BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Army

Department Of The Army's First-Year Implementation Of The Federal Managers' Financial Integrity Act

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

This report highlights the progress made and problems encountered by the Department of the Army in its first year of experience with this new act. The report focuses on the Army's efforts to evaluate internal controls, review accounting systems, and improve the evaluation processes as a result of identified problems.

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MAY 1, 1984

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The Honorable John O. Marsh, Jr.
The Secretary of the Army

Dear Mr. Secretary:

We have reviewed the Army's efforts to implement and comply with the Federal Managers' Financial Integrity Act of 1982. Our review was part of a GAO governmentwide assessment of the act's first-year implementation. The results of our review are summarized below. Additional information is included in appendix I along with the review's objective, scope and methodology.

We are pleased to report that the Army has made progress in complying with guidelines provided by the Office of Management and Budget (OMB) for evaluating internal controls. This effort is impressive considering the scope of the Army's program and the broad coverage of the Financial Integrity Act. The Army has also made reasonable efforts to determine conformance of its accounting systems with the Comptroller General's accounting principles and standards.

However, we did note some weaknesses in the processes involved in this first year's internal controls evaluations and accounting system compliance evaluations. These weaknesses need to be corrected to provide better assurance for future annual reports to the Secretary of Defense on the status of Army's financial and administrative controls.

THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT

The Federal Managers' Financial Integrity Act requires continuing evaluations and annual reports to the President and the Congress concerning the adequacy of each executive agency's systems of internal accounting and administrative control. The act also requires each agency to report annually whether its accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General of the United States. We believe full implementation of this act will enable you to identify major internal control and accounting

problems and improve controls essential to the development of an effective management control system and a sound financial management structure for the Army.

In December 1983, the Secretary of Defense provided his first annual report to the President and the Congress on DOD's compliance with the act. The report was based on separate reports from 24 DOD reporting centers, one of which was the Army. As required by DOD's implementing instructions, reports are to be provided each year and will be the basis for the Secretary of Defense's annual report.

In accordance with the act, the Director of the Office of Management and Budget has established guidelines for the agencies to evaluate systems of internal accounting and administrative control. These guidelines provide a basic approach for evaluating, improving, and reporting on internal controls. OMB recommends the following steps as an efficient, effective way to perform the required evaluations:

--Organize the internal control evaluation process.
--Segment the agency to create an inventory of assessable units.
--Conduct vulnerability assessments on assessable units to determine their susceptibility to waste, loss, unauthorized use, or misappropriation.
--Review internal controls.
--Take corrective actions.
--Report on the adequacy of internal controls and plans for corrective action.

THE ARMY'S INTERNAL CONTROL EVALUATION PROCESS

Considerable effort was made in organizing and institutionalizing the Army internal control program. Top level managers, in particular the Assistant Secretary for Installations, Logistics and Financial Management and the Vice Chief of Staff, have given this program their personal attention and commitment. Given this support, the Comptroller of the Army, who is responsible for organizing and directing the evaluation process, has sufficient authority to implement the program in accordance with OMB guidelines. In addition, the Auditor General was asked to independently review the effectiveness of program implementation as suggested by OMB and DOD; and feedback was provided to major unit commanders and to you. This is a traditional audit compliance role, and our work verified the accuracy of Army Audit Agency findings and the soundness of their recommendations.

Army regulation (AR) 11-2, which implements the act, complies with the policies and procedures suggested in the OMB guidelines. Army units were instructed to identify assessable units by functions within each organizational component as suggested by OMB. Implementation of this part of AR 11-2 provided broad coverage and, because of the highly decentralized nature of the Army, resulted in over 56,000 assessable units as of September 30, 1983.

The 45,000 vulnerability assessments reported by the Army were done primarily in two time frames--mid-to-late 1982 in response to early OMB and DOD criteria and mid-to-late 1983 in accordance with revised OMB guidelines and AR 11-2. Because of changing guidance, Army managers determined that most of the earlier assessments were unacceptable. For example, many assessments were not documented consistently. As a result, many of these assessments have been or will be redone prior to the second annual report. Moreover, we believe some of the later assessments are also unacceptable according to current Army and OMB criteria. For example, as with the earlier assessments, many of these later assessments did not adequately document full consideration of GAO's internal control standards. The Army is redesigning its entire internal controls evaluation process, and we believe the related development of more specific guidance and training should help improve the quality and consistency of future vulnerability assessments.

The internal controls review process, described in the OMB guidelines and AR 11-2, represents difficult and time-consuming tasks for managers. An internal control review is a detailed examination of a program or function's system of internal controls. We found a wide variance in the quality and documentation of these reviews. For example, some reviews were not sufficiently detailed to identify specific control weaknesses and provide a basis for corrective action. We also found that many internal control reviews did not adequately consider automated systems. We agree with the Auditor General that lower level managers need more specific training in conducting internal control reviews, and we believe that Army plans to redesign the evaluation process should help increase the usefulness of future internal control reviews.

Some followup and corrective actions were taken as a result of internal control reviews, but they were limited this first year. The Comptroller has identified responsible officials for each of the reported internal control weaknesses, and each major reporting unit will do the same. We believe prompt action to correct identified weaknesses is vital to this program, and we encourage your managers to continue to devote the resources necessary to do so.

In general, we believe the Army attempted to fully disclose areas of weakness in internal controls in its report to the Secretary of Defense. (See app. II.) However, this year's report was based mainly on issued audit reports and the assurances of knowledgeable managers rather than on the specific results of the internal controls evaluation process. We believe that future reports need to be better supported by the evaluation process established by OMB.

ACCOUNTING SYSTEM COMPLIANCE

Section 4 of the act requires a report on the status of accounting system compliance with the Comptroller General's principles and standards. We believe the Army has made reasonable efforts to identify accounting system components, to make initial determinations of compliance with Comptroller General principles and standards, and to identify areas of deficiency. For example, the Army report cites problems with general ledger control and cost accounting. (See app. II.) However, more needs to be done by the Army to better judge if accounting systems fully comply with the Comptroller General's accounting principles and standards. Army plans include more detailed compliance evaluations and development of a comprehensive inventory of accounting system components. These actions should enable you to make more meaningful annual statements.

CONCLUSIONS

In summary, the Army has made progress in implementing and complying with the act. The broad scope of the Army program has encouraged managers at all levels to develop an increased awareness of the importance of internal controls in preventing waste. In addition, Army plans for redesigning its internal control evaluation program and for providing more training for managers are expected to improve the quality of the individual evaluations and therefore the level of reasonable assurance you will have for future annual reports to the Secretary of Defense. We recognize that major efforts still lie ahead and believe that continued top management attention will be necessary to sustain the initiative gained this year and to effectively accomplish the intent of the act in the future.

AGENCY COMMENTS

We discussed a draft of this report with Defense officials and were subsequently given written comments. (See app. III.) Defense officials agreed with the factual content of the report and concurred with our proposed recommendation that the Comptroller (1) ensure that both general and application controls be reviewed on automated systems and (2) develop a process to coordinate evaluations of Army-wide standard automated systems.

We now believe that both Army and DOD officials recognize the special problems associated with internal control reviews of automated activities and that actions taken or planned should adequately address our concerns. Accordingly, we have not included a recommendation in this report, but we do plan to follow this issue as part of our continued monitoring of the Army's internal controls program.

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    We are sending copies of this report to the Chairmen of the House Committee on Government Operations and the Senate Committee on Governmental Affairs, as well as to the Chairmen of the House and Senate Committees on Appropriations, Armed Services and the Budget. We are also sending copies to the Director, Office of Management and Budget, and to the Secretary of Defense.

Sincerely yours,

Frank C. Conahan
Director

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C o n t e n t s

ABBREVIATIONS

ADP   Automated Data Processing

DOD   Department of Defense

GAO   General Accounting Office

OMB   Office of Management and Budget

OBSERVATIONS ON THE ARMY'S
FIRST-YEAR IMPLEMENTATION
OF THE FINANCIAL INTEGRITY ACT

INTRODUCTION

The Congress, in 1982, enacted the Federal Managers'
Financial Integrity Act, 31 U.S.C. 3512(b) and (c), in response
to continuing disclosures of waste, loss, and unauthorized use of
funds and property across a wide spectrum of government
operations. The act was to strengthen the existing requirement
of the Accounting and Auditing Act of 1950 that executive
agencies establish and maintain systems of accounting and
internal control to provide effective control over, and accounta-
bility for, all funds, property, and other assets, 31 U.S.C.
3512(a) (3).

We believe that full implementation of the Financial
Integrity Act will enable the heads of federal departments and
agencies to identify their major internal control and accounting
problems and to improve controls essential to the development of
an effective management control system and a sound financial man-
agement structure for their agency. To achieve this, the act
requires

--Each agency to establish and maintain its internal
   accounting and administrative controls with the
   standards prescribed by the Comptroller General.
   These standards are to reasonably ensure that (1)
   obligations and costs comply with applicable law,
   (2) all funds, property, and other assets are safe-
   guarded against waste, loss, unauthorized use, or
   misappropriation, and (3) revenues and expenditures
   applicable to agency operations are recorded and
   properly accounted for.

--Each agency to evaluate and report annually on
   internal control systems. These reports are to
   state whether agency systems of internal controls
   comply with the objectives of internal controls set
   forth in the act and with the standards prescribed
   by the Comptroller General. The act also provides
   for agency reports to identify material weaknesses
   involved and describe plans for corrective action.

--Each agency to prepare a separate report on whether
   the agency's accounting systems conform to the
   principles, standards, and related requirements
   prescribed by the Comptroller General.

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--The Office of Management and Budget (OMB) to issue
   guidelines for federal departments and agencies to
   use in evaluating internal accounting and
   administrative control systems. These guidelines
   were issued in December 1982.

--The Comptroller General to prescribe standards for
   federal agencies' internal accounting and
   administrative control systems. The Comptroller
   General issued these standards in June 1983.

On September 29, 1983, at a meeting of the assistant
secretaries for management, the Comptroller General outlined
expectations concerning agency efforts to report on conforming
accounting systems to Comptroller General principles and
standards (section 4 of the act). Recognizing that not all
agencies had begun to implement section 4, the Comptroller
General emphasized the following constructive actions which could
be taken to provide building blocks for future years'
implementation:

--Organize for completing accounting systems
   evaluations and issue needed written policies and
   procedures.

--Inventory accounting systems.

--Identify prior reported system deviations.

--Rank the systems according to the materiality of
   potential deviations from GAO's accounting
   principles and standards.

--Initiate reviews of systems.   ·

--Plan for the first year report.

This report on the Department of the Army is one of 22 GAO
reports on federal agencies' efforts to implement the act.

INTERNAL CONTROLS EVALUATION PROCESS

A brief status report follows on the Army's compliance with
OMB's guidelines for the evaluation of internal accounting and
administrative controls, the Auditor General's involvement, and
the Army's separate report on compliance of accounting systems
with Comptroller General principles and standards.

Management commitment

High-level management commitment to the internal controls program is encouraged by OMB. We found that the Army program has the active support of the Assistant Secretary for Installations, Logistics and Financial Management and of the Vice Chief of Staff. Further, top-level managers in major commands and staff offices were being held accountable for, and had become progressively more involved with, the program during this first year. Widespread endorsement of the program by these senior officials is important in the Army because of its very decentralized management/command structure.

Segmentation

OMB suggests that agencies segment themselves by organizations and major functions to help assure that responsible managers are identified for all assessable units. Army regulation (AR) 11-2 makes the Army's major commands and staff offices responsible for implementing the evaluation program. It directs them to identify assessable units by considering each of 27 major functions, which break down to 417 subfunctions, for each subordinate organization. Because the Army is highly decentralized, this process resulted in over 56,000 assessable units being identified by the Army, and we believe, in comprehensive coverage of organizational components, operations, functions, and programs.

Vulnerability assessment

The evaluation of an individual assessable unit's risk to waste, loss, unauthorized use, or misappropriation is called a vulnerability assessment. These assessments were first performed by the Army in 1982 in response to OMB guidance and DOD instructions. Army managers at many of the major commands and staff offices were assisted by a contractor during these first assessments. Later, after passage of the act and publication of AR 11-2, many units redid the earlier assessments because managers recognized that they were inconsistently documented and were inadequately carried out when compared to the later OMB and Army guidance. The Army's first year internal controls report to the Secretary of Defense stated that managers had assessed risks on about 45,000 units. The Army determined that risks were high, medium, or low on about 7,000, 12,000, and 26,000 units, respectively. The Army is currently developing more extensive training materials and redesigning the structure of the evaluation process.

Internal control review

Internal control reviews are the next step in OMB's evaluation process. We found that AR 11-2 guidance closely follows OMB criteria and that the Army reported that 8,300 reviews had been completed the first year. However, the actual reviews varied widely in quality and many were found to be inadequate when compared to AR 11-2. For example, some reviews were not adequately documented or did not include all of the steps recommended in the Army regulation. To address these and other problems in internal control evaluation, the Army is developing a new evaluation process which will include more specific guidance. The Army is also developing a training program.

Tracking

The Army is still organizing and defining various ways to keep track of all vulnerability assessments, internal control reviews, reported weaknesses, and approved corrective actions. These efforts reflect both the OMB guidelines and the Army's decision to make each successive organization responsible for monitoring its own evaluations and for promptly correcting identified internal control weaknesses.

Reporting

On November 15, 1983, the Secretary of the Army reported to the Secretary of Defense on the status of the Army's first-year implementation of the act. This report closely followed OMB's suggested format and described the evaluation process in an attachment. The report disclosed 53 areas of internal control weaknesses--22 were reported corrected and 31 in need of further corrective action. These areas represent a roll-up and refinement of over 190 weaknesses identified by individual major commands and staff offices. The Army stated that the reasonable assurance cited in its annual report is based on the assurances given by heads of organizational units, audit and inspection reports, Army regulations and other known forms of internal control.

Auditor General's role

The Auditor General, as the head of the Army Audit Agency, reviewed the act's implementation at 21 locations this first year. Army Audit Agency staff provided feedback to major unit commanders and the Auditor General reported to the Secretary that managers had made reasonable and conscientious efforts to implement the act. Even so, the Auditor General will soon issue a report which identifies various problems concerning managers' compliance with AR 11-2 and other guidance.

Accounting systems

The Army Comptroller's organization performed the accounting system compliance effort discussed below. The accounting systems inventory contained one military system composed of 75 operating system components, 16 of which were specifically determined to be materially in compliance with the Comptroller General's principles and standards. The compliance determinations consisted of judgements by system managers that the system components, approved in design by GAO, were still operating in accordance with their original designs. The Army's report to the Secretary of Defense identified areas of deficiency in the military system to include general ledger control and reporting; property accounting; cost accounting; pay entitlements; intransit and document float; timeliness; documentation; and interfaces between components. To correct system component deficiencies, the Army has initiated a major development program to redesign systems. The Auditor General reported that a reasonable reporting base was established, but that more needs to be done to fully disclose compliance.

IMPROVEMENTS NEEDED IN ARMY'S
INTERNAL CONTROLS EVALUATION PROCESS

We believe that the Army has made progress in implementing its internal controls evaluation process. However, continued attention by management is necessary in several parts of the process if the Army's annual report to the Secretary of Defense is to provide the level of assurance contemplated in the act and in the OMB guidelines. This is particularly true with regard to (1) the need for more specific guidance and training materials, (2) the evaluation of automated systems, and (3) accounting systems compliance efforts.

More Specific Guidance and Training
Needed to Improve Evaluations

We found that due to a lack of specific guidance and training materials, many of the Army's vulnerability assessments and internal control reviews were performed inconsistently or were inadequate when compared to OMB guidelines or AR 11-2. The Army Audit Agency, which also reviewed the Army's internal control compliance effort, reported similarly that the Army's assessment and internal control review results were inconsistent because of insufficient guidance and a lack of specific training for managers. We believe that the inconsistent and sometimes inadequate assessments and internal control reviews done by the Army may not provide a sound basis for this year's internal control evaluation report. Although the Army completed vulnerability assessments on 80 percent of its assessable units and internal control reviews on 15 percent of its assessable units,

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irregularities in the process may mean that some risks were
overlooked. As a result, significant internal control problems
and their associated material weaknesses may not have been
recognized.

Guidance

The following guidance problems adversely affected the
Army's internal control evaluation efforts:

--Guidance varied because OMB and Army guidance was pub-
lished at various times during the 18-month period in
which evaluations were done.

--Once guidance was published, distribution to managers was
slow.

--The Army regulation provided suggested formats but did not
require standard documentation; it did not contain
specific step-by-step instructions for persons doing
evaluations.

--No detailed guidance for evaluation of automated activi-
ties was issued.

The lack of specific guidance during the Army's multiphased
evaluation effort permitted variety in documentation. For
example, many risk assessments were incompletely documented and
internal control review records varied from one page to complete
documentation packages. Even at units that used the standard
forms provided in AR 11-2, review documentation was not always
sufficiently detailed to provide a basis for corrective action or
to allow a review of the validity of conclusions reached as sug-
gested by OMB guidelines.

Training

The following training deficiencies hampered the Army's
internal control evaluation process:

--Army-level training efforts were limited mainly to orien-
tation sessions.

--Little detailed how-to training was provided to persons
involved in the internal controls evaluation process.

--Major commands and staff offices devised their own train-
ing programs which varied in length and content.

--No special automated data processing training was provided
for persons involved in internal control evaluations of
automated activities.

Training deficiencies were especially noticeable in the
internal control review training provided line managers. Content
varied and sessions were often limited to a few hours of instruc-
tion or workshops which served only to acquaint managers with the
requirements and guidelines for conducting evaluations but did
not teach managers how to perform the actual evaluations.
Accordingly, managers' response to the training varied: some
considered it adequate while others remained confused about the
internal control process even after training.

Army Plans

Army officials agreed that consistency and adequacy were
problems with first year evaluations and have taken two actions
to change the evaluation process and improve its operation.
First, the Army plans to restructure its entire internal con-
trols evaluation process through a new approach which will
involve greater participation by functional managers on the Army
staff. This major restructuring is intended to better align the
individual manager's responsibilites with capabilities. It is
expected to improve internal control evaluations by simplifying
line manager participation in the process. It will also provide
more specific guidance and will encourage uniform methods and
documentation. The Army briefed key internal controls program
managers from major commands and staff offices on these plans in
late February 1984.

For example, under the new approach, functional managers on
the Army staff, such as the Deputy Chief of Staff for Logistics,
will provide detailed functionally-oriented checklists and for-
mats to assist lower level managers in their internal control
evaluations. To help eliminate duplication of effort for line
managers of similar functions, the standard materials will cover
such steps as the identification of event cycles, control objec-
tives and control techniques. (See glossary.) The new approach
is also expected to give lower level managers more of the tech-
nical guidance they need and to allow them to concentrate their
evaluation efforts on verifying (testing) that prescribed con-
trols are in operation.

Improvements in the adequacy of the internal control evalu-
ation process are expected to result from the redirected evalu-
ation program. Such a strengthening of the process will provide
a more meaningful basis for statements of reasonable assurance
required in future Army internal control reports to the Secretary
of Defense.

As a second action to improve its internal controls evaluations, the Army is developing a training program to provide managers instruction on the current internal control process. This program will complement planned DOD initiatives in internal control training for lower level managers. We believe these additional training materials are needed and should help correct the inadequacies and inconsistencies we noted in the current Army program.

Because the Army plans to make extensive revisions to its internal control evaluation program and is developing more specific internal control guidance and training materials for managers, we are not making a recommendation at this time. However, we do plan to follow the Army's efforts to improve the program during the second year, including activities leading up to the Army's annual report for 1984 on internal controls.

COMPREHENSIVE EVALUATION OF ADP CONTROLS NEEDED

The Army is highly dependent upon computers to carry out its mission and administrative functions. The Army mission and many of its functions, such as personnel, payroll, and supply, would be difficult to perform effectively without the aid of computers. Although ADP has a crucial role in many Army programs, our review showed that some automated systems were not considered by managers, while other Army-wide systems were not comprehensively evaluated. As a result, the Army lacks adequate assurance that internal controls of automated systems are functioning properly.

While the current OMB guidelines do not specifically address ADP issues in depth, draft OMB guidance is much more specific. OMB will suggest that managers include a review of automated systems within their evaluation of internal and administrative controls. Such reviews are to consider "general" controls such as security, system development and maintenance, computer operations, and backup and recovery procedures, as well as "application" controls, such as those pertaining to the input, processing, and output of automated data. AR 11-2 states, in very broad terms, that managers should be aware of the internal control strengths and exposures inherent in automated systems, and the regulation's transmittal letter suggested that managers should seek the help of computer specialists when conducting internal control evaluations of automated systems.

We found a general lack of attention to the evaluation of ADP controls at the offices and commands we visited. For example, at one Army staff office we visited neither the staff office nor its supporting system development unit looked at the automated systems for which the staff office was responsible. Moreover, we found that usually when controls over automated

systems were evaluated, only general controls were considered.
For example, the Depot System Command considered some of the
general controls when conducting internal control evaluations of
automated activities. However, when evaluating their major
Standard Depot System, no consideration was given to application
controls within the system.

The evaluation of internal controls for standard Army-wide
ADP systems poses special problems. Different Army organizations
are responsible for system requirements, design, and operation of
the system. No process exists to coordinate the evaluations of
all organizations involved in standard systems or to ensure that
standard systems are reviewed as a whole. Consequently, standard
automated systems are not being comprehensively evaluated. For
example, the Army's Finance and Accounting Center and the
Computer Systems Command designed and developed an Army standard
system which operates at about 60 financial stations throughout
the world. In order to evaluate the entire system of controls,
all of these organizations should participate in the internal
control review process. However, the organizations mentioned
above did not coordinate their efforts or combine and report
overall system review results.

As previously mentioned, we believe that most problems
relating to the review of automated systems were generally due to
inadequate detailed guidance and training provided to managers
involved in the evaluation of automated systems. In addition,
since Army-wide systems cross organizational lines, a process
must be developed to coordinate the various organization's inter-
nal control evaluations to ensure comprehensive coverage of the
entire system. Army officials acknowledged that application con-
trols may not have been adequately evaluated in fiscal year 1983
due to time constraints. They intend to place greater management
emphasis on reviewing both general and application controls in
the future. Moreover, Army's plan to redesign the internal con-
trols evaluation process should result in better guidance to line
managers who are evaluating automated systems and should help
solve the Army's coordination problems. Accordingly, we are not
making a recommendation at this time; however, we plan to review
future Army efforts to adequately evaluate ADP controls.

ACCOUNTING SYSTEM COMPLIANCE

The Army made reasonable efforts this first year to identify
accounting system components and determine accounting system com-
pliance with Comptroller General requirements. However, more
needs to be done by the Army to better judge if accounting sys-
tems fully comply with Comptroller General accounting principles
and standards and thus make annual statements more meaningful.
Specifically, the Army needs to (1) ensure that its inventory of

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accounting system components is complete, and (2) perform
operational evaluations of system components it reported in
compliance. For systems scheduled to be replaced, we believe
timely, cost-effective, interim corrections are important.

Accounting System Inventory Should be Complete

To ensure that all accounting system components are identi-
fied and evaluated for compliance with the Comptroller General's
accounting principles and standards, DOD instructed that a com-
plete systems inventory be developed and verified.

DOD guidance suggests that the inventory should include all
system components which authorize, account, and report on
appropriations. A complete inventory is vital because this is
the only way for an agency to know that it has under control all
operations involving the authorizing, recording, classifying, and
reporting of financial data related to revenues, expenses,
assets, liabilities and equity. By developing a complete
inventory, the Army would have a basis for assuring that all sys-
tem components are being evaluated.

The Army began developing a comprehensive accounting system
components inventory for the first year's report. The inventory
listed 75 system components. However, the Army did not com-
pletely validate the inventory during this first year because
time did not permit full field studies of all accounting
operations. Consequently, in January 1984, the Comptroller
instructed all Army fiscal stations and major account offices to
validate and update the accounting system components inventory.

Because the Army recognizes the importance of having a com-
plete inventory and has started the process of validating and
updating their inventory, we are not making a recommendation at
this time. We will, however, be following the progress being
made toward the development of a complete inventory of accounting
system components.

Limited Evaluations to Support Compliance

During this first year, the Army determined that 16 account-
ing system components were materially in compliance with GAO
requirements. In making these determinations, Army officials
considered (1) whether the accounting system design had been
approved by GAO, (2) audit findings regarding the systems, and
(3) judgment of knowledgeable managers. While the approach used
in the initial year adequately conformed to DOD guidance, we
believe that the Army should test systems in operation because
only through testing can one be assured that the system operates
as intended. This would make the annual conformance statements
more meaningful in future years.

In addition, of the 75 system components reported, 59 were
in noncompliance, although each component was not evaluated
against the specific Comptroller General's accounting principles
and standards. Rather, the Army had previously determined that
these components did not fully comply with Comptroller General
accounting requirements and had targeted them for replacement.

The Army plans to do more detailed compliance evaluations in
future years. For those system components reported in
compliance, the Army plans are still being developed but cur-
rently include a managers' checklist developed from the
Comptroller General's principles and standards. For those 59
components in noncompliance, the Army plans to replace the major-
ity of them as part of its major accounting systems development
program. The Army has thus far specifically identified 17 sub-
systems for replacement between January 1984 and October 1986.
For the remaining components, replacement dates are not yet
established but the Army reported plans to determine on a case-
by-case basis whether interim corrections to existing components
would be cost effective. We believe timely, cost-effective
interim corrections are important to maintain the integrity of
the accounting system components.

Because of these planned, expanded compliance evaluation
efforts, the potential cost-effective correction of weaknesses,
and the scheduled replacement of some of the components, we are
not making a recommendation at this time. We plan, however, to
follow the Army's progress.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate the Army's
progress in (1) implementing the Federal Managers' Financial
Integrity Act and (2) reporting the status of internal controls
and accounting systems. Because our first-year review was
limited to an evaluation of the implementation process, we did
not attempt to determine the status of the Army's internal con-
trol systems or the extent to which Army accounting systems
comply with Comptroller General principles and standards.

We reviewed the first year's implementation of the internal
controls evaluation program at 14 units. (See app. IV.) Within
these units, our review was generally limited to discussions with
key officials at headquarters and a few subordinate units. We
also reviewed available documentation relative to the evaluation
process, including a limited number of vulnerability assessments
and internal control reviews as well as the support for the
Army's first-year internal controls report.

Because our first-year work was limited to an examination of evaluation processes, and because of time constraints, we did not take valid, random, statistical samples of records. However, we did discuss data we reviewed and our analysis with agency officials during the review. We also closely coordinated our work with a similar review by the Army Audit Agency. Our work was conducted in accordance with generally accepted government audit standards.

REPORTED INTERNAL CONTROL AND
ACCOUNTING SYSTEM WEAKNESSES

The Army's report to the Secretary of Defense identified 22 corrected material internal control weaknesses as well as 20 Army-wide and 11 command-unique areas which contain material weaknesses in internal controls that were scheduled for correction. Actions taken, actions required, and scheduled completion dates were also listed in the report. The accounting compliance portion of the report addressed weaknesses related to the Army's military accounting system.

INTERNAL CONTROL WEAKNESSES CORRECTED

The Army's report to the Secretary of Defense highlighted corrected material internal control weaknesses. It stated that the Army had

--Conserved funds and improved mission performance by limiting incentive bonuses to those skills for which bonuses are necessary to meet Army needs;

--Realized significant savings by improving procedures for recovering precious metals;

--Reduced Federal interest costs by over $1.6 million in FY 1983 by improving Army cash control procedures;

--Avoided costs, estimated at $3.3 million for one weapon system, by more effective use of assets;

--Reduced transportation costs by improving delivery date determinations; and

--Corrected $71 million of accumulated errors in civil service retirement fund financial records.

ARMY-WIDE INTERNAL CONTROL
WEAKNESSES NEEDING CORRECTION

Automation Activities

° Management attention to automation security policies and procedures relating to control over, use of, and access to computers was not adequate and

° Inadequate planning and management in the justification, acquisition and operation of small computers was reported.

Base Support Services

   ° Diversion of food items and ineffective inventory
     practices were being investigated.

Financial Management

   ° Personnel turmoil caused by wholesale downgrading of
     travel voucher examining clerks has resulted in increased
     error rates and excessive delays in voucher payments;

   ° Army is experiencing difficulty in recouping all nonre-
     curring costs on direct sales by contractors to foreign
     customers;

   ° Current industrial fund revenue authorization request
     procedures understate amounts needed to achieve planned
     yearend cumulative operating results on multiyear orders;

   ° Accounting system changes are necessary to ensure that
     Foreign Military Sales customers are properly billed for
     the repair or rebuild of foreign owned military
     equipment;

   ° Physical security of cash and other sensitive assets
     needs improvement at several locations; and

   ° The military accounting system, in total, does not con-
     form to the Comptroller General's principles, standards
     and related requirements.

Industrial Preparedness

   ° Accountability and control over government material and
     property at contractor plants were not adequate.

Intelligence

   ° Technology transfer policy responsibility was diffused on
     the Army staff, impeding effective management of tech-
     nology transfer issues.

Maintenance

   ° The Army continues to be criticized for not properly
     determining maintenance expenditure limits for tactical
     wheeled vehicles and

° Policies and procedures were not adequate to prevent possible over-stockage of Operational Readiness Float material.

Personnel

° Retirement, death, and resignation claims were not being timely processed and

° Excessive course attrition and recycle rates in special forces training were caused by ineffective recruiting procedures.

Procurement

° Staffing and training is deficient at many locations and

° Replenishment spare parts acquisition controls were not being followed because of manpower constraints.

Supply

° War reserve stock policies and procedures need improvement and methods for distribution/redistribution to Reserve Forces are inadequate and

° Overall inventory controls are weak at many locations throughout the Army.

Transportation

° Procedures to account for and collect refunds due from passenger carriers for unused tickets, and for voiding them, need strengthening.

COMMAND-UNIQUE INTERNAL CONTROL
WEAKNESSES NEEDING CORRECTION

Base Support Services

° Span of control over commissaries is too great;

° Computer-generated recommended order quantity report for commissaries is unreliable due to high rates of input errors; and

° New dining facility plans did not adequately consider existing excess capacity at seven locations.

Command and Control

* Absence of a comprehensive installation-level management information system.

Procurement

* Fraud cited in the contractor fast payment orders system;

* Procedures were not followed to assure preparation of independent government estimates of costs;

* Procedures were not adequate to assure that contractor performance data were requested and used; and

* More timely pricing of delivery orders and deobligation of unneeded funds is necessary.

Supply

* Worldwide asset visibility system is obsolete and insufficent to assure adequate supply management.

Transportation

* Procedures are inadequate to reconcile and report discrepancies between actual and manifested quantities of accountable packing and lashing material and

* Cost analysis supporting the selection of transportation services for small lots of hazardous or sensitive cargo needs improvement.

ACCOUNTING SYSTEM COMPLIANCE

The Army report stated that it maintained two accounting systems--one in support of civil works functions, the other in support of military functions. The civil works system was reported to conform materially to the Comptroller General's principles and standards. The Army further reported that, as a whole, the military accounting system contains "good internal controls," but that some features of component subsystems do not adequately meet GAO standards.

The Army's report identified the following areas of
deficiency in its military accounting system:

* General ledger control and reporting   * Property Accounting
* Intransit and document float   * Cost Accounting
* Interfaces between components   * Documentation
* Pay Entitlements   * Timeliness

The Army reported that a complete redesign of its military
accounting system is underway. New systems will be designed to
1) take advantage of the latest data processing and communica-
tions technologies, 2) assure that proper accounting principles
and standards are employed, 3) establish effective internal
controls, and 4) expand the accounting functions into a modern
financial management information system. A general officer has
been designated as Project Manager for Army Financial Systems to
oversee this massive program.

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

COMPTROLLER

27 MAR 1984

Mr. Frank C. Conahan
Director, National Security
   and International Affairs
   Division
General Accounting Office
441 G Street, NW, Room 4804
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to General
Accounting Office (GAO) Draft Report, "The Department of the
Army's First Year Implementation of the Federal Managers'
Financial Integrity Act," dated March 12, 1984 (GAO Code No.
390000), OSD Case No. 6466.

DoD appreciates GAO's recognition of the Army's progress in
implementing the Federal Managers' Financial Integrity Act and
related instructions published by the Office of Management and
Budget. Efforts by the Army to comply with the internal control
requirements have indeed been monumental. The cooperative
attitude of the GAO staff and timely feedback and suggestions for
improvement throughout the review process are also appreciated.
Problems highlighted by the GAO review were a major factor in the
Army decision to make major adjustments in the way the internal
control program is administered in the Army. The revised approach
should resolve many of the problem areas identified in the Draft
Report.

The Department concurs in the recommendation set forth in the
Draft Report. Detailed comments on the recommendation are
enclosed.

Sincerely,

John P. Quetsch

Principal Deputy Assistant Secretary of Defense
(Comptroller)

Enclosure

                          DoD Comment
                             on
GAO Draft Report, "The Department of the Army's First Year
Implementation of the Federal Managers' Financial Integrity Act,"
dated March 12, 1984 (GAO Code No. 390000), OSD Case No. 6466

GAO RECOMMENDATION

     To ensure that automated activities meet internal control
requirements, we recommend that you direct the Comptroller to
(1) ensure that all automated activities are reviewed for both
general and applications controls, and (2) develop a process to
coordinate evaluations of Army-wide standard ADP systems. (p. 8,
Draft Report)

DoD COMMENT   [GAO NOTE: See p. 8, this report.]

     Concur. Under revised procedures now being staffed,
responsibilities for the conduct of the Army Internal Control
Program have been more clearly defined: (1) departmental level
functional proponents are responsible for designing sound internal
controls into the Army regulatory procedures and systems, and
(2) field operating managers are responsible for implementing/
sustaining these controls. Thus, functional proponents will
develop internal control checklists applicable to their
subfunctions to guide operating managers in testing to ensure that
specified controls are operative. Specifically, "General"
controls will be incorporated into checklists developed by the
functional proponents responsible for the "Automation Activities"
subfunctions. "Application" controls contained in standard
automated and manual systems which support Army subfunctions will
be incorporated into the checklists developed by the functional
proponents responsible for those subfunctions. Major Command and
operating activities will augment the checklists to incorporate
unique automated and manual systems controls which they have
added.

     The Army has existing automation life cycle management
procedures to ensure the integrity of standard Army-wide systems.
In the design and maintenance of automated systems, these
procedures result in a closed-loop process between the functional
proponent, the automation systems developed, and the systems user
to assure that application controls are prescribed, developed,
tested and implemented in an orderly manner. These procedures
provide the necessary process to coordinate evaluations of
standard Army automated systems.

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INTERNAL CONTROLS PROGRAM
REPORTING UNITS

ARMY SECRETARIAT

    1. Assistant Secretary of the Army for Installations,
       Logistics, and Financial Management

ARMY STAFF OFFICES
       Office of the Chief of Staff:

    2. Ballistic Missile Defense Program Office
    3. Operational Test and Evaluation Agency
1/   4. Concepts and Analysis Agency
    5. Command and Control Support Agency

       The Army Staff:

      6. The Inspector General
2/   7. The Auditor General
1/2/ 8. Comptroller of the Army
2/   9. Deputy Chief of Staff for Personnel
1/2/ 10. Deputy Chief of Staff for Operations and Plans
2/   11. Deputy Chief of Staff for Logistics
    12. Deputy Chief of Staff for Research, Development,
       and Acquisition
2/   13. Assistant Chief of Staff for Intelligence
    14. The Judge Advocate General
2/   15. Chief of Chaplains
    16. The Adjutant General
    17. Chief of Engineers
    18. The Surgeon General
    19. Chief, National Guard Bureau
2/   20. Chief, Army Reserve

    MAJOR ARMY COMMANDS

2/   21. U.S. Army Europe and Seventh Army
1/2/ 22. Materiel Development and Readiness Command
2/   23. Forces Command
2/   24. Training and Doctrine Command
    25. Intelligence and Security Command
    26. Communications Command
1/2/ 27. Military Traffic Management Command
    28. Military District of Washington
    29. Criminal Investigation Command
    30. Health Services Command
    31. Eighth Army
    32. U.S. Army Japan
    33. Western Command

1/ ADP-specific audit steps were performed at these reporting units.
2/ On-site audit work was conducted at these reporting units.

GLOSSARY

The following definitions were developed by GAO for our review of the implementation of the Federal Managers' Financial Integrity Act.

Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a governmental unit or any of its funds, or organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting and financial reporting.

Administrative Function

An activity in an agency which is carried out to support the accomplishment of an agency's programs, missions, or objectives. These activities may include ADP, travel, or consulting services. However, there is no uniform definition of administrative functions; each agency's may be unique.

ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to assure the quality of data origination, input, processing, and output.

ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include

> --organizational controls for the ADP unit;
> --system design, development, and modification
>   controls;
> --data center management controls;
> --data center security controls;
> --system software controls; and
> --hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

Agency Component

A major organization, program, or functional subdivision of an agency having one or more separate systems of internal control, and a specific, responsible manager.

Assessable Unit

A program or administrative function or subdivision thereof, which is to be the subject of a vulnerability assessment. An agency should identify its assessable units in such a way as to (1) include the entire agency and (2) facilitate meaningful vulnerability assessments. All agency programs or administrative functions must be assessed, with the exception of those involved in the performance of policymaking or statutory formulation.

Control Objective

A desired goal or condition for a specific event cycle, system, or subsystem. An agency's control objectives should be developed for each agency activity and should address the three objectives in the Federal Managers' Financial Integrity Act. An example of a control objective may be "Paychecks should be issued to all, and only, entitled persons." "Control Objectives" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Control Technique

Any mechanism relied on to efficiently and effectively accomplish a control objective. These mechanisms, if operating as intended, help prevent fraud, waste, abuse, or mismanagement. An example of a control technique might be the comparison of automated personnel and payroll master files prior to computing and issuing paychecks. "Control Techniques" are one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Documentation

That information which would allow an independent reviewer to reach the same conclusions as the original reviewer regarding an agency's internal controls; and the methods used, personnel involved, and conclusions reached in conducting its internal control evaluation, improvement, and reporting process. This information should be current and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Event Cycle

A grouping of similar activities. An entity's activities
can be grouped into a discrete number of cycles. These
groupings are based on what is accomplished, and therefore
facilitate the identification of cycle objectives. For
example, most agencies will have a disbursement cycle which
will include all events contributing to the objective of
providing reasonable assurance that all payments are legal,
proper, accurate, and timely.

General Control Environment

Those environmental factors that can influence the
effectiveness of internal controls over program and
administrative functions. An evaluation of the general
control environment is the first step in the vulnerability
assessment process required by OMB's Guidelines.

This evaluation may be performed for the component as a
whole, or individually for each program and administrative
function within the component. The determining factors
would be the size, nature, and degree of centralization of
the programs and functions conducted within the agency
component.

Inherent Risk

The inherent potential for waste, loss, unauthorized use,
or misappropriation due to the nature of an activity
itself. An analysis of each assessable unit's inherent
risk is the second step in the vulnerability assessment
process required by OMB's Guidelines. OMB's Guidelines
suggest that the matters to be considered in the analysis
should include, but need not be limited to, the following:
purpose and characteristics, budget level, impact outside
the agency, age and life expectancy, degree of
centralization, special concerns, prior reviews, and
management responsiveness.

Internal Controls

The plan of organization and all coordinate methods and
measures adopted by an agency to provide reasonable
assurance that the three objectives of the Federal
Managers' Financial Integrity Act of 1982 are achieved.
Internal controls should be established in accordance with
the Comptroller General's Internal Control Standards.
Typically, an internal control represents the combination
of a control objective along with a control technique (or
set of techniques) which are being relied on to achieve
that control objective.

Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost effective manner. OMB's Guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability; those most vulnerable should be reviewed first.

Internal Control Standards

In 1983, the Comptroller General issued a set of Standards For Internal Controls In The Federal Government. The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with these standards. There are five general standards, six specific standards, and one audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.

OMB Guidelines

The document issued by the Office of Management and Budget in December 1982, Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government. An evaluation conducted in accordance with these guidelines is to provide a basis for an agency's annual statement required by the act.

Program

Generally, an organized set of activities directed toward a common purpose or goal, and undertaken or proposed by an agency in order to carry out its responsibilities. In practice, however, the term "program" has many meanings. It is used to describe the agency's mission, functions, activities, services, projects, and processes.

Quality Assurance

The process(es) or system(s) of an agency which provide reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB Guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters, and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process, appropriate IG role in the process, adequacy of resources and overall organization of the process, appropriate training for managers with internal control responsibilities, and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

Reasonable Assurance

Internal control systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Segmentation

The process by which an agency identifies its assessable units; i.e., its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to pro-vide a basis for the conduct of meaningful vulnerability assessments. The OMB Guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory.

There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.

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Testing

The examination of available evidence to determine whether internal controls are functioning as intended. Testing is the fifth step recommended in OMB's Guidelines for the performance of an internal control review. The nature of the controls, the significance of the cycle, importance of control objective, the nature of the specific risks, possible compensating controls, testing resources, and timing must all be considered in developing appropriate tests. Generally, testing can be categorized as either "compliance" or "substantive." Compliance testing is generally used when the judgment regarding specific risk has given reason to rely on a control technique. It is designed to verify if one or more internal control techniques are operating. The other category of testing, "substantive" testing, is used when the specific risk is sufficiently great that the control cannot be relied on. A substantive test is designed not to verify the operation of a control technique but rather to verify the results of the process to which the control was applied.

Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB's Guidelines prescribe three basic steps for the conduct of vulnerability assessment: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards.

The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.

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