

THE EVOLUTION OF AUDIT IN THE ARMY

The audit function has been an integral part of the Army from its inception. As you trace the audit function in the Army through the years, you can see the scope of the audit mission grow. The audit function began as a verification of vouchers prior to payment to full scope audits addressing program effectiveness and the economy and efficiency of operations. It also became apparent as the audit mission grew that the function needed to be more independent. The audit function moved from being a line function under the control of the finance department to an organizationally independent function reporting directly to the Secretary of the Army. A final trend you see throughout the evolution of the audit function is an effort to centralize the function to make it more cost effective and to eliminate duplication.

In this article we will trace the audit function in the Army from its inception and show how the mission increased, and the function became more independent and centralized.

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Era of 100 percent Audits

The auditing function has been an integral part of the Army's management control system from the very beginning. Early in the Revolution, George Washington, in his capacity as Commander-in-Chief of the Continental Armies, recognized the need for the auditing function. In an address to the Continental Congress, George Washington stated:

"I am truly sensible the time of the congress is much taken up with a variety of important matters, but the establishing of some office for auditing accounts is a matter of exceeding importance to the public interest. It is the minutia that must be gone into; the propriety of each charge examined, the vouchers looked into."

The examination of accounts was originally the responsibility of various committees of the Continental Congress, then that of a Superintendent of Finance and when the Treasury Department was created in 1789, the responsibility for these examinations transferred to the Treasurer. The Treasurer had officers called an Auditor and a Comptroller. The auditor had the duty of examining the accounts and certifying the balances to the Comptroller. The Comptroller remained under the Department of Treasury until the Budget and Accounting Act of 1921 established the General Accounting Office and moved it under the Legislative Branch.

During the remainder of the 18th and 19th centuries and into the 20th century, audits were performed on 100% of the vouchers. In the early part of the 20th century, the audit mission expanded to include 100% audits of military property.

World War II Forces Changes to Audit Process

With the build up of the armed forces prior to our entry into World War II, it became apparent that given the sheer volume of transactions, it would be impractical to audit each transaction. A board of officers was appointed to propose a system that would be more practicable for an Army greatly in excess of the present strength. The board recommended:

- The elimination of the requirement to prepare a detailed balance list of property at times of transfer of accountability and in connection with property audits.
- Audits of less than 100 percent scope.
- A simplified system of accounting for organizational property.

By the end of 1942, it became apparent that the audit process needed to be simplified even further. A March 1943 study approved by the Commanding General, Army Service Forces stated that one of the major stumbling blocks to the development of a simplified procedure for handling equipment and supplies was that the procedures, forms and records were built around the concept of pecuniary liability and complete auditing instead of around operational needs. As a result of the study, the pecuniary liability for property ceased except for property issued to an individual for their personal use and responsibility for controlling property became a function of command. In conjunction with this new philosophy, came inventory adjustment reports and reports of survey.

By 1945, the Army accounting system had gone from an exact system in prewar days to one that allowed accountable officers to use reports of survey and inventory adjustment reports to control an account in any manner they saw fit. The audit system also weakened as audits that identified accountability problems could be corrected by the installation commander, simply by signing an adjustment report. The Comptroller General severely criticized the War Department for the degradation of its system of auditing and accounting. The Comptroller General pointed out that the basic principle of auditing is that it should be performed by completely disinterested parties. The Comptroller also stated that the War Department didn't have a unified system for auditing, didn't have a training program and that decentralized and unrelated audit groups were inefficient and wasted manpower. The General Accounting Office recommended that the Army consolidate its audit function into one independent Agency.

After much discussion and negotiation, the Under Secretary issued a directive giving approval for the establishment of an independent audit agency. On 12 November 1946, War Department General Order No. 135 established the Army Audit Agency as a division within the Office, Chief of Finance and responsible to the Under Secretary of War. The General Order provided that the Army Audit Agency would perform, within the zone of the interior (CONUS), on an Army-wide basis, audits of:

- Military property and sales accounts.
- Civilian payroll records.
- Industrial property accounts.
- Current, completed and terminated contracts to include contractor accounts.
- Accounts pertaining to all activities under appropriations for civil functions of the War Department.

General Order No. 83, issued on 30 August 1947, expanded the Agency's role to include providing technical supervision of audit operations in overseas commands.

The 1950's and 1960's Bring Significant Changes to Audit Process

The 1950's and 1960's saw the audit mission expand significantly from financial control and accountability into the operational side of the Army. The centralization of the audit function also continued.

In the 1950's, the Army Audit Agency undertook a comprehensive study of the internal audit area. The study resulted in the issuance of Army Regulation 36-5 on 30 June 1952. The regulation expanded the Agency's audit responsibility to appropriation and fund accounting, receipts and disbursements of cash, military pay, nonappropriated funds, financial aspects of procurement and working capital funds.

The biggest change occurred in the area of contract auditing. Prior to 1952, contract audits were limited to the verification of costs claimed by the contractor and examination of contractor maintained records of Government property. During the period 1952-1955, significant advances were made in the area of contract audits.

- Voucher verifications under cost type contracts evolved into comprehensive reviews of contractors' records and controls.
- Audits of industrial property were integrated with the related cost examinations.

In 1961 the concept of "management audits of contractors" was initiated to assist procurement officials in deterring and reducing costs. The audits consisted of two phases:

- The pre-award phase was an analysis of contractor pricing proposals and the performance of accounting and financial system surveys.
- The contract administration phase was an assessment of the costs claimed by the contractor to determine if they were incurred and were proper charges to Government contracts.

Another significant change in the way audits were performed occurred with the establishment of installation audits. Up to this point, the Army Audit Agency did individual audits of military property accounts, cash accounts, appropriation and fund accounting etc.

and prepared a separate report for each accountable office. Beginning in May 1953, the Agency did its first installation audits. These audits addressed all the functions on the installation. This new concept also expanded beyond the examination of books and accounts to the evaluation of controls and management of total resources by installations and contractors.

The audit mission expanded again in 1965 when Congress became concerned over the quantity of supplies and materials being sent to Vietnam and asked the General Accounting Office to do a review. The General Accounting Office issued a report in July 1966 recommending the resumption of audit activity in the combat theater. In August 1966, the Army Audit Agency was directed to develop an audit plan and to propose an organization and locations. The Audit Agency established the Saigon field office on 1 February 1967 with an authorized strength of 15 personnel. This office provided audit coverage in the combat theater until it was closed on 10 February 1973. Since this time, audit has been embedded in combat theaters to include during and after Operations Desert Storm, Joint Endeavour, Joint Guard, Enduring Freedom and Iraqi Freedom.

As the audit mission expanded, efforts were underway to centralize the audit function. In December 1954, a Department of Defense Order transferred audit responsibility for overseas audit activities to the Army Audit Agency. Before this, each overseas command had its own audit activity. This order consolidated all audit in the Army under one Agency. In 1965, actions were taken to further consolidate audit. On 1 July 1965, DoD Directive 5105.36 established the Defense Contract Audit Agency and consolidated the contract audit function into one entity at the DoD level and accordingly the personnel performing this function. Before, 1965, each service had their own contract audit team. On 20 August 1965, DoD Instruction 7600.3 established a requirement that all internal audit responsibilities in each department be carried out by a central audit organization to assure independence and comprehensive audit coverage.

The 1970's Brings More Changes in the Audit Mission and Significant Organizational Changes

The 1970's began with significant discrepancies and irregularities at the clubs and messes being brought to the attention of Congressional committees. In response to inquiries by the Congress, the Secretary of the Army requested The Auditor General to perform a special worldwide survey of the operations of Army clubs and open messes. The survey resulted in the Secretary of the Army assigning the U.S. Army Audit Agency responsibility for performing 75 percent of the annual audits of the Army clubs and open messes—the remaining 25 percent were to be performed by contractors. This created a significant workload for the Agency that continued through the remainder of the 70's and into the 1980's.

The Audit function also went through considerable organizational alignment changes in the 1970's. In August 1974, General Order No. 26 transferred the Army Audit Agency from under the Comptroller of the Army to a field operating agency under the jurisdiction of The Inspector General and Auditor General. This provoked Congressional concern and a review by the General Accounting Office that was very critical of the Army's internal audit function.

The report, issued in July 1977, cited numerous deficiencies to include that the internal audit function was not placed high enough in the organization and that the Agency was headed by a military officer which was contrary to DoD policy. A House of Representatives' report was issued soon thereafter titled "Improving Internal Audit in the Department of the Army." The report was critical of the decreasing strength of audit resources in the department and the use of the resources to do non-audit services and nonappropriated audits.

As a result of these reports, the Chief of Staff issued a Memorandum reassigning the Army Audit Agency from a field operating agency under the Inspector General and Auditor General to a field operating agency under the jurisdiction of the Office of the Chief of Staff, Army and directed that a new civilian position of Auditor General be created. The first civilian Auditor General was selected and assigned effective 29 October 1979.

Changes to the Audit Mission Continue in the 1990's

After a relatively stable 1980's, where the only notable change in the audit function occurred as a result of the Goldwater Nichols Act of 1986, (The Act increased the Army Audit Agency's independence by realigning it under the sole jurisdiction of the Secretary of the Army), the 1990's brought significant changes to the audit function. The decade began with the issuance of the Chief Financial Officer's Act of 1990. This Act required federal agencies to prepared financial statements and for the statements to be audited. This changed the audit workload in the Army Audit Agency significantly. Before this Act, the Agency was doing a minimal amount of financial audits. However, after the Act was signed the audits of the Army's General Fund, Working Capital Fund and Corps of Engineers Civil Works Statements consumed over 20 percent of the Agency resources for the majority of the 1990's. At the same time, the Army Audit Agency, in an attempt to become more responsive to Army leaders, began conducting consulting services. This new service caught on and grew to about 15 percent of the Agency's resources in 2001.

The consulting service trend, which had also become a big part of the public accounting firms' mission, came crashing down after the Enron collapse and the issuance of the Sarbannes Oxley Act in 2002. The General Accounting Office, which was already in the process of updating the Generally Accepted Government Auditing Standards (GAGAS), issued standards that all but ended audit organizations from providing non-audit services and auditing services to the same client—much like Sarbannes Oxley did to the public accounting firms. The new standards established two overarching principles:

- Audit organizations should not provide nonaudit services that involve performing management functions or making management decisions.
- Audit organizations should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant /material to the subsequent matter of audits.

The new standards eliminated the Army Audit Agency's performance of consulting services and shifted the Agency's focus back to providing comprehensive audit services.

Army Audit Agency Today

AAA is the only internal audit organization in the Army. AAA's mission is to serve America's Army by providing objective and independent auditing services. AAA helps the Army make informed decisions, resolve issues, use resources effectively and efficiently, and satisfy statutory and fiduciary responsibilities.

To accomplish this mission, the AAA does comprehensive, independent and objective assessments of an Army entity, function, program or activity in accordance with generally accepted government auditing standards. All audit organizations in the government are bound by these standards which are issued by the Comptroller General. In accordance with these standards, the AAA does three basic types of audits:

Performance Audits. This is by far the largest portion of AAA's workload. These audits focus on program effectiveness—audits that measure the extent to which a program is achieving its goals and objectives—and economy and efficiency—audits that determine whether an entity is acquiring, protecting and using its resources in the most productive manner to achieve program objectives.

Financial Audits. These audits are primarily concerned with providing reasonable assurance about whether financial statements are presented fairly. The AAA provides financial audit support to the Army in support of its annual financial statements—General Fund, Working Capital Fund and Civil Works. This includes ensuring financial controls and financial systems will allow the Army to produce reliable financial data.

Attestation Engagements. These audits are a review of a specific assertion made by an Army activity. These include asserting to the accuracy of the A-76 studies, correction of material weaknesses, and accuracy of performance measures or other data such as the data supporting the Army's recommendations to the Base Realignment and Closure Commission. These audits are generally requested by an Army organization that needs to assert to the accuracy of data being provided to a higher level or outside organization.

AAA uses a strategic audit planning process that ties its audit plan to the Army's Strategic Readiness System. The process involves the review of the Army's corporate documents—The Army Plan, Army Campaign Plan, Transformation Roadmap etc.—along with extensive communication with Army leadership to identify key Army issues that would benefit from audit. Examples of issues AAA is answering include:

- Are estimated Base Realignment and Closure savings supported, realistic and achievable?
- Is the Elimination of Chemical Weapons Program achieving its mission of destroying the nation's stockpile of unitary munitions within established cost and schedule milestones?
- Is the Army applying a "risk management approach (which includes a systemic, analytical process) to determine the likelihood that a threat will negatively impact

physical assets, individuals or operations and identifying the actions needed to reduce risks?

AAA designs a series of audits to answer these issues and provide the Army leadership with timely information to achieve its strategic readiness goals.

To accomplish its mission, the AAA is functionally aligned. It is headed up by The Auditor General of the Army and the Principal Deputy. The Agency has 3 Deputy Auditors General, each of whom is in charge of specific aspects of Agency operations (Acquisition and Logistics Audits, Forces and Financial Audits, and Policy and Operations Management). The Agency is headquartered in Alexandria, Virginia, and has 23 field offices—21 in the Continental United States and 3 overseas (in the Republic of Korea, Hawaii, and Germany).