

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on
Readiness, Committee on Armed Services,
House of Representatives

December 1988

AUDIT RESOLUTION

DOD's Policy Can Be Strengthened





United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-226903

December 16, 1988

The Honorable Nicholas Mavroules
Chairman, Subcommittee on Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

As requested by the former Chairman, in July 1987 we reported instances in which better use could be made of audits conducted by Department of Defense (DOD) auditors.¹ Specifically, we reported delays of up to 2 years from agreed-upon schedules for implementing audit recommendations with potential monetary benefits of \$363 million and instances when the agreed-to recommendations were not implemented. As part of that request, we also reviewed the DOD policy for audit resolution to determine whether it sufficiently ensures that timely corrective actions are taken on internal audit recommendations.

Although DOD's Directive 7650.3 generally contains sound policy requirements for correcting the problems found by its auditors, we believe the directive could be more definitive regarding (1) the auditor's role in reviewing and commenting on management's plans and schedules to implement audit recommendations, (2) the types of follow-up reviews that are needed, (3) reports of delays to top management, and (4) the extent of records needed to substantiate the completion of corrective actions. We believe that including these more detailed requirements in the directive would help to prevent the type of conditions that we observed in our earlier report. We are recommending changes to Directive 7650.3 that would add the needed requirements.

Background

The Department of Defense has four central internal audit organizations² which are an integral part of the Department's internal controls over its operations. In fiscal year 1988, the auditors issued 2,355 reports containing several thousand recommendations to DOD managers to correct problems identified during the audits. The auditors estimated that the potential monetary benefits associated with these recommendations

¹ Audit Resolution: Responsiveness of Defense Management to Internal Audit Recommendations (GAO/AFMD-87-37BR, July 31, 1987).

² These are the Army Audit Agency, Air Force Audit Agency, Naval Audit Service, and the Department of Defense Office of Inspector General.

amounted to about \$4.3 billion. Consequently, the audits could have enormous value if management agrees with and implements the audit recommendations.

The Congress, the Office of Management and Budget (OMB), DOD, and GAO have long recognized the importance of internal auditors and the need for effective systems to ensure that timely corrective action is taken on audit findings. In several reports issued during the past decade, we have strongly recommended the need for clear government policies and effective systems for audit resolution. Congressional committees have held several hearings and have also made similar recommendations to the Executive Branch.

In response, OMB revised its policy for federal agency audit resolution contained in Circular A-50 in 1982. Circular A-50 requires agencies to establish audit resolution systems which ensure prompt and proper decisions on audit recommendations and implementation of corrective actions.

Also, GAO established an audit resolution standard on June 1, 1983, pursuant to requirements of the Federal Managers Financial Integrity Act of 1982. The standard, contained in Standards for Internal Controls in the Federal Government, states:

“Managers are to (1) promptly evaluate findings and recommendations reported by auditors, (2) determine proper actions in response to audit findings and recommendations, and (3) complete, within established timeframes, all actions that correct or otherwise resolve the matters brought to management’s attention.”

DOD established its audit resolution program in January 1981. DOD Directive 7650.3, dated March 19, 1985, governs audit resolution in DOD and incorporates governmentwide policies and standards. The directive calls for prompt, responsive, constructive, and corrective actions to be taken for agreed-upon recommendations to improve the effectiveness and efficiency of Department operations. The directive also calls for systems to be established to follow up on recommendations in all DOD components.

For example, the Secretaries of the military departments are required to designate an audit follow-up official to administer a follow-up program which includes selective on-site verification efforts to help determine whether corrective actions taken by managers are complete, timely, and responsive. The Secretaries are also required to designate audit follow-up focal points as appropriate throughout the departments to maintain

records of the audit resolution and follow-up process. These records include the department's position on findings and recommendations, the organization responsible for implementing the corrective action, time schedules for completion, and the status of the corrective actions and potential monetary benefits. The focal points are required to close recommendations when corrective actions have been completed and documented in follow-up files. The focal points also include summary information from their records in a report issued every 6 months to the DOD Inspector General. In addition, the DOD directive makes the audit organizations responsible for assisting follow-up officials in assessing the responsiveness of actions taken on agreed-upon recommendations.

Our 1987 report on audit resolution in DOD included instances where DOD was not adhering to the principles contained in the governmentwide policies and DOD Directive 7650.3. For example, we found 45 recommendations that management had agreed to implement but had not implemented within at least 1 year, and in some instances as much as 2 years, after the scheduled implementation dates. These audits had potential benefits of \$363 million. In addition, we found that 16 percent of agreed-upon recommendations from a sample of 377 had not been implemented as DOD management and the internal auditors had thought. Both types of problems were found throughout the Department.

Objectives, Scope, and Methodology

Our objective was to determine whether the DOD policy on audit resolution is sufficient for ensuring that timely corrective actions are taken on internal audit recommendations. We reviewed the requirements in DOD Directive 7650.3 in view of observations in our 1987 report about the implementation of recommendations. We were looking for ways to strengthen the DOD policy to help prevent the types of problems noted in the earlier report. We conducted our analysis from February through June 1988.

In early fiscal year 1987 we also sampled closed fiscal year 1986 recommendations of the Army Audit Agency addressed to Army commands in Europe. Our objective was to determine if problems similar to those reported about closed recommendations in our July 1987 report were continuing. We reviewed follow-up records and interviewed Army officials to determine if corrective actions had been implemented and if recommendations had been closed properly. For those recommendations which were improperly closed, we looked for explanations. Information from this sample was used to determine if DOD Directive 7650.3 provides

sufficient directions for closure decisions. Fiscal year 1986 recommendations were chosen because they were the most recent recommendations for which there would have been sufficient time to implement the recommendations by the time of our review.

Our work was conducted in accordance with generally accepted government auditing standards.

Improving the DOD Audit Resolution Policy

Recommending ways to prevent the delays and failures to implement recommendations was not an objective of our 1987 report. However, this review does focus on how DOD audit resolution policy could be improved to prevent the types of problems observed in the earlier report. Based on our latest review, we believe DOD could prevent many of the problems that we observed in July 1987 by strengthening DOD Directive 7650.3 in four ways.

First, DOD Directive 7650.3 requires that audit follow-up focal points include in their records the planned corrective actions for audit findings with time schedules for completion. Under this system, the official who is responsible for acting on the audit recommendation prepares a correction plan and provides it to the audit organization as part of the response to the audit. However, the plans are sometimes not detailed about what actions are planned and when they will be completed. For example, we reviewed planned corrective actions for cases in our 1987 report and they sometimes only consisted of auditee promises not to repeat mistakes or promises that corrections would be made without specifying what would be done and when it would be accomplished.

According to the DOD Assistant Inspector General for Audit Followup, it has been DOD's intention for the audit organizations to review and comment on the appropriateness of the correction plans. The Assistant Inspector General said that the auditors often have been concerned only with whether management is in agreement with the recommendation rather than what the corrective action plan contains.

Directive 7650.3 is silent about the audit organizations' role in this process. If Directive 7650.3 specified the audit organizations' responsibilities, there would be an added degree of assurance that planned actions are responsive to the reported deficiencies and that schedules established for accomplishing these actions are reasonable.

Second, the DOD directive requires that follow-up focal points maintain records on the status of planned corrective actions. However, the directive does not specify how frequently the follow-up focal points or follow-up officials should determine the status of corrective actions. While the Air Force specifies that the status of corrective action will be determined at least yearly, other DOD components do not have a similar requirement. We believe that the status should be determined periodically because it helps to identify those corrective actions that are not on schedule.

Third, with the exception of DOD Inspector General (IG) and GAO audits, the DOD directive does not require that top management be notified when the implementation of audit recommendations will be significantly delayed. The IG is required to report any such delays in implementing IG or GAO recommendations. Such reports help to focus high-level attention on significant implementation delays so that the reasons for the delays may be overcome. For other audit recommendations, the directive could be revised to require that audit follow-up officials in the military departments report deviations from agreed-upon schedules of 1 year or longer to the Secretaries of the Army, Navy, and Air Force, or the DOD IG, as appropriate, depending on the significance of the issue.

While the above changes to DOD Directive 7650.3 would help prevent unreasonable delays in implementing recommendations, there is a fourth way in which the DOD directive could be strengthened. This would entail detailing the type of documentation, such as records of completed transactions or follow-up personnel observations of actions taken, which DOD considers suitable for closing recommendations.

Our current review of Army commands in Europe has confirmed our earlier report findings that agreed-upon audit recommendations are closed even when corrective action has not been taken. Based on our earlier review, we believe the observations of this problem in Europe may be typical of other DOD components in other locations.

As agreed with your office, we judgmentally selected a sample of 38 recommendations from Army Audit Agency reports issued in fiscal year 1986 to the Army commands in Europe that Army reported as closed. In our sample of 38 closed recommendations, we found that a total of 11 (29 percent) should not have been closed because corrective actions had

not been taken. This result is similar to the results in our 1987 report and other reports.³³

Follow-up focal points in Europe did not consistently obtain documentary evidence to support their decisions to close the recommendations. Several of the recommendations were closed because the scheduled implementation date passed and the focal points thought they could close the recommendations without any additional information.

According to DOD Directive 7650.3, a closed recommendation is one in which any disputes between management and auditors over a recommendation have been resolved and corrective action has been completed and documented in follow-up files. However, the directive does not specify what constitutes adequate documentation to make a closure decision. In our cases in Europe, we observed wide variances—ranging from scheduled closure dates passing, to records of direct observations that corrections had been made—in what audit follow-up focal points thought satisfied DOD policy for documentation to support closure decisions. One consequence in our view is that some recommendations were closed which should not have been. This problem could be avoided with better guidance on what type of documentation is acceptable for closing recommendations.

Conclusions

Well-conceived audit resolution policies are a key for ensuring that management takes prompt and responsive actions on audit recommendations. Generally, DOD has sound policies. However, as we noted in our earlier report and, on a more limited basis, as we confirmed in this review, there have been some problems with the extent to which DOD management has been timely and responsive in implementing its internal audit recommendations.

Recommendations

We recommend that the Secretary of Defense supplement existing requirements in DOD Directive 7650.3 concerning audit follow-up to specify that

- audit organizations are required to review corrective action plans, which includes reviewing and commenting on whether planned actions

³³Our 1987 report found that 16 percent of a sample of 377 closed recommendations had not been implemented based on audit follow-up files in Defense agencies, the Army, and the Air Force. The Naval Audit Service reported in 1985 and 1986 reports that 21 percent of recommendations it had reviewed in the Navy were improperly closed.

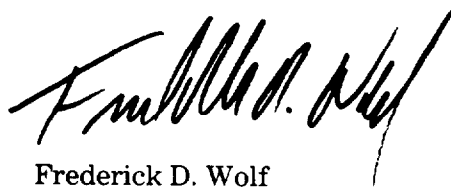
appear to correct reported deficiencies and whether scheduled implementation dates are reasonable;

- audit follow-up personnel periodically determine the status of corrective actions within a reasonable period of scheduled implementation dates, preferably at least yearly;
- audit follow-up officials report significant delays in implementing audit recommendations, for example 1 year or longer, to the military department secretaries or other top officials, as appropriate; and
- recommendations be closed only when audit follow-up personnel have appropriate documentation supporting a closure decision. The directive should provide guidance for the type of documentation that is appropriate.

We discussed our report with appropriate DOD officials and have included their comments where appropriate.

As arranged with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from its date. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,



Frederick D. Wolf
Director