

GAO

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

April 1989

ARMY AUDIT AGENCY

Staff Reductions and Audit Quality Issues





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

**Accounting and Financial
Management Division**

B-226903

April 21, 1989

The Honorable Earl Hutto
Chairman, Subcommittee on Readiness
Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

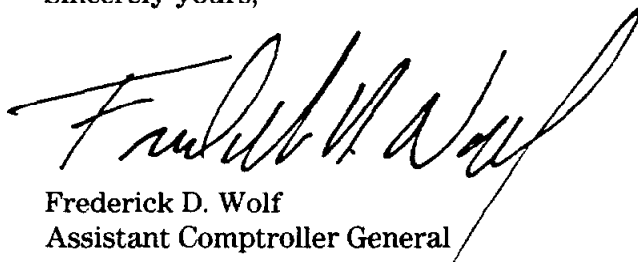
At the request of the Subcommittee on Readiness, we reviewed the effectiveness of the Army Audit Agency. This is the second in a planned series of reviews of Department of Defense audit organizations.

We concluded that the Army Audit Agency has generally been effective in providing audit service to the Department of the Army. We believe the Army's 3-percent reduction to Army Audit Agency fiscal year 1989 staffing probably will not seriously impact audit operations and coverage. We also believe the Army Audit Agency could (1) enhance audit coverage with more focused financial management audits and improved follow-up efforts and (2) improve the quality of its audits.

Unless you publicly announce the contents of this report earlier, we will not distribute it until 14 days from the date of this report. At that time, we will send copies of the report to the Secretary of Defense, the Secretary of the Army, the Auditor General of the Army, the Director of the Office of Management and Budget, interested congressional committees, and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of John J. Adair, Director, Audit Oversight and Policy. Major contributors are listed in appendix II.

Sincerely yours,



Frederick D. Wolf
Assistant Comptroller General

Principal Findings

Audit Coverage and Staff Resources

Based on an analysis of audits planned and conducted, GAO believes that AAA has generally provided appropriate audit coverage to Army's major commands and budget areas.

In April 1988, the Acting Secretary of the Army directed a 13-percent reduction in AAA staffing. A reduction of this magnitude would have put audit resources at the lowest level in more than 11 years and could have significantly impaired the internal audit coverage in the Army, where audit workload has expanded during the past 8-year period of Defense buildup. However, the reduction was limited in fiscal year 1989 to 3 percent, which is comparable to Armywide civilian personnel reductions for the year. The 3-percent reduction does not appear to seriously impact audit coverage. At this time, the Army has not specified if additional reductions will be made in future years. (See chapter 2.)

Long-Range Planning and Focused Financial Management Audits Needed

While AAA does not currently have a long-range audit plan, GAO believes such an initiative, particularly in the area of financial management, could help ensure coverage of significant areas. Currently, AAA's financial management audits are not designed to review Army's financial reports and the reliability of the systems that produce these reports. Such audits could help improve the Army's accounting systems and its overall financial management structure. (See chapter 2.)

More AAA Follow-Up Needed

Army management is primarily responsible for ensuring that prompt, responsive action is taken on all audit findings and recommendations. However, GAO believes that AAA should determine if appropriate action is taken on its significant findings and recommendations. AAA generally does not know what action has been taken until a subsequent audit is conducted, usually from 1 to 10 years later. Revised government auditing standards effective for audits starting January 1, 1989, call for government auditors to have a process that enables them to track the status of management's actions on significant findings and recommendations from their prior audits. (See chapter 2.)

financial reports are beneficial for (1) stimulating the development of modern accounting systems, (2) ensuring a proper link between accounting transactions and reporting to the Department of the Treasury, the Office of Management and Budget, the Congress, and the public, and (3) determining whether adequate safeguards are in place to protect agency resources.

DOD also did not agree that AAA should become involved in Army's audit follow-up procedures. According to DOD, these functions are already being performed by other Army groups. GAO continues to believe that AAA should get reliable information on what action has been taken on its significant findings and recommendations. (See Agency Comments and Our Evaluation, chapter 2.)

GAO incorporated technical changes throughout the report based on DOD's comments.

performed at locations Armywide or within the geographical boundaries of an AAA region. A single location audit is a review of one or more functions of an activity performed at one location. A mandatory audit is one required by law, regulation, or directive and includes audits such as that of the American Red Cross and reviews of Army's cost estimates made to decide whether an activity should be procured commercially. Mandatory audits may be multilocation or single location audits.

AAA issues two types of reports, formal and informal, to communicate its audit results. Formal audit reports normally contain significant findings and recommendations for corrective action. AAA's informal audit reports are those that discuss (1) minor deficiencies, (2) problems of wide interest identified and reported in prior audits, or (3) audits curtailed due to lack of significant adverse conditions. During fiscal year 1987, AAA issued 194 formal and 91 informal audit reports.

Formal reports are normally distributed to the audited entity, its major command and Army staff office, and other interested Army activities. Army policy stipulates that after publishing a formal audit report, AAA wait 60 days before releasing it outside the Department of the Army. This 60-day period enables the audited activity, higher commands, and Army staff agencies to present their positions on audit findings and recommendations and ultimately to establish an official Army position on the audit findings. AAA's formal audit reports usually include the audited entity's comments to the draft report. However, according to Army policy, such comments do not constitute the official command position because the comments have not yet been coordinated and approved by Department of the Army headquarters officials. The Army's official position on AAA findings is established after the final audit report is issued.

Occasionally, AAA issues special formal audit reports, which AAA defines as the results of limited-effort audits performed in response to a request by the Secretary of the Army, Under Secretary, Chief of Staff, or Vice Chief of Staff. These reports are normally issued only to the requesting official. Since AAA's special audit reports usually contain suggested actions rather than recommendations, these reports are not subject to the Army's command reply, audit resolution, or audit follow-up processes. AAA produced seven special reports in fiscal year 1987.

AAA's informal audit reports usually receive limited distribution. However, AAA provides Armywide distribution for the informal reports which discuss problems of wide interest identified and reported in prior

Our review of AAA's allocation of resources focused on AAA's annual planning and programming process, its responsiveness to management requests for audits, its coverage of major Army commands and budget areas, its reported benefits, and changes in AAA staffing levels.

To determine the factors influencing AAA's annual planning process, including management requests for audits, we interviewed AAA headquarters officials and reviewed AAA planning documents for fiscal years 1986, 1987, and 1988.

For our evaluation of AAA's audit coverage, we reviewed audit resource allocations for fiscal year 1986, planned allocations for fiscal years 1987 and 1988, and fiscal year 1987 Army budget documents. We compared the allocations for the types of audits conducted as well as the Army major commands and appropriations that had been or were going to be audited. We also interviewed AAA headquarters personnel to obtain AAA resource allocation information.

To determine the benefits of AAA audits, we reviewed the working papers supporting AAA-reported monetary benefits as well as AAA's role in implementing the Federal Managers' Financial Integrity Act. We judgmentally selected six fiscal year 1987 AAA audit reports with identified monetary benefits of nearly \$1.1 billion. This sample represents about 66 percent of the total monetary benefits reported by AAA in fiscal year 1987. We also reviewed the Secretary of the Army's annual reports on internal control and accounting system weaknesses for 1986 and 1987 to determine how many of the weaknesses were identified by AAA.

For our review of the changes in AAA staffing levels, we reviewed Army and AAA budget documents for fiscal years 1985 through 1989 and AAA personnel strength reports for fiscal years 1983 through 1988. We also interviewed AAA and Army officials to determine how AAA requests and obtains audit resources and to discuss the impact that proposed staff reductions would have on AAA audit coverage.

In reviewing audit quality, we concentrated on evaluating the (1) sufficiency of evidence in audit working papers, (2) inclusion of all findings in audit reports, (3) development and reporting causes of problems, (4) support for claimed monetary benefits, (5) clarity, conciseness, and convincingness of audit reports, and (6) extent of compliance with audit standards.

Chapter 1
Introduction

in Atlanta, Georgia; Philadelphia, Pennsylvania; and Frankfurt, Germany. Our review was performed in accordance with generally accepted government auditing standards.

supplies, and equipment were inadequate, leaving these items susceptible to diversion and unauthorized use. Management agreed to implement a series of recommendations designed to tighten controls over future exercises.

- AAA reported that Army reserve units had overstated requirements for rifles, automatic weapons, and other training equipment by \$13.9 million. AAA recommended that quantities be adjusted before finalizing the equipment procurement contracts. Army management agreed to adjust the quantities and considered the potential monetary benefits to be reasonable.

AAA also plays an important role in assisting Army management to implement the Federal Managers' Financial Integrity Act of 1982. This act requires federal managers to (1) maintain adequate internal control and accounting systems, (2) report annually to the President and the Congress whether these systems comply with standards set by the Comptroller General, and (3) describe plans for correcting weaknesses in internal control systems that do not comply with applicable standards.

AAA reviewed the Army's first year implementation of the act at 21 Army locations and issued a report identifying various problems concerning compliance with Army regulations on internal control systems. AAA's more recent involvement in the Army's internal control program has included the following major activities:

- an annual Armywide review of the internal control program,
- a continuing evaluation of the Army's internal control program during the normal course of audits,
- a determination as to whether Army management corrects material weaknesses, and
- identification of 7 of the 11 weaknesses included in the Secretary of the Army's 1987 report on internal control and accounting systems weaknesses and 8 of the 12 weaknesses reported in 1986.

Audit Coverage Generally Extensive

In our opinion, AAA has generally provided appropriate audit coverage, in view of its authorized staffing resources. The coverage included virtually every major command and major budget area within the Army.¹

¹Our review of AAA audit coverage did not include the Army's highly classified operations known as special access programs. While AAA has a staff dedicated to auditing these programs, we cannot comment on how extensive this audit coverage is because the operations' classified nature precludes AAA and us from determining the total number of programs involved. AAA issued eight classified reports on these programs in fiscal year 1987.

and could include a plan for achieving the goals. For example, AAA's long-term audit plan could include a goal of improving the efficiency of Army National Guard armory operations and specify several audits for accomplishing the goal. An example of a functional goal could be to strengthen Army acquisition practices and specify cyclic audits of equipment procurement, supply purchases, construction contracts, military installation support services, and other types of Army acquisitions to achieve this long-range goal. We believe that long-range planning can be helpful in ensuring that audit resources are concentrated on the more significant program areas.

During our review, AAA drafted a regulation on audit planning to better identify future issues and trends that may affect programs, functions, or activities. This regulation would require preparation of a plan to cover a period 2 years beyond the current year. We believe that long-range planning is essential and agree with AAA's proposed action to develop such a plan.

More Focused Coverage of Financial Management Needed

AAA could improve its financial management audit coverage by (1) conducting more financial management audits Armywide than it currently does, (2) closely monitoring the Army's \$380 million accounting system redesign, and (3) undertaking audits to determine the accuracy and validity of the Army's financial reports prepared for the Department of the Treasury and the suitability of accounting systems that generate financial management information. We have reported on the need to reform federal financial management through initiatives such as the strengthening of financial systems, internal controls, and financial reporting. AAA would contribute substantially to bringing about these reforms in the Army by directing more of its coverage into the areas discussed.

We reviewed AAA's financial management audit efforts for fiscal years 1987 and 1988 and found that about half focused on Armywide financial management systems. In fiscal year 1987, for example, the Armywide effort focused on three issues: (1) cash and debt management policies and practices throughout the Army, (2) the Army's overall progress in implementing the Federal Managers' Financial Integrity Act, and (3) an Armywide audit of local travel procedures. The remaining effort was primarily localized or regionalized audits of either one particular financial and accounting office or a select financial management function at a single location or region.

take in our agency financial management surveys. Our methodology for financial management surveys includes determining the source and responsibility for the amounts included in the agency's reports to the Department of the Treasury. Specifically, we review the processes by which financial information is (1) entered into agency subsidiary financial management systems, (2) transmitted and summarized through the agency's primary financial management system, and (3) included in the agency's financial reports. Through this approach, we assess the extent to which financial management systems can (1) produce accurate, reliable, and useful information and (2) be relied upon for purposes of financial statement audits.

AAA Needs to Follow Up on Significant Recommendations

Army management has primary responsibility for ensuring that prompt, responsive action is taken on all audit findings and recommendations. However, we believe that AAA also has a role in ascertaining that appropriate action is taken on its findings and recommendations. Currently, AAA does very little to fulfill this role.

One of the principal ways an audit organization can follow up on its findings and recommendations is by conducting a second audit. Generally, the second audit's scope is limited to finding out whether corrective actions have been taken and, in some cases, determining if the actions were effective. This is a technique sometimes used by AAA. However, we believe that AAA has not performed or scheduled enough follow-up audits to cover all its significant findings and recommendations. For example, only two of the 285 audit reports issued in fiscal year 1987 were for follow-up audits. Further, of 266 total audits in its fiscal year 1987 annual plan, AAA included only 6 follow-up audits. In addition, of 292 total audits in its fiscal year 1988 annual plan, AAA included only 4 follow-up audits. AAA officials acknowledged that there have been few follow-up audits performed during recent years.

AAA officials told us that once management accepts AAA's findings and recommendations, AAA's responsibility for audit follow-up ends until the next audit is conducted. At that time, which could be 1 to 10 years later, depending on the audit area, it is AAA's policy that auditors ascertain what action has been taken on any previous audit recommendations relevant to the scope of their work. In the Auditor General's view, any verification prior to the subsequent audit is a management responsibility.

Impact of Staff Reductions

Department of the Army proposals for reducing the size of AAA in fiscal year 1989 have ranged from a 13-percent reduction, or 108 staff years, ordered in April 1988, to a 3-percent reduction, or 28 staff years, that Army decided to make. Staffing for fiscal year 1988 was set at 861. Comparatively, the Army is reducing its total civilian personnel by 4 percent due to budget limitations for fiscal year 1989. Other Department of Defense audit components are also faced with personnel reductions.

Not only was the planned reduction disproportionate to other reductions in the Army, we believe that it could have also significantly impaired audit coverage. Subsequent to congressional complaints and appeals by the Auditor General, Army implemented the smaller reduction. In our opinion, the smaller reduction will probably not significantly impair coverage, and it is proportional to staff reductions in other Army offices. Although the Army has not indicated whether or not it expects additional staffing cuts in the future, any significant reduction should be carefully considered in view of AAA's expanded responsibilities over the past few years and in the interest of maintaining satisfactory audit quality.

AAA audit responsibilities have increased during the 1980's, concurrent with the significant growth of the Army's budget. Several major weapon systems have been developed and purchased. In addition, the Army has expanded by establishing two new active duty divisions and two National Guard units. This growth has increased AAA's universe of auditable entities by 12 percent, from 1,305 in 1980 to 1,463 in 1988. In addition, AAA was assigned new missions, including continuous audit coverage of Army's most highly classified programs, known as "black programs." Overall, the Army's budget (in constant 1980 dollars) grew from \$34.4 billion in fiscal year 1980 to \$52.4 billion in fiscal year 1989. During the same period, AAA staffing decreased from 869 in fiscal year 1980 to 833 in fiscal year 1989. Figure 2.1 illustrates the extent of Army's budget growth compared with AAA staffing.

The Assistant Secretary of the Army for Manpower and Reserve Affairs, in his role as the Acting Secretary of the Army in April 1988, directed the 13-percent reduction in AAA staffing. The reduction was based in part on a 1985 internal Army study which recommended that AAA perform its mission with fewer personnel. The study had recommended reductions primarily because its authors believed there was too much supervision and quality control being performed within the agency.

The Army did not adopt the recommendations included in the 1985 study. At the time, Army officials, including all assistant secretaries or their deputies, the Auditor General, and an assistant to the Secretary commented that the study lacked an understanding of the audit process and used inaccurate data. The Assistant Secretary of the Army for Manpower and Reserve Affairs told us that the study was reconsidered in 1988 because the Army is being forced by budgetary reductions to consider staff reductions.

Conclusions

AAA has generally provided appropriate audit coverage of major commands and the major budget items in the Army. However, AAA could improve its audit planning process by including long-range goals, such as improving the Army's financial management operations. AAA's draft regulation on audit planning includes a provision for long-range planning. We endorse this idea and believe the Auditor General should continue efforts to establish AAA's long-range audit plan.

AAA could improve its financial management audit coverage by (1) conducting more financial management audits Armywide than it currently does, (2) closely monitoring the Army's \$380 million accounting system redesign, and (3) undertaking audits to determine the accuracy and validity of the Army's financial reports prepared for the Department of the Treasury and the suitability of accounting systems that generate financial management information. Audits of this type increase awareness for sound financial management and assist in ensuring financial integrity.

AAA's recommendations to reduce costs, improve operations, or increase program effectiveness provide an indication of its impact on Army operations. However, in our opinion, the true measure of an audit organization's impact is whether its recommendations have actually been implemented. Currently, the Army does not have sufficient assurance that agreed-upon recommendations are implemented. We believe AAA

accounting transactions and reporting to the Department of the Treasury, the Office of Management and Budget, the Congress, and the public, and (3) determining whether adequate safeguards are in place to protect agency resources.

DOD also did not agree that AAA should become involved in Army's audit follow-up procedures. According to DOD, these functions are already being performed by the Army Inspector General and by internal review groups assigned to commands. We believe these other groups should continue to perform their assigned responsibilities, but AAA should get reliable information on what actions have been taken on its significant findings and recommendations so that it can (1) target its own follow-up audits where corrective action is not being accomplished in a timely and effective manner and (2) satisfactorily comply with government auditing standards.

DOD also commented that AAA has access to information that follow-up groups maintain. However, we found that there is no systematic reporting of this information to AAA, and AAA has not requested such data on a regular basis. Our earlier reviews also raised questions about the reliability of information that these groups maintain on the status of recommendations. As a part of the follow-up effort, we believe that AAA needs to verify that the information obtained can be relied upon for targeting follow-up audits in those areas where corrective action has not been properly taken.

Our difference with DOD on this issue of follow-up could be resolved if the Army Inspector General would, on a test basis, provide a semiannual report to the Auditor General on the status of all significant findings and recommendations. As part of this test, AAA could evaluate the information contained in the report to determine if it is satisfied with the progress made toward correcting reported problems and implementing agreed-to recommendations. After a reasonable period, perhaps 2 years, the Army Inspector General and the Auditor General could assess whether the semiannual report is effective and useful.

differences in the extent of a problem or deficiency reported by AAA which did not materially affect the validity of the finding.

In some cases, we found that early report drafts accurately reported facts and findings as supported in working papers. However, changes were made to drafts as they were being reviewed and revised by audit supervisors, edited, and retyped. We were unable to trace the source of the changes because AAA did not keep a complete set of drafts which would show when these changes had occurred.

Army Regulation 36-7, Professional Audit Standards, requires indexing of draft and final audit reports to working papers as a means of verifying the adequacy of working-paper evidence. Indexing refers to the practice of noting on the report the location of evidence in the working papers to support statements or positions being made in the audit report. The AAA handbook for conducting and managing audits assigns this responsibility to the auditor-in-charge.

We found that AAA's regional offices were inconsistently applying these indexing policies. Generally, draft reports were indexed. However, in the European office, final audit reports were not always being cross-indexed to working papers because the auditors-in-charge were given new audit assignments before audit reports they were working on were finalized. Audit supervisors did not assume responsibility for indexing the final audit reports to the working papers, and no other individuals assumed this task. We believe auditors-in-charge or other auditors who are knowledgeable of the audit evidence should remain available to ensure that working papers contain sufficient evidence to support any changes made to draft reports.

In AAA's Northeast Regional Office, we found that final reports were being indexed to working papers, but the indexing was not precise. For example, entire paragraphs were indexed to a single document and specific pages were not cited. Therefore, the indexing was insufficient for purposes of readily locating evidence to support positions and statements in the audit report.

Such discrepancies between working papers and final audit reports could be detected before report publication through a quality control procedure like referencing. Referencing is a process by which an auditor independent of the audit team verifies that the report is accurate and that evidence is adequate and evaluates whether conclusions and recommendations flow logically from the evidence. Although not required by

are not sure why the problem exists. A valid reason for the x-ray results being missing from the records has not been determined.... We will audit the entire system and attempt to define the cause of the problem and establish procedures to assure that x-ray results are filed in the proper records.”

As a result of the command comments, AAA changed its recommendation. In the final report, AAA recommended that the Medical Department Activity “Ensure that all x-rays are included in medical records.” The command agreed with the revised recommendation. However, we believe this type of recommendation is vague and less useful to management than one which is based on a clearly established cause and which provides a more definitive corrective action.

AAA Regulation 36-53 recognizes the need for specific recommendations. This regulation states that auditors should specify actions that will correct the problems and avoid vague recommendations to emphasize, consider, or evaluate. The regulation also states that auditors “should not recommend that a regulatory provision be complied with; instead, they should recommend the specific action necessary to accomplish compliance.”

The AAA written procedures thoroughly discuss the importance of identifying and reporting the causes of problems. We also reviewed AAA manuals for beginning and advanced auditor internal training courses and found that the course content includes discussions of identifying cause. The course outline appears to be consistent with the requirements of AAA Regulation 36-53.

On March 31, 1988, the DOD Office of Inspector General issued an oversight report on audit report quality for the internal audit organizations in Army, Navy, Air Force, and the DOD Office of Inspector General for Auditing. The DOD Inspector General reported that AAA had not clearly reported the cause for 47 of the 62 findings reviewed.

The Auditor General recently acknowledged AAA’s difficulties in this aspect of audit reporting. The Auditor General sent a letter to each AAA regional auditor general and to headquarters managers, emphasizing that audit reports should clearly and specifically identify the cause for each finding reported. In offering examples, the Auditor General’s letter clearly states that in cases where a condition arose from the failure of command personnel to follow established procedures, the report should specify why procedures were not followed. The Auditor General stressed the need for increased management attention in this area of

should correct the problems noted. Furthermore, we discussed the relationship between the Auditor General and the Assistant Secretary with AAA and Army management officials and found nothing in the relationship that we regarded as an impairment to AAA independence.

Conclusions

We generally found AAA audits satisfied applicable auditing standards that we tested, with the exception of some instances when working-paper evidence was insufficient and underlying causes of problems were not appropriately developed. Insufficient evidence in audit working papers to support findings and conclusions raises doubts as to the extent or validity of some findings in AAA audit reports. Additionally, we believe that by not fully developing the causes of identified problems, AAA lessens the effectiveness and impact of its work. Only by identifying and developing the cause of a problem can recommendations be designed to prevent the problem's recurrence. When cause is not developed, the appropriateness of AAA's conclusions and recommendations may be questioned. Thus, the utility of the audit and its report is diminished.

Recommendations

To ensure the accuracy and validity of AAA audit reports, we recommend that the Secretary of the Army direct the Auditor General to

- require that auditors-in-charge or other appropriate individuals remain involved in audit assignments during the processing of audit reports to fulfill the responsibility for documenting all meetings with Army management and for indexing the final audit report to the working papers;
- institute improved quality control procedures, such as report referencing, to provide verification of information in final audit reports; and
- schedule a quality assurance review to determine if causes of problems are being appropriately identified, analyzed, and reported following implementation of the recommended report review procedures, and report to the Secretary within one year on the progress toward correcting this weakness.

Agency Comments and Our Evaluation

In its written comments, DOD generally concurred with the findings and recommendations contained in this chapter. The DOD Office of the Inspector General will monitor implementation of the agreed-to corrective actions.

agree that the AAA should implement a duplicative followup tracking system or become involved in followup procedures. These functions are already being performed by the Office of the Army Inspector General and the local command internal review organizations.

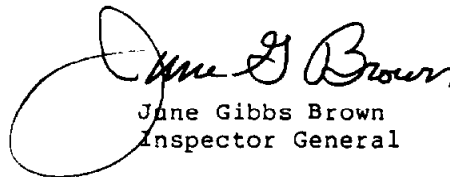
See comment 2.

The DoD is committed to effective Military Service internal audit organizations and continually monitors them through various quality assurance reviews. As part of that continuing process, the Office of the Inspector General, DoD, will monitor the implementation of the agree-to corrective actions in response to the recommendations contained in the draft report.

See comment 3.

The detailed DoD comments on the report findings and recommendations are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,



Jane Gibbs Brown
Inspector General

Enclosure

Major Contributors to This Report

**Accounting and
Financial Management
Division, Washington,
D.C.**

John J. Adair, Director, Audit Oversight and Policy, (202) 275-9359
Rex Simmons, Assistant Director, Audit Oversight and Policy
H. Vernon Davis, Evaluator-in-Charge
Ann R. Lewis

**Atlanta Regional
Office**

Thomas C. Howle, Audit Manager
Clarence L. Tull, Site Supervisor

**Philadelphia Regional
Office**

Norman C. Berman, Site Supervisor
John R. Kirstein

European Office

Byron L. Matson, Site Supervisor
Lacinda Baumgartner

Requests for copies of GAO reports should be sent to:

**U.S. General Accounting Office
Post Office Box 6015
Gaithersburg, Maryland 20877**

Telephone 202-275-6241

The first five copies of each report are free. Additional copies are \$2.00 each.

There is a 25% discount on orders for 100 or more copies mailed to a single address.

Orders must be prepaid by cash or by check or money order made out to the Superintendent of Documents.

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

**Official Business
Penalty for Private Use \$300**

**First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100**

The following are GAO's comments on the Department of Defense's letter dated February 10, 1989.

GAO Comments

1. The DOD response is discussed under Agency Comments and Our Evaluation at the end of chapter 2.
2. The DOD response is discussed under Agency Comments and Our Evaluation at the end of chapter 3.
3. The detailed DOD comments are not being included because of their length. GAO will make copies of the comments available upon request.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

FEB 10 1989

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "ARMY AUDIT AGENCY: Staff Reductions and Audit Quality Issues," dated December 22, 1988 (GAO Code 911612/OSD Case 7867). With two exceptions, the DoD generally concurs with the report.

The DoD agrees that:

- the recent 3-percent staff reduction imposed on the Army Audit Agency (AAA) probably will not impact seriously the AAA operations and coverage, but further reductions could adversely affect both audit coverage and quality;
- the AAA is independently and objectively carrying out its mission; and
- the AAA audit work is resulting in significant actual and potential cost savings and management improvements.

See comment 1.

The Department does not, however, agree that the AAA should review the financial reports the Army submits to the Treasury Department. It is the DoD position that such an effort would be premature and currently not a prudent or effective use of scarce audit resources. Until such time as the DoD plans for the upgrade and integration of financial systems are implemented, system audits will continue to provide greater benefits and assistance to DoD manager than would annual financial statement audits.

See comment 1.

In addition, the DoD does not agree with the GAO conclusion that the current Army followup system is ineffective. While the the Army Audit Agency should maintain close communication with the Office of the Army Inspector General as to the status of management's actions on AAA recommendations, the DoD does not

Chapter 3
AAA Needs to Improve Audit
Quality Controls

We deleted a proposal that was in our draft report to amend report review procedures which would have required reviewers to verify the reporting of specific causes of problems. The Auditor General revised these procedures in July 1988 to require the verification of cause of each finding.

report preparation. The Auditor General also amended report review procedures in July 1988 to help ensure the verification of cause of each finding. We think these are good steps to help ensure the reporting of causes in AAA reports.

To further ensure appropriate reporting of underlying causes, AAA could strengthen its quality controls over audit reports. AAA has an established process for headquarters staff to review audit reports. The report review sheet used in this process includes a number of technical items but does not require the reviewer to verify that the cause is identified for each reported problem. Including a verification of cause identification on the review checklist could lead to improved reporting of causes in AAA reports.

Finally, a follow-up on the reporting of causes could be incorporated into AAA's new post-issuance quality assurance program. If problems continue to exist, identifying auditors who need special training would be an appropriate approach.

Reorganization Has Enhanced Independence

A recent reorganization in the Department of the Army, following enactment of the Goldwater-Nichols Department of Defense Reorganization Act of 1986, has enhanced the organizational independence of AAA. Prior to the Act, the Auditor General was accountable to both the Secretary of the Army and the Army Chief of Staff. The Auditor General also received technical supervision and policy guidance from the Assistant Secretary of the Army (Financial Management). With the reorganization, the Auditor General will be responsible to the Secretary of the Army. The Assistant Secretary's responsibility will include support for the Auditor General and coordination of internal audits, investigations, and other reviews.

These changes establish that the Auditor General is accountable only to the Secretary of the Army and no other Army official. Such an arrangement helps to achieve organizational independence consistent with government auditing standards.

An early 1988 report issued by the House Committee on Appropriations, Surveys and Investigations Staff, noted problems with language in a draft regulation on the reorganization. The report concluded that such language would possibly impair AAA independence by maintaining the Assistant Secretary's role with AAA as it was before the reorganization act. We were furnished revisions made to the draft regulation that

government auditing standards, referencing provides an effective mechanism for helping to achieve those standards. Referencing is a quality control procedure used in many audit organizations, and we believe AAA could improve the accuracy of its audit reports by using this procedure.

In response to a DOD Inspector General oversight report, dated March 4, 1988, AAA agreed to establish a quality assurance program. As one element under this program, AAA staff, other than line auditors, will review audit reports and working papers after report issuance to evaluate compliance with audit standards as well as DOD and AAA policies and procedures. Results will be summarized and reported to auditors. Although the overall quality of AAA work will benefit from this initiative, it is not an adequate substitute for good indexing and referencing for individual reports because it will be completed after a report has been issued.

Not Reporting Underlying Causes of Findings

Government auditing standards also state that the underlying cause of problems should be reported to assist in identifying appropriate corrective actions. AAA Regulation 36-53, Audit Report Formats, also requires reporting of the underlying cause of reported problems. The regulation states that the "cause of an unsatisfactory situation must be identified so a meaningful recommendation for corrective action can be made."

AAA did not report the underlying cause of 21 of the 68 findings in audit reports we reviewed. In some instances, AAA auditors had identified the cause in their working papers but did not include it in the audit report. In other cases, AAA cited a failure to follow regulations as the cause of a problem but did not report why regulations were not followed.

For example, in one audit we reviewed, AAA reported that x-ray results were not on file in individuals' medical records. In the draft report AAA recommended that procedures be established for medical records personnel to pick up all x-ray results daily and include them in medical records. The Medical Department Activity at Redstone Arsenal, Alabama, did not concur with the recommendation because the medical activity recognized that AAA had not identified the cause of the problem. The medical activity responded to the draft report by stating:

"We accept the finding but non-concur in the inferred cause of the problem ... and in the recommendation for resolving the problem. The section on x-ray does not provide any evidence that would lead a reasonable person to believe that the problem is the failure of medical records personnel to pick up x-ray results on a daily basis. Conversation with the auditors responsible for this area revealed that the auditors

AAA Needs to Improve Audit Quality Controls

We found that AAA has operated independently in accordance with generally accepted government auditing standards. We also found that AAA audit reports were usually clearly and concisely written and that the reports contained the significant audit findings identified by auditors. However, we identified some audit and/or report quality problems in aspects of 11 of the 17 audit reports and related working papers that we reviewed. In general, these problems involved

- insufficient working-paper evidence to support significant statements or positions in five audit reports and less significant inaccuracies in five reports and
- not reporting the underlying cause for 21 of the 68 audit findings we reviewed.

Insufficient Evidence in Working Papers

Government auditing standards state that “. . . all facts, findings, and conclusions should be supported by sufficient objective evidence” and that auditors need to report factual data accurately and fairly. The standards also state that “One inaccuracy in a report can cast doubt on the validity of an entire report and can divert attention from the substance of the report.”

We found insufficient evidence in working papers to support some statements in 5 of the 17 audit reports we reviewed. In these cases, AAA was unable to provide supporting working-paper evidence for audit work for key facts upon which auditors based their finding. The audit managers responsible for these audit reports were unable to adequately explain the absence of supporting working papers for facts and statements in reports.

For instance, in a report on management of ammunition in Europe, AAA reported that the seven activities reviewed had adequately implemented the Army’s internal control program. The audit program required auditors to determine whether managers had been given responsibility for the internal control program, management reviews were being performed, identified weaknesses were being tracked, and corrective actions were being planned. AAA working papers did not contain any evidence that these audit steps were completed, and the audit manager was unable to provide any data to show that the audit work was done.

In addition, we found discrepancies between audit reports and working papers for five reports reviewed. These discrepancies generally involved

could have a greater impact in improving Army operations by taking a more active role in audit follow-up.

Budgetary concerns will likely again raise the issue of how many auditors are appropriate for AAA. Any decision will require a good deal of judgment because savings achieved from a budget reduction may be lost in audit benefits. Although a fiscal year 1989 reduction proportional to other Armywide reductions will cause no major problems, further reductions could adversely affect audit coverage as well as quality unless AAA productivity improves or its workload decreases.

Recommendations

To enhance audit coverage and ensure that audit recommendations are implemented to improve Army operations, we recommend that the Secretary of the Army direct the Auditor General to

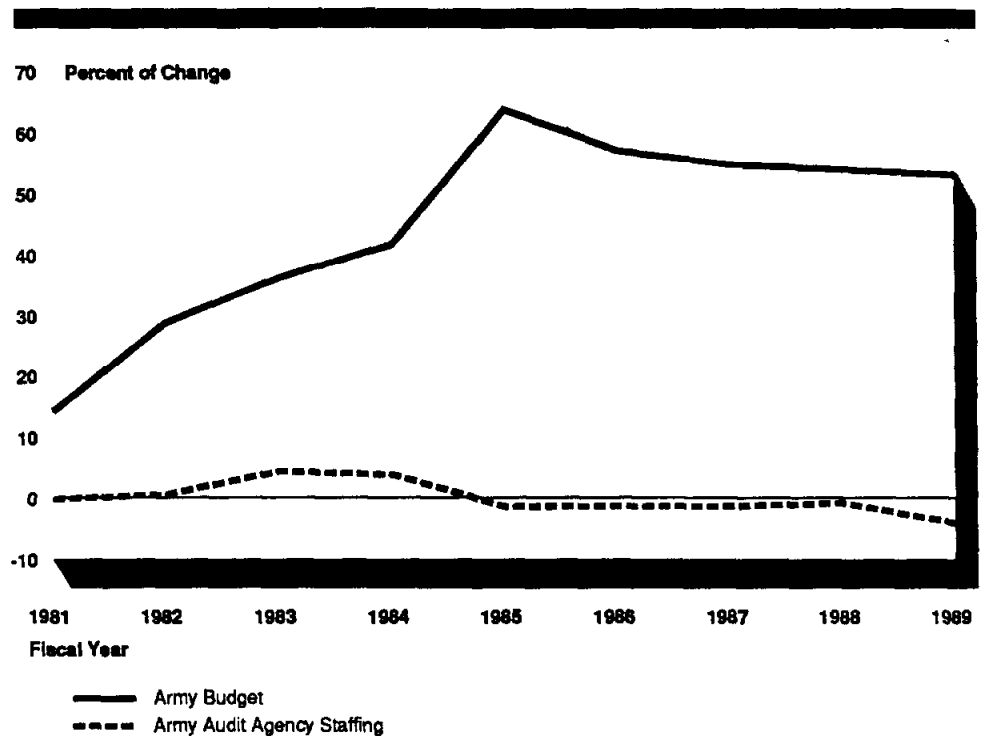
- direct more of AAA's financial management coverage toward auditing Armywide issues, accounting system redesign efforts, and the data included in the Army's financial reports and
- follow up to determine whether appropriate corrective actions have been taken on all significant AAA audit findings and recommendations.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report. (See appendix I.) With two exceptions, DOD generally concurred with the findings and recommendations in this chapter. Specifically, DOD agreed that the 3-percent staff reduction imposed on AAA probably will not seriously impact AAA operations and coverage and that further reductions could adversely affect both audit coverage and quality. DOD also stated that AAA will concentrate its financial management audits on issues with Armywide significance to the extent that resources permit and on major accounting system redesign efforts.

DOD did not agree that AAA should review the financial reports that the Army submits to the Department of the Treasury. DOD believes that such an effort would be premature in view of DOD's plans to upgrade and integrate its financial systems. Instead, DOD believes systems audits will be more beneficial. We believe that audits of both accounting systems and financial reports are beneficial. We encourage DOD to include audits of financial reports in its long-range audit planning. Audits of financial reports can complement systems audits by (1) stimulating the development of modern accounting systems, (2) ensuring a proper link between

Figure 2.1: Comparison of Changes in Army Budget and AAA Staffing for Fiscal Years 1981 to 1989



- Notes:
1. Each year reflects percentage of change from 1980.
 2. Using constant 1980 dollars.

When the 13-percent reduction in AAA staffing was planned, the Department of the Army had the Auditor General prepare an analysis showing its potential impact. He predicted that a reduction in audit strength of the proposed magnitude would reduce the number of audits performed and that it would be detrimental to audit coverage. His plan proposed curtailing those audits requested throughout the year by management to address unanticipated issues. He also proposed cutting back his program of "cost comparison reviews" which are used to decide which services could be performed more economically by Army personnel and which should be procured commercially. The Auditor General also proposed the possibility of eliminating audit work of nonappropriated funds, primarily at clubs, commissaries, and recreational activities. These audits proposed for curtailment or elimination have in the past been beneficial in influencing policy changes; ensuring cost-beneficial decisions; and identifying fraud, waste, and abuse. The Auditor General has advised us that the 3-percent reduction can be absorbed with a minimum effect on audit coverage.

There are several reasons why we think AAA should strengthen its own follow-up efforts. One reason is that the system designed by Army management has not been as effective as it should be. Army management has designated the Army Inspector General as the audit follow-up official to establish a tracking system and to ensure that agreed-upon actions are taken. In a 1987 review of Department of Defense follow-up systems, which included the one in Army, we reported that 16 percent of recommendations were closed although agreed upon corrective actions appeared not to have been implemented (Audit Resolution: Responsiveness of Defense Management to Internal Audit Recommendations (GAO/AFMD-87-37BR July 31, 1987)). Reviews by AAA and subsequent GAO reviews substantiate this problem. As a result, the Army may have lost the potential savings and benefits which would be achieved by implementing the audit recommendations.

Furthermore, government policies call for auditors to have an active role in follow-up. Army Regulation 36-2, Processing Internal and External Audit Reports and Followup on Findings and Recommendations, stipulates that follow-up is a responsibility shared by managers and auditors. Also, in Internal Controls in the Federal Government, we have issued standards which state that auditors are responsible for following up on audit findings and recommendations to ascertain that resolution—including the completion of corrective action—has been achieved. Finally, revised government auditing standards established in July 1988, effective for audits starting January 1, 1989, require that government auditors have a process that enables them to track the status of management's actions on significant or material findings and recommendations from prior audits.

AAA has several options for strengthening its follow-up efforts. It could receive periodic reports from the Army Inspector General to track the status of management's actions. However, until the information on corrective actions maintained by the Inspector General can be shown to be reliable, some type of verification by AAA would probably be necessary, such as correspondence, telephone calls, and reviews of follow-up records kept by Army commands as well as follow-up audits on more significant issues. Alternatively, AAA could establish its own tracking system which would function independently from the Army Inspector General's system. There would be some duplication, but considering the previously reported problems with the accuracy of data from the Army Inspector General's office, AAA may find this a desirable option.

We believe that Armywide audits are beneficial because they provide more comprehensive audit coverage of an issue and should identify systemic deficiencies. Some of AAA's localized work, such as military and civilian payroll audits, has the potential for identifying problems that could have an impact on Armywide financial management operations. In this respect, AAA could issue an overall capping report outlining the weaknesses identified at the individual sites. Such a summary could alert Army management to the possibility of commonly-occurring deficiencies throughout payroll operations.

AAA could make a significant contribution to the Army's major accounting system redesign effort. The redesign is a plan to correct long-standing problems and inadequacies which the Army has recognized in its accounting system. The Army started this system project in the mid-1970's to redesign its 60 accounting systems into fewer standard systems. We reviewed the Army's redesign efforts and reported in May 1987 that the Army needed an updated project plan and revised cost estimates to reflect management changes to the original redesign plan. About the time our report on the redesign efforts was issued, the Under Secretary of the Army requested that AAA perform a review to determine causes for the delays in completing the redesign. AAA's review resulted in suggestions in a March 1988 report to strengthen management authority and control over the Army's accounting system redesign effort. Since performing its review, AAA's monitoring efforts have been minimal.

We believe that AAA should continue an audit presence in this major redesign effort. Appendix III to Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies contains standards which encourage ongoing audit involvement wherein internal auditors (1) advise management on the design and development of accounting and financial management systems and (2) review and evaluate the system development process. Furthermore, audit involvement during a system's design is important because it is often more difficult and costly to correct problems and to incorporate adequate controls after a system has been implemented.

Another important type of work that AAA could undertake is to review the accuracy and validity of the figures in the financial reports (SF 220 and 221) which the Army submits annually to the Department of the Treasury. In addition, AAA could review the adequacy of the accounting systems which generate the information for the Army's financial reports. A possible approach to this type of work could be one that we

Chapter 2
Audit Coverage Could Be Constrained by
Resource Reductions

We reviewed AAA's audits for fiscal years 1986 through 1988 to determine the extent of coverage. With the exception of the Criminal Investigation Command, AAA conducted audits in each major Army command.

AAA's audit staff is allocated to 10 functional areas of operation, which include acquisition, financial management, and personnel and family support. We compared AAA's fiscal year 1987 functional area staff allocations to the Army's major budget appropriations and determined that AAA used 65 percent of its resources to audit functional area operations funded by the Army's three largest appropriations, namely military personnel, procurement, and operations and maintenance. These appropriations comprised 73 percent of the total Army budget for fiscal year 1987.

We recognize that a comparison of the Army budget and AAA's staff allocations gives only an approximation of how audit resources should be most effectively used. The vulnerability of an area to fraud, waste, and abuse, or the work of other evaluation groups might be justification to adjust resources toward some areas and away from others. For example, the current concern with Defense procurement might justify an increased use of audit resources in the functional areas involving procurement issues.

AAA has an annual audit planning process to establish a plan for providing audit coverage of Army operations. In developing its annual audit plan, AAA solicits suggestions for Armywide audits from the office of the Secretary of the Army and staff offices, major commands, AAA headquarters management and regional auditors general.

Army management requests for audits during the year extend audit coverage beyond the annual audit plan. In fiscal year 1987, senior Army officials requested more than 60 audits that were in addition to AAA's plan. According to AAA officials, because AAA responds to all high-level requests, planned audits must sometimes be delayed, often shifted into the next fiscal year. Because AAA's management information system does not accumulate data for audit postponements, we could not determine the exact number of planned audits delayed or shifted into the next year to accommodate management requests.

Although AAA's annual planning process appears to be an effective way to identify and schedule audits, AAA has not established long-range objectives for its audit program. We believe such objectives could establish AAA goals to be achieved, either programmatically or functionally,

Audit Coverage Could Be Constrained by Resource Reductions

Army Audit Agency audits resulted in reported monetary benefits of \$1.6 billion for fiscal year 1987 and included significant recommendations for improved Army operations. AAA has generally provided extensive audit coverage to the Department of the Army through its audits and responsiveness to audit requests from top Army management. Two areas where we believe AAA needs to focus more attention are audits of financial management and follow-up on its significant audit recommendations.

The Department of the Army has considered several proposals to reduce AAA staffing for fiscal year 1989. In April 1988, the Acting Secretary of the Army directed a 13-percent reduction in staffing. A reduction of this magnitude would have put audit resources at the lowest level in more than 11 years and could have significantly impaired the internal audit coverage in the Army. However, the reduction was limited in fiscal year 1989 to 3 percent, which is comparable to Armywide civilian personnel reductions for the year. In our opinion, the smaller reduction does not appear to impact audit coverage. At this time, the Army has not specified if additional reductions will be made in future years.

Audit Benefits Are Significant

Potential and realized benefits of AAA audits are significant. Considering AAA's fiscal year 1987 approved funding of \$40.2 million, identified monetary benefits represent a potential return of about \$40 for every dollar spent for AAA operations.

We reviewed working papers supporting approximately \$1.1 billion of the \$1.6 billion reported monetary benefits and found the amounts to be adequately supported. The following examples illustrate some of the monetary benefits and management improvements reported by AAA during fiscal year 1987:

- AAA found that three planned civil works water projects, estimated to cost about \$802 million, were based on assumed hydroelectric power benefits, with no assurance that the power was marketable. Auditors recommended canceling these projects because they were not economically justified. Army management agreed with the recommended cancellation and associated potential monetary benefits. This audit resulted in AAA's largest reported monetary benefit in fiscal year 1987.
- In an audit of a military exercise conducted to furnish training for soldiers in the tropical environment of Panama and Honduras, AAA found that controls over the receipt and use of ammunition, weapons,

We selected a sample of audit reports from 285 issued between October 1, 1986, and September 30, 1987. We did not include informal audit reports in our sample because they contained either no findings or insignificant findings and often involved a minimum amount of audit work. We excluded reviews of the Red Cross and activities not funded by congressional appropriations because they were not representative of AAA's major work. We classified the remaining 183 audits as large (those requiring more than 500 staff days), medium (those requiring 300 to 499 staff days), and small (those requiring fewer than 300 staff days); determined, judgmentally, the number of audits we would review; and judgmentally selected the specific audits within each of the staff day classifications. Where possible, in order to ensure that our sample contained a cross-section of AAA audits, we selected a small, medium, and large audit in which AAA had identified cost savings or cost avoidances available by implementing its recommendations, as well as a small, medium, and large audit with no identified monetary savings.

We reviewed 17 audit reports—6 from AAA's Northeastern region, 6 from the Southern region, and 5 from the European region. We reviewed the supporting working papers for a maximum of three audit findings which we judged to be the most important from each report. For each report, we interviewed and discussed all identified audit quality problems with auditors-in-charge or regional auditors general.

To evaluate the independence of AAA, we reviewed the reporting structure between the Auditor General and Army management. We also reviewed policy and procedure changes made as a result of the Goldwater-Nichols Department of Defense Reorganization Act of 1986. Finally, as part of our reviews of individual audits, we looked for any possible impairments to independence.

During our review, we met periodically with the Auditor General and his staff to discuss our evaluation results as well as our observations on other management practices which we thought AAA should consider adopting. In addition, we provided AAA headquarters and regional staff the detailed findings on each audit we reviewed. In all cases where we identified deficiencies, AAA was afforded the opportunity to provide additional information to support the reports' findings, conclusions, and recommendations or otherwise resolve our questions.

We performed our review between July 1987 and October 1988 at AAA headquarters in Alexandria, Virginia, and at three AAA regional offices

audits. Because AAA informal reports contain suggested actions rather than recommendations, a formal reply from the audited activity is not required.

Prior GAO Reviews

In our 1977 report on AAA operations, Why the Army Should Strengthen Its Internal Audit Function (FGMSD-77-49, July 26, 1977), we made several recommendations for improving the Army's internal audit activities, including follow-up of audit findings. The Army has taken action to implement most of the recommendations we made in 1977. In chapter 2 we discuss further actions which are needed to improve AAA's follow-up on audit recommendations.

The Army has developed an audit follow-up process that is managed by the Army Inspector General and internal review functions at major commands and installations. In 1985, AAA reviewed Army's follow-up system and identified continuing problems. In addition, we reported in 1987 that DOD management, including the Army, needed to (1) take prompt, responsive action on internal audit findings and recommendations and (2) ensure that closed recommendations have in fact been implemented (Audit Resolution: Responsiveness of Defense Management to Internal Audit Recommendations, GAO/AFMD-87-37BR, July 31, 1987). In December 1988, we reported instances of AAA recommendations closed by Army follow-up officials although corrective actions had not been taken. In this report, we recommended actions to strengthen DOD's policy for audit follow-up (Audit Resolution: DOD's Policy Can Be Strengthened; GAO/AFMD-89-8, December 16, 1988).

Objective, Scope, and Methodology

Our objective was to assess AAA's effectiveness by evaluating its allocation of audit resources, audit quality, and independence.

To accomplish our audit objective, we reviewed Army regulations pertaining to AAA operations, various AAA policies and procedures for conducting audits, the U.S. Army Audit Agency Handbook for Conducting and Managing Audits, DOD instructions and directives, and the DOD Internal Audit Manual. AAA and DOD directives require compliance with generally accepted government auditing standards, as contained in the Comptroller General's Standards for Audit of Government Organizations, Programs, Activities, and Functions, 1981 revision. These standards were revised in 1988 and are applicable to audits starting after January 1, 1989.

Introduction

The Department of Defense (DOD) internal audit organizations are responsible for determining whether funds are handled properly and programs are operated effectively, efficiently, and economically. In audits conducted during fiscal years 1983 through 1987, Army Audit Agency (AAA) auditors identified \$6.1 billion in monetary benefits that could be realized from implementing their audit recommendations. This total represents 38 percent of the \$16 billion in potential monetary benefits reported by all DOD internal auditors during the same period. The performance of these audit organizations is important to the Congress because DOD auditors have a vital responsibility to evaluate how well the resources given to DOD are being managed.

In light of this importance, the former Chairman, Subcommittee on Readiness, House Committee on Armed Services, asked us to review the effectiveness of the DOD audit organizations. This report on the AAA is the second in a planned series of reviews of DOD audit organizations. We issued the first report in the series, Naval Audit Service: Effectiveness of Navy's Internal Audit Organization Is Limited (GAO/AFMD-88-12), on February 24, 1988.

Background

The AAA is the centralized internal audit organization within the Department of the Army. Established by the War Department in 1946, AAA has as its mission to provide an independent and objective internal audit service to all Army organizations and activities and all aspects of management. To accomplish its mission, AAA assists the Army in determining whether management policies, practices, procedures, and controls are adequate in concept and effective in application; in ensuring financial integrity and effective use of resources; and in detecting fraud and waste within its various programs and activities.

AAA is headed by the Auditor General of the Army and consists of a headquarters office located in Alexandria, Virginia, and seven operating regional offices, six in the United States and one in Europe. The headquarters organization includes four directorates—one for planning, policy, and resource management, plus three operational directorates which are organized to align with DOD functional areas such as research and development, acquisition, supply and maintenance, and personnel management. For fiscal year 1988, AAA had an authorized strength of 861 individuals and a budget of \$41 million.

AAA categorizes its audits as multilocation, single location, and mandatory. A multilocation audit is a review of a system, program, or function

Contents

Executive Summary		2
Chapter 1		8
Introduction	Background	8
	Prior GAO Reviews	10
	Objective, Scope, and Methodology	10
Chapter 2		14
Audit Coverage Could Be Constrained by Resource Reductions	Audit Benefits Are Significant	14
	Audit Coverage Generally Extensive	15
	Impact of Staff Reductions	21
	Conclusions	23
	Recommendations	24
	Agency Comments and Our Evaluation	24
Chapter 3		26
AAA Needs to Improve Audit Quality Controls	Insufficient Evidence in Working Papers	26
	Not Reporting Underlying Causes of Findings	28
	Reorganization Has Enhanced Independence	30
	Conclusions	31
	Recommendations	31
	Agency Comments and Our Evaluation	31
Appendixes	Appendix I: Comments From the Department of Defense	34
	Appendix II: Major Contributors to This Report	37
Figure	Figure 2.1: Comparison of Changes in Army Budget and AAA Staffing for Fiscal Years 1981 to 1989	22

Abbreviations

AAA	Army Audit Agency
DOD	Department of Defense
GAO	General Accounting Office

Improvements Needed in Audit Quality Controls

GAO found insufficient evidence to support some of the key statements and positions in 5 of the 17 audit reports reviewed. The lack of support for these key statements could raise doubts as to the validity of AAA audit findings. The problem centers on AAA's regional offices being inconsistent in their implementation of AAA quality controls to verify information in draft reports.

Also, AAA auditors do not always report the underlying cause of identified problems. Identifying the cause of a problem is the basic element in developing a recommendation that will be effective in correcting the problem. The Auditor General has recognized the need to specifically report the cause of problems identified during audits and has recently stressed the need for increased management attention to this area. (See chapter 3.)

Recommendations

GAO believes AAA should develop a long-range audit plan which includes greater attention to audit follow-up and financial management coverage such as auditing Armywide financial management issues, accounting system redesign, and the data included in the Army's financial reports.

GAO recommends a number of specific actions to improve the quality of AAA audits. These recommendations center on efforts to improve the accuracy of report content and to ensure that sound recommendations are developed.

Agency Comments

DOD provided written comments on a draft of this report. (See appendix I.) With two exceptions, DOD generally concurred with the report. Specifically, DOD agreed that the 3-percent staff reduction imposed on AAA probably will not seriously impact AAA operations and coverage but that further reductions could adversely affect both audit coverage and quality. DOD also commented that AAA will improve its quality controls as GAO recommended. Several actions have already been taken and others are under way. The DOD Office of the Inspector General will monitor implementation of the agreed-to corrective actions. (See Agency Comments and Our Evaluation, chapter 3.)

DOD did not agree that AAA should review the financial reports the Army submits to the Department of the Treasury. DOD stated that such an effort would be premature in view of its plans to upgrade and integrate its financial systems. Instead, DOD believes systems audits will be more beneficial. GAO believes that audits of both accounting systems and

Executive Summary

Purpose

During fiscal years 1983 through 1987, the Army Audit Agency reported actual and potential cost avoidances and savings totaling \$6.1 billion. This total represents 38 percent of the \$16 billion in potential monetary benefits reported by all DOD internal auditors during the same period. Thus, audit work is very important to both the Congress and the Department of Defense as they try to balance defense needs with other budgetary demands.

The former Chairman, House Committee on Armed Services, Subcommittee on Readiness, requested that GAO review the effectiveness of the internal audit organizations within the Department of Defense by evaluating their allocation of audit resources, audit quality, and independence. This review of the Army Audit Agency (AAA) is the second in a planned series of reviews to meet this request.

Background

AAA was established by the War Department in 1946 as Army's internal audit organization. It is headed by the Auditor General of the Army, a civilian who reports to the Secretary of the Army. AAA's mission is to provide an independent and objective internal audit service to all Army organizations and activities.

In fiscal year 1988, AAA had an authorized staffing level of 861 and an operating budget of \$41 million. AAA issued 285 audit reports during fiscal year 1987, the most current year for which statistics were available at the time of GAO's review.

Results in Brief

The Department of the Army has considered several proposals to reduce AAA staffing for fiscal year 1989, ranging from a proposed 13-percent reduction to the actual 3-percent reduction that was imposed on AAA. GAO believes the 3-percent reduction probably will not seriously impact AAA operations and coverage. However, further reductions in future years could adversely affect audit coverage as well as quality.

Based on a review of AAA reports and working papers, GAO found that, while the findings in audit reports were generally supported, there was insufficient evidence for some key statements and positions in AAA reports. Also, AAA auditors are not always determining or reporting the cause of identified problems, thus impeding their ability to make effective recommendations. GAO found that AAA is independently and objectively carrying out its mission.

