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By law, the head of each Government agency must set up and maintain systems of accounting and internal control, of which internal audit is an integral part. In the Navy, internal auditing is done by the Naval Audit Service under the direction of the Assistant Secretary of the Navy for Financial Management, who also serves as Comptroller. Findings/Conclusions: The Navy should make its internal audit stronger to keep top management better informed on how operations are conducted and recommendations for improvement are carried out. The internal audit function is not placed high enough in the Navy's organization to grant auditors maximum independence in conducting and reporting on audit work. The current organizational structure is inconsistent with the Comptroller General's audit standards which advocate that the audit function be placed at the highest practical level. The Department of Defense policy requires all nonmilitary positions to be filled by civilians. Contrary to this policy, the Audit Service is headed by a military officer and it employs 34 other military officers. The Naval Audit Service has been unable to meet its audit goals and has a large audit backlog, due in part to the massive workload and the use of audit resources on work not in keeping with its primary mission. The Navy's audit followup system does not provide assurance that all deficiencies identified by audits are promptly corrected. Opportunities for savings are lost and inefficient and ineffective operations continue. Recommendations: The Secretary of Defense should use his reorganization authority to relocate the Naval Audit Service under the Secretary or Under Secretary of the Navy and direct the audit staff to report directly to that official. The Secretary of Defense should direct the Secretary of the Navy to fill all positions, including the Director, with professionally

qualified civilians and improve the Audit Service's ability to cover its workload. Alternatives to be considered are to: reduce significantly the use of audit staff on special requested and nonappropriated fund work and bring the audit workload and staff capability into balance; and strengthen the audit function and require the Naval Audit Service to participate more fully in the process. (Author/SW)

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REPORT TO THE CONGRESS



BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

The Naval Audit Service Should Be Strengthened

The Navy could obtain greater management benefits from internal auditing by

- placing the audit function at a higher organizational level,
- filling all military positions with qualified civilians,
- bringing the audit workload and staff capability into balance,
- reducing the use of auditors on work that is not fully productive, and
- strengthening the audit followup system.



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

B-134192

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

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

This survey is 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.

The report is being issued without agency comments. The Department of Defense did not comment within the 30 days we gave them or within the 60 day extension we allowed.

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


ACTING Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE NAVAL AUDIT
SERVICE SHOULD BE
STRENGTHENED

D I G E S T

By law, the head of each Government agency must set up and maintain systems of accounting and internal control, of which internal audit is an integral part. In the Navy, internal auditing is done by the Naval Audit Service under the direction of the Assistant Secretary of the Navy for Financial Management, who also serves as Comptroller.

FINDINGS AND CONCLUSIONS

The Navy should make its internal audit stronger to keep top management better informed on how operations are conducted and recommendations for improvement are carried out.

The internal audit function is not placed high enough in the Navy's organization to grant auditors maximum independence in conducting and reporting on audit work. The current organizational structure is inconsistent with the Comptroller General's audit standards which advocate that the audit function be placed at the highest practical level. (See pp. 3 to 6.)

Department of Defense policy requires all nonmilitary positions to be filled by civilians. Contrary to this policy, the Audit Service is headed by a military officer and employs 34 other military officers. (See pp. 7 to 10.)

The Naval Audit Service has been unable to meet its audit goals and has a large audit backlog. This is due in part to the massive workload and the use of audit resources on work that is not in keeping with its primary mission. (See pp. 11 to 16.)

FGMSD-78-5

The Navy's audit followup system does not provide assurance that all deficiencies identified by audits are promptly corrected. Opportunities for savings are lost and inefficient and ineffective operations continue. (See pp. 17 to 19.)

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

The Secretary of Defense should use his reorganization authority under 10 U.S.C. 125 to relocate the Naval Audit Service under the Secretary or Under Secretary of the Navy and direct the audit staff to report directly to that official. (See p. 5.)

Also, the Secretary of Defense should direct the Secretary of the Navy to:

- Fill all positions, including the Director, with professionally qualified civilians. (See p. 10.)
- Improve the Audit Service's ability to cover its workload. Alternatives to be considered are to reduce significantly the use of audit staff on special requested and nonappropriated fund work and bring the audit workload and staff capability into balance. (See p. 16.)
- Strengthen the audit followup function and require the Naval Audit Service to participate more fully in the process. (See p. 19.)

RECOMMENDATION TO THE CONGRESS

In order to assure that the greater audit independence recommended is maintained in the future, we also recommend that the Congress amend the National Security Act of 1947, as amended, to place the internal audit functions of the three military departments under the Secretary or Under Secretary of the respective departments and have the internal auditors report directly to those officials. This recommendation was made in a previous report (FGMSD-77-49, July 26, 1977).

Because the Subcommittee on Legislation and National Security, House Committee on Government Operations, requested a November 3, 1977, release date, this report is being issued without agency comments. The Department of Defense did not comment within the 30 days GAO gave them or within the 60 day extension GAO allowed.

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ABBREVIATIONS

ADP	automatic data processing
CPA	certified public accountant
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration

CHAPTER 1

INTRODUCTION

Section 113 of the Accounting and Auditing Act of 1950 made top management within each Federal agency responsible for its internal 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 recognized the growing information needs of public officials, legislators, and the general public, and established a framework for full-scope examinations of Government programs by independent and objective auditors. In August 1974 we incorporated the standards in a revised policy statement entitled "Internal Auditing in Federal Agencies." In 1973 the General Services Administration (GSA) issued Federal Management Circular 73-2, setting forth policies to be followed by agencies in audits of Federal operations and programs.

The Department of Defense (DOD) and its component military departments and agencies have joined with the Congress, our office, and GSA in recognizing the importance of and the need for (1) internal audit, (2) performance standards for a wide range of audit services, and (3) policies for implementation and guidance of internal audit organizations.

INTERNAL AUDITING IN THE DEPARTMENT OF THE NAVY

The Naval Audit Service is the internal audit organization of the Department of the Navy. It is headed by the Auditor General of the Navy, who is a member of the military and serves collaterally as the Director of the Naval Audit Service. In fiscal year 1976 the Audit Service reported over \$177 million of potential savings. Of this amount \$64.4 million was recovered by major claimants and reapplied in other programs. Compared with total annual costs of audit operations of about \$13 million, these recovered savings represent a return on investment of 4.9 to 1.

The Naval Audit Service Headquarters is located in Falls Church, Virginia. The operating elements of the organization are located in four regional offices: northeast region, Camden, New Jersey; capital region, located with Headquarters in Falls Church, Virginia; southeast region, Virginia Beach, Virginia; and the western region, San Diego, California.

PREVIOUS REVIEWS AND EVALUATIONS OF THE NAVAL AUDIT SERVICE

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

SCOPE OF REVIEW

Our survey of the internal audit activities of the Naval Audit Service was conducted during the period August 1976 to March 1977. Site visits were made to the southeast and western regions and meetings were held with appropriate officials at the capital region and Naval Audit Service Headquarters. We wanted to know whether the internal audit functions of the Naval Audit Service were being performed in accordance with our audit standards and were being effectively and efficiently carried out.

The Audit Service enjoys a high level of competence and professionalism among its staff. Generally, internal audit policies, plans, and operations comply with the requirements of an effective internal audit system. However, we believe that the independence and effectiveness of the Naval Audit Service can be enhanced as discussed in succeeding chapters.

CHAPTER 2

THE INTERNAL AUDIT FUNCTION SHOULD BE LOCATED

AT A HIGHER ORGANIZATIONAL LEVEL

The Naval Audit Service is not placed high enough in the Navy's organization to insure that its auditors have maximum independence in 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 Naval Audit Service does not provide this assurance.

GAO POSITION ON PLACEMENT OF AUDIT

We have consistently advocated that

--the positions of internal auditors in an organization should be such that they are independent of the officials who are responsible for the operations the auditors review and

--to provide an adequate degree of independence, internal auditors 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.

We have also pointed out that, for internal auditing to be of maximum usefulness, the internal auditor should be free to determine the scope and character of the audit and the content of the audit report. Navy auditors have not been free to do this, in our opinion, because they are not totally independent of officials who are responsible for some of the operations they review.

LOCATION OF AUDIT IN THE NAVY

Organizationally the Naval Audit Service is under the Assistant Secretary of the Navy (Financial Management), who also serves as Comptroller of the Navy and senior automatic data processing (ADP) policy official for the Navy. The Assistant Secretary, as Comptroller, is responsible for budgeting, accounting, progress and statistical reporting, providing financial assistance to defense contractors, internal auditing, and for the management information system and related management functions within the Department of the Navy. As the senior ADP policy official for the Navy, he is required to

- implement the ADP program within the Department of the Navy,
- approve the acquisition of ADP equipment by contractors,
- establish criteria for the validation of data processing requirements, and
- issue procedures for the review and approval of the Navy's ADP resources.

LIMITATIONS ON REPORTING

As a result of the organizational placement of the Naval Audit Service, the Assistant Secretary of the Navy (Financial Management) has been able to place limitations on reporting of the Audit Service. Placement of the Auditor General as coequal to some management positions within the Office of the Comptroller of the Navy has caused dissention when in-house disagreements arise over audit findings. Using his authority, the Assistant Secretary has promulgated a "working agreement" for his staff as a solution.

In April 1975 the Assistant Secretary established special procedures for resolving in-house disagreements on audit reports. He reported that, in the past, audit reports had sometimes included recommended changes to the Navy Comptroller's policies and procedures which were not fully concurred in by management. The Assistant Secretary reasoned that this practice of publishing audit reports showing unresolved disagreements within the Comptroller organization would no doubt confuse field activities as to the correct guidance to follow--the Audit Service or the Comptroller. Under the special procedures, any management responses from the Office of Budgets and Reports; Assistant Comptroller, Financial Management

Systems; and General Counsel sections of the Comptroller's organization which expressed disagreement with audit findings or recommendations are to be referred to the Deputy Comptroller for resolution before publication. This can and does give the Deputy the power to limit disclosure of controversial findings.

One such case occurred during a fiscal year 1976 review of the Navy Finance Information System. The Assistant Comptroller of the Navy for Financial Management Systems did not concur with a finding which reported that he had exceeded his approval authority for contracting for automatic data processing services. In a memorandum to the Deputy Comptroller, the Auditor General stated that a full disclosure of this finding was in consonance with their other activities in the ADP world and should be reported to insure the proper handling of these matters by other auditable activities. After discussing the matter with the Deputy Comptroller, the Auditor General directed that the controversial finding be removed from the final report.

CONCLUSIONS

Under the current organizational arrangement, the Audit Service is too far removed from the highest organizational level of the Navy to insure maximum audit independence and effectiveness and appropriate management attention to audit findings.

The Assistant Secretary of the Navy (Financial Management) is responsible for all budgeting, accounting, progress and statistical reporting, management information systems, and ADP programs within the Department of the Navy. The inclusion of the internal audit function with these other responsibilities has resulted in unnecessary limitations on reporting of the Naval Audit Service. Further, it can contribute to the appearance of impaired independence since one individual is responsible not only for the performance of the audit but also for the day-to-day operations of some of the organizations audited.

Audit independence in the Department of the Navy would be enhanced and audit results improved by placing the audit staff directly under the Secretary or the Under Secretary.

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We recommend that, to improve the effectiveness of internal auditing in the Department of the Navy and to help insure maximum audit independence in accordance with our standards,

the Secretary of Defense place the Naval Audit Service under the Secretary or Under Secretary of the Navy and direct the staff to report directly to that official.

RECOMMENDATION TO THE CONGRESS

In order to assure that the greater audit independence recommended is maintained in the future, we also recommend that the Congress amend the National Security Act of 1947, as amended, to place the internal audit functions of the three military departments under the Secretary or Under Secretary of the respective departments and have the internal auditors report directly to those officials. This recommendation was made in a previous report (FGMSD-77-49, July 26, 1977).

CHAPTER 3

MORE NAVAL AUDIT SERVICE AUDIT POSITIONS

SHOULD BE CONVERTED TO CIVILIAN

The positions of Director and Deputy Director of the Naval Audit Service and most audit positions currently filled with military personnel should be filled with qualified civilians.

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 October 1976 article for the Defense Management Journal, 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."

DOD policy notwithstanding, the Navy has followed the practice of appointing high-ranking military officers to the positions of Director, Deputy Director, and District Office Director(s) of the Naval Audit Service. Because military officers are subject to periodic rotation, there have been many incumbents. Since 1970, the Audit Service has had four different military directors.

At the end of fiscal year 1976, the Naval Audit Service employed 35 military personnel, many of whom were in high level policy and management positions. Based on discussions with Audit Service officials, there appears to be no audit which specifically requires military staffing. However, the Auditor General and several of the military staff believe that, as a result of the diversity of the work performed, the audit experience generally makes officers more effective in accomplishing their responsibilities at subsequent duty stations than are officers of comparable rank not previously assigned to the Audit Service. Also, audit officials believe that, as a result of their training and background, military personnel are more oriented toward combat-related functions and are thus better able to audit these areas than civilians of comparable grade.

While there may be some advantage to appointing a small number of military staff to positions as management interns or in training positions, military personnel are not needed to audit combat-related functions. Other defense audit agencies have for a long time successfully reviewed combat-related functions without military staffing. In our opinion, audits of combat-related or tactical functions are not unique. The audits are conducted by comparing performance with standards prescribed by both military and civilian personnel. In this kind of audit, auditors review reported accomplishments, compare them to the prescribed standards, and determine whether the standards have been met. Military personnel are not necessarily better able to do this than civilians. For instance, using these and other generally accepted auditing techniques, it is not necessary for auditors to know how to shoot a rifle to determine whether the rifle has been accurately fired, or well maintained.

OPPORTUNITY TO REALIZE SAVINGS

Public Law 93-365, dated August 5, 1974, states that:

"It is the sense of Congress that the Department of Defense shall use the least costly form of manpower * * * consistent with military requirements and other needs of the Department * * *."

The 1976 Department of Defense Appropriation Bill contained data resulting from the Committee on Appropriations' review comparing military and Federal civilian compensation levels. The Committee's report included an analysis of both direct and indirect compensation. Factors included in the military's total compensation and benefits were basic pay, actuarial evaluation of retirement, health care, commissary and exchange, and the Government's contribution to social security. Civilians' total compensation and benefits consisted of the average base pay for classified personnel at step five of each pay grade, overtime and holiday pay, retirement, life insurance, and health benefits. The Committee said it was not in a position to state unequivocally that the military is or is not better paid than civilians. It did say, however, that its analysis represented a reasonable comparison. The schedule below presents data taken from the report.

<u>Military</u>		<u>Comparable GS civilian grade</u>	<u>Military cost over civilian</u>
<u>Rank</u>	<u>Grade</u>		
Rear Admiral	07	17/16	\$7,536
Captain	06	15	4,456
Commander	05	14/13	3,970
Lieutenant Commander	04	12	3,703
Lieutenant	03	11/10	4,255
Lieutenant J.G.	02	9/8	5,326

Using these figures we estimate that the Naval Audit Service would save about \$162,000 annually if a totally civilian staff were employed.

CONCLUSIONS

The positions of Director, Deputy Director, District Office Director, and other military positions of the Naval Audit Service entail skills found in the civilian community and do not require the factors set forth by DOD criteria for using military personnel. These positions should be filled by highly qualified civilians with extensive experience in audit management. This arrangement not only would be consistent with DOD policy but would result in reduced costs, would provide a longer tenure for incumbents of the positions, and

would result in greater continuity of management policies and procedures.

An Advisory Committee to the American Institute of Certified Public Accountants reached similar conclusions 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 and most of the staff of each of the audit groups in DOD (including the Naval Audit Service) be civilians with expertise in audit management. The committee pointed out that these recommended changes

"* * * 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 * * *."

The committee further concluded that the recommended changes would provide more attractive career opportunities for professional auditors and would improve the likelihood of attracting and retaining highly competent people.

RECOMMENDATIONS

To enhance career opportunities for professional auditors and to attract and retain competent people, we recommend that the Secretary of Defense direct the Secretary of the Navy to

- redesignate as civilian the positions of Director, Deputy Directors, and directors of district offices of the Naval Audit Service and, as they become available, fill these positions with qualified civilian personnel and
- as they become open, staff other military positions with qualified civilian personnel.

CHAPTER 4

AUDIT STAFF COULD BE USED MORE EFFECTIVELY

The Naval Audit Service has not met its audit goals and has accumulated a large audit backlog. This is due in part to its workload and the use of audit time on work that is either not consistent with the Audit Service's primary mission or is not sufficiently productive to warrant allocation of scarce audit staff resources.

The Audit Service's primary responsibility is to provide the Navy at all levels with an independent and objective internal audit service which evaluates the effectiveness of the Navy's control and management of resources. Implicit in its 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.

IMBALANCE BETWEEN WORKLOAD AND STAFF

In 1974 the Assistant Secretary of Defense (Comptroller) placed special emphasis on increasing the effectiveness of internal auditing in the Department of Defense. A joint study group was formed consisting of representatives from each DOD audit organization. The first area reviewed was the workload of the internal audit organizations within DOD.

The study group compared Naval Audit Service resources with its identified workload and concluded that the Audit Service did not have sufficient resources to achieve biennial audit coverage of activities--the cycle established by DOD Instruction 7600.3. Based on personnel strength as of June 30, 1974, and the percentage of time directly attributable to audit during fiscal year 1974, the study group reported that the Audit Service would require 6.2 years of concentrated effort to perform a complete audit of all Navy entities. At four Naval Audit Service offices the study group noted that audit cycles ranged from 8 to 15 years as shown in the following schedule:

	<u>Direct man-hours</u>		<u>No. of years required to complete one cycle</u>
	<u>Audit workload</u>	<u>FY 1974 program</u>	
Aviation Supply Office	157,250	10,400	15.1
Naval Air Station, Alameda	88,500	8,400	10.5
Naval Air Station, Norfolk	60,600	6,100	9.9
Ships Parts Control Center	98,500	11,700	8.4

In February 1976 the Naval Audit Service completed a staffing study which was conducted primarily to determine the personnel resources needed to meet its projected workload requirements, including the elimination of the current audit backlog, through fiscal year 1980. The recommended target manpower strength and yearly staff increases needed to achieve it are presented in the following schedule.

	<u>Fiscal year</u>				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
Target	729	729	729	729	729
Staffing	<u>a/572</u>	590	633	680	729
Shortfall	157	139	96	49	-

a/Actual fiscal year 1976 ending strength.

CURRENT AUDIT BACKLOG

The Audit Service backlog is made up of four distinct areas. These are:

- Activities on the periodic inventory listing which are one or more years behind schedule.
- Activities on the periodic inventory listing which have never been audited.
- Activities not planned for audits.
- Navy ships.

In arriving at the projected manpower needs above, audit officials considered only the first two backlog areas.

As of October 1976, agency figures showed that, for approximately 30 percent (161) of the activities on the periodic inventory list, audit coverage is one or more years behind schedule. There are also 164 activities on the periodic inventory list which have never been audited. Audit

officials have projected that this combined backlog for 325 activities can be eliminated by fiscal years 1980 or 1981, but only if the Audit Service is permitted to attain the staffing level recommended in its study.

As noted, Audit Service officials did not consider ships or activities at which audits were not planned in their backlog statistics. Excluded were 475 active duty ships and 60 reserve force ships. The list of entities not planned for audits contains approximately 1,300 small activities that have never been audited and that would require an estimated 106 additional staff years to audit. This list was also excluded from the Audit Service's statistics. We believe that by not including ships and entities not planned for audits, the Audit Service has seriously understated its backlog and the staffing level required to meet its workload requirements.

OPPORTUNITY TO IMPROVE AUDIT CAPABILITY

With the audit workload greater than staff capability, it is imperative that the Audit Service be prudent in utilizing its staff resources. The audit staff does several kinds of work which either are not consistent with its primary mission or are not sufficiently productive to warrant allocation of scarce staff resources. This work includes special request audits and audits of activities supported by nonappropriated funds.

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

Special request audits

The Naval Audit Service spends a considerable amount of staff time on audits specifically requested by commanders of naval installations and activities. These special audits are generally limited in scope to examination of a specific problem in response to a request from some management level. In fiscal years 1975 and 1976, the Audit Service spent 50,960 staff-hours on special request audits with limited report utilization and distribution and 71,136 staff-hours on special request audits with normal report utilization and distribution. The value of this combined service was about \$2.6 million, computed on the basis of the Audit Service's average cost per staff-hour.

Requests for audit assistance are handled on a case-by-case basis. Before acceptance, each request is investigated to ascertain

- the size and scope of the job and manpower requirements,
- the impact on audits in progress or scheduled, and
- whether action within the purview of audit is actually required, or whether assistance from a source other than audit would be more appropriate.

In our 1968 report entitled "Internal Audit Activities in the Department of Defense" (B-132900), we noted that, in performing special request audits, DOD's internal audit organizations were limiting their reporting function and were performing as internal review groups rather than as internal audit organizations.

Audits of nonappropriated fund activities

The Naval Audit Service devotes a large amount of staff time to audits of activities which are operated primarily for the benefit of military personnel and their dependents. In fiscal years 1975 and 1976, it spent 66,976 staff-hours in auditing nonappropriated fund activities. The value of this service was about \$1.4 million, computed on the basis of the Audit Service's average cost per staff-hour. The Audit Service estimates it will spend 30,875 staff-hours (valued at about \$650,000) in making these audits in fiscal year 1977. The Audit Service is not reimbursed by the audited activities for the cost of this work.

There are several levels of audit inspection and review applied to Navy's nonappropriated fund activities. They include the local command, the immediate superior in command, the Bureau of Naval Personnel, certified public accountants (CPAs), and the Naval Audit Service. According to Naval Audit Service Instruction 7520.7A, a 2-year cycle has been designated for coverage of nonappropriated fund activities by the Audit Service. Although the Audit Service is not able to meet the 2-year cycle, the audit coverage of nonappropriated funds is, on a cyclical basis, relatively greater than the coverage of appropriated funds.

A report issued on October 30, 1972, by a special subcommittee of the House Armed Services Committee discussed audit support provided to nonappropriated fund activities. 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 utilize appropriated-fund resources.

The subcommittee recommended that the secretary of each military department establish an audit staff directly under him to audit all nonappropriated funds.

Audits of the Navy Relief Society

During the past few years, the Audit Service has performed semiannual audits of the Navy Relief Society Headquarters, a nonappropriated fund activity. These examinations covered transactions shown in the books and records of the Society. The audit for the year ended December 31, 1975, took about 750 direct staff-hours. The audit, completed in September 1976 for the 6-month period ended June 30, 1976, took about 500 direct staff-hours. Because of other workload requirements, the present Auditor General has requested that the Navy Relief Society utilize CPA firms for these audits.

CONCLUSIONS

The Naval Audit Service has not been able to cover its established workload--there is a large imbalance between its workload and the Audit Service's ability to meet it. It is important that the two be brought into balance so that the Audit Service can reduce its backlog and improve its audit coverage. Internal audit staffs should be of an adequate size to perform required audits within established time frames.

The Naval Audit Service devotes a substantial amount of staff time to marginally productive and nonmission-related audit work and to special request and nonappropriated fund audits. If these types of efforts were reduced, the Audit Service would have additional staff time available each year for carrying out its primary mission and reducing the current audit backlog.

The Audit Service's policy of conducting audits on specific problems, some with reporting limited to the requesting officials, results in reduced effectiveness of the auditing and reporting functions of a central audit agency. These types of efforts appear to be within the scope of internal review responsibilities for which a capability already exists at command levels.

The Audit Service has devoted too large an amount of staff time for audits of nonappropriated fund activities. Using internal auditors to review nonappropriated fund activities is questionable from a management viewpoint because these audits represent a free service provided at the taxpayers' expense to activities which were set up to be largely self-supporting.

RECOMMENDATIONS

We recommend that the Secretary of Defense direct the Secretary of the Navy to improve the Audit Service's ability to cover its workload. Among the alternatives to be considered are:

- Assess the minimum required workload of the Naval Audit Service and the capability of the audit staff to perform that work and take action to bring the two into balance,
- Significantly reduce the number of special request audits performed, and
- Reduce audits of nonappropriated fund activities.

CHAPTER 5

NEED FOR MORE EFFECTIVE FOLLOWUP OF AUDIT FINDINGS

The Navy'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 deficiencies identified. In our opinion, the true measure of an internal audit organization's effectiveness is its success in bringing about needed improvements. To 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 correction action.

GUIDANCE ON FOLLOWUP OF FINDINGS

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

Our guidance on internal auditing in Federal agencies recognizes that primary responsibility for action and follow-up on audit recommendations rests with management. Still, reporting a finding, observation, or recommendation should not end an internal auditor's concern with the matter. He should ascertain whether his recommendations have received serious management consideration and whether satisfactory corrective actions have been taken.

NAVAL AUDIT SERVICE FOLLOWUP IS SPOTTY

The Audit Service does not have a formal system that can effectively track the progress of findings and recommendations after reports are issued. Significant findings and recommendations in certain audit reports are selected for the attention of the cognizant assistant secretaries, the Under Secretary, and the Secretary of the Navy. These selected audit cases require senior Navy and Marine Corps officials to provide management's position on

- the adequacy of the corrective actions taken or planned by management,
- the propriety of the target dates for completion of unfinished corrective actions, and
- the reasons for nonconcurrence with any audit recommendations.

There have been only 10 such cases since 1972. Also, the Audit Service conducts followup reviews as requested by management or as directed by the Assistant Secretary of the Navy (Financial Management). In certain instances the Auditor General personally apprises management of the audit situation through letters. Still, these followup actions by the Audit Service have not been good enough.

The Audit Service has not established a formal followup system because it has not been directed to do so. Department of Defense Instruction 7600.3, amended November 28, 1975, specifies that an independent office should be assigned responsibility for monitoring actions taken on audit findings and recommendations, but does not designate the internal audit organization as this independent office. Navy instructions clearly require managers to monitor corrective actions but do not specifically require the Audit Service followup on its own reports.

During our review of audit reports, we noted that about one out of every six audit reports issued in fiscal years 1974 and 1975 contained "repeat findings," previously reported deficiencies which had not been corrected, as illustrated in the following schedule:

<u>Fiscal year</u>	<u>Number of repeat findings</u>	<u>Number of reports with repeat findings</u>	<u>Total number of reports issued</u>
1974	124	53	245
1975	105	39	347

Many of the repeat findings involve savings over long periods of time. For example, during an audit of the Naval Hospital, Key West, Florida, in fiscal year 1974, the Audit Service reported that savings would accrue if the manual switchboard at the hospital were converted to an automated dial system. The auditor's computations showed potential annual savings of \$17,556. Audit reports issued in May 1966 and October 1970 had also reported the same type of finding with command concurrence.

Another example occurred during audits of the Naval Regional Medical Center, Portsmouth, Virginia. In fiscal year 1974, the Audit Service reported that the Medical Center would realize savings through increased use of Federal sources of supply to satisfy material requirements. The auditors reviewed some procurement items and compared the cost of similar items in Federal supply sources showing that they could have been purchased at a savings of about \$90,900. This condition had also been reported in a previous audit report issued in October 1970 with command concurring.

CONCLUSIONS

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

The large number of repeat findings indicates the inadequacy of both management's implementation of audit recommendations and its present procedures for audit followup. In effect, Naval Audit Service's appraisals have not effectively insured appropriate followup actions by management. To correct this situation, the Audit Service should establish a formal followup system--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. The results of these evaluations should be summarized and reported to appropriate top management levels in the Navy.

RECOMMENDATIONS

To increase the effectiveness of the Navy's audit followup system, we recommend that the Secretary of Defense direct the Secretary of the Navy to:

- Require the Audit Service to make more followup reviews to determine whether appropriate corrective action has been taken on all significant audit findings.
- Instruct other Navy activities to prepare written reports as to the actions taken on audit recommendations and require the Audit Service to evaluate the reports to determine whether appropriate corrective actions have been taken.
- Require the Audit Service to periodically report the results of its followup evaluations in summary form to top management officials.

RESPONSIBILITIES OF THE AUDITOR GENERAL
OF THE NAVY/DIRECTOR, NAVAL AUDIT SERVICE

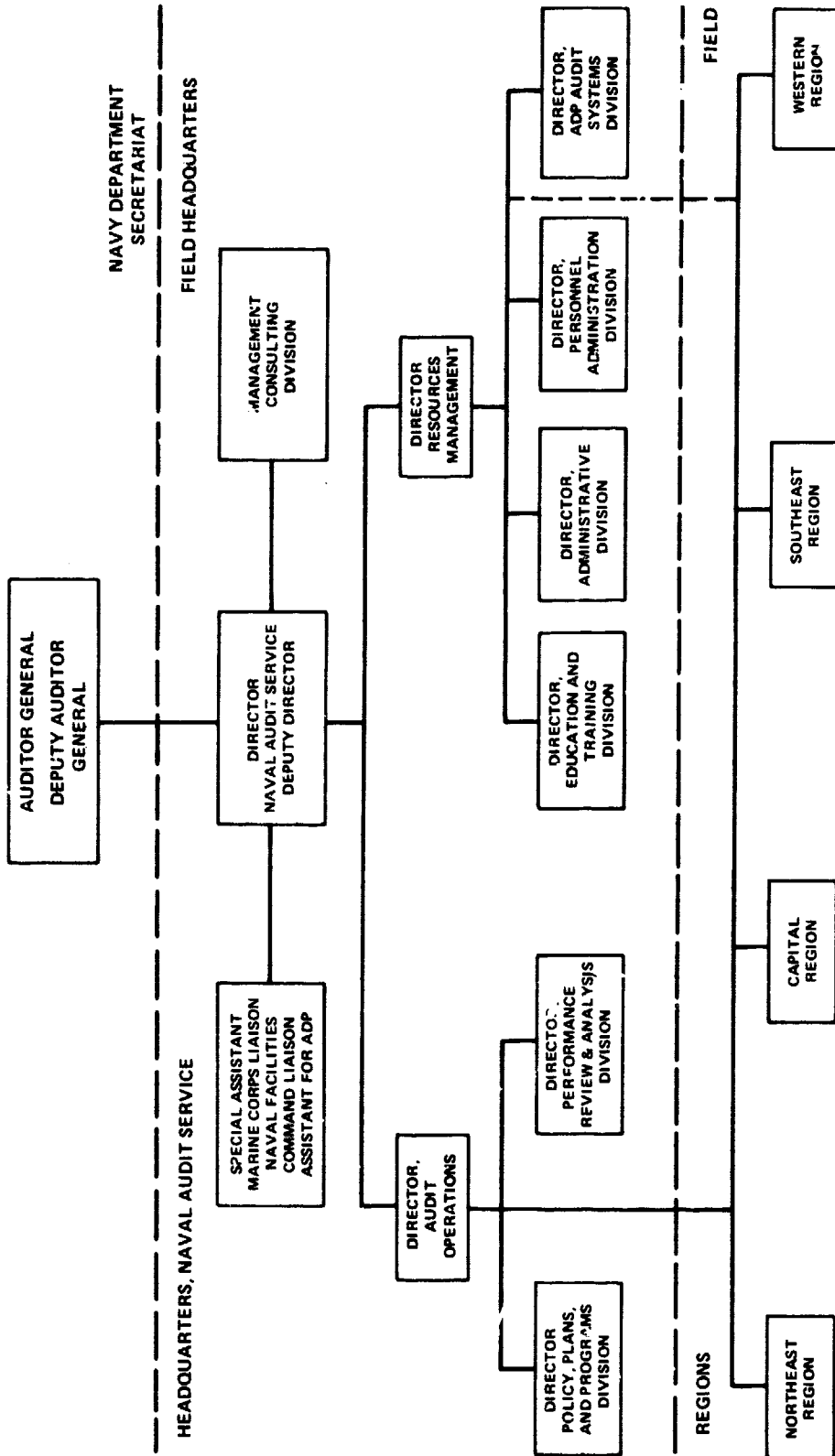
The Auditor General will

- be responsible for the implementation of audit policies established by the Comptroller of the Navy;
- coordinate internal audit matters with the General Accounting Office, the Office of the Secretary of Defense, defense agencies, and other military departments; and
- serve as Director, Naval Audit Service.

The Director, Naval Audit Service will

- as directed by the Deputy Comptroller of the Navy, be responsible for the command and primary support of naval field audit activities;
- develop internal audit principles and policies, and prescribe internal audit programs, methods, and procedures; and
- perform internal audits of all activities within the Department of the Navy, render reports thereon recommending corrective action where necessary.

OFFICE OF THE AUDITOR GENERAL OF THE NAVY



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 P. Clements, Jr. (acting)	Nov. 1975	Nov. 1975
James R. Schlesinger	July 1973	Nov. 1975

DEPARTMENT OF THE NAVY

SECRETARY OF THE NAVY:

W. Graham Claytor, Jr.	Feb. 1977	Present
G. D. Penisten (acting)	Feb. 1977	Feb. 1977
David R. MacDonald (acting)	Jan. 1977	Feb. 1977
J. W. Middendorf	June 1974	Jan. 1977
J. W. Middendorf (acting)	Apr. 1974	June 1974
John Warner	May 1972	Apr. 1974

ASSISTANT SECRETARY OF THE NAVY
(FINANCIAL MANAGEMENT)/COMPTROLLER
OF THE NAVY:

Rear Adm. J. R. Ahern (acting)	May 1977	Present
G. D. Penisten	Oct. 1974	May 1977
Rear Adm. S. H. Moore (acting)	Apr. 1974	Oct. 1974
Robert D. Nesen	May 1972	Apr. 1974

AUDITOR GENERAL OF THE NAVY/
DIRECTOR, NAVAL AUDIT SERVICE:

Rear Adm. P. H. Engel	May 1975	Present
Rear Adm. J. E. Forrest	July 1972	May 1975

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