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# *REPORT TO THE CONGRESS*

*BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES*

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## **Why The Army Should Strengthen Its Internal Audit Function**

Internal audit is a vital part of a good management control system. GAO believes Army managers could obtain greater benefits from internal auditing by

- removing existing restrictions on the scope of audit work,
- placing the audit function at a higher organizational level,
- having the audit organization headed by a qualified civilian,
- using auditors more effectively by eliminating work that is not fully productive or is not directly related to the audit organization's basic mission, and
- strengthening the audit followup system.



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

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To the President of the Senate and the  
Speaker of the House of Representatives

This report, the second of a series on Department of Defense internal audit activities, describes how the Department of the Army can improve its internal auditing.

We made this review as part of our current effort to expand and strengthen internal audit activities of Government departments and agencies. We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). The Act of 1950 requires us to consider the effectiveness of any agency's internal controls, including internal audit, in determining the extent and scope of our examinations.

We are sending copies of this report to the Director, Office of Management and Budget, and to the Secretaries of Defense and the Army.

*James P. Atchefs*  
Comptroller General  
of the United States

COMPTROLLER GENERAL'S  
REPORT TO THE CONGRESS

WHY THE ARMY SHOULD  
STRENGTHEN ITS INTERNAL  
AUDIT FUNCTION

D I G E S T

The Congress should amend the National Security Act to require placing internal audit functions of the three U.S. military departments under the respective Secretaries or Under Secretaries so that the internal auditors report directly to those top officials. (See p. 19.)

This recommendation is based on findings and conclusions, in this second of a series of GAO reports, on the results of its evaluations of the effectiveness of Department of Defense internal audit activities, as follows:

- The Army needs to strengthen its internal audit function so auditors can keep top management better informed on how operations are conducted and on recommended improvements to be carried out.
- Auditors are not free to select areas to audit because their plans are subject to review and revision by persons responsible for operations to be audited. (See pp. 5 to 8.)
- Auditors have been restricted by the Inspector General from auditing combat readiness or tactical activities with the result that the most important part of the Army's operations has been excluded from audit. (See pp. 8 to 12.)
- The Army's rationale for excluding these activities from audit is that they can be better evaluated by inspections made by Inspector General personnel. GAO points out that limiting internal audits to nontactical activities is contrary to the Comptroller General's audit policy, which states that the scope of internal auditing should not

be restricted but should extend to all agency activities. (See pp. 5, 8, 9, 11, and 12.)

--The internal audit function is not placed high enough in the Army's organization. Consequently, auditors do not have maximum independence. The current organizational structure, in which the Audit Agency is two reporting levels removed from the Secretary of the Army, is a situation not consistent with the Comptroller General's audit standards of requiring the audit function to be located at the highest practical organizational level. (See pp. 17 and 18.)

Contrary to Department of Defense policy, which requires all nonmilitary positions to be filled by civilians:

--The Audit Agency is headed by a military officer. (See pp. 20 and 21.)

--Army auditors spend much of their time on work not directly related to the Audit Agency's basic mission. (See p. 23.)

--The Audit Agency lost 2,957 staff-days in fiscal year 1976 through use of auditors for nonaudit work. (See pp. 25 and 29.)

--The Army incurs substantial costs, for which it is not reimbursed, in auditing non-appropriated-fund activities, a use of auditors that is questionable because these audits represent a free service provided at the taxpayers' expense to activities intended to be self-supporting. (See pp. 26 and 27.)

--The Department of Defense is required by law to audit annual financial reports of the American National Red Cross. The Audit Agency spends about 1,000 staff-days a year on these audits, the cost of which is reimbursed by the Red Cross to the U.S. Treasury. (See pp. 27 and 28.)

- Internal audit has been further reduced by the Agency's recent heavy emphasis on financial management audits at the expense of audits concerned with economy, efficiency, and program results. While the Audit Agency action was probably necessary for immediate financial management improvement, GAO believes the practice should be limited to the time needed for adequate assessment of problems and recommended solutions. (See pp. 29 to 31.)
- The Army's audit followup system does not provide assurance that all deficiencies identified by audits are promptly corrected. Reported deficiencies sometimes are not corrected until the next scheduled audit, which may not occur until several years later. (See pp. 35 to 38.)

RECOMMENDATIONS TO THE  
SECRETARY OF DEFENSE

The Secretary of Defense should use his reorganization authority under 10 U.S.C. 125 to relocate the Army Audit Agency under the Secretary or Under Secretary of the Army and have the audit staff report directly to that official. (See p. 19.)

Also, the Secretary of Defense should direct the Secretary of the Army to

- abolish the Inspection and Audit Priority Committee (see p. 15);
- insure that internal auditors will not be restricted in selecting activities for audit and determining the scope of audit work (see p. 15);
- more clearly define the nature and scope of audits and inspections (see p. 16);
- fill the position of Chief of the Army Audit Agency with a professionally qualified civilian (see p. 21);
- discontinue using auditors on nonaudit work and decrease their use on commander-requested

audits and audits of non-appropriated-fund activities (see p. 32);

--allocate audit staff time so that appropriately balanced audit coverage is given to financial/compliance, economy/efficiency, and program result audits (see p. 32); and

--transfer the audit followup function from the Office of the Inspector General to the Army Audit Agency and otherwise strengthen the Army's audit followup system (see p. 39).

FURTHER RECOMMENDATIONS  
TO THE CONGRESS

GAO recommends also that the American National Red Cross Act of 1905 be further amended to relieve the Department of Defense of its responsibility for auditing the Red Cross financial operations. (See p. 32.)

AGENCY ACTION

The Department of Defense agrees that there should be no restriction on the selection or scope of internal audit work. The Department concurs with most of GAO's recommendations to strengthen the internal audit function in the Army and agrees to raise the reporting level of the Audit Agency, appoint a civilian head, abolish the Audit and Inspection Priority Committee, clarify the Army regulations governing audits and inspections, and seek ways to more effectively use its staff. (See app. VIII.)

The Department does not agree with GAO's recommendation that audit followup function should be transferred to the Audit Agency but promised to explore ways of improving it. GAO agrees that audit followup is properly a management responsibility but believes that significant savings recommended by the Audit Agency were not achieved because followup was not performed. The Department should consider GAO's recommendations when exploring ways to improve the followup function. (See app. VIII.) (See p. 39.)

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Assistant Secretary of Defense

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IX Principal officials responsible for  
administering activities discussed in  
this report

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ABBREVIATIONS

DOD Department of Defense

GAO General Accounting Office

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## CHAPTER 1

### INTRODUCTION

The U.S. Army Audit Agency is the professional internal audit organization for the Department of the Army. Established by War Department Order in 1946, the Audit Agency was a staff operating agency under the Comptroller of the Army from 1952 to 1974. An Army staff reorganization in 1974 resulted in the redesignation of the Audit Agency as a field operating agency under the supervision and control of the Inspector General and Auditor General of the Army. The Audit Agency is responsible for making independent, objective evaluations of the effectiveness with which all Army resources are managed and controlled. In fiscal year 1976, the Army had a combined civilian and military personnel strength of about 1.2 million, with an operating budget of about \$24.6 billion.

The Congress and Department of Defense (DOD) top-level managers need to know how funds are spent and what objectives are achieved. The internal auditor has a vital role in reporting on appraisals of operations and performance. The internal audit function uniquely supplements routine management controls through its independent approach and methods of review. The function is one of the essential tools of management, complementing other elements of internal control.

The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66a) made top management within each agency responsible for its auditing by providing 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 \* \* \*."

In 1972 we issued a booklet entitled "Standards for Audit of Governmental Organizations, Programs, Activities & Functions." These standards, as summarized in appendix I, recognize the growing information needs of public officials, legislators, and the general public and establish a framework by which full-scope examinations of governmental programs by independent and objective auditors may be conducted. In 1973 the General Services Administration issued Federal

Management Circular 73-2 (see app. II), setting forth policies to be followed by agencies in audits of Federal operations and programs and requiring that our governmental audit standards be used as the basic criteria for these audits. In August 1974 we incorporated our standards in a revised statement entitled "Internal Auditing in Federal Agencies."

DOD and its component military departments and agencies, including the Army Audit Agency, have joined the Congress, GAO, and the General Services Administration in recognizing the importance of, and the need for, (1) internal audit, (2) standards for performance of a wide range of audit services, and (3) policies for implementation and guidance of internal audit organizations and management.

#### INTERNAL AUDITING IN THE DEPARTMENT OF THE ARMY

During fiscal years 1973-76 the Army Audit Agency issued about 3,260 internal audit reports to all command levels in the Department of the Army. These reports identified opportunities for the Department to save hundreds of millions of dollars and contained many recommendations for achieving lower costs and increased efficiency.

In fiscal year 1975 the Audit Agency identified about \$171 million that the Army could save by implementing the audit recommendations. Whether actual savings will be achieved depends upon the action management officials will take in each instance. But, considering the Audit Agency's annual operating cost, which totaled about \$21 million in fiscal year 1975, these accomplishments are noteworthy.

The Audit Agency's headquarters is located in Falls Church, Virginia. Its internal audit operations are performed at 6 district offices and 32 area offices in major cities and at Army installations in the United States and overseas. (See app. III.) At June 30, 1976, the Audit Agency had a staff of 891, including 678 professional auditors. While staffing levels have decreased during the last several years, the Audit Agency's annual operating cost increased to about \$22 million in fiscal year 1976. Nevertheless, its annual operating cost has been and continues to be less than one-tenth of 1 percent of the Army's total budget.

PRIOR REVIEWS AND EVALUATIONS  
OF THE ARMY AUDIT AGENCY

We discussed the Army Audit Agency's operations in reports to the Congress in March 1968 and January 1970 (B-132900). These reports contained recommendations for improving DOD's internal audit operations, including coordination and overall control of the total audit effort. Also, in 1970 a Blue Ribbon Defense Panel, convened by the President as part of a comprehensive study of DOD management procedures, made several recommendations for improving the Army Audit Agency's organizational structure and internal audit operations.

OUR CONCERN ABOUT INSPECTOR GENERAL CONTROL  
OF AUDITS

The 1974 Army staff reorganization, that placed the Army Audit Agency under the Army Inspector General, concerned us. In March 1974 we advised the Secretary of Defense that we considered the combining of the two organizations to be a serious step backward in terms of GAO and DOD efforts to strengthen DOD internal audit capabilities.

We were concerned that, by consolidating Inspector General and Army Audit Agency functions, the traditionally narrower scope of Inspector General examinations (inspections) could cause a similar narrowing of the scope of audit work. We were also concerned that the Army's policy of denying us free access to Inspector General reports (which generally are not made available to us except in highly summarized form) would be extended to include audit reports. Because we rely on internal audit reports in planning our audit work, restricting access to these reports would mean that we would have to audit Army activities even more heavily than in the past.

In response, the Secretary of Defense assured us in May 1974 that

- the consolidation of audit and Inspector General functions would not degrade or retrogress the audit function;
- the audit and Inspector General functions, organizations, or staff activities would not integrate;
- the Army Audit Agency would be kept as a completely separate and independent operation; and

--audit effectiveness would not be impaired nor the audit function subordinated to the Inspector General function.

At our suggestion, the Inspector General was officially redesignated as the Inspector General and Auditor General to clearly identify the independent nature of inspection and audit functions.

NATURE AND RESULTS OF  
OUR LATEST REVIEW

This is the second of a series of reports on the results of our evaluations of the effectiveness of DOD internal audit activities. This review covered the Army Audit Agency's internal audit activities from August 1975 to September 1976. The review was made to evaluate and compare the Audit Agency's operations with our "Standards for Audit of Governmental Organizations, Programs, Activities & Functions." We made the review at the Audit Agency's headquarters and its six district offices and covered selected aspects of the Army's internal audit activities before and after the 1974 reorganization. The scope of the review is discussed in chapter 7.

The Audit Agency enjoys a high level of competence and professionalism among its staff members. However, a number of conditions, when measured against our standards and DOD's policy, are causes for concern. These conditions are discussed in detail in succeeding chapters of this report.

## CHAPTER 2

### THE SCOPE OF INTERNAL AUDITS

#### SHOULD NOT BE RESTRICTED

Restrictions placed on the Army Audit Agency in planning and conducting its audit work have resulted in a lack of audit coverage in important areas of the Army's operations.

Our statement on internal auditing in Federal agencies points out that, for internal auditing to be of maximum usefulness, the scope of the internal auditor's activity should not be restricted but should be extended to all agency activities and related management controls.

In keeping with these principles, the Audit Agency mission statement (see app. IV) provides that it should audit all Army activities. The Audit Agency is not completely free, however, to select its own audit targets because its audit plans are subject to review by the Priority Committee, which provides guidance on priorities to be assigned to proposed audits. In addition, since the 1974 Army staff reorganization, which placed the Army Audit Agency under the supervision and control of the Army Inspector General, the Audit Agency has been restricted from auditing activities considered to be of a "tactical" <sup>1/</sup> nature. Audit restrictions imposed on the Audit Agency by the Priority Committee and the Inspector General are discussed below.

#### RESTRICTIONS BY PRIORITY COMMITTEE

Representatives of Army staff agencies, having management responsibility for systems, programs, and functions subject to audit, review audit plans. This practice has resulted in the cancellation of audits of activities identified by the Audit Agency as needing audit attention.

The Audit Agency devotes much of its effort to multi-location audits of systems, programs, and functions made

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<sup>1/</sup>Tactical activities have been defined by a member of the Inspector General's staff as being combat-related functions or units designed to fight in a wartime situation (as distinguished from activities concerned with support or administration).

at two or more commands, such as the Army's enlisted personnel reporting system, its environmental pollution abatement program, and its military family housing. These are known as Army-wide audits.

To insure that audit effort is directed toward areas of greatest management concern, the Audit Agency solicits requests for Army-wide audits each year from Army staff agencies, major commands, and the Audit Agency's own district offices. After reviewing all requests, the Audit Agency develops proposals for the best 18 to 23 audits, assigns them tentative priorities, and presents them to the Priority Committee for review.

Before the 1974 reorganization, the Priority Committee (then known as the Audit Priority Committee) was chaired by either the Comptroller or the Assistant Vice Chief of Staff of the Army and consisted of general officers from Army staff agencies having management responsibility for major functional areas of the Army's operations, such as logistics, personnel, financial management, and research and development.

After the reorganization, the Committee was reconstituted under the chairmanship of the Inspector General, with its name changed to the Inspection and Audit Priority Committee and with the grade level of participants reduced from general officers to field grade officers or their civilian equivalents. These persons, like the previous Committee members, represent Army staff agencies responsible for operations subject to audit.

About 6 months before the beginning of each fiscal year, the Committee meets to vote on recommended priorities to be assigned to proposed Army-wide audits for that year. Although the Committee's recommendations theoretically are only advisory, the Audit Agency usually adheres to them in scheduling and performing audit work.

The Committee's recommendations can result and have resulted in the cancellation of proposed audits in two ways. First, the Committee can recommend that an audit be deleted from the list of proposed audits and not be performed. Second, the Committee can recommend that an audit tentatively given a high priority by the Audit Agency be assigned a low priority. Because the Audit Agency has enough available staff



to do only a limited number (10 to 15) of Army-wide audits a year, this action has the effect of canceling the audit.

For example, in January 1973 the Audit Agency presented 18 proposed Army-wide audits to the Priority Committee for fiscal year 1974 and estimated that 10 to 12 of these audits could be made with available staff. Two of the audits which the Audit Agency had tentatively assigned high priorities were not made because of Committee actions, as discussed below.

One of the audits, which involved an evaluation of contractor-performed operations, research, and management studies, had been tentatively assigned priority 6 by the Audit Agency. This audit was, in effect, canceled when the Committee reduced it to priority 17.

The subject of the other audit was the development, procurement, and use of training devices and simulators on which millions of dollars was spent. In previous audit work, the Audit Agency found indications of (1) inadequate accounting for millions of dollars in development, procurement, and support costs for these items and (2) problems in identifying aircraft when using training aids because they sometimes contained erroneous profiles or descriptions of friendly and enemy aircraft and did not include many types of modern aircraft. There also were indications that training aids generally were too expensive, too sophisticated, too long in development, limited in number, and not always available.

Notwithstanding the significance of potential audit findings, this audit was disapproved by the Committee. According to an Audit Agency official who attended the Committee meeting, the Committee's decision to disapprove the audit resulted from the Chairman's suggestion that the Chief of Research and Development study the problems before scheduling an audit because that official was responsible for these matters.

The following examples show how audit work can be restricted by the practice of having representatives of Army staff agencies participate in assigning priorities to audits of functions for which their agencies are responsible.

In January 1975 the Audit Agency presented to the Priority Committee 23 proposed Army-wide audits for fiscal year 1976 and indicated that only 15 of these audits could be made with available staff. The Audit Agency's top 15 proposals included an audit of the financial management and

control of communications funds (with a tentative priority of 11) and an audit of food service operations (with a tentative priority of 12). The Committee assigned these audits low priorities (thus, in effect, canceling them) because of comments made by Committee members representing Army staff agencies having responsibility for these operations.

The Committee member from the Office of the Deputy Chief of Staff for Operations, which has Army staff responsibility for telecommunications, commented that the Army Communications Command did not agree with the scope of the proposed audit of communications funds and recommended that the audit be assigned priority 17. The Committee member from the Office of the Deputy Chief of Staff for logistics, which has Army staff responsibility for the Army food program, recommended that the proposed audit of food service operations be assigned a priority below 15. Consequently, the Committee voted to assign a priority of 17 to the communications funds audit and a priority of 23 to the food service audit. As a result, neither audit was made.

#### RESTRICTIONS BY THE INSPECTOR GENERAL

In 1975 the Inspector General announced a decision to channel internal audits out of tactical activities and to have the Army Audit Agency concentrate its efforts on supply, maintenance, administrative, and financial functions. The stated reason for this decision was that evaluations of tactical activities are considered to be more appropriate for inspections by Inspector General personnel 1/ than for audits.

The rationale for the Inspector General's decision, as explained by a staff member, is that Inspector General personnel, by virtue of their military backgrounds, are more qualified than auditors to evaluate activities of a tactical nature. We believe that, for several reasons, this rationale does not sufficiently justify excluding auditors from evaluating these activities.

First, inspections lack the depth of coverage of audits (see p. 12 for a discussion of differences between inspections and audits) and, consequently, do not satisfy our standards for full-scope auditing of all governmental activities and functions (see app. I).

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1/The mission of Inspectors General (see app. V) is to inquire into mission performance, economy, discipline, and morale of the Army.

Second, the greater objectivity resulting from the auditors' lack of military backgrounds should be viewed as an asset, in our opinion, in making independent, unbiased evaluations of tactical activities--particularly when it is considered that they have evaluated these activities for many years and have demonstrated that they are well qualified, by virtue of their professional audit training and experience, to make such evaluations.

Finally, there is no assurance that proposed inspections substituted for audits are always performed. We found that in most instances, the inspections were not made.

Following are some specific examples of how the Audit Agency has been restricted from evaluating tactical activities.

#### Canceled fiscal year 1975 audits

The reorganization which placed the Audit Agency under the Inspector General was announced in January 1974. At about that time, the Inspector General began to review the Audit Agency's proposed Army-wide audits before they were submitted to the Priority Committee. As a result of an Inspector General's review of the Audit Agency's fiscal year 1975 audit proposals, the Inspector General determined that three proposed audits--involving evaluations of military personnel education and training programs and Army airfield and aircraft operations--were better suited for inspections than for audits. The Priority Committee agreed that these proposed audits should not be scheduled. By the end of fiscal year 1976, only one of the deleted audit areas--airfield and aircraft operations--had been inspected. A discussion of the other two canceled audits and their importance follows.

#### Army education programs

This audit was requested by the Deputy Chief of Staff for Personnel, who pointed out that soldier surveys identified education as being a high incentive for enlistment and reenlistment, and, therefore, a significant factor in the success of the all-volunteer Army. The Deputy Chief of Staff believed there was a need for an audit to determine whether commanders were developing effective education programs and allowing enough time for soldier participation.

The inspection that was to replace the canceled audit had not been made at the end of fiscal year 1976. The reason, according to members of the Inspector General's staff, was a lack of available staff.

### Individual training

The audit proposal for evaluating the Army's individual military training capability noted that, at current strength levels, the Army's investment in individual training was more than \$5 billion. According to the proposal, recent audits had shown that the Army was training too many personnel in some skills. The proposal noted also that the Army was spending large sums of money (\$30,000 to \$90,000 for each person) for advanced training of personnel having a high attrition rate because of private industry demand for the skills in which they were trained.

According to Inspector General officials, an inspection in place of the canceled audit had not been made at the end of fiscal year 1976 because of a lack of available staff.

### Canceled fiscal year 1976 audit

After his advance review of the Audit Agency's fiscal year 1976 Army-wide audit plans, the Inspector General said that a proposed audit of military unit training, which had been suggested by the Deputy Chief of Staff for Operations, dealt with a subject that was better suited for evaluation by an inspection rather than an audit. Consequently, the Audit Agency deleted this audit from its plans. A proposed inspection, to replace the deleted audit, was presented to the Priority Committee by the Inspector General's Office. Although the Committee approved this proposal and assigned it the highest priority, an inspection had not been made at the end of fiscal year 1976, reportedly because of a lack of available staff.

In its proposal for the audit, the Audit Agency noted that the Army devotes most of its resources to developing a well-trained military force and maximizing combat readiness and that the need for effective training and readiness had increased as a result of the Army's planned buildup to a 16 division force. In suggesting the audit, the Deputy Chief of Staff for Operations noted that Army field commanders frequently had not fulfilled their responsibilities for setting training goals. Moreover, recent audits had shown that soldier attendance at prime training exercises was poor because of a lack of support by field commanders.

Thus, canceling the audit deprived Army management of the benefits of an evaluation of unit training and combat readiness at a time when the 16 division buildup necessitated more effective training programs and increased readiness.

### Other restricted audits

During a visit to Europe in June 1975, the Inspector General provided the Commander, U.S. Army, Europe; the Inspector General attached to that headquarters; and the Audit Agency's European District Manager with guidance for implementing his decision to channel audits out of tactical activities and to have them concentrate on supply, maintenance, administrative, and financial functions.

Acting on this guidance, these officials and Audit Agency headquarters officials reviewed the European District's scheduled and ongoing audits to identify audits concerned with tactical activities. As a result of these reviews, the Audit Agency deleted from further audit coverage such tactical areas as weapons systems effectiveness and military personnel training and readiness. Some of the audits affected are discussed below.

### Ongoing audit of a missile system

After reviewing the European District's audit program for fiscal year 1976 in light of the Inspector General's guidance, the Inspector General, attached to the U.S. Army, Europe, recommended to the District Manager that an ongoing audit of a missile system--which had been approved by the Priority Committee before the Inspector General's guidance was issued--be modified to exclude audit coverage of operational training and targeting procedures.

Shortly afterward, the Commander, U.S. Army, Europe, determined that, based on the Inspector General's guidance, some aspects of the audit appeared to be tactical in nature and better suited for an inspection than for an audit. He suggested to the Inspector General that operational training, targeting procedures, and target acquisition problems be eliminated from audit coverage. In accordance with this suggestion, the Inspector General revised the audit objectives to exclude coverage of operational training and target acquisition procedures and to emphasize supply, maintenance, and personnel operations.

Later, to insure compliance with the Inspector General's guidance, the Chief of the Audit Agency further revised the audit objectives to eliminate coverage of two additional tactical areas--individual training in deployed units and unit training. Audit work accomplished before these areas were eliminated had indicated that training schedules were improperly prepared, training programs were not followed, annual service firing practice evaluations were not standardized,

and unit readiness reports were incorrectly computed and did not include all data needed to make them meaningful. Because the Chief considered these to be tactical areas, the auditors were precluded from pursuing these matters and developing conclusive findings.

#### Scheduled audit of an air defense system

After receiving the guidance limiting audit work to non-tactical areas, the Commander, U.S. Army, Europe, determined that one of the audits scheduled for fiscal year 1976 should be canceled entirely because it conflicted with the guidance. This was an audit of an air defense system which had been requested by Headquarters, U.S. Army, Europe, before the guidance was received.

The Commander advised the Inspector General that, based on the guidance, this audit appeared to be tactical in nature and thus better suited for an inspection. The Inspector General accordingly canceled the audit and stated that the subject system would be considered for evaluation by an inspection. According to Inspector General officials, however, the system had not been inspected at the end of fiscal year 1976 because of a lack of available staff.

A previous audit of the system by the Audit Agency's European District had identified problems in crew training and operational planning which significantly affected the operating units' ability to carry out their assigned missions. The Commander, U.S. Army, Europe, in suggesting to the Inspector General that the audit be canceled, noted that the audit would have covered all aspects of the operation of an air defense system in which there were many problems.

#### DIFFERENCES BETWEEN INSPECTIONS AND AUDITS

The Army regulations governing audits and inspections are very similar and the spheres of activity of the two functions are identical. Both regulations extend to all Army elements and functions but neither describes the scope nor contains an explanation of the differing nature of audits and inspections. (See app. IV and V.)

In actual practice, however, there are fundamental differences in the objectives, depth of coverage, and other aspects of audits as opposed to inspections.

In some instances, the Army Inspector General has substituted or has proposed to substitute inspections for audits. These inspections are of two types: general and special.

General inspections are regularly recurring examinations of individual Army commands, installations, and activities. Some general inspections are made by Inspectors General in the Office of the Army Inspector General and some are made by local Inspectors General (see app. V) who are permanently attached to the staffs of, and report directly to, Army commanders but who receive training, guidance, and technical supervision from the Office of the Army Inspector General. General inspections provide a means for quickly surfacing problems needing correction.

In December 1973, about a month before the announcement of the Army staff reorganization to consolidate inspection and audit functions in the Office of the Army Inspector General, the Inspector General expanded the traditional role of Inspectors General by forming a Special Inspection Division <sup>1/</sup> in his office to make special inspections (nonrecurring, multilocation examinations) of Army programs, systems, and functions. General inspections, however, have continued to make up the great bulk of the Army's inspection work.

Both types of inspections normally are done in much less time than audits and do not identify underlying causes or measure the extent of deficiencies noted. Audits, on the other hand, provide management with information on the extent of problems identified and their underlying causes so that appropriate corrective action can be taken.

The relative lack of depth of inspections, compared to audits, was demonstrated in a 1973 Audit Agency analysis of inspection and audit coverage of several Army activities and functional areas. This analysis showed that audits are conducted in considerably more depth than inspections and, therefore, provide useful management information to a degree not attainable from inspections.

The analysis showed, for example, that inspection reports on 76 Army reserve units contained no comments on the accuracy of unit readiness reports, which Army managers at all levels rely on to make combat readiness assessments. Audits of readiness reports of 30 of these units, however, revealed inaccurate reporting by 12 units. Also, whereas the inspections

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<sup>1/</sup>This division was abolished in July 1975 and its functions transferred to the Inspection and Survey Division, which has continued to carry on the special inspection program.

revealed recruiting problems in only 11 of the 76 units, audits of the recruiting practices of 54 of these units identified recruiting problems in 42 units.

Active-duty training for reservists was another subject not commented on by the inspectors in their reports on the 76 reserve units. Under this program, reserve recruits are placed temporarily on active duty for training in skills to meet current or future needs of their units. The auditors found that 11 percent of the reservists they considered received active-duty training in skills for which their units had no requirement. The auditors estimated that, on an average, it cost the Army more than \$3,000 for each reservist trained in an unneeded skill.

The Department of Defense has determined that inspections and audits complement, rather than duplicate, each other. An Army study group concluded in 1970 that there are fundamental differences in concept, scope, emphasis, and methodology between inspections and audits that make it essential that all Army activities be subjected to both types of evaluations to insure completeness of coverage and responsiveness to Army management needs.

#### CONCLUSIONS

The practice of having Army-wide audit priorities established by a committee, the members of which are persons responsible for operations subject to audit, unnecessarily restricts the scope of audit work and is inconsistent with our stated policy that internal auditing should extend to all agency activities. The auditors are in the best position to identify and select activities for audit and should be free to do so without outside interference.

An even more serious impairment of audit independence has resulted from the Inspector General's policy of restricting internal audits to nontactical activities. The Army's basic mission, simply stated, is to prepare and maintain land forces in a state of combat readiness. Thus, excluding the Army Audit Agency from examining tactical activities means that the Audit Agency is prevented from auditing any of the activities directly related to the Army's basic mission, to which the Army devotes most of its resources. Therefore, the Audit Agency is limited to auditing activities of a purely administrative and support nature, such as procurement of supplies and equipment, inventory management, financial operations, equipment maintenance, motor pool operations, clothing sales, and laundry and dry cleaning operations.



As a result of this exclusion, the Congress, DOD's top-level managers, and the Department of the Army are being denied the benefits of independent, indepth evaluations needed to effectively manage the most important part of the Army's operations.

The Inspector General's decision to restrict the scope of internal audit work to nontactical areas is based on a misconception of the role of the internal auditor in independently evaluating all agency activities and keeping management informed on how these activities are being carried out. The assumption that inspections can be substituted for audits is, in our view, not supportable because inspections lack the depth of audits and therefore do not satisfy our standards for full-scope audit coverage.

Moreover, we rely on internal audit coverage in planning our work and have access to all internal audit reports. Army inspection reports, however, are not routinely made available to us. Thus, preventing the Army Audit Agency from auditing tactical activities could result in significant problems not being surfaced and reported to Army top management and GAO and could substantially increase our responsibilities for auditing these activities.

A basic cause of confusion regarding the nature of Army internal audit and inspection activities may be the ambiguity of Army regulations (see apps. IV and V) governing these activities. The regulation pertaining to each activity sets forth similar objectives, and each regulation provides that examinations are to extend to all Army elements and functions. Neither regulation describes the scope of the examinations nor contains any explanation of their differing nature. In the absence of clear Army policy guidance, it is not surprising that confusion exists.

#### RECOMMENDATIONS

To eliminate existing restrictions on the Army's internal audit function, we recommend that the Secretary of Defense direct the Secretary of the Army to

- abolish the Inspection and Audit Priority Committee;
- clearly specify in the Army Audit Agency's mission statement that the Agency will not be restricted in selecting activities for audit and in determining the scope of the audit work; and

--revise Army regulations to more specifically delineate the respective scope of internal audits and inspections, explain the difference between them, and emphasize that they are complementary rather than duplicatory.

DOD COMMENTS

By letter dated June 15, 1977, the Assistant Secretary of Defense (Comptroller) agreed that the selection or scope of audit work within the context of proper management supervision should not be restricted. He said that

--the Audit and Inspection Priority Committee will be abolished;

--the Army Audit Agency mission statement will be revised to state that the scope of internal audit policy is broad and encompasses all financial, operational, and support activities in accordance with DOD audit policies; and

--Army regulations will be clarified to delineate differences between audit and inspection, emphasize their complementary nature, and describe the scope of each function.

In our opinion, these actions, if properly implemented, should provide for more independent, indepth audit coverage of a broader range of functional areas important to top-level Army managers and should eliminate any confusion as to the respective responsibilities of the Inspector General and the Auditor General.

### CHAPTER 3

#### THE INTERNAL AUDIT FUNCTION SHOULD BE LOCATED AT A HIGHER ORGANIZATIONAL LEVEL

The Army Audit Agency is not placed high enough in the Army's organization to insure that its auditors are granted maximum independence in selecting activities for audit, reviewing and evaluating Army operations, and reporting on the results of audit work.

Government agencies, if they are to receive the full benefits of internal auditing, must locate their audit functions at a sufficiently high organizational level to insure that auditors are insulated against internal agency pressures so they can conduct their auditing objectively and report their conclusions completely without fear of censure or reprisal. In our opinion, the present organizational placement of the Army Audit Agency does not provide this assurance.

We have consistently advocated that

- the internal auditor's position in an organization should be such that he is independent of the officials who are responsible for the operations he reviews and
- the internal auditor, to realize an adequate degree of independence, 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.

These principles are emphasized in our standards for governmental auditing and in our statement on internal auditing in Federal agencies.

The National Security Act Amendments of 1949 (10 U.S.C. 3014, 5061, and 8014) established positions of Comptroller of the Army, Comptroller of the Navy, and Comptroller of the Air Force and included internal audit as one of their responsibilities. The Army Audit Agency remained under the Comptroller of the Army until the Secretary of Defense, as part of the 1974 Army staff reorganization, transferred the Audit Agency to the Office of the Army Inspector General and Auditor General. (See app. VI.)

The authority for the 1974 reorganization action, including transfer of the audit function, was 10 U.S.C. 125 which states that

"\* \* \* the Secretary of Defense shall take appropriate action (including the transfer, reassignment, consolidation, or abolition of any function, power or duty) to provide more effective, efficient, and economical administration and operation, and to eliminate duplication, in the Department of Defense."

#### CONCLUSIONS

Although we did not evaluate the consequences of the Audit Agency's previous organizational placement under the Comptroller of the Army, this arrangement was undesirable because the Comptroller is responsible for an important functional area (Army financial management) which is subject to internal audit. The arrangement was undesirable also because the Comptroller, as a member of the Army General Staff, does not report directly to the Secretary of the Army but reports to the Army Chief of Staff and the Assistant Secretary of the Army (Financial Management).

The 1974 relocation of the Army Audit Agency from the Office of the Comptroller to the Office of the Army Inspector General did not improve the Audit Agency's organizational placement because the Inspector General is relatively no higher in the Army organization than the Comptroller. The Inspector General is a member of the personal staff of the Chief of Staff and reports directly to that official. The Chief of Staff is responsible to the Secretary of the Army for the efficiency of the Army and its preparedness for military operations.

The current organizational placement of the Audit Agency does not comply with our standards requiring the audit function to be located at the highest practical organizational level. With the audit staff reporting to the Inspector General, there are two reporting levels (see app. VII) between the Audit Agency and the Secretary of the Army. Under the current organizational arrangement, the Audit Agency is too far removed from Army top management to insure maximum audit independence and effectiveness and appropriate management attention to audit findings.

Locating the internal audit function under one of the Assistant Secretaries of the Army also would be objectionable because it would place auditors under an official having responsibility for operations they review. Adequate audit independence in the Department of the Army cannot be provided, nor objective auditing and useful audit results insured, unless the audit staff is placed directly under the Secretary or the Under Secretary.

A significant benefit of the reorganization placing the Audit Agency under the Inspector General was that internal auditors were granted access to all Army inspection reports. Before the reorganization, the auditors did not have access to inspection reports issued by the Army Inspector General's Office and had only limited access to inspection reports prepared by local Inspectors General. Because inspection reports contain information that may be highly useful in planning and conducting audit work, the internal auditors should continue to have access to these reports.

RECOMMENDATION TO THE  
SECRETARY OF DEFENSE

We recommend that, to increase the effectiveness of internal auditing in the Department of the Army and to insure maximum audit independence in accordance with our standards, the Secretary of Defense use his reorganization authority under 10 U.S.C. 125 to relocate the Army Audit Agency under the Secretary of the Army and have the audit staff report directly to that official.

RECOMMENDATION TO THE CONGRESS

We recommend that, to provide for more effective internal auditing in the Department of Defense, consistent with our audit standards, the Congress amend the National Security Act to require placing internal audit functions of the three military departments under the Secretaries or Under Secretaries of the respective departments and have the internal auditors report directly to those officials.

DOD COMMENTS

In his reply, the Assistant Secretary (Comptroller) said that DOD plans to have the Army Audit Agency report concurrently to the Chief of Staff and the Secretary of the Army. Technical guidance will be provided to the Audit Agency by the Assistant Secretary of the Army (financial management).

We believe that this change, if properly implemented, will give the Audit Agency direct access to the highest management levels in the Department of the Army and is consistent with our standards. An added benefit of the change is that it recognizes the joint leadership provided by both military and civilian staff within the Department of the Army.

## CHAPTER 4

### THE CHIEF OF THE ARMY AUDIT AGENCY

#### SHOULD BE A CIVILIAN

The head of the Army Audit Agency should be a highly qualified civilian. Contrary to Department of Defense policy, the Audit Agency is headed by a high-ranking military officer.

DOD Directive 1100.4 states that the military services should employ civilians in positions which

- do not require military incumbents for reasons of law, training, security, discipline, rotation, or combat readiness;
- do not require a military background for successful performance of the duties involved; and
- do not entail unusual hours not normally associated or compatible with civilian employment.

DOD Directive 1100.9 states that management positions in professional support activities should be designated as military or civilian according to the following criteria:

Military--when required by law, when the position requires skills and knowledge acquired primarily through military training and experience, and when experience in the position is essential to enable officer personnel to assume responsibilities necessary to maintain combat-related support and proper career development.

Civilian--when the skills required are usually found in the civilian economy and continuity of management and experience is essential and can be better provided by civilians.

The Assistant Secretary of Defense (Manpower and Reserve Affairs), in an article for the Defense Management Journal, October 1976, stated that

"Defense Department policy is that each position be filled by a civilian unless it can be proven that a military person is required. As a result, the burden of proof is on the Services to show that each position programmed as a military space can only be filled by a military person."

In conformance with DOD policy, the Army has staffed its Audit Agency with civilian personnel to manage and conduct audits. However, DOD policy notwithstanding, the Army has followed the practice of appointing a high-ranking military officer to the position of Chief of Audit Agency. Because military officers are subject to periodic rotation, many incumbents have been assigned this position. Since May 1970, the Audit Agency has had five different military chiefs.

#### CONCLUSIONS

Because the position of Chief of the Army Audit Agency entails skills found in the civilian community and does not require the factors set forth by DOD criteria for using military personnel, this position should be filled by a highly qualified civilian. This arrangement not only would be consistent with DOD policy but also would provide a longer tenure for incumbents of the position and would therefore result in greater continuity of management policies and procedures.

A similar conclusion was reached by an advisory committee to the American Institute of Certified Public Accountants in 1970. In an analysis of the audit function in DOD, prepared for the Blue Ribbon Defense Panel and included as an appendix to the panel's July 1970 report to the President, the committee recommended that the head of each of the audit groups in DOD (including the Army Audit Agency) be a civilian, preferably a GS-18, who has had considerable expertise in audit management. The Committee pointed out that this recommended change

"would provide a longer period of tenure for the head of the audit group, assuring greater continuity of audit policy and direction than is likely to be attained under the present arrangement of having the group headed by a military officer who usually has had little or no professional experience in internal auditing."

#### RECOMMENDATION

We recommend that the Secretary of Defense direct the Secretary of the Army to fill the position of Chief of the Army Audit Agency with a professionally qualified civilian.

DOD COMMENTS

The Assistant Secretary in his reply said that DOD agrees that the position of Chief of the Army Audit Agency should be filled by a professionally qualified civilian and will initiate appropriate action to convert this position from military to civilian.



## CHAPTER 5

### MORE EFFECTIVE USE OF AUDIT STAFF NEEDED

The Army Audit Agency is faced with a situation in which its audit capability is decreasing because of personnel reductions levied by external entities while audit demands are increasing. Although these factors make it imperative that audit staff time be used in the most productive manner possible, the Audit Agency devotes a considerable amount of audit staff time to work that either is not consistent with its primary mission or is not sufficiently productive to warrant allocation of scarce audit staff resources.

Also, an Audit Agency decision to allocate 50 percent of its audit staff time to audits of financial operations for 21 months, while probably necessary, may significantly reduce its capability to make economy/efficiency and program results evaluations and will result in an imbalance of audit coverage of Army operations, if continued beyond the planned period.

### INCREASED AUDIT DEMANDS AND DECREASED AUDIT STAFF

While authorized audit staffing levels have decreased, the demands for audit services are increasing. For example, Department of Defense guidance for fulfilling audit responsibilities sets forth desirable audit frequency objectives as follows: DOD installations performing significant functions should be audited every 2 years, while those without significant responsibilities should be surveyed at least every 4 years. For several years, the Audit Agency has not had enough auditors to meet these DOD cyclical audit objectives. The current average audit cycle for appropriated-fund activities is more than 6 years, with the cycle for some of these activities being as long as 10 years.

DOD guidance also states that audit emphasis should be placed where needs exist. The Army Audit Agency responds to audit needs by soliciting requests for Army-wide audits before the beginning of each fiscal year (as described in ch. 2) and by accepting requests for audits during the year. Each year the Audit Agency receives far more requests for Army-wide audits than it can satisfy with available staff. In addition, requests for audits received during each year are increasing.

Over the past several years, the Army Audit Agency's staff has decreased from 1,029 at the end of fiscal year 1973 to 891 at the end of fiscal year 1976. The Department of the Army recently required the Audit Agency to reduce its staff by 11 percent by the end of fiscal year 1976 because of a reallocation of personnel spaces within the Army to support the combat structure (accounting for 10 percent of the reduction) and a congressionally imposed ceiling on Army civilian personnel strength (accounting for 1 percent of the reduction).

Even more recently, in August 1976 the Deputy Secretary of Defense directed that 50 personnel spaces be transferred from the Army Audit Agency to a newly established Defense Audit Service, which will conduct all interservice audits. <sup>1/</sup> Because the Army Audit Agency's past involvement in interservice audits averaged only about 27 staff-years annually, this 50-space reduction represents a net loss to the Audit Agency of about 23 auditors.

#### PRIMARY AUDIT RESPONSIBILITY

The Audit Agency's responsibility, as set forth in Army Regulation 36-5, is to provide the Army at all levels with an independent and objective internal audit service which evaluates the effectiveness with which the Army's total resources are being controlled and managed. Implicit in this mission statement is the mandate that the audit service is, or should be, primarily concerned with the management and control of funds appropriated by the Congress.

#### OPPORTUNITY TO IMPROVE CAPABILITY TO PERFORM PRIMARY MISSION

In the face of decreasing audit capability and increasing audit demands, it is imperative that the Audit Agency be prudent in using its audit staff resources. The audit staff is used for several kinds of work. However, we believe the work is neither consistent with the Audit Agency's primary mission nor sufficiently productive to warrant allocation of scarce staff resources. This work includes nonaudit work performed by auditors on loan to

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<sup>1/</sup>Audits of functions carried on by two or more military services, previously performed at the direction of the Deputy Comptroller for Audit Operations, Office of the Assistant Secretary of Defense (Comptroller).

other organizations, commander-requested audits which address specific local problems, and result in low-level reporting, audits of activities not supported by funds appropriated by the Congress, and audits of American Red Cross activities.

The use of audit staff for these secondary efforts causes a significant drain on scarce audit resources and impairs the Audit Agency's ability to carry out its primary mission.

#### Loans of auditors to other organizations

The Audit Agency occasionally loans auditors to other organizations for work of a nonaudit nature. These loans have increased since the Army staff reorganization of 1974. In fiscal year 1973, the Audit Agency lost only 110 staff-days because auditors were on loan. By fiscal year 1976, staff-days lost through loans had increased to 3,032. This included 2,957 days devoted to the operational task of reconciling the Army Materiel Command's customer order accounts. At the request of the Comptroller of the Army, the Audit Agency loaned a total of 66 auditors over a period of several months to the Army Materiel Command, where they provided assistance in reconciling customer order records of major subordinate commands with those of the International Logistics Command.

#### Commander-requested audits

The Audit Agency spends considerable staff time on audits specifically requested by Army commanders. These audits, which are evaluations of local problems already identified by the respective installations or commands, result in reports with limited distribution and low visibility. Audit staff time devoted to these efforts has increased dramatically since the reorganization, from a level of 1,330 staff-days in fiscal year 1973 to 7,015 in fiscal year 1975, 5,247 in fiscal year 1976, and an estimated 7,000 for fiscal year 1977.

A commander-requested audit is an audit of a function or activity requested by an installation or other commander because of a known problem. These audits are performed on a privileged basis in that reports on the results are distributed only to the requesting commanders. Consequently, corrective action is at the discretion of the commanders.

The Audit Agency's policy is to encourage commander requests for audits and to accept them, providing that

- the request is for an audit related to a known problem in specific activities or functions and requires professional capability not normally available to the requestor;
- the audit is not in the nature of an audit normally performed by the Audit Agency on a cyclical basis and the command is not scheduled for audit during the current fiscal year;
- the request is not for an audit of a non-appropriated-fund activity for which the commander's internal review staff has audit responsibility; 1/ and
- the request is not for audit work in an area in which fraud, criminal conduct, or violation of law is known to exist.

In making commander-requested audits, auditors may be asked to answer such questions as "Why is the meat market (of an Army commissary) losing money?" or "Is the price for a new camouflage system too high?" Many of the requested audits call for special evaluations of non-appropriated-fund activities.

In our 1968 report, entitled "Internal Audit Activities in the Department of Defense" (B-132900), we noted that, in performing commander-requested audits, the Army Audit Agency was limiting its reporting function and was performing as an internal review group rather than an internal audit organization.

#### Audits of non-appropriated-fund activities

The Army Audit Agency devotes much staff time to audit activities which are operated solely to benefit military personnel and their dependents and are not supported by funds appropriated by the Congress. The audited activities do not reimburse the Audit Agency for the cost of this work. In fiscal year 1976, the Audit Agency spent 9,512 staff-days

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1/Internal review staffs have been assigned responsibility to audit certain non-appropriated-fund activities not subject to periodic audits by the Army Audit Agency.

auditing non-appropriated-fund activities. The value of this free service was about \$1.4 million. <sup>1/</sup> The Audit Agency estimates it will spend 10,500 staff-days (valued at about \$1.5 million <sup>1/</sup>) in making these audits in fiscal year 1977.

Under DOD and Army policy, 25 percent of the Army's clubs and open messes are audited by independent public accountants, who are paid for their services from the profits of these non-appropriated-fund activities. The Army Audit Agency is responsible for auditing the remaining 75 percent of these activities on a nonreimbursable basis.

According to DOD instructions, each significant non-appropriated-fund activity is supposed to be audited at least once every 2 years, which is the same frequency goal DOD has set for significant appropriated-fund activities. Although the Army Audit Agency falls far short of meeting the 2-year frequency objective in auditing appropriated-fund activities (see p. 23), Audit Agency and DOD officials said that the Audit Agency generally does meet this objective in making audits of non-appropriated-fund activities, with some problem activities being audited annually.

In a report issued by a special subcommittee of the House Armed Services Committee on October 30, 1972, audit support provided to non-appropriated-fund activities was discussed. The subcommittee noted that the three military department audit agencies are funded by appropriated funds and that their primary mission is to conduct audits to evaluate the effectiveness with which commanders use appropriated-fund resources to accomplish their missions. The subcommittee concluded that the Army Audit Agency could not accomplish its primary mission and conduct non-appropriated-fund audits with its available staff. The subcommittee recommended that the Secretary of each military department establish an audit staff directly under him to audit all non-appropriated-fund activities and that these staffs be supported by nonappropriated funds.

#### Red Cross audits

The American National Red Cross Act of January 5, 1905, as amended (36 U.S.C. 6), provides that DOD shall audit the

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<sup>1/</sup>Computed on the basis of the Audit Agency's average cost per staff-day for fiscal year 1976.

annual reports of Red Cross receipts and expenditures. In accordance with the audit provisions of DOD Directive 1330.5, dated August 16, 1969, the Army Audit Agency has been assigned responsibility for these audits.

The Red Cross bylaws require annual financial audits of the corporation's local chapters by public accountants, and a national accounting firm is responsible for certifying the financial statements of the corporation. The Army Audit Agency fulfills its responsibility by reviewing the work of the national accounting firm, auditing from 60 to 65 out of 3,150 individual Red Cross chapters each year, and developing its own opinion on the Red Cross' combined statement of income and expenditures.

The Audit Agency spends about 1,000 staff-days a year auditing the Red Cross. The Red Cross reimburses the U.S. Treasury for these audits, but the Army Audit Agency receives no compensation for its effort. The cost of audit service provided by the Audit Agency to the Red Cross for fiscal year 1976 was about \$135,000. <sup>1/</sup>

Additional staff time which could be  
made available for more productive  
and more mission-related audit work

The amount of audit staff time devoted by the Army Audit Agency to nonaudit work and marginally productive and non-mission-related audit work (including commander-requested, non-appropriated-fund, and Red Cross audits) is substantial. If these types of efforts were eliminated, the Audit Agency would have additional staff time available each year for more effectively carrying out its primary mission.

For example, if audit staff time had not been used for these efforts in fiscal year 1976, an additional 18,745 staff-days would have been available for productive audit work more consistent with the Audit Agency's primary mission. Similarly, if no staff time had been allocated to these efforts for fiscal year 1977, an additional 18,500 staff-days could have been made available for more mission-related work, as shown below.

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<sup>1/</sup>Amount of Red Cross reimbursement to the Treasury. The Audit Agency estimates that the reimbursement for fiscal year 1976 audit service will be about \$150,000.

| <u>Type of audit service</u>        | <u>Fiscal year</u><br><u>1976</u> | <u>Fiscal year</u><br><u>1977 (estimated)</u> |
|-------------------------------------|-----------------------------------|---|
|                                     | ----- (staff-days) -----          |   |
| Loans of auditors for nonaudit work | 2,957                             | -   |
| Commander-requested audits          | 5,247                             | 7,000   |
| Non-appropriated-fund audits        | 9,512                             | 10,500  |
| Red Cross audits                    | <u>1,029</u>                      | <u>1,000</u>                                  |
| Total                               | <u>18,745</u>                     | <u>18,500</u>                                 |

IMBALANCE IN AUDIT COVERAGE

Recent heavy emphasis on audits of financial operations has impaired the Audit Agency's ability to achieve balanced audit coverage by substantially reducing the amount of staff time available to conduct economy/efficiency and program results reviews.

Our standards for governmental auditing require periodic, full-scope internal audits. The standards define full scope as a combination of the following elements of an audit.

1. Financial and compliance--determines (a) whether financial operations are properly conducted, (b) whether the financial reports of an audited entity are presented fairly, and (c) whether the entity has complied with applicable laws and regulations.
2. Economy and efficiency--determines whether the entity is managing or utilizing its resources (personnel, property, space, and so forth) in an economical and efficient manner and the causes of any inefficiencies or uneconomical practices, including inadequacies in management information systems, administrative procedures, or organizational structure.
3. Program results--determines whether the desired results or benefits are being achieved, whether the objectives established by the legislature or other authorizing body are being met, and whether the agency has considered alternatives which might yield desired results at a lower cost.

Although the standards recognize that every internal audit need not involve work in all the above categories,

they point out that for most governmental programs, officials authorizing audit have not discharged their full responsibility for obtaining work unless the full scope of audit work set forth in the standards is performed. Thus, the standards implicitly call for a balanced audit coverage, with appropriate attention given to each of the three audit categories.

Beginning in fiscal year 1976, the Audit Agency has placed substantially increased emphasis on audits of financial operations, with the result that the amount of time available for economy/efficiency and program results evaluations has been substantially decreased, as follows.

| <u>Fiscal year</u> | <u>Audits of financial operations</u> | <u>Time available for economy/efficiency and program results reviews</u> |
|--------------------|---------------------------------------|--|
|                    | ----- (staff-days) -----              |  |
| 1975               | 23,790                                | 106,700  |
| 1976               | 48,373                                | 79,324   |
| 1977 (estimated)   | 70,000                                | 44,800   |

The substantial increase in the time allocated to audits of financial operations has resulted from financial management problems in the Department of the Army. Because of an increased number of violations of laws and directives and breakdowns in financial management controls at major and subordinated commands, the Army Chief of Staff, in November 1975, initiated an Army financial management improvement program to reestablish the basic integrity of Army financial management during the budget execution phase.

The Chief of Staff assigned the Army Inspector General and the Army Audit Agency responsibility for developing plans for conducting audits under the program in accordance with guidance to be provided by the Comptroller of the Army. According to Audit Agency officials, however, no formal guidance was provided to the Audit Agency by the Comptroller. In the absence of such guidance, the Audit Agency decided to carry out its assigned responsibilities under the program by increasing from 10 to 50 percent the proportion of its total staff time allocated to financial management audits for a 21-month period beginning January 1976. This decision was later approved by the Comptroller.



The allocation of one-half of total staff time to audits of financial operations, while probably necessary in this instance, creates an imbalance in audit coverage between the three basic audit categories of financial and compliance, economy and efficiency, and program results. Army management thus is deprived the full benefit of internal auditing in evaluating all aspects of Army operations.

### CONCLUSIONS

The Audit Agency's use of scarce staff resources for secondary efforts (such as those described on pp. 24 to 29) and its allocation of one-half its total staff time to audits of financial management activities have significantly reduced its capability to perform its primary mission and decreased its value as a management tool.

Using auditors for operational work is contrary to our standards and DOD regulations, which state that internal audit is a staff and advisory function and that auditors should not be given direct operating responsibilities. Rather, auditors should be independent of operational responsibilities to objectively evaluate management activities better.

The Audit Agency's policy of conducting audits requested by commanders on specific local problems, with reporting limited to the requesting commanders, results in reduced effectiveness of the auditing and reporting functions of a central audit agency. These kinds of effort appear to be within the scope of internal review responsibilities.

Using internal auditors to audit non-appropriated-fund activities is questionable from a management standpoint because these audits represent a free service provided at the taxpayers' expense to activities which were set up to be self-supporting. Also questionable from a management viewpoint is the fact that audit frequency goals for these activities are being met while similar goals for appropriated-fund audits, the Audit Agency's primary mission, are not being met.

Using auditors to audit the American National Red Cross, although required by law, is inconsistent with the Army Audit Agency's mission and represents a drain on its limited staff resources. If the law were amended to relieve DOD of audit responsibility for the Red Cross, thus leaving that organization free to obtain its own audit services from independent

public accountants, the internal audit capabilities of the Army Audit Agency would be increased.

Finally, a disproportionate allocation of staff resources to audits of financial operations, at the expense of economy/efficiency and program results evaluations is inconsistent with our standards requiring full-scope auditing of governmental activities and functions and deprives Army management of the full benefits it is entitled to receive from internal auditing. While the Audit Agency's action was probably necessary for immediate financial management improvement, the practice should be limited to the time needed for adequate assessment of problems and recommended solutions after which a return to a more balanced approach to full scope auditing should be made.

#### RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We recommend that the Secretary of Defense direct the Secretary of the Army to

- discontinue using auditors on nonaudit work and decrease their use of commander-requested audits and audits of non-appropriated-fund activities and
- after giving reasonable audit attention to immediate financial management problems, allocate audit staff time to insure that appropriately balanced audit coverage is given to financial/compliance, economy/efficiency, and program results audits.

#### RECOMMENDATION TO THE CONGRESS

We recommend that the Congress make more time available for DOD internal audit work by amending the American National Red Cross Act of 1905, as amended, to relieve DOD of its responsibility for auditing Red Cross financial operations.

#### DOD COMMENTS

The Assistant Secretary, in his reply, commented that the use of auditors for operational work as a matter of course, is contrary to DOD and Army Audit policies, as well as GAO standards. While he agreed that auditors should not be committed to operational responsibilities, the Assistant Secretary said that the Secretary of the Army has management authority to use auditors, when necessary for brief periods

when audit expertise is required to serve the best interest of DOD. He also said that although such usage is not the norm, it seems appropriate to retain flexibility in this regard.

We agree that such usage is not the norm. However, we also believe that the task for which 66 auditors were used over a period of several months did not require skills unique to the Army auditors. Reconciling customer orders can be accomplished by accountants and others familiar with the fiscal processes involved. Moreover, the work which the auditors performed, while probably necessary in the circumstances, placed the Audit Agency in a unique position of having the responsibility to subsequently audit their own work, thus potentially reducing their objectivity.

We agree that the Army acted in this instance out of necessity. However, we believe that this kind of practice should be avoided in the future.

On performing commander-requested audits, the Assistant Secretary commented that these audits are performed mainly because the commanders' internal review groups may not possess adequate personnel or skills to cope with specific tasks. He said the Audit Agency should have some flexibility in this regard but will reemphasize the need to devote optional resources to mission-oriented audits. The Assistant Secretary also said that normal distribution of audit reports, whether commander-requested or self-initiated, will be required in accordance with DOD audit policy.

We recognize that there may well be times when the commanders' internal review staff may not be able to cope with specific tasks. We agree that in these instances and others, such as potential fraudulent activities, commanders should have the flexibility to request internal audit assistance. But requests for assistance should be subject to the same priorities given to other functional audit areas. Also, requiring normal distribution of audit reports will allow top departmental management to more readily determine whether this kind of audit work is properly managed and should be continued in the future.

The Assistant Secretary concurred in principle with discontinuing the use of auditors on audits of non-appropriated-fund activities. He pointed out, however, that audits are one

critical management control of the non-appropriated-fund activity and that DOD will continue to require the central audit organizations to perform a limited number of these audits and monitor the quality of audits performed by others.

We agree that audits of non-appropriated-fund activities are a critical management control feature of the non-appropriated-fund activity and should continue to be performed. However, as we pointed out, the Audit Agency's primary mission--appropriated-fund work--could not always be accomplished because of limited resources while frequency objectives for non-appropriated-fund work generally were being met.

DOD should continue to provide audit coverage of non-appropriated-fund activities while exploring alternative ways of increasing coverage of primary mission audit areas. Alternatives to be considered can include, but are not limited to (1) reduced audit coverage by central audit organizations, (2) billing of non-appropriated-fund activities for services provided by internal auditors, and (3) increased coverage by Certified Public Accountings, internal reviewers, and others.

## CHAPTER 6

### MORE EFFECTIVE FOLLOWUP OF

#### AUDIT FINDINGS NEEDED

The Army's audit followup system does not provide assurance that all deficiencies identified by internal audits are promptly corrected.

Internal auditing, regardless of how well it is done, is useless unless prompt and effective action is taken to correct the deficiencies. Thus, in our opinion, the true measure of an internal audit organization's effectiveness is its success in bringing about needed improvements. To help insure that appropriate management action is taken on audit recommendations, there must be an effective audit followup system which promptly apprises top management of the adequacy of corrective action.

General Services Administration Federal Management Circular 73-2 (see app. II) sets forth policies to be followed in the audit of Federal operations and programs by executive departments and establishments. The circular requires that agencies designate officials responsible for following up on audit recommendations and submit periodic reports to agency management on actions taken on audit recommendations.

Our publication entitled "Internal Auditing in Federal Agencies" states that reporting a finding or recommendation should not end the internal auditor's concern. From time to time, the auditors should ascertain whether recommendations have received serious management consideration and whether satisfactory corrective action has been taken.

The Army's audit followup system is operated by the Audit Compliance Branch of the Office of the Inspector General and Auditor General. The system is not fully effective because the Audit Compliance Branch

- generally accepts promises of audited commands and Army staff agencies that action will be taken to correct reported deficiencies, without doing anything further to determine that the promised actions actually are taken,

- rarely uses its own staff to make followup reviews to determine the adequacy of corrective actions but

assigns followup responsibility to other Army organizations,

- usually does not ask its organizations to submit written reports on the results of their followup efforts,
- seldom asks the Army Audit Agency to make followup evaluations, and
- does not provide summaries of the results of followup evaluations to Army top management.

As a result, the full benefit of the internal audit function as a management tool is not being achieved. Deficiencies identified by audits sometimes are not corrected until the Audit Agency's next audit of a particular installation or activity, which may not occur until several years later. In the meantime, opportunities for savings are lost and inefficient and ineffective operations continue to exist.

For example, the Audit Agency reported in February 1974 that the Army Armament Command, in providing packaging protection for material being purchased, was paying for unnecessarily high levels of packaging. Because the Armament Command promised to take corrective action, the Audit Compliance Branch did not request a followup evaluation. In a subsequent audit, almost 2 years later, the Audit Agency found that the problem still existed and that the Army could be saving about \$2.3 million a year by using lower packaging levels.

In another example, the Audit Agency reported in January 1972 that requisitions for large quantities of furniture and equipment for military family housing and bachelor quarters in the U.S. Army, Europe, and the Seventh Army were not supported by valid data. The audited commands promised to take corrective action; consequently, no followup evaluation was requested by the Audit Compliance Branch. In a subsequent audit, almost 3 years later, the Audit Agency found that the previously reported deficiency still existed. The auditors found that \$8 million of the \$15 million of requisitioned items they reviewed exceeded current requirements.

In a third example, the Audit Agency reported in September 1972 that many military personnel in the U.S. Army, Europe, and the Seventh Army were not being used in

their primary occupational specialties. The audited commands promised to take corrective action. The Audit Compliance Branch was satisfied with this response and closed its file on the matter without requesting a followup evaluation or asking for reports from the commands on specific actions taken.

In a subsequent audit, more than 2 years later, the Audit Agency found that the problem still had not been corrected. In its report on this audit, the Audit Agency noted that at least 4,900 soldiers, who had received training at a cost of \$26 million, were not performing duties for which they had been trained. In most instances, vacancies existed in positions for which these soldiers were trained, and they could have been assigned these positions.

Our examination of internal audit reports issued during fiscal years 1974, 1975, and 1976 identified 32 reports in which the auditors highlighted, as repeat findings, previously reported deficiencies which had not been corrected. Our analysis showed that reported deficiencies remained uncorrected from 11 to 69 months. Moreover, it appears that the length of the time it takes the Audit Agency to follow up on its findings is increasing. While the elapsed time between initial and subsequent reporting of repeat findings averaged 29 months in fiscal year 1974, it increased to 33 months in fiscal year 1975 and to 38 months in fiscal year 1976.

The Audit Compliance Branch has a staff of seven people, four of whom are assigned to follow up on Army Audit Agency recommendations. Because of this small staff, the Branch's involvement in following up on these recommendations is limited primarily to administrative aspects of the followup process, mostly by means of correspondence. The Branch very rarely conducts followup evaluations with its own staff but must rely primarily on other Army organizations for this work. The reason for not assigning more of this work to the Army Audit Agency, according to the Chief of the Branch, is that the Audit Agency already is heavily burdened with other audit work.

The Branch's practice of not requesting reports of followup results is dictated by a desire to keep its paperwork within manageable proportions. A Branch official explained that, if the Branch were to receive reports on all followup evaluations, it would be inundated with paperwork in a volume with which it would be unable to cope.

The Branch's paperwork is also reduced by its acceptance of audited commands' and staff agencies' promises to take corrective action, without requesting followup evaluations. According to the Branch Chief, in following this practice the Branch must rely on the integrity of the officials making the promises to see that they are carried out. As brought out in our previous discussion of this matter, this reliance is not always well placed.

Because the Branch usually does not receive reports on followup results and does not request followup evaluations when corrective action is promised, it is not in a position to provide top management with periodic summaries of followup evaluations as required by Federal Management Circular 73-2. The Branch Chief explained that, in lieu of this type of reporting, the Branch provides management officials with summaries of audit findings in special cases when audit reports are issued, in the hope that this information will trigger management pressure to see that reported deficiencies are corrected.

Although this highlighting of audit findings in special cases may generate some management interest in these particular instances, we believe a system for periodically reporting the results of followup evaluations, in accordance with Federal Management Circular 73-2, would be much more effective in keeping top management informed of the status of actions taken in response to audit recommendations and insuring that appropriate corrective action is promptly taken.

#### CONCLUSIONS

The Army's audit followup system should be strengthened to insure prompt evaluation of all corrective actions taken in response to audit recommendations and to provide reports of these evaluations to top management.

Because of its limited staff, the Audit Compliance Branch can handle only the administrative aspects of the audit followup process by evaluating written statements. Thus, the Branch cannot evaluate actual changes made but must rely on other Army organizations to make followup evaluations. However, because the Branch usually does not ask for reports on the results of these followup evaluations, it generally is not aware of whether deficiencies have been corrected. Consequently, the Branch cannot report results of corrective action to top management. Such a followup system can endanger the effectiveness of the whole audit effort because it does not provide assurance



that potential savings and needed management improvements will be realized.

The most effective way to strengthen the audit followup function would be to place responsibility for following up on all audit findings with the Army Audit Agency--thus permitting auditors who are already located in the field and who are familiar with reported conditions to evaluate the adequacy of corrective actions taken and to verify that all significant weaknesses have been corrected. Also, the results of these evaluations should be summarized and reported to appropriate top management levels in the Army.

#### RECOMMENDATIONS

We recommend that the Secretary of Defense, to increase the effectiveness of the Army's audit followup system, direct the Secretary of the Army to

- transfer the audit followup function from the Office of the Inspector General and Auditor General to the Army Audit Agency;
- require the Army Audit Agency to make timely followup reviews to determine whether appropriate corrective action has been taken on all significant audit findings;
- instruct other Army organizations, which the Audit Agency may charge with following up some internal audit findings, to provide written reports of the results of all such followup efforts;
- require the Army Audit Agency to evaluate all such reports, together with detailed comments by audited installations and commands, to determine whether appropriate corrective action has been taken; and
- require the Audit Agency to periodically report the results of followup evaluations in summary form to top management officials.

#### DOD COMMENTS

The Assistant Secretary did not agree with our recommendation to transfer the audit followup function from the Office of the Inspector General to the Army Audit Agency. However, he pointed out that primary responsibility for action and followup on audit recommendations rests with management. He said that DOD policy now requires the central

audit organizations to follow up promptly on significant findings in the intervals between audits.

The Assistant Secretary took the position that subsequent review, whether by inspection or audit, logically would look into action taken on audit findings because intervals between audits have increased.

According to the Assistant Secretary, DOD, as part of a current study of functions and organizations of various internal review groups, intends to explore the strengthening of existing followup procedures.

We agree that the audit followup function is primarily the responsibility of management, and not internal audit. Our principal objection to the organizational placement of the followup function was that the Inspector Generals' staff responsible for auditing followup generally did not know whether deficiencies reported by internal auditors had been corrected.

The Assistant Secretary did not address our other recommendations concerning followup efforts, the Audit Agency's evaluation of those reports, and the Audit Agency's requirement to periodically report the results of followup evaluations to top management officials. However, the Army, in its response to the Assistant Secretary, said, in effect, that our recommendations are already accomplished by the Audit Agency. We believe that the examples discussed on pages 36 and 37 of our report indicate that this is not always the case. Further, the examples demonstrate that the amount of potential savings foregone by not following up on findings was substantial.

We believe that in exploring ways that the followup function can be strengthened, the Assistant Secretary should consider these and other matters discussed in our report, as well as actions contemplated by the Army.

## CHAPTER 7

### SCOPE OF REVIEW

We made our review at Army Audit Agency Headquarters, Falls Church, Virginia, and at its six district offices in Linthicum Heights, Maryland; Philadelphia, Pennsylvania; Atlanta, Georgia; St. Louis, Missouri; Redwood City, California; and Frankfurt, Germany. The review, made from August 1975 through September 1976, covered selected aspects of the Audit Agency's internal audit activities before and after the 1974 Army staff reorganization which placed the Audit Agency under the supervision and control of the Army Inspector General.

We reviewed the organization and operations of the Audit Agency in relation to our audit standards and the General Services Administration's Federal Management Circular requirements, which set forth policies to be followed in auditing Federal operations and programs.

We also made a limited review of selected operations of the Office of the Inspector General and Auditor General of the Army, including inspection coverage of Army activities and functional areas deleted from audits and the Office's audit compliance and followup functions.

Our examination did not include all aspects of the Army Audit Agency's operations. Rather, we concentrated on areas needing attention, as identified by our survey work, including restrictions on the scope of audit work, organizational placement of the audit function, the extent to which DOD policy was followed as to employing civilians, the Audit Agency's use of staff resources, and its involvement and effectiveness in following up audit findings.

## SUMMARY OF GOVERNMENTAL AUDIT STANDARDS <sup>1</sup>

The audit standards below are intended to be more than the mere codification of current practices tailored to existing audit capabilities. Purposely forward-looking, these standards include some concepts and areas of audit coverage which are still evolving in practice but which are vital to the accountability objectives sought in the audit of governments and of intergovernmental programs. Therefore, the audit standards have been structured so that each of the three elements of audit can be performed separately if this is deemed desirable.

### General Standards

1. The full scope of an audit of a governmental program, function, activity, or organization should encompass:
  - a. An examination of financial transactions, accounts, and reports, including an evaluation of compliance with applicable laws and regulations.
  - b. A review of efficiency and economy in the use of resources.
  - c. A review to determine whether desired results are effectively achieved.

In determining the scope for a particular audit, responsible officials should give consideration to the needs of the potential users of the results of that audit.

2. The auditors assigned to perform the audit must collectively possess adequate professional proficiency for the tasks required.

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<sup>1</sup>Excerpts from *Standards for Audit of Governmental Organizations, Programs, Activities & Functions*, Comptroller General of the United States (Washington, D.C., U.S. General Accounting Office, 1972.)

3. In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.

The auditor's independence can be affected by his place within the organizational structure of governments. Auditors employed by Federal, State, or local government units may be subject to policy direction from superiors who are involved either directly or indirectly in the government management process. To achieve maximum independence, such auditors and the audit organization itself not only should report to the highest practicable echelon within their government but should be organizationally located outside the line-management function of the entity under audit.

4. Due professional care is to be used in conducting the audit and in preparing related reports.

#### Examination and evaluation standards

1. Work is to be adequately planned.
2. Assistants are to be properly supervised.
3. A review is to be made of compliance with legal and regulatory requirements.
4. An evaluation is to be made of the system of internal control to assess the extent it can be relied upon to ensure accurate information, to ensure compliance with laws and regulations, and to provide for efficient and effective operations.
5. Sufficient, competent, and relevant evidence is to be obtained to afford a reasonable basis for the auditor's opinions, judgments, conclusions, and recommendations.

### Reporting standards

1. Written audit reports are to be submitted to the appropriate officials of the organizations requiring or arranging for the audits. Copies of the reports should be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others responsible or authorized to receive such reports. Copies should also be made available for public inspection.
2. Reports are to be issued on or before the dates specified by law, regulation, or other arrangement and, in any event, as promptly as possible so as to make the information available for timely use by management and by legislative officials.
3. Each report shall:
  - a. Be as concise as possible but, at the same time, clear and complete enough to be understood by the users.
  - b. Present factual matter accurately, completely and fairly.
  - c. Present findings and conclusions objectively and in language as clear and simple as the subject matter permits.
  - d. Include only factual information, findings, and conclusions that are adequately supported by enough evidence in the auditor's working papers to demonstrate or prove, when called upon, the bases for the matters reported and their correctness and reasonableness. Detailed supporting information should be included in the report to the extent necessary to make a convincing presentation.

- e. Include, when possible, the auditor's recommendations for actions to effect improvements in problem areas noted in his audit and to otherwise make improvements in operations. Information on underlying causes of problems reported should be included to assist in implementing or devising corrective actions.
- f. Place primary emphasis on improvement rather than on criticism of the past; critical comments should be presented in balanced perspective, recognizing any unusual difficulties or circumstances faced by the operating officials concerned.
- g. Identify and explain issues and questions needing further study and consideration by the auditor or others.
- h. Include recognition of noteworthy accomplishments, particularly when management improvements in one program or activity may be applicable elsewhere.
- i. Include recognition of the views of responsible officials of the organization, program, function, or activity audited on the auditor's findings, conclusions, and recommendations. Except where the possibility of fraud or other compelling reason may require different treatment, the auditor's tentative findings and conclusions should be reviewed with such officials. When possible, without undue delay, their views should be obtained in writing and objectively considered and presented in preparing the final report.
- j. Clearly explain the scope and objectives of the audit.

- k. State whether any significant pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information should be described, and the law or other basis under which it is withheld should be stated.
4. Each audit report containing financial reports shall:
- a. Contain an expression of the auditor's opinion as to whether the information in the financial reports is presented fairly in accordance with generally accepted accounting principles (or with other specified accounting principles applicable to the organization, program, function, or activity audited), applied on a basis consistent with that of the preceding reporting period. If the auditor cannot express an opinion, the reasons therefor should be stated in the audit report.
  - b. Contain appropriate supplementary explanatory information about the contents of the financial reports as may be necessary for full and informative disclosure about the financial operations of the organization, program, function, or activity audited. Violations of legal or other regulatory requirements, including instances of noncompliance, and material changes in accounting policies and procedures, along with their effect on the financial reports, shall be explained in the audit report.



GENERAL SERVICES ADMINISTRATION  
OFFICE OF FEDERAL MANAGEMENT POLICY

***FEDERAL MANAGEMENT CIRCULAR***

FMC 73-2: Audit of Federal Operations and Programs  
by Executive Branch Agencies

September 27, 1973

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

1. Purpose. This circular sets forth policies to be followed in the audit of Federal operations and programs by executive departments and establishments.
2. Supersession. This circular supersedes Office of Management and Budget Circular No. A-73, dated August 4, 1965.
3. Policy intent. The primary objectives of this circular are to promote improved audit practices, to achieve more efficient use of manpower, to improve coordination of audit efforts, and to emphasize the need for early audits of new or substantially changed programs.
4. Applicability and scope. The provisions of this circular are applicable to all executive departments and establishments. The terms "agency" and "Federal agency" throughout this circular are synonymous with the term "departments and establishments" as defined in FMC 73-1.
5. Definitions.
  - a. The term "audit" as used in this circular means a systematic review or appraisal to determine and report on whether:
    - (1) Financial operations are properly conducted;
    - (2) Financial reports are presented fairly;
    - (3) Applicable laws and regulations have been complied with;

(4) Resources are managed and used in an economical and efficient manner; and

(5) Desired results and objectives are being achieved in an effective manner.

The above elements of an audit are most commonly referred to as financial/compliance (items 1, 2, and 3), economy/efficiency (item 4), and program results (item 5). Collectively, they represent the full scope of an audit and provide the greatest benefit to all potential users of Government audits. In developing audit plans, however, the audit scope should be tailored to each specific program according to the circumstances relating to the program, the management needs to be met, and the capacity of the audit facilities.

b. The term "audit standards" refers to those standards set forth in the Standards for Audit of Governmental Organizations, Programs, Activities & Functions issued by the Comptroller General of the United States.

6. Policies and procedures. Agencies are responsible for providing adequate audit coverage of their programs as a constructive aid in determining whether funds have been applied efficiently, economically, effectively, and in a manner that is consistent with related laws, program objectives, and underlying agreements. The audit standards will be the basic criteria on which audit coverage and operations are based. Agencies administering Federal grant, contract, and loan programs will encourage the appropriate application of these standards by non-Federal audit staffs involved in the audit of organizations administering Federal programs. Each agency will implement the policies set forth in this circular by issuing policies, plans, and procedures for the guidance of its auditors.

a. Organization and staffing. Audit services in Government are an integral part of the management process. Audit services and reports must be responsive to management needs. However, it is important in order to obtain the maximum benefit from this function that agency audit organizations have a sufficient degree of independence in carrying out their responsibilities. To provide an appropriate degree of independence, the audit organization should ordinarily be located outside the program management structure, report

to an agency management level sufficiently high to ensure proper consideration of and action on audit results, and be given reasonable latitude in selecting and carrying out assignments. Adequate and qualified staff should be assigned this important function. The audit of all programs under a single Federal department or agency must be coordinated, and where economies and a more effective audit service will result, especially in large and geographically dispersed programs, the audit operations within a department should be consolidated. It is also important to establish close coordination between audit and such other management review activities as may exist in an agency.

b. Determination of audit priorities. Each agency will establish procedures requiring periodic review of its individual programs and operations to determine the coverage, frequency, and priority of audit required for each. The review will include consideration of the following factors:

- (1) Newness, changed conditions, or sensitivity of the organization, program, activity, or function;
- (2) Its dollar magnitude and duration;
- (3) Extent of Federal participation either in terms of resources or regulatory authority;
- (4) Management needs to be met, as developed in consultation with the responsible program officials;
- (5) Prior audit experience, including the adequacy of the financial management system and controls;
- (6) Timeliness, reliability, and coverage of audit reports prepared by others, such as State and local governments and independent public accountants;
- (7) Results of other evaluations; e.g., inspections, program reviews, etc.;
- (8) Mandatory requirements of legislation or other congressional recommendations; and
- (9) Availability of audit resources.

c. Cross-servicing arrangements. To conserve manpower, promote efficiency, and minimize the impact of audits on the operations of the organizations subject to audit, each Federal agency will give full consideration to establishing cross-servicing arrangements under which one Federal agency will conduct audits for another--whenever such arrangements are in the best interest of the Federal Government and the organization being audited. This is particularly applicable in the Federal grant-in-aid and contract programs where two or more Federal agencies are frequently responsible for programs in the same organization or in offices located within the same geographical area. Under such circumstances, it will be the primary responsibility of the Federal agency with the predominant financial interest to take the initiative in collaborating with the other appropriate Federal agencies to determine the feasibility of one of the agencies' conducting audits for the others, and to work out mutually agreeable arrangements for carrying out the required audits on the most efficient basis.

d. Reliance on non-Federal audits. In developing audit plans, Federal agencies administering programs in partnership with organizations outside of the Federal Government will consider whether these organizations require periodic audits and whether the organizations have made or arranged for these audits. This consideration is especially necessary for those agencies that administer Federal grant-in-aid programs through State and local governments and which are subject to OMB Circular A-102, Attachment G. Attachment G provides standards for financial management systems of grant-supported activities of State and local governments and requires that such systems provide, at a minimum, for financial/compliance audits at least once every 2 years. Federal agencies will coordinate their audit requirements and approaches with these organizations to the maximum extent possible. The scope of individual Federal audits will give full recognition to the non-Federal audit effort. Reports prepared by non-Federal auditors will be used in lieu of Federal audits if the reports and supporting workpapers are available for review by the Federal agencies, if testing by Federal agencies indicates the audits are performed in accordance with generally accepted auditing standards (including the audit standards issued by the Comptroller General), and if the audits otherwise meet the requirements of the Federal agencies.

e. Audit plans. Based on the considerations set forth in b, c, and d, above, each agency will prepare an audit plan at least annually. At a minimum, such plans will reflect the:

(1) Audit universe (all programs and operations subject to audit);

(2) Programs and operations selected for audit, with priorities and specific reasons for selection;

(3) Audit organization that will conduct the audit;

(4) Audit cycle or frequency, the locations to be audited, and the reasons therefor;

(5) Scope of audit coverage to be provided and the reasons therefor; and

(6) Anticipated benefits to be obtained from the audits.

The plans should be adjusted as necessary to provide for audit coverage of unforeseen priorities.

f. Coordination of audit work. Federal agencies will coordinate and cooperate with each other in developing and carrying out their individual audit plans. Such actions will include continuous liaison; the exchange of audit techniques, objectives, and plans; and the development of audit schedules to minimize the amount of audit effort required. Federal agencies will encourage similar coordination and cooperation among Federal and non-Federal audit staffs where there is a common interest in the programs subject to audit.

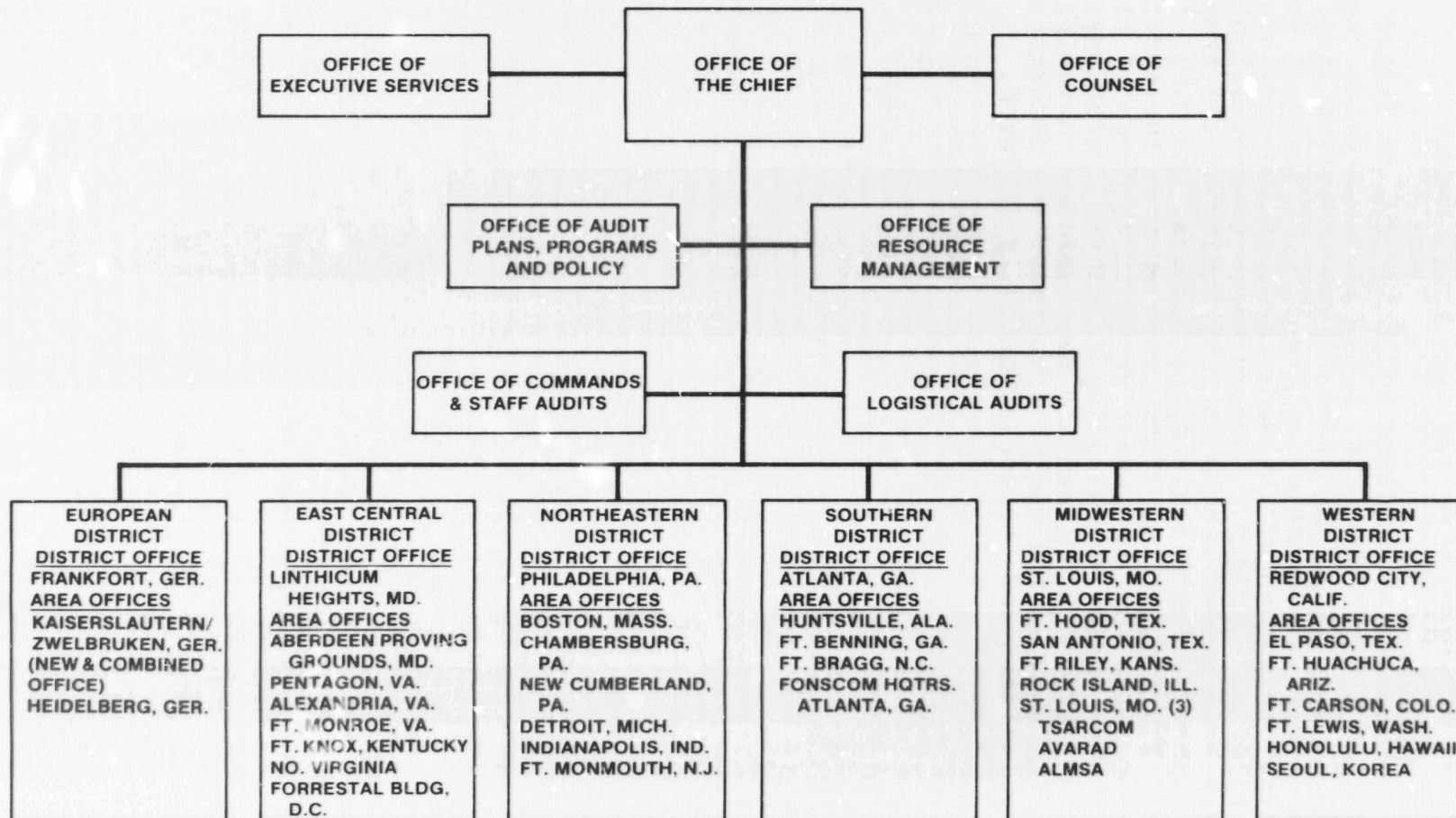
g. Reports. Reporting standards are set forth in the Audit Standards for the guidance of Federal agencies. With respect to release of audit reports, each agency will establish policies regarding the release of audit reports outside the agency. Such policies will be in consonance with applicable laws, including the Freedom of Information Act, and, to the maximum extent possible, will provide for the dissemination of such reports in whole or in part to those interested in such information.

h. Agency action on audit reports. Each agency will provide policies for acting on audit recommendations. Timely action on recommendations by responsible management officials is an integral part of the effectiveness of an agency's audit system and has a direct bearing on it. Policies will provide for designating officials responsible for following up on audit recommendations, maintaining a record of the action taken on recommendations and time schedules for responding to and acting on audit recommendations, and submitting periodic reports to agency management on recommendations and action taken.

7. Responsibilities. Federal agencies will review the policies and practices currently followed in the audit of their operations and programs, and will initiate such action as is necessary to comply with the policies set forth in this circular. The head of each Federal agency will designate an official to serve as the agency representative on matters relating to the implementation of this circular. The name of the agency representative should be sent to the General Services Administration (AM), Washington, DC 20405, within 30 days after the receipt of this circular.

8. Reporting requirement. Each Federal agency will submit a report to the General Services Administration (AM), Washington, DC 20405, by December 31, 1973, on the action it has taken to implement the policies set forth in this circular. Specifically, the report will include actions taken on the issuance of policies, plans, and procedures for the guidance of its auditors; determination of audit priorities; new cross-servicing arrangements made; additional reliance on non-Federal audits; development of audit plans; and coordination of audit work between Federal agencies and between Federal and non-Federal audit staffs. Reports will be submitted at 6-month intervals on the additional actions taken until the circular is fully implemented. Copies of agency issuances on the implementation of this circular will be submitted to the Office of Federal Management Policy, General Services Administration, upon request.

# ORGANIZATION US ARMY AUDIT AGENCY



APPENDIX III

APPENDIX III

MISSION OF THE ARMY AUDIT AGENCY

The mission of the Army Audit Agency, as stated in Army Regulation 36-5, November 8, 1974, is "to provide the Army at all levels with an independent and objective internal audit service which evaluates the effectiveness in which the total resources of the Department of the Army are being controlled and managed." According to the regulation, audit service so provided should include audits of all Army military commands, installations, activities, and civil functions. The regulations states further that the Audit Agency is responsible for comprehensive audit coverage of all Army activities, including examining financial operations, evaluating compliance with laws and regulations, reviewing economy and efficiency in the use of resources, and determining whether desired results are effectively achieved.



MISSIONS OF INSPECTORS GENERALBefore the 1974 Army staff reorganization:Mission.

"a. The Inspector General of the Army. The Inspector General of the Army is a confidential representative of the Secretary of the Army and the Chief of Staff and is a member of the personal staff. He inquires into and reports upon matters affecting the performance of mission and the state of economy, efficiency, discipline, and morale of the Department of the Army. \*\*\*

"b. Other inspectors general. Other inspectors general are confidential representatives and are members of the personal staff of their head of HQDA [Headquarters, Department of the Army] staff agency or commander. They inquire into and report upon matters affecting the performance of mission and the state of economy, efficiency, discipline, and morale of the activity in which they serve. \*\*\*--Army Regulation 20-1, April 18, 1973.

Sphere of activity.

"a. The Inspector General of the Army. The sphere of activity of The Inspector General of the Army embraces every phase of activity of the Department of the Army." \*\*\*

"b. Other inspectors general. The sphere of activity of all other inspectors general embraces every phase of activity of the HQDA staff agency or command to which they are assigned."--Army Regulation 20-1, April 18, 1973.

After the 1974 reorganization:Mission.

"a. The Inspector General and Auditor General. The Inspector General and Auditor General is a confidential representative of the Secretary of the Army and the Chief of Staff and is a member of the personal staff. The Inspector General and Auditor General inquires into and reports upon matters affecting the performance of mission and the state of economy, efficiency, discipline, and morals of the Department of the Army. \*\*\*

"b. Other Inspectors General. Other Inspectors General are confidential representatives and are members of the personal staff of their head of HQDA staff agency or commander.

appropriate actions to convert this position within the Army from military to civilian.

Recommendation

" --discontinue using auditors on non-audit work, including loans of auditors to other Army organizations for use in an operating capacity."

Comment. The use of auditors for operational work as a matter of course is contrary to DoD and Army audit policies as well as GAO standards. While fully agreeing that auditors should not be committed to operational responsibilities, the Secretary has management authority to use auditors, when necessary, for brief periods when audit expertise is required to serve the best interests of the Department. Although such usage is not the norm, it seems appropriate to retain flexibility in this regard.

Recommendation

" --discontinue performing commander-requested audits."

Comment. Audits requested by local commanders consume approximately 2 percent of the total Army Audit Agency effort. They are performed mainly because the commanders' internal review groups may not possess adequate personnel or skills to cope with specific tasks. Although the Army Audit Agency should have some flexibility in this regard, we will reemphasize the need to devote optimal resources to mission-oriented audits. Regardless of the reason audits are performed, whether commander-requested or self-initiated, normal distribution of the audit reports will be required, in accordance with DoD audit policy.

Recommendation

" --discontinue using auditors on audits of non-appropriated fund activities."

Comment. Although we concur in principle on this recommendation, current DoD policy either requires or encourages audit coverage of most nonappropriated-fund activities by local internal review groups or by independent public accountants. Army Audit Agency application of only 6 percent of its resources to these audits in FY 76 is in compliance with this policy and represents an actual reduction from 20 percent applied in 1973. Congressional guidance requires the Department to support troop morale and welfare services, and audits are one critical management control of this requirement. Thus, we will continue to require the central audit organizations to perform a limited number of nonappropriated-fund audits and monitor the quality of audits performed by others.

Recommendation

" --allocate audit staff time to insure that appropriately balanced audit coverage is given to financial/compliance, economy/efficiency, and program results audits."

Comment. We agree that audit coverage should be balanced. Emphasis was placed on financial management audits in certain instances because of indicated need; however, the scope of many audits of financial operations often encompasses the economy/efficiency and program results elements as well. A balanced audit program is planned contingent on special needs of management.

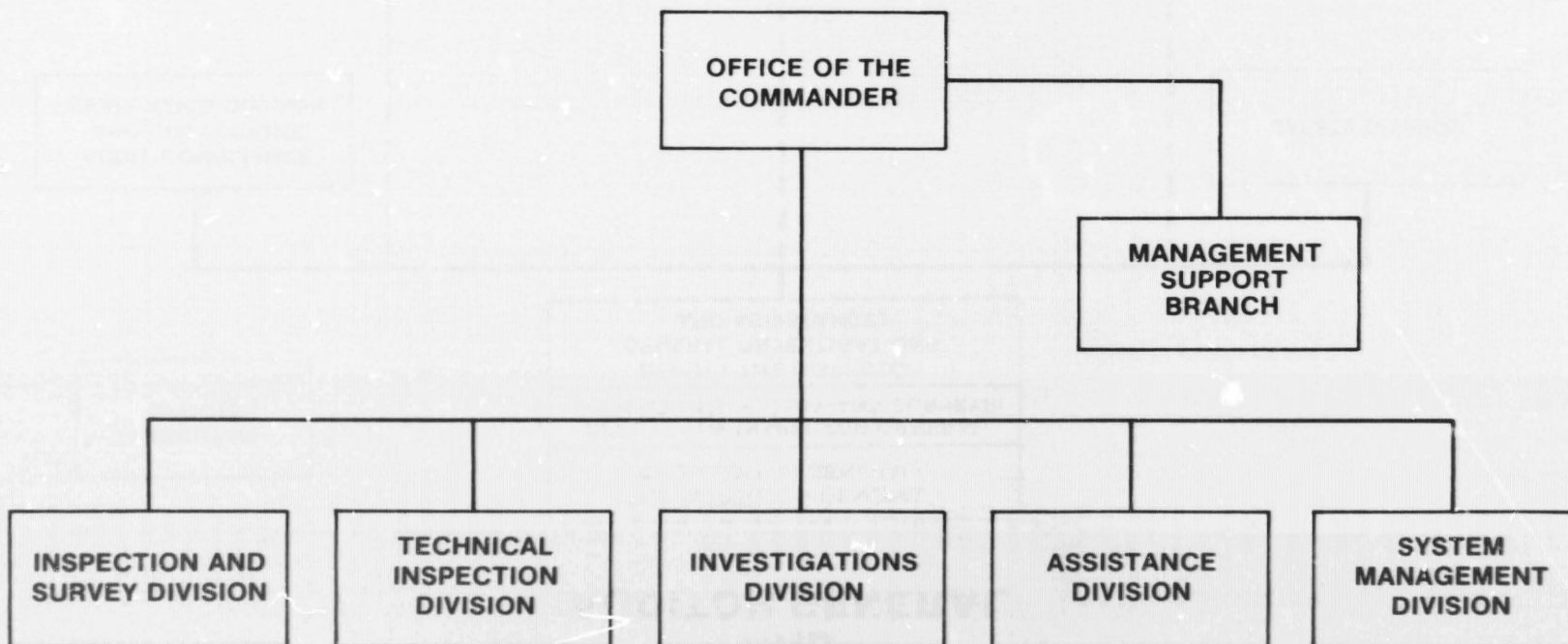
Recommendation

" --transfer the audit follow-up function from the Office of the Inspector General to the Army Audit Agency and otherwise strengthen the Army's audit follow-up system."

Comment. We believe that primary responsibility for action and follow-up on audit recommendations rests with management. Subsequent review, whether by inspection or audit, logically would look into action taken on audit findings because intervals between audits have increased. DoD policy now requires the central audit organizations to follow up promptly on significant findings in the interim. To devote a significantly greater part of Army Audit Agency's efforts to follow up on audit findings would be counterproductive, further reducing the time available for high priority audit work. As an alternative, we intend to explore the strengthening of existing follow-up procedures. This is being considered during our current study of the functions and organizations of the various internal review groups within the DoD.

# UNITED STATES ARMY INSPECTOR GENERAL AGENCY ORGANIZATIONAL CHART

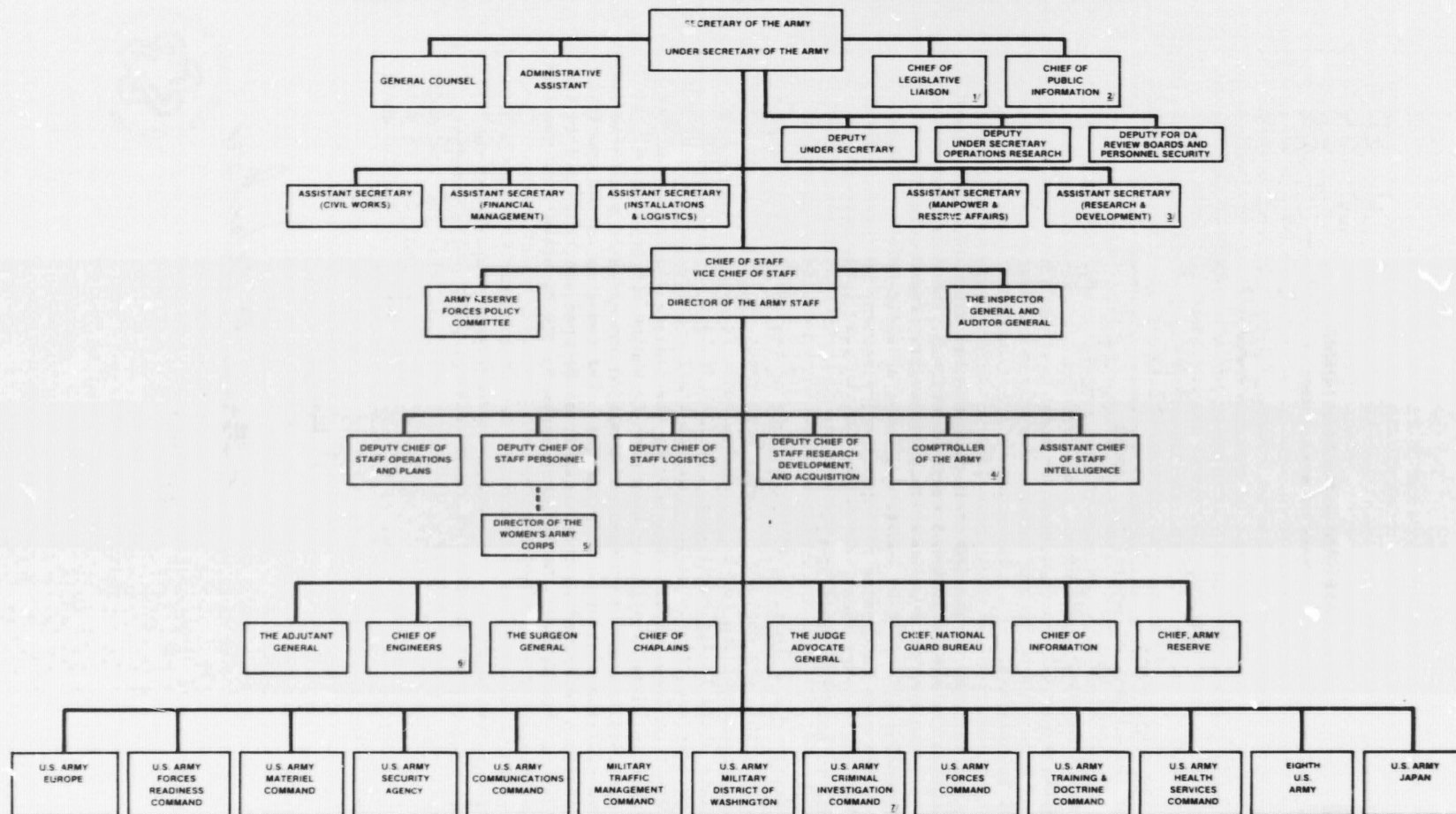
APPENDIX VI



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APPENDIX VI

# ORGANIZATION OF THE DEPARTMENT OF THE ARMY



1) CHIEF OF LEGISLATIVE LIAISON REPORTS DIRECTLY TO THE SECRETARY OF THE ARMY AND IS RESPONSIVE TO THE CHIEF OF STAFF.  
 2) THE CHIEF OF PUBLIC INFORMATION IS ALSO RESPONSIVE TO THE CHIEF OF STAFF FOR PUBLIC INFORMATION MATTERS AND SERVES CONCURRENTLY AS CHIEF OF INFORMATION.  
 3) THE INSPECTOR GENERAL AND AUDITOR GENERAL SERVES AS THE CONFIDENTIAL AGENT OF AND REPORTS DIRECTLY TO THE SECRETARY OF THE ARMY AND TO THE CHIEF OF STAFF UPON THE MORALE, DISCIPLINE, EFFICIENCY, AND ECONOMY OF THE ARMY.  
 4) THE COMPTROLLER OF THE ARMY IS UNDER THE DIRECTION AND SUPERVISION OF AND IS DIRECTLY RESPONSIBLE TO THE ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT) WITH CONCURRENT RESPONSIBILITY TO THE CHIEF OF STAFF.  
 5) THE DIRECTOR OF THE WOMEN'S ARMY CORPS ADVISES THE SECRETARY OF THE ARMY AND CHIEF OF STAFF ON MATTERS RELATED TO WOMEN'S ARMY CORPS AND AS A PERSONAL STAFF OFFICER HAS DIRECT ACCESS TO THE CHIEF OF STAFF.  
 6) THE CHIEF OF ENGINEERS REPORTS THROUGH THE ASSISTANT SECRETARY OF THE ARMY (CIVIL WORKS) TO THE SECRETARY OF ARMY ON CIVIL WORKS MATTERS.  
 7) COMMANDER, U.S. ARMY CRIMINAL INVESTIGATION COMMAND REPORTS DIRECTLY AND CONCURRENTLY TO THE SECRETARY OF THE ARMY AND THE CHIEF OF STAFF ON CRIMINAL INVESTIGATION MATTERS.

APPENDIX VII

APPENDIX VII



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D.C. 20301

15 JUN 1977

Mr. Donald Scantlebury  
Director, Financial and General Management  
Studies Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Scantlebury:

This letter responds to the GAO draft report dated March 14, 1977, "Need to Strengthen the Army's Internal Audit Function." The report addresses the overall GAO concern that some limitations exist that could affect the independent selection of audits and scope of audit effort. Specific comments were made concerning organizational placement of internal audit, use of the audit staff, audit follow-up system, and use of military personnel to head the audit agency.

We agree that there should be no restriction on the selection or scope of audit work within the context of proper management supervision. We concur with the recommendations to strengthen the audit function and will take appropriate steps to implement them. We plan to have the Army Audit Agency report concurrently to the Chief of Staff and the Secretary of the Army, with technical guidance provided by the Assistant Secretary of the Army (Financial Management). We also plan to change the position of the Chief, Army Audit Agency to a civilian position and assign a professionally qualified civilian auditor to fill the job. Our comments on the specific recommendations addressed to the Secretary of Defense are contained in the attachment to this letter. Detailed comments by the Department of the Army are also attached for your information.

We appreciate the opportunity to comment on this draft report and the objective observations furnished by your staff concerning the internal audit function. We are pleased to note your statement that the Army Audit Agency staff has a high level of competence and professionalism. We plan to further improve audit services to management by acting on the GAO audit recommendations.

Sincerely,

Fred P. Wacker  
Assistant Secretary of Defense

Enclosures 2



DoD Comments on GAO Draft Report  
"Need to Strengthen the Army's Internal Audit Function"

Recommendation

" . . . relocate the Army Audit Agency under the Secretary or Under Secretary of the Army and have the audit staff report directly to that official."

Comment. We agree with the recommendation and will relocate the Army Audit Agency under the Secretary of the Army. The Army Audit Agency will report concurrently to the Chief of Staff and to the Secretary, and receive technical guidance from the Assistant Secretary (Financial Management).

Recommendation

" --abolish the Inspection and Audit Priority Committee."

\* \* \* \* \*

" --insure that internal auditors will not be restricted in selecting activities for audit and determining the scope of audit work."

Comment. We agree that there should be no restriction in the selection or scope of audit work within the context of proper management supervision. Accordingly, the Army Inspection and Audit Priority Committee will be abolished and the Army Audit Agency mission statement will be revised to state that the scope of internal audit responsibility is broad, and encompasses all financial, operational, and support activities in accordance with DoD audit policies.

Recommendation

" --more clearly define the nature and scope of audits and inspections."

Comment. Army regulations will be clarified to delineate differences between audit and inspection, emphasize their complementary nature, and describe the scope of each function.

Recommendation

" --fill the position of Chief of the Army Audit Agency with a professionally qualified civilian."

Comment. We concur that the position of Chief of the Army Audit Agency should be filled by a professionally qualified civilian and will initiate

appropriate actions to convert this position within the Army from military to civilian.

Recommendation

" --discontinue using auditors on non-audit work, including loans of auditors to other Army organizations for use in an operating capacity."

Comment. The use of auditors for operational work as a matter of course is contrary to DoD and Army audit policies as well as GAO standards. While fully agreeing that auditors should not be committed to operational responsibilities, the Secretary has management authority to use auditors, when necessary, for brief periods when audit expertise is required to serve the best interests of the Department. Although such usage is not the norm, it seems appropriate to retain flexibility in this regard.

Recommendation

" --discontinue performing commander-requested audits."

Comment. Audits requested by local commanders consume approximately 2 percent of the total Army Audit Agency effort. They are performed mainly because the commanders' internal review groups may not possess adequate personnel or skills to cope with specific tasks. Although the Army Audit Agency should have some flexibility in this regard, we will reemphasize the need to devote optimal resources to mission-oriented audits. Regardless of the reason audits are performed, whether commander-requested or self-initiated, normal distribution of the audit reports will be required, in accordance with DoD audit policy.

Recommendation

" --discontinue using auditors on audits of non-appropriated fund activities."

Comment. Although we concur in principle on this recommendation, current DoD policy either requires or encourages audit coverage of most nonappropriated-fund activities by local internal review groups or by independent public accountants. Army Audit Agency application of only 6 percent of its resources to these audits in FY 76 is in compliance with this policy and represents an actual reduction from 20 percent applied in 1973. Congressional guidance requires the Department to support troop morale and welfare services, and audits are one critical management control of this requirement. Thus, we will continue to require the central audit organizations to perform a limited number of nonappropriated-fund audits and monitor the quality of audits performed by others.



Recommendation

" --allocate audit staff time to insure that appropriately balanced audit coverage is given to financial/compliance, economy/efficiency, and program results audits."

Comment. We agree that audit coverage should be balanced. Emphasis was placed on financial management audits in certain instances because of indicated need; however, the scope of many audits of financial operations often encompasses the economy/efficiency and program results elements as well. A balanced audit program is planned contingent on special needs of management.

Recommendation

" --transfer the audit follow-up function from the Office of the Inspector General to the Army Audit Agency and otherwise strengthen the Army's audit follow-up system."

Comment. We believe that primary responsibility for action and follow-up on audit recommendations rests with management. Subsequent review, whether by inspection or audit, logically would look into action taken on audit findings because intervals between audits have increased. DoD policy now requires the central audit organizations to follow up promptly on significant findings in the interim. To devote a significantly greater part of Army Audit Agency's efforts to follow up on audit findings would be counterproductive, further reducing the time available for high priority audit work. As an alternative, we intend to explore the strengthening of existing follow-up procedures. This is being considered during our current study of the functions and organizations of the various internal review groups within the DoD.



SECRETARY OF THE ARMY  
WASHINGTON

1 June 1977

MEMORANDUM FOR THE ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)

ATTN: ASSISTANT FOR AUDIT REPORTS

SUBJECT: GAO Draft Report, Dated March 14, 1977, "Need to  
Strengthen the Army's Internal Audit Function"  
(OSD Case #4573)

This responds to your request for comments on the draft General Accounting Office report, "Need to Strengthen the Army's Internal Audit Function."

The report presents valuable information regarding management of internal auditing within the Army. To ensure that all of the issues were fully evaluated and considered, the Army formulated its response based on data provided by Army Staff agencies, the auditor community, and top Army managers. In essence, the Army agrees with the GAO comments. Our plans to strengthen internal auditing, keyed to each of the basic recommendations, are provided in the summary documents at Tab A.

The Army agrees that there should be no restriction on the scope of audit work within the context of proper management supervision. To emphasize this basic aspect of audit independence, the Inspection and Audit Priority Committee will be abolished, the AAA mission statement will be revised, and Army regulations will be clarified as recommended.

The Army will select a professionally qualified civilian as AAA Chief. The Chief will have direct access to both the Secretary of the Army and the Chief of Staff. Audit policy guidance and daily review and management matters will continue to be provided the AAA by the Assistant Secretary responsible for Financial Management.

The Army agrees that the audit staff should be used most effectively to ensure a balanced audit coverage. Consequently, the Army does not plan to use auditors for operational work.

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will strengthen its internal review function with the objective of eliminating the need for commander-requested audits, will evaluate alternatives to more economically manage non-appropriated fund audits, will allocate audit staff time to ensure balanced audit coverage, and agrees with the recommendation to ask the Congress to amend the law relieving DOD of its responsibility to audit the Red Cross.

The Army supports the need to strengthen the audit follow-up system and agrees that AAA should have a role in verifying the correction of deficiencies. However, primary responsibility for the follow-up function should rest with management. The Office of The Inspector General provides an independent staff element, reporting directly to the Chief of Staff of the Army and the Secretary of the Army, to assure proper compliance with audit findings and recommendations.

I believe that our audit capability will be improved as a result of the GAO report and the follow-on actions we are taking.



Clifford L. Alexander, Jr.

Inclosure

APPENDIX VIII

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DRAFT GAO REPORT

NEED TO STRENGTHEN THE ARMY'S INTERNAL AUDIT FUNCTION

CHAPTER 2

THE SCOPE OF INTERNAL AUDITS SHOULD NOT BE RESTRICTED

APPENDIX VIII

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RECOMMENDATION: To eliminate existing restrictions on the Army's internal audit function, abolish the Inspection and Audit Priority Committee.

ARMY POSITION: Concur that the Inspection and Audit Priority Committee be abolished.

DISCUSSION: The Priority Committee was initially established to augment the staff process to plan, select, and prioritize audits. Auditors, operational managers, and top decisionmakers participated. In recent years, however, the Priority Committee has ceased to be a constructive mechanism in managing internal audits in the Army. Consequently, it will be abolished thereby helping to streamline the Army's internal audit function within the context of the staff process. This will ensure that auditors as well as top management are involved in the audit selection process.

RECOMMENDATION. To eliminate existing restrictions on the Army's internal audit function, clearly specify in the mission statement of the AAA that there will be no restrictions on the Agency in selecting activities for audit and in determining the scope of audit work.

ARMY POSITION: Concur that the AAA mission statement be clarified to state that audit selection and scope will be unrestricted.

DISCUSSION:

1. The Army agrees that there should be no restrictions on audit selection and scope and will change AAA's mission to reflect this concept. However, top management will approve and prioritize audits and the use of audit resources. Whether a particular activity is audited or inspected depends on organizational priorities, the need for improved audit-inspection coordination to reduce duplication, the need to provide the most effective coverage for the Army, and how to best use the special talents and capabilities of the Army's auditors and inspectors.

2. Since the scope of activities to be audited or inspected is universal and the same, tactical and nontactical activities are valid considerations for both audit and inspection. The informal policy decision to exclude auditors from tactical areas was sincerely made with the intent of best utilizing auditor and inspector personnel and skills. There was no intent to misuse authority or conceal problems. Unfortunately, the decision was not judicious and was further exacerbated by the fact that planned inspections of the tactical activities excluded from auditor purview never occurred. The change in TIC/AC leadership and the current AAA audit schedule clearly indicate that this informal policy no longer exists. In fact, a sampling of current and future audits in tactical areas include a survey of the TOW missile system, US Army Air Defense School, the D.C. and Virginia Army National Guard, and the 3rd Armored Cavalry Regiment at Ft. Bliss.

RECOMMENDATION: To eliminate existing restrictions on the Army's internal audit function, revise Army regulations to more specifically delineate the respective scope of internal audits and inspections, explain the difference between them, and emphasize that they are complementary rather than duplicative.

ARMY POSITION: Concur that existing regulations need to be revised.

DISCUSSION: Army regulations governing audits and inspections are ambiguous thus causing confusion and misinterpretations within the Army. Regulations will be clarified to strengthen audit and inspection definitions, to delineate differences, emphasize their complementary nature, and describe the scope of both functions.

DRAFT GAO REPORT

NEED TO STRENGTHEN THE ARMY'S INTERNAL AUDIT FUNCTION

CHAPTER 3

THE INTERNAL AUDIT FUNCTION SHOULD BE LOCATED  
AT A HIGHER ORGANIZATIONAL LEVEL



RECOMMENDATION: To increase the effectiveness of internal auditing in the Department of the Army and to ensure maximum audit independence in accordance with our standards, relocate the Army Audit Agency under the Secretary of the Army and have the audit staff report directly to that official.

ARMY POSITION: Concur

DISCUSSION: In evaluating the best organizational placement for the AAA, the Army considered a number of organizational alternatives. Based on this evaluation, the Army concluded that the AAA should be an independent organization. The head of the AAA will have unencumbered access to both the Secretary of the Army and the Chief of Staff. Policy guidance and daily review and management matters will be provided the AAA by the Assistant Secretary for Financial Management.

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DRAFT GAO REPORT

NEED TO STRENGTHEN THE ARMY'S INTERNAL AUDIT FUNCTION

CHAPTER 4

THE CHIEF OF THE ARMY AUDIT AGENCY SHOULD BE A CIVILIAN

RECOMMENDATION: The Secretary of Defense direct the Secretary of the Army to fill the position of Chief of the Army Audit Agency with a professionally qualified civilian.

ARMY POSITION: Concur.

DISCUSSION:

1. The Army recognizes the merit of establishing a high degree of auditor expertise and job continuity at the top management level of the AAA. There is also a strong requirement to provide military direction and guidance to the audit effort, since the AAA mission is to serve the Army's overall best interests.
2. A survey of pertinent organizational documents (DOD Directives 1100.4, 1100.9, and DOD Instruction 7600.5, and Army Regulation 570-4) state general, but not determining criteria for the delineation of the AAA Chief. Thus, from a strictly regulatory standpoint, there is no objection or requirement for either a military or civilian chief.
3. From the standpoint of background and professional experience, it is felt that the position of head of the AAA can best be filled by a civilian.

DRAFT GAO REPORT

NEED TO STRENGTHEN THE ARMY'S INTERNAL AUDIT FUNCTION

CHAPTER 5

NEED FOR MORE EFFECTIVE USE OF AUDIT STAFF

RECOMMENDATION: The Secretary of Defense direct the Secretary of the Army to discontinue using auditors on nonaudit work, including loans of audits to other Army organizations for use in an operating capacity.

ARMY POSITION: Concur in principle.

DISCUSSION:

1. The use of auditors for operational work is contrary to GAO standards and DOD and Army policies which state that internal audit is a staff and advisory function and that auditors should not be given direct operating responsibilities.
2. The loan of auditors to the Army Materiel Command was directed by the Assistant Secretary of the Army for Financial Management to reconcile customer order records on an exception basis to meet a critical Army requirement. The TIG/AC and the Chief, AAA objected to this use of the audit staff. However, the directed loan and the professional accomplishments of the auditors involved contributed greatly to the correction of a major Army financial problem.
3. The Army fully agrees that auditors should not be committed to operational responsibilities. At the same time, the Secretary of the Army and the Chief of Staff Army have the management authority to use auditors, when necessary, for brief periods when audit expertise is required to serve the best interests of the Army.

RECOMMENDATION: The Secretary of Defense direct the Secretary of the Army to discontinue performing commander-requested audits.

ARMY POSITION: Concur in principle.

DISCUSSION:

1. Commander-requested audits consume approximately 2% of the total AAA audit effort. They are performed mainly because the commander's internal review group does not possess adequate personnel or skills. Until the internal review function is improved, the AAA will continue to perform commander-requested audits. In order to bring this program into full compliance with CAO standards and DOD policy, distribution of commander-requested audit reports will be the same as for other AAA reports.

2. The Army acknowledges that the internal review function needs to be strengthened so that the AAA can devote its professional staff to more mission oriented audits. A recent improvement in the internal review function is the fact that AAA has assumed the responsibility for training internal review personnel. This will raise the standards and value of the internal review function, improve the professionalism of internal review personnel, and improve operating efficiency in audit followup actions by commands. Ultimately, a strong internal review function in the Army will eliminate the need for AAA to perform commander-requested audits.

RECOMMENDATION: The Secretary of Defense direct the Secretary of the Army to discontinue audits of nonappropriated fund activities.

ARMY POSITION: Concur in principle.

DISCUSSION:

1. Congressional guidance requires the Department of Defense to support morale and welfare services. Audits are a critical management control on this requirement. To eliminate AAA audits of nonappropriated fund activities may pave the way for further erosion of appropriated fund support for essential morale and welfare activities. A decrease in appropriated funds for morale and welfare activities may be viewed by service personnel as a decrease in military benefits at a time when the Army cannot afford adverse publicity which could affect recruitment and retention. Therefore, the recommendation transcends purely audit considerations.
2. The key question is who will audit nonappropriated fund activities if the AAA does not. Audits performed by public accounting firms are normally limited to financial areas whereas audits by the AAA involve economy/efficiency and program results as well. Thus, the AAA can more comprehensively audit such activities. Other solutions include AAA auditing these activities but getting reimbursed from either the nonappropriated funds themselves or from a separate budget account and AAA sharing the workload with internal review groups. In addition, a more judicious selection by management of nonappropriated fund activities to be audited will decrease the number of these audits which are performed at the expense of appropriated fund activities audits. Toward this goal, AAA support of nonappropriated fund activities audits decreased from 19.7% in FY 73 to 6.2% in FY 76.
3. Because of the Army requirement to support morale and welfare activities, it is essential that these activities be audited. The AAA and possible internal review groups are the best organizations to do this; however, the Army will evaluate alternatives to more economically manage this requirement.

RECOMMENDATION: The Secretary of Defense direct the Secretary of the Army to allocate audit staff time to ensure that appropriately balanced audit coverage is given to financial/compliance, economy/efficiency, and program results.

ARMY POSITION: Concur.

DISCUSSION: The directed (50%) audit program in financial management was limited from inception to a 21 month period. AAA long range plans (FY 78-80) indicate that 25% of the total audit effort will be devoted to financial management. In addition, audits of financial operations are seldom pure financial and compliance type audits since often they encompass economy/efficiency and program results. The Army plans to operate a balanced audit program contingent upon management and user needs.



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RECOMMENDATION: Congress make more time available for DOD internal audit work by amending the law to relieve DOD of its responsibility for auditing the financial operations of the American National Red Cross.

ARMY POSITION: Concur.

DISCUSSION: This recommendation is logical and reasonable based on data presented in the GAO report. However, it should be noted that the internal audit capabilities of the AAA would not be significantly increased since only 1,000 staff days are spent on the Red Cross audits.

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DRAFT GAO REPORT

NEED TO STRENGTHEN THE ARMY'S INTERNAL AUDIT FUNCTION

CHAPTER 6

NEED FOR MORE EFFECTIVE FOLLOWUP OF AUDIT FINDINGS

**RECOMMENDATION:** To increase the effectiveness of the Army audit follow-up system, require the AAA to make timely follow-up reviews to determine whether appropriate corrective action has been taken on all significant audit findings.

**ARMY POSITION:** Concur in principle.

**DISCUSSION:**

1. The Army recognizes the benefits to be obtained by requiring timely follow-up reviews. Precise procedural changes will be developed to comply with the spirit of this recommendation, although not necessarily limiting the follow-up review role to auditors.
2. In some cases, follow-up reviews of significant audit findings can be performed by inspectors or auditors during regularly scheduled visits. Although perhaps less timely in some instances, this approach is more economical than special "timely follow-up reviews" and can be equally as effective. It is agreed that some audit findings merit early follow-up, and the Army will seek to do a better job in the future.

RECOMMENDATION: To increase the effectiveness of the Army's audit followup system, transfer the audit followup function from the OTIG/AG to the AAA.

ARMY POSITION: Nonconcur.

DISCUSSION:

1. GAO Standards of 1974 state: "Primary responsibility for action and followup on audit recommendation rests with management. . .The responsibility for such followup should be that of management officials, but the internal auditors should participate."
2. DOD Instruction 7600.3 states: "An independent office shall be assigned responsibility for monitoring action taken on audit reports to assure proper disposition of audit findings and recommendations. The office should be at a sufficiently high level to provide authority needed to adequately perform this function. . . It is preferable that this office not be assigned to the central audit organization."
3. Transferring the followup function from OTIG to the AAA is contrary to both GAO standards and DOD policy which state that compliance is a function of management. The transfer of this function would remove the independent review of audit recommendations. Responsibility for the direction of corrective actions emanating from audit findings must remain with the Chief of Staff, Army. To combine this responsibility with the audit function would create an unacceptable command authority.
4. The placement of the followup function in the OTIG is ideal since it rests in an authoritative position on the DA Staff and enhances the independence of followup evaluations. Most important, this organizational arrangement facilitates the correlation of common problems noted during audits and inspections thus providing Army managers with a constructive management tool to improve the functions they supervise.
5. Currently, procedures are being developed to strengthen followup responsibilities within the context of the regular IG process. Inspection teams will be provided in advance with information pertaining to audit report recommendations and will ensure that field elements are, in fact, following up.

RECOMMENDATION: To increase the effectiveness of the Army's audit follow-up system, instruct other Army organizations which the Audit Agency may charge with following up some internal audit findings, to provide written reports of the results of all such followup efforts.

ARMY POSITION: Concur in principle that the organization charged with audit followup should require written reports of followup results.

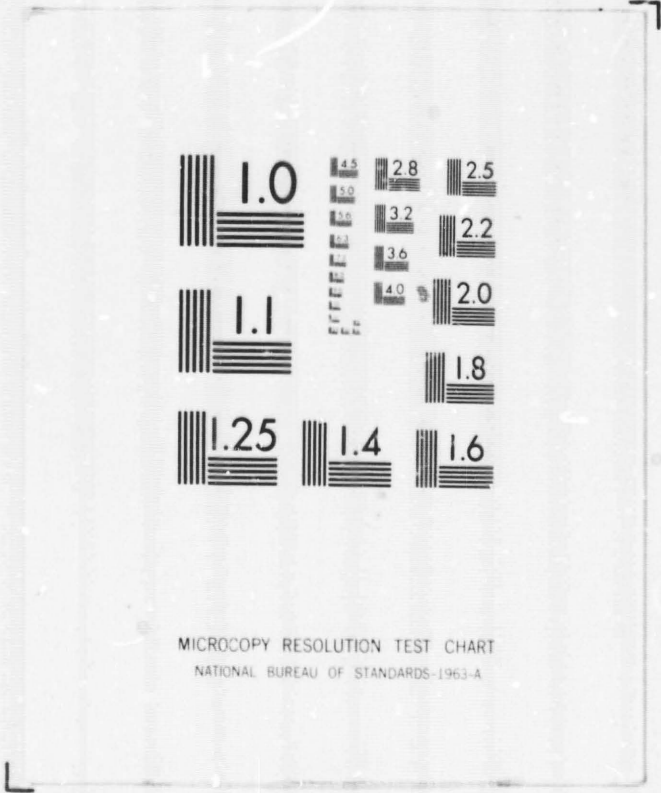
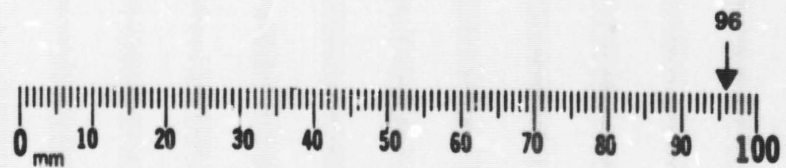
DISCUSSION:

1. As previously discussed, the Army does not agree that the audit follow-up function should be transferred to the AAA.
2. The Audit Compliance and Inspection Evaluation Division of the OTIG will be more thorough in future followup actions. Further, when an organization is tasked to perform followup reviews, the results will be reported to the requestor.

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RECOMMENDATION: To increase the effectiveness of the Army's audit follow-up system, require the Army Audit Agency to evaluate all such reports, together with detailed comments by audited installations and commands, to determine whether appropriate corrective action has been taken.

ARMY POSITION: Concur in principle.

DISCUSSION:

1. The recommendation involves the assessment of follow-up reports of corrective action on audit findings by the AAA. This is currently being done by the AAA and will continue.
2. The AAA reviews all corrective action replies regarding audit findings, at least twice. This review process starts with the command reply to Tentative Findings and Recommendations, and the results are recorded in audit reports. The AAA reviews and comments on the official command replies which are submitted approximately 60 days after publication of audit reports. These comments provide constructive advice and recommendations on further actions required by HQDA. In short, the AAA is constructively involved in the follow-up process.



RECOMMENDATION: Require the Audit Agency to periodically report the results of follow-up evaluations in summary form to top management officials.

ARMY POSITION: Concur in principle.

DISCUSSION:

1. As discussed previously, this task will be performed by the Audit Compliance office of the Comptroller of the Army. The value of keeping top managers informed of the results of audit follow-up evaluations is recognized. The Army believes that this task is both desirable and essential, particularly in the area of improved resource management.
2. The AAA contributes to this reporting process through continued review and analysis of corrective action replies.

PRINCIPAL OFFICIALS  
RESPONSIBLE FOR ADMINISTERING ACTIVITIES  
DISCUSSED IN THIS REPORT

Tenure of office  
From                      To

DEPARTMENT OF DEFENSE

SECRETARY OF DEFENSE:

|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Harold Brown                         | Jan. 1977 | Present   |
| Donald H. Rumsfeld                   | Nov. 1975 | Jan. 1977 |
| William F. Clements, Jr.<br>(acting) | Nov. 1975 | Nov. 1975 |
| James R. Schlesinger                 | July 1973 | Nov. 1975 |

DEPARTMENT OF THE ARMY

SECRETARY OF THE ARMY:

|                       |           |           |
|-----------------------|-----------|-----------|
| Clifford L. Alexander | Feb. 1977 | Present   |
| Martin R. Hoffman     | Aug. 1975 | Feb. 1977 |
| Howard H. Callaway    | May 1973  | July 1975 |

CHIEF OF STAFF:

|                           |           |            |
|---------------------------|-----------|------------|
| General Bernard W. Rogers | Oct. 1976 | Present    |
| General Fred C. Weyand    | Oct. 1974 | Sept. 1976 |
| General C. W. Abrams      | Oct. 1972 | Sept. 1974 |

INSPECTOR GENERAL AND AUDITOR

GENERAL:

|                                      |           |           |
|--------------------------------------|-----------|-----------|
| Lt. General Marvin D. Fuller         | Nov. 1976 | Present   |
| Lt. General H. N. Maples             | Mar. 1974 | Oct. 1976 |
| Major General Ronald J.<br>Fairfield | Oct. 1973 | Feb. 1974 |

CHIEF, ARMY AUDIT AGENCY:

|                                  |            |           |
|----------------------------------|------------|-----------|
| Major General H. S. Long, Jr.    | Sept. 1974 | Present   |
| Major General Donald H. McGovern | Sept. 1973 | Aug. 1974 |

