed that VA develop and implement a policy for training personnel involved in internal control evaluation activities. In the agency comments, VA stated that it distributed literature on training courses to its internal control officers and encouraged training within its components. VA also stated that a number of its internal control officers

and other personnel have attended training courses, and the Department of Medicine and Surgery is planning a sizable training effort for its personnel.

VA further stated that it plans to continue to encourage its components to provide training for personnel involved in internal control evaluation activities as needs are identified. Finally, in a subsequent discussion with the Management Control Staff, it agreed to address the need for VA components to provide training necessary to accomplish internal control duties in VA's revised internal control directive.

IMPROVEMENT NEEDED IN EFFORTS
TO ASSESS CONFORMANCE WITH
ACCOUNTING PRINCIPLES AND STANDARDS

The act also requires a report on whether an agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General. As the basis for its report, VA compared the policies of its six reported accounting systems to these principles and standards. It also reviewed audit reports and the annual accounting certifications from its field organizations to detect weaknesses in its accounting operations. As a result of these steps, no significant discrepancies were found.

VA reported that it is planning to place increased emphasis on the operations of its systems in future evaluations. These evaluations should provide a better basis for determining if the accounting systems are in conformance. We discuss additional steps below that we believe will be helpful to VA in evaluating the operations of its accounting systems.

Policies and procedures are needed
for the accounting systems evaluations

On September 29, 1983, in a meeting with various agency assistant secretaries, the Comptroller General discussed several steps agencies could take in determining accounting systems conformance. During this meeting he said that the tasks of reviewing accounting systems conformance with principles and standards and correcting the deviations will require a substantial sustained effort by each agency. He suggested that each agency develop policies and organizational structures for evaluating accounting systems because they are essential for both the short- and long-term implementation of the accounting system requirements of the act.

During discussion with Office of Budget and Finance officials, we were told that VA had no documented policies and procedures to follow in determining accounting systems conformance. We were also told that there was limited involvement by field organizations.

We suggest that VA establish the policies and procedures to be followed in reviewing its accounting systems. These policies and procedures should provide for such areas as the assignment of responsibilities, the documentation required to support the evaluations, the quality assurance over the process, and the type of training for personnel conducting the evaluations. We also suggest that the field organizations be given a more active role in determining conformance. We believe their participation is necessary in order to promote a greater awareness among managers of their accounting responsibilities.

Evaluate accounting
systems in operation

In an April 18, 1983, memorandum to the heads of federal departments and agencies, the Comptroller General said that accounting systems are comprised of the various operations involving the authorizing, recording, classifying, and reporting of financial data. A review of these operations for purposes of accounting system approval would involve an evaluation of the procedures and processes from the point a transaction is authorized (initiated) through processing of data (either manually or automatically) to issuance of financial and management reports. This evaluation will include testing selected transactions in the operating systems. We believe the report required by the act should be based on a similar evaluation. One of the steps VA took to determine conformance was to compare the policies of its six reported accounting systems to the principles and standards. A review performed in this manner does not provide the assurance that the daily operations of the systems are performed in accordance with the prescribed principles and standards.

VA reported that it does not consider the review of its systems to be complete and that it will place increased emphasis on the operations in future evaluations. We understand that VA has already begun to look at the operations by statistically sampling the disbursements made by one of the systems to identify weaknesses in the disbursement process. Although we have not reviewed the methodology used in performing this evaluation, we believe statistical sampling is a reasonable way to determine conformance.

We suggest that in evaluating its accounting systems in operation, VA selectively test various types of accounting transactions from the point of initiation through the issuance of reports. These tests should be performed in such a manner as to identify which accounting operations are not being performed in accordance with the principles and standards.

Our draft report proposed that VA establish policies and procedures to conduct evaluations of its accounting operations that include sufficient testing of controls to determine accounting systems conformance. In the agency comments, VA stated that it will establish policies and procedures which will provide for the assignment of responsibilities, documentation required to support the evaluations, quality assurance over the process, type of training for personnel conducting the evaluations, and participation of field organizations.

MATERIAL WEAKNESSES

VA identified material weaknesses in the following areas during its internal control evaluation process and reported them in its annual statement to the President and the Congress dated December 29, 1983:

- Fee basis contract hospitalization.
- Civilian Health and Medical Program of the Veterans Administration.
- Compensation and pension processing and procedures.
- Education processing and procedures.
- Modernization of Department of Veterans Benefits through technology.
- Field finance processing and procedures.
- Adopting economic order quantity principles in the VA depot system.
- Use of foreign made material in construction projects.
- Organizational effectiveness of VA construction program.
- Improvement in project design and construction.

Office of the
Administrator
of Veterans Affairs

Washington DC 20420



APRIL 4- 1984

Mr. Richard L. Fogel
Director, Human Resources Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Fogel:

Your March 16, 1984 draft report "First Year Implementation of the Federal Managers' Financial Integrity Act in the Veterans Administration" has been reviewed by my staff.

Generally, I agree with your findings and recommendations. The enclosure contains comments on the recommendations and suggestions for rephrasing certain portions of the report.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Harry N. Walters', written over the printed name and title.

HARRY N. WALTERS
Administrator

Deputy Administrator - For

Enclosure

GAO note: Page references have been changed to agree with the final report.

**VETERANS ADMINISTRATION COMMENTS ON THE
MARCH 16, 1984 DRAFT REPORT, "FIRST YEAR IMPLEMENTATION
OF THE FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT
IN THE VETERANS ADMINISTRATION"**

GAO recommended that the Administrator of Veterans Affairs direct the Deputy Administrator to:

--develop a comprehensive inventory of assessable units,

The findings leading to this recommendation appear to be based on the different manner in which VA and GAO define an inventory of assessable units. In VA, the segmentation process involved units with both functional and organizational names which do not always reflect the full range of functional areas covered by the segment. VA has maintained records of how the agency was segmented and published information about this in our 1982 and 1983 annual reports.

We agree that some components did not adequately document and may not have adequately considered some significant functional areas within their assessable units. We recognized this and have been working with those components to correct the situation. The Deputy Administrator's October 3, 1983 memorandum, cited on page 9, is an example of this effort to insure complete coverage. We plan to address this situation again when the draft of a proposed revision to MP-1, Part II, Chapter 15 is released.

The discussion of the October 3 memorandum is somewhat misleading because it suggests that the memorandum represents the finding of the Deputy Administrator. Rather, it was advisory in nature and was intended to explain to VA components the concerns of many organizations including GAO, the Office of Management and Budget, the VA Office of Information Resources Management, and VA's Inspector General regarding the completeness of their assessments. We suggest para. 3, line 5, on page 9 be changed from "... were not assessed." to "... were not assessed or were not properly documented."

We believe this recommendation would more appropriately read, "... continue efforts to have VA components assess and provide documented evidence that the vulnerability assessment process identified and considered all significant functions within a component."

--assign responsibility to assess functions which cut across department and office lines,

Concur. This will be included in the revised MP-1, Part II, Chapter 15 which is in process.

--and take steps to obtain greater field participation in the internal control evaluation process.

We believe the discussion and recommendation are somewhat misleading and do not reflect the actual situation.

The need for field participation in the internal control review and evaluation process has been recognized from the beginning, and we have consistently encouraged components to involve field facilities. The decision to leave many field facilities out of the first round of vulnerability assessments in 1982 was based on time constraints which precluded meaningful field participation. In addition, it was recognized that field facilities in the major components had long-established systematic review processes that already provided for many of the requirements of Circular A-123. The persons conducting and/or reviewing the assessments included persons who had intimate knowledge of field operations. Under these circumstances, we believed a rush effort to involve more field personnel would not have served a useful purpose. Subsequent to that initial effort, the need for field involvement was repeatedly emphasized. In recent months, information received from VA components shows significant field participation has occurred. We will continue to emphasize the need for continuing field participation.

GAO recommended that the Administrator:

- Require VA components, when conducting vulnerability assessments, to document existing and potential weaknesses identified through the assessment process and to provide information on how key factors which affect internal controls are considered in reaching conclusions on overall vulnerability.

Concur. The revised MP-1, Part II, Chapter 15 will contain this requirement.

GAO also recommended that the Administrator direct the Deputy Administrator to:

- issue further guidance on conducting internal reviews and appropriate alternatives in accordance with OMB's guidelines,

Concur. The revised Chapter 15 will address the conduct of internal control reviews, selection of other appropriate alternatives, and minimum requirements for information on the scope, methodologies, conclusions, and planned actions. We also plan to issue the draft guides in final form.

- and develop and implement a policy for training personnel involved in internal control evaluation activities.

In the past, literature on training courses was distributed to Internal Control Officers (ICO's) and training within VA components was encouraged. As needs are identified, these efforts will continue. A number of ICO's and other staff employees have attended training courses, and the Department of Medicine and Surgery is planning a sizeable training effort for its personnel.

GAO recommended that the Administrator:

- require the Director, Office of Budget and Finance (Controller) to establish policies and procedures to conduct evaluations of VA's operations that include sufficient testing of controls to determine accounting systems conformance.

Concur. The policies and procedures will provide for the assignment of responsibilities, documentation required to support the evaluations, quality assurance over the process, type of training for personnel conducting the evaluations, and participation of field organizations.

A definition of vulnerability assessments appears in the Glossary, page 36. We believe it should be modified to reflect the following points: [See GAO note.]

The frequency of vulnerability assessments should be as needed, but at least once every 2 years. Situations can change, and changes may justify more frequent assessments.

The primary purpose of vulnerability assessments encompasses far more than setting the priorities for internal control reviews. The assessments should address other appropriate follow-up actions as well.

Assessments may be very quick and abbreviated. Much of the intent behind the assessment process is the quick elimination of further work in areas that do not promise potential for further improvement or significant savings. In this manner, agencies can concentrate resources on the areas with the greatest potential for improvement.

GAO note: Our draft report contained a glossary, which is deleted in the final report.

(203500)

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