

Inspector General

United States
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Quality Control Review of the Defense Finance and Accounting Service Audit Organization

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Department of Defense Inspector General
OIG-APO
ATTN: Suite 11H25
4800 Mark Center Drive
Alexandria, VA 22350-1500



Acronyms and Abbreviations

ACE	Audit Client Executive
AICPA	American Institute of Certified Public Accountants
DFAS	Defense Finance and Accounting Service
GAGAS	Generally Accepted Government Auditing Standards
IR	Internal Review
MOCAS	Mechanization of Contract Administration Services
OMB	Office of Management and Budget



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

FEB 28 2013

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Quality Control Review of the Defense Finance and Accounting Service Audit Organization (Report No. DODIG-2013-047)

We are providing this report for your review and comment. We have reviewed the system of quality control for the audit organization of the Defense Finance and Accounting Service Office of Internal Review (DFAS IR) in effect for the period ended June 30, 2011. We determined that the audit organization's system of quality control for audits was suitably designed in accordance with quality standards established by generally accepted government auditing standards (GAGAS). However, the audit organization did not comply with the system of quality control to provide DFAS IR audit management with reasonable assurance of performing and reporting in conformity with GAGAS in all material respects. Accordingly, we are issuing a fail opinion on the audit organization's system of quality control used on audits for the review period ended June 30, 2011.

GAGAS require that an audit organization performing audits in accordance with GAGAS have an appropriate internal quality control system in place and undergo an external quality control review at least once every 3 years by reviewers independent of the audit organization being reviewed. An audit organization's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance that they meet the objectives of the quality control. We tested the DFAS IR audit organization's system of quality control to the extent we considered appropriate.

Appendix A discusses our review of the DFAS IR system of quality control and Appendix B contains matters that resulted in the fail opinion. In addition, Appendix C contains comments and observations where the DFAS IR audit organization can improve its quality control program related to auditing practices. Appendix D contains the scope and methodology of the review.

Please provide comments to the final report by March 29, 2013.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877).

A handwritten signature in black ink, appearing to read "R. Stone", is written over the typed name.

**Randolph R. Stone
Deputy Inspector General
Policy and Oversight**

Introduction

Defense Finance and Accounting Service

The Defense Finance and Accounting Service (DFAS) is the world's largest finance and accounting operation. DFAS pays all DoD military and civilian personnel, retirees and annuitants, as well as major DoD contractors and vendors. DFAS also supports customers outside of the Department of Defense, to include the Executive Office of the President, Department of Veterans Affairs, and the Department of Health and Human Services. In FY 2011, DFAS:

- processed 171.7 million pay transactions,
- made 7.7 million travel payments,
- paid 11.8 million commercial invoices,
- managed \$559.4 billion in military retirement and health benefits funds,
- made \$608 billion in disbursements to pay recipients, and
- maintained 264.1 million general ledger accounts.

DFAS Internal Review Organization

DFAS Internal Review (IR) is an independent office within DFAS that provides responsive, professional and objective services to enhance DFAS stewardship and value to its customers. DFAS IR examines programs, systems, and processes and provides information, analyses, recommendations, and other assistance applicable to DFAS management's objectives. The Director, Internal Review, reports directly to the Deputy Director, DFAS. The DFAS IR audit organization has offices in Columbus, Ohio; Cleveland, Ohio; and Indianapolis, Indiana. Additional details on the DFAS IR organization and the scope and methodology for this review are contained at Appendix D.

Appendix A. System of Quality Control Was Suitably Designed

With the exception of a few areas, DFAS IR's system of quality control was suitably designed. Generally accepted government auditing standards (GAGAS) 3.52,¹ requires that each audit organization must document its quality control policies and procedures and communicate those policies and procedures to its personnel. DFAS IR had established its comprehensive quality control system in the DFAS IR Policies and Procedures Manual (the Manual²).

The areas in the Manual requiring improvement included inaccurate policies and procedures pertaining to attestation engagements and reaching a consensus on audit findings. However, the issues we identified with DFAS IR's system of quality control were not cumulatively significant enough to rise to the level of deficiency or significant deficiency. In addition, we made other recommendations in Appendix B pertaining to the policies and procedures where appropriate based on the type of significant deficiency we found.

DFAS IR's quality control policies and procedures required amending because they provide inaccurate information. Specifically, the Manual, Exhibit 1700-6, Attestation Engagements Plan, December 2010, contains the following guidance:

The Institute of Internal Auditors Performance Standard 2201³ states that in planning an engagement, auditors should consider the significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.

GAGAS 1.16a states for performance audits, auditors may use other standards in conjunction with GAGAS, such as the "International Standards for the Professional Practice of Internal Auditing." However, the "International Standards for the Professional Practice of Internal Auditing" does not apply to attestation engagements. DFAS IR's inclusion of this information within Exhibit 1700-6 misleads audit personnel on the planning requirements for attestation engagements.

In addition, the second area requiring improvement in the Manual for attestation engagements is the presentation of inaccurate information in Exhibit 1700-4, the Agreed-Upon Procedures Completion Checklist. GAGAS 6.01 and American Institute of Certified Public Accountants (AICPA) standards limit the work performed to specific procedures performed on a subject matter and require the report on agreed-upon procedures to be in the form of procedures and findings, and not indicate any level of assurance. However, Exhibit 1700-4 contained steps to

¹ The newest version of GAGAS is dated December 2011. However for this review, we were required to use the July 2007 version of GAGAS, as it covered the period of our review, October 1, 2009 to March 31, 2011.

² The Manual was updated in 2008, 2009, and 2010. We used those versions to conduct our external quality control review.

³ The Institute of Internal Auditors Performance Standard 2201 refers to the "International Standards for the Professional Practice of Internal Auditing."

check for documentation in the project files to support conclusions, recommendations, and elements of findings.

Additionally, the Manual should be updated to include guidance for situations in which consensus on audit findings and plans of action are not possible to ensure timely reporting of audit results. Though the Manual contains policies and procedures on the process DFAS IR uses to report DFAS management views on audit findings, situations may arise when DFAS management does not agree with the audit findings or proposed plans of action, which could impact the timeliness and relevance of the DFAS IR audit report.

DFAS IR encourages personnel to work with DFAS management to reach an agreement on audit findings and related plans of action to address deficiencies. The Manual, Chapter 1300, Preparing the Audit Report, December 2010, states that the Audit Manager, Audit Client Executives (ACE), and Deputies should continue working with DFAS management until DFAS management concurs and keep the audit team informed. Further, Chapter 1230, Developing the Findings, July 2008, states that the audit team must⁴ work with DFAS management and program officials when developing action plans. Meetings with DFAS management to discuss and finalize action plans should include the applicable DFAS IR managers necessary to reach a consensus and must be documented in the working papers. Audit issues that the staff and DFAS management cannot agree on must be elevated up the DFAS IR chain of command for action.

GAGAS 8.36 states that when the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditor's recommendations, the auditors should evaluate the validity of the entity's comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement. Conversely, the auditors should modify their report as necessary if they find that the comments are valid and supported with sufficient appropriate evidence.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 1. Update the DFAS IR Policies and Procedures Manual to include policies and procedures that:**
 - a. Remove all references to the “International Standards for the Professional Practice of Internal Auditing,” from Chapter 1700, Attestation Engagements, December 2010.**

⁴ For Manual references within this report, language that is bolded and underlined was emphasized by DFAS IR.

Management Comments

The Director, DFAS, agreed stating that the DFAS IR Policies and Procedures Manual, Attestation Chapters 4, 5, and 6 will replace Chapter 1700 from the previous manual and will not make reference to any standards other than GAGAS and AICPA Standards for Attestation Engagements. The DFAS IR Policies and Procedures Manual will be updated by February 1, 2013. The Director, DFAS, also stated that GAGAS 5.44b, 5.52b, and 5.62b do allow the possibility of following the “International Standards for the Professional Practice of Internal Auditing” in attestation engagements.

Our Response

DFAS comments were responsive. We do agree that GAGAS 5.44b, 5.52b, and 5.62b indicate that internal audit organizations may also follow the “International Standards for the Professional Practice of Internal Auditing” when communicating the results of attestation engagements. However, the Manual, Chapter 1700, Attestation Engagements, December 2010, did not contain information on this requirement. Instead, the Manual directed auditors to follow the “International Standards for the Professional Practice of Internal Auditing” when executing planning for attestation engagements instead of AICPA or GAGAS standards. No additional comments are needed.

- b. Revise Exhibit 1700-4, Agreed-Upon Procedure Completion Checklist, and remove the GAGAS fieldwork and reporting standards that are not applicable.**

Management Comments

The Director, DFAS, agreed stating that the DFAS IR Policies and Procedures Manual, will not include the Exhibit 1700-4 completion checklist. A revised checklist will be incorporated as a TeamMate template and will not contain Performance or Financial audit fieldwork or reporting standards. The DFAS IR Policies and Procedures Manual will be updated by February 1, 2013.

Our Response

DFAS comments were responsive. No additional comments are needed.

- c. Reference GAGAS 8.36 guidance to address situations where consensus on the auditor’s findings or proposed plans of action is not possible.**

Management Comments

The Director, DFAS, agreed. She stated that the GAGAS 2007 version 8.36 paragraph is now paragraphs 4.38, 5.37, and 7.37 in the GAGAS December 2011 version. Further, she stated except for GAGAS paragraph 4.38 which pertains to financial audits and is not applicable, the GAGAS paragraphs 5.37 and 7.37 will be incorporated into the DFAS IR Policies and Procedures Manual. The DFAS IR Policies and Procedures Manual will be updated by February 1, 2013.

Our Response

DFAS comments were responsive. No additional comments are needed.

Appendix B. Significant Deficiencies That Provide the Basis for the Fail Opinion

We identified significant deficiencies that existed in DFAS IR's compliance with its system of quality control. GAGAS 3.51 states that an audit organization's system of quality control encompasses the audit organization's leadership, emphasis on performing high-quality work, and the audit organization's policies and procedures designed to provide reasonable assurance of complying with professional standards and applicable legal and regulatory requirements. The significant deficiencies identified do not provide the DFAS IR audit organization with reasonable assurance of performing and reporting in conformity with GAGAS in all material respects. Therefore, we are issuing a fail opinion on its external quality control review.

Significant deficiencies affecting our opinion on the DFAS IR audit organization's compliance with its system of quality control are:

- DFAS IR did not exercise sufficient professional judgment as evidenced by substantive noncompliance with GAGAS, AICPA standards, and its system of quality control on seven of eight assignments reviewed;
- Internal quality control monitoring of projects was not effective;
- Quality control checklists for a project were not effective;
- Supervisory reviews of work performed did not prevent repeated instances of noncompliance with GAGAS, AICPA standards, or DFAS IR policies and procedures;
- Project type changes caused significant noncompliance with GAGAS and DFAS IR policies and procedures;
- Performance of nonaudit services created an organizational impairment to independence;
- A nonaudit service was reported on as an engagement survey; and
- Substantive noncompliance with GAGAS, AICPA Standards for Performing and Reporting on Agreed-Upon Procedures and Examination Attestation Engagements, and DFAS IR policies and procedures.

These significant deficiencies provide the basis for the opinion and our concerns about the audit organization's inability to comply with the DFAS IR quality control system to provide reasonable assurance of compliance with GAGAS.

Implementing the recommendations identified in this report would assist the DFAS IR's efforts in improving its audit organization's system of quality control and help to increase compliance with GAGAS requirements.

Failure to Exercise Sufficient Professional Judgment

We determined that the DFAS IR audit organization did not exercise professional judgment due to the vast array of noncompliances found in the majority of auditing standards areas including, but not limited to, independence, planning, supervision, performing and reporting attestation

engagements, reporting, and quality control. Specific examples of the audit organization's lack of professional judgment are included in Tables 1 and 2 and are discussed in detail throughout this report. An "X" in the column indicates that the project reviewed did not comply with the standard.

Table 1. Deficiencies for Performance Audits and Attestation Engagements

Project Reviewed	Independence	Professional Judgment	Planning	Supervision	Evidence and Documentation	Reporting	Criteria	Quality Control
Columbus Audit Office								
Review of Mechanization of Contract Administration Services (MOCAS) Erroneous Payments*	X	X	N/A	N/A	N/A	N/A	N/A	X
Agreed-Upon Procedures: MOCAS Accounts Payable**	X	X	X	X		X	X	X
Cleveland Field Office								
Audit of Internal Controls over the Thrift Savings Plan Voucher Process	X		X		X		N/A	X
Transitional Readiness Audit of the R&A Pay Conversion to the Government	X	X	X	X	X	X	N/A	X
Indianapolis Field Office								
Vendor Pay Erroneous Payment Audit Round Six*	X	X	N/A	N/A	N/A	N/A	N/A	X
Independent Examination of the Columbus Cash Accountability System, Phase 2**	X	X	X	X	X	X	X	X

*We determined the MOCAS Erroneous Payments and the Vendor Pay Erroneous Payments projects were nonaudit services.

DFAS IR reported these projects as audits conducted in accordance with GAGAS.

**The Criteria column is applicable only to the two attestation engagement projects.

Table 2. Deficiencies for Nonaudit Services⁵

Project Reviewed	Independence	Quality Control
Columbus Audit Office		
End-to-End Assessment of DFAS Texarkana Operations	X	X
Indianapolis Audit Office		
Closeout: Survey of DFAS Certifying Legislation, Standard Operating Procedures*	X	X

*The Engagement Survey was not announced or reported as a GAGAS performance audit or attestation engagement.

Deficiencies in multiple standards areas, which evidenced a lack of professional judgment, were reflected at all DFAS IR audit offices. The Cleveland audit office was noncompliant in seven standard areas for one performance audit reviewed and had four deficiencies for the other performance audit reviewed. The Columbus and Indianapolis offices were noncompliant in three standard areas for two performance audits reviewed, which we determined were actually nonaudit services that involved the auditors performing a management function. Two additional nonaudit service engagements completed by the Columbus and Indianapolis offices disclosed a lack of consideration of GAGAS independence requirements. The attestation engagement completed by the Columbus audit office was noncompliant in seven standard areas and the attestation engagement completed by the Indianapolis audit office was noncompliant in eight standard areas. The significant deficiencies in independence, supervision, reporting, quality control, and professional judgment coupled with the deficiencies in multiple other GAGAS areas serve as the basis for the fail opinion.

Quality Assurance Program

The DFAS IR internal quality control monitoring did not identify noncompliances with GAGAS and the Manual for a project that we identified as part of our review. GAGAS 3.54 states that audit organizations should analyze and summarize the results of their monitoring procedures at least annually and identify any systemic issues needing improvement, along with recommendations for corrective action.

The Manual Chapter 1100, Quality Control System, September 2010, states:

To comply with GAGAS 3.54, DFAS IR managers will conduct annual monitoring of audit procedures under IR's Enterprise Risk Management Program and provide recommended corrective actions to address any identified systemic issues. Risk identification, assessment of controls, and testing will serve to measure product quality regarding

⁵ GAGAS does not cover professional services other than audits and attestation engagements. However, audit organizations that provide nonaudit services must evaluate whether providing the service creates an independence impairment.

adherence to GAGAS, IR audit policies and procedures, and other supplemental guidance, as applicable.

Internal Quality Control Monitoring of One Project Failed to Identify GAGAS Noncompliance

The DFAS IR's FY 2011 Enterprise Risk Management report October 3, 2011, identified six quality control areas needing improvement such as consideration of fraud risk factors, audit planning, and reporting. Project Number CL08PRP010CL, Transitional Readiness Audit of the Retired and Annuitant (R&A) Pay Conversion to the Government, August 30, 2010, was included as part of DFAS IR's internal quality control monitoring and was also evaluated during our external quality control review. DFAS IR staff did not identify several noncompliances with GAGAS and DFAS IR policies and procedures.

DFAS IR changed a nonaudit service to a limited scope performance audit and inappropriately classified the change as a change in project scope, despite the fact that most of the fieldwork was completed and performed as a nonaudit service. When the project type was changed, DFAS IR was required to adhere to the GAGAS standards for general and performance planning, and fieldwork and reporting.

DFAS IR did not consider the independence implications resulting from the decision to change the work from a nonaudit service to a limited scope audit when the same personnel were conducting the work. As a supplemental safeguard for maintaining auditor independence when performing nonaudit services, GAGAS 3.30c states that audit organizations should exclude personnel who provided the nonaudit services from planning, conducting, or reviewing audit work in the subject matter of the nonaudit service. The Manual, Chapter 1210, Planning the Audit, July 2009, requires the Audit Manager to preclude personnel who performed related nonaudit services from participating in planning, conducting, or reviewing audit work related to the nonaudit services under the principle that auditors cannot audit their own work.

Further, the Manual, Chapter 1500, Nonaudit Services, July 2009, states that the appropriate Audit Client Executive (ACE) **must** establish and document an understanding with DFAS management regarding the objectives, scope of work, and product or deliverables of the nonaudit service. The ACE should also establish and document an understanding with management that management is responsible for the substantive outcomes of the work. Therefore, ACEs have a responsibility to be in a position, in fact and appearance, to make an informed judgment on the results of the nonaudit service. There was no evidence in the project files to indicate that DFAS IR considered these requirements when the nonaudit service was started.

DFAS IR's failure to identify significant noncompliance with GAGAS was caused by its insufficient understanding of the use and application of GAGAS. Further, DFAS IR reviewers did not have an adequate understanding of their organization's policies and procedures. As a result, DFAS IR personnel did not identify significant departures from GAGAS and internal requirements to address issues that we found.

Quality Control Checklists for One Project Was Not Effective

As part of the quality assurance program, DFAS IR created numerous checklists that require auditors to consider GAGAS and AICPA standards and the Manual when performing and reporting the results of their work. In most instances, the required checklists were completed by auditors and managers. However, for Project Number IN10SRA004CO.00, Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2, March 18, 2011, the quality control checklists were not effective.

- The Internal Review Project Checklist for Attestation Engagements was completed for this project. The Reporting section of this document contained elements applicable to attestation engagement reporting. However, the responsible auditor and manager signed that the steps were completed, despite the lack of required information in the final report. As a result, the report did not comply with numerous GAGAS and AICPA reporting requirements.
- The Internal Review Project Checklist for Attestation Engagements was not included in the Manual and not recognized as official DFAS IR policies and procedures. Instead, Exhibit 1700-5, Examination or Review Completion Checklist, December 2010, outlined the procedures auditors were expected to follow to ensure their work complied with GAGAS and AICPA standards. Exhibit 1700-5 required auditors to provide written documentation if they did not follow specific requirements or if a requirement was not clearly relevant to the work performed. If the auditors had considered the detailed requirements in Exhibit 1700-5, most of the deficiencies noted by the external reviewer may have been corrected prior to the project's completion.
- A checklist that was similar to Exhibit 1330-3a, Independent Referencing Checklist for Performance Reviews, December 2010, was used to evaluate this examination attestation instead of the correct one. This checklist was titled Independent Referencing Checklist and was not part of DFAS IR's official policies and procedures. Because the checklist addressed DFAS IR's reporting requirements for audits, many of the items were indicated as not applicable by the reviewer. However, the Manual's Exhibit 1330-3c, Independent Referencing Checklist Examination and Reviews, December 2010, was not used by the independent reviewer nor required by the responsible audit manager. Additionally, Exhibit 1330-3c did not include specific information on GAGAS or AICPA requirements for performing and reporting examination attestations. Lastly, one of the steps in Exhibit 1330-3c required the independent reference to verify that the auditor had completed Exhibit 1700-5, Examination or Review Completion Checklist, as part of their review. If the independent referencer had used the correct checklist during their review, auditors may have been required to consider the requirements within Exhibit 1700-5.
- An independent referencing review was conducted on the draft report. However, a comparison of the draft and final reports disclosed significant changes, which were not verified by an independent party prior to the report's release. Chapter 1330, Independent Referencing, December 2010, states that when information is added, modified, or deleted from a previously referenced report, the referencer ensures that

changes do not affect unmodified sections of the report. The referencer then completes independent referencing for all added information and any modifications made to previously referenced sections of the report.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 2. Establish a 2-year plan to review all audit offices for compliance with internal quality assurance policies and procedures and GAGAS.**

Management Comments

The Director, DFAS, agreed stating that by March 1, 2013, DFAS IR will develop a plan to review all audit offices for compliance with internal quality assurance policies and procedures and GAGAS.

Our Response

DFAS comments were responsive. No additional comments are needed.

- 3. Revise the DFAS IR Policies and Procedures Manual, Exhibit 1330-3c, to include specific information on GAGAS and AICPA requirements for performing and reporting attestation engagements.**

Management Comments

The Director, DFAS, agreed stating that the DFAS IR Policies and Procedures Manual will include the specific GAGAS and AICPA requirements for performing and reporting attestation engagements. Further, she stated that there is no Exhibit 1300-3c in the current DFAS IR manual as referenced in the recommendation. However, if Exhibit 1330-3c was the exhibit in question, that checklist will reside in a TeamMate template and will be updated to reflect the necessary elements for attestation reviews. The DFAS IR Policies and Procedures Manual will be updated by February 1, 2013.

Our Response

DFAS comments were responsive. The exhibit in question was 1330-3c and we have revised the recommendation to reflect that. No additional comments are needed.

Supervisory Review of Projects Did Not Prevent Repeated Noncompliance With GAGAS, AICPA Standards, or DFAS IR Policies and Procedures

For three of the four performance audit and attestation projects reviewed, supervision was not adequate. Although the projects contained evidence of supervisory reviews, we identified

significant noncompliance with GAGAS and AICPA standards. Further, DFAS IR management repeatedly did not follow policies and procedures described in the Manual.

GAGAS paragraphs 7.52 and 7.53 contain the following requirements for audit supervision for performance audits:

Audit supervisors or those designated to supervise auditors must properly supervise audit staff. Audit supervision involves providing sufficient guidance and direction to staff assigned to the audit to address the audit objectives and follow applicable standards, while staying informed about significant problems encountered, reviewing the work performed, and providing effective on-the-job training.

For attestation engagements, GAGAS 6.04 requires that auditors must adequately plan the work and properly supervise any assistants. Further, GAGAS 6.22c states that auditors should document evidence of supervisory review, before the engagement report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the engagement report.

The Manual, Chapter 1100, Quality Control System, September 2010, requires thorough reviews of all working papers, audit/attestation documentation, and draft reports to ensure accurate, relevant, timely, efficient, economical, and effective reports. DFAS IR managers are required to review these products to ensure that they meet standards, are understandable, relevant, and practical. Further, Chapter 1000, Overview of the DFAS Internal Review Directorate, April 2010, describes the responsibility of each DFAS IR manager to ensure that all work products comply with relevant standards.

Those responsibilities include the following:

- The Director and Deputy Directors of DFAS IR are the executives responsible for ensuring that the overall operations conform to GAGAS.
- DFAS IR has two ACEs that support DFAS Operations, Strategic Business Management, and Corporate Organizations. ACEs ensure that specific functional and policy concerns of DFAS leadership are addressed, and that they have input into the work plan, and provide information and feedback on all reviews affecting them. The ACE also reviews draft and final reports for quality and adherence to applicable standards.
- DFAS IR has eight managers that manage performance reviews, system reviews, and data mining projects. The managers provide oversight of ongoing work by participating in the engagement planning, advising teams on standards and techniques, and reviewing working papers, as necessary.

Specific examples of the deficiencies in supervision are detailed in Table 3.

Table 3. Supervision Deficiencies

Project	Listing of Deficiencies in Supervision
Audit of the Retired and Annuitant (R&A) Pay Conversion to the Government	<ul style="list-style-type: none"> Supervisors directed staff to change the project type from a nonaudit service to a limited scope performance audit. However, the same staff continued to perform the work, supervise staff, and report the results. Supervisors did not require staff to develop a written audit plan. GAGAS 7.50 requires auditors to develop a written audit plan for each audit. The Manual Chapter 1210, Planning the Audit, July 2009, states that the team must prepare a written plan for each audit. Final approval of the audit plan and audit program is the responsibility of the Audit Manager, Deputy, and ACE. Although there was adequate evidence that DFAS IR communicated the planning and performance of the nonaudit service to DFAS management, the project files did not contain any evidence that DFAS IR communicated its decision to change from a nonaudit service to a limited scope performance audit to DFAS management.
Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2, and the Agreed-Upon Procedures: MOCAS Accounts Payable	<ul style="list-style-type: none"> The examination and the agreed-upon procedures engagements did not comply with most of the GAGAS and AICPA reporting requirements. The agreed-upon procedures project did not comply with the AICPA reporting requirements, which require the report to be presented in the form of procedures and findings. Instead, the report included procedures, results, conclusions, and recommendations. An independent referencing review was conducted on the draft examination report. However, a comparison of the draft and final reports disclosed significant changes which were not verified by an independent party prior to the report's release.

Management Comments on the Finding and Our Response

Management Comments

The Director, DFAS, did not agree with our conclusion that the Agreed-Upon Procedures MOCAS Accounts Payable project had supervision deficiencies related to independent reference reviews. Specifically, there were not significant changes that were not verified by the independent reference reviewer.

Our Response

The deficiency related to independent reference reviews was related to the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2 project and not the Agreed-Upon Procedures: MOCAS Accounts Payable project.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 4. Establish and document by February 28, 2013, a quality control monitoring process to ensure that supervision is sufficiently improved to increase compliance with GAGAS, AICPA standards, and the DFAS IR Policies and Procedures Manual.**

Management Comments

The Director, DFAS, agreed. She stated that as part of the plan to review all audit offices for compliance with internal policies and procedures and GAGAS, DFAS IR will include test aspects to assess the quality of supervision provided by audit managers and the results will be used to hold them accountable with their performance plans. The plan will be developed by March 1, 2013.

Our Response

DFAS comments were responsive. No additional comments are needed.

- 5. Issue a memorandum to DFAS IR managers emphasizing the importance of effective supervision when evaluating manager's performance.**

Management Comments

The Director, DFAS, agreed stating that she issued a memorandum to the Director, DFAS IR, emphasizing the importance of effective supervision when evaluating manager's performance and directed the results of quality control reviews be leveraged to evaluate DFAS IR manager's performance.

Our Response

DFAS comments were responsive. The memorandum was issued to the Director, DFAS IR, on December 20, 2012. No additional comments are needed.

- 6. Monitor and evaluate DFAS IR managers' training for FYs 2013 and 2014 and identify areas that may need improvement, based on the results of this review.**

Management Comments

The Director, DFAS, agreed. She stated that DFAS IR will use the results of their FY 2013 and 2014 quality control testing to identify areas where audit managers may need additional training

or development to ensure continued compliance with internal policies and procedures, GAGAS, and AICPA standards.

Our Response

DFAS comments were responsive. No additional comments are needed.

Project Type Changes Caused Significant Noncompliance With GAGAS and DFAS IR Policies and Procedures

For two of the projects: Project Number CL08PRP010CL, Transitional Readiness Audit of the Retired and Annuitant (R&A) Pay Conversion to the Government, August 30, 2010, and Project Number CO10PRS003DFAS.001, End-to-End Assessment of DFAS Texarkana Operations, January 20, 2011, DFAS IR changed the project type before the results of the review were reported. As a result, DFAS IR had significant deficiencies regarding the use and application of GAGAS. In addition, DFAS IR failed to document and evaluate potential impairments to independence.

GAGAS 1.18 states that all audits and attestation engagements begin with objectives and those objectives determine the type of audit to be performed and the applicable standards to be followed. GAGAS 1.27 states that a performance audit is a dynamic process that includes the consideration of applicable standards throughout the course of the audit. An ongoing assessment of the objectives, audit risk, audit procedures, and evidence during the course of the audit facilitates the auditor's determination of what to report and the proper context for the auditor's conclusion, including a discussion about the sufficiency and appropriateness of evidence being used as a basis for audit conclusions. Performance audit conclusions logically flow from all these elements and provide an assessment of the audit findings and their implications. The Manual, Chapter 1210, Planning the Audit, July 2009, states that it is critical that audits begin with a precise statement of the audit objectives.

For the Transitional Readiness Audit of the Retired and Annuitant (R&A) Pay Conversion to the Government the decision to change the project type from a nonaudit service to a limited scope performance audit resulted in significant deficiencies in compliance with GAGAS independence, performance audit planning, fieldwork, and reporting standards. DFAS IR management decided to change the nonaudit service to a limited scope performance audit after most of the fieldwork was completed and performed as a nonaudit service.

For the End-to-End Assessment of DFAS Texarkana Operations, DFAS IR management changed the project type from an agreed-upon procedures attestation engagement to a nonaudit service a week before the report was issued. When this decision was made, about 10 months had elapsed since the project started. GAGAS 3.30 states that the audit organization should document its consideration of the nonaudit services, including its conclusions about the impact on independence. The Manual, Chapter 1500, Nonaudit Services, July 2009, requires DFAS IR to evaluate and propose to the DFAS IR Director whether providing the nonaudit service creates independence impairment either in fact or appearance. If the determination was that impairment would exist, then the Director for IR must approve in writing all nonaudit service engagements.

The project files did not contain any evidence of DFAS IR's consideration of potential independence impairments for the nonaudit service when the project type change occurred.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 7. Issue a memorandum to the DFAS IR staff that communicates the importance of documenting the consideration of potential independence impairments prior to performing future nonaudit services.**

Management Comments

The Director, DFAS, agreed stating that she issued a memorandum to the Director, DFAS IR, communicating the importance of documenting the consideration of potential independence impairments prior to performing future nonaudit services in accordance with the DFAS IR Policies and Procedures Manual.

Our Response

DFAS comments were responsive. The memorandum was issued to the Director, DFAS IR, on December 20, 2012. No additional comments are needed.

- 8. Update the DFAS IR Policies and Procedures Manual to require:**

- a. Documentation of the impact of changing project types, and if a substantial amount of work is completed, consideration of GAGAS and AICPA standards and DFAS IR policies and procedures.**
- b. Written approval of all project type changes by the Director, DFAS IR.**
- c. Written notification to audit clients regarding the decision to change the project type, to include any changes in applicable GAGAS and AICPA standards, and the level of assurance provided.**

Management Comments

The Director, DFAS agreed stating that by February 1, 2013, the DFAS IR Policies and Procedures Manual will include all the elements in recommendations 8.a, 8.b, and 8.c.

Our Response

DFAS comments were responsive. No additional comments are needed.

Independence

Performance of Nonaudit Services Created an Organizational Impairment to Independence

DFAS IR performed two projects as audits when they were nonaudit services. By performing the nonaudit services, DFAS IR impaired the audit organization's independence. We determined that the work performed on Project Number IN09SRC001DFAS, Vendor Pay Erroneous Payment Audit Round Six, February 10, 2011, and Project Number CO10SRC001CO, Review of MOCAS Erroneous Payments for April 2008 – December 2008, February 11, 2011, was payment recapture audit work. As such, DFAS IR audit offices' organizational independence was impaired because the work performed was prohibited by Office of Management and Budget (OMB) Circular A-123, "Management's Responsibility for Internal Control", December 21, 2004 Appendix C. Also, since the DFAS IR audit offices perform operational audits of processes for DFAS's commercial pay business line, the auditors were reviewing controls they previously tested for DFAS operations management when conducting payment recapture audits.

GAGAS 3.22 discusses the two overarching principles that apply to auditor independence when assessing the impact of performing a nonaudit service: auditors must not (1) perform management functions and (2) audit their own work. In addition, GAGAS 3.29 discusses the category of nonaudit services that directly support agency operations and impair the audit organization's ability to meet either or both of the overarching independence principles. Specifically, GAGAS 3.29j states that the performance of management's assessment of internal controls is a type of nonaudit service that would impair an audit organization's independence. The Manual, Chapter 1500, Nonaudit Services, July 2009, also states that staff may not perform management functions nor audit their own work.

OMB Circular A-123, which implements the Federal Manager's Financial Integrity Act of 1982, states that management is responsible for establishing and maintaining internal control and that management is responsible for monitoring internal control. Additionally, OMB implementing guidance on the Improper Payments Elimination and Recovery Act legislation of July 2010, OMB Memorandum Number M-11-16, April 14, 2011, Subject: Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123, states that payment recapture audit work is a management function and responsibility.

On May 24, 2012, we issued a Notice of Concern to alert DFAS management of the organizational impairment to independence. In the Notice of Concern, we recommended that the Director, DFAS, mandate that the DFAS IR offices discontinue performing the OMB Circular A-123, Appendix C, payment recapture audit. Further, we recommended that the Director, DFAS, require DFAS IR to examine its portfolio of work to ensure that DFAS IR is not performing additional management functions.

On June 8, 2012, the Director, DFAS, agreed with these recommendations and stated that all payment recapture auditing work was terminated. In addition, the Director, DFAS, stated that DFAS IR examined the portfolio of its current audit work and determined that the objectives did not duplicate DFAS operations or result in DFAS IR's performance of management's functions

or responsibilities. During our follow-up review, we will examine DFAS IR's portfolio of work to confirm that they are not performing management functions or responsibilities.

Nonaudit Service Reported on as an Engagement Survey

One of the projects DFAS IR performed and reported on was an engagement survey. GAGAS contains requirements for performing and reporting the results of audits and attestation engagements. However, GAGAS does not contain guidance for performing or reporting on the results of engagement surveys.

DFAS IR indicated that Project Number IN10PRS005DFAS, Closeout Survey of DFAS Certifying Officer Legislation Standard Operating Procedures, September 30, 2010, was initiated to determine the audit readiness of specific areas within DFAS. The announcement letter did not state that DFAS IR would follow GAGAS and the report did not state that the work was performed in accordance with GAGAS. However, DFAS IR briefed DFAS management and indicated that GAGAS would be followed. GAGAS 3.30 states that the audit organization should document its consideration of the nonaudit services, including its conclusions about the impact on independence. The Manual, Chapter 1500, Nonaudit Services, July 2009, requires DFAS IR to evaluate and tell the DFAS IR Director whether providing the nonaudit service creates independence impairment either in fact or appearance. If the determination was that impairment would exist, then the Director for DFAS IR must approve in writing all nonaudit service engagements. We found no evidence in the project files to indicate that DFAS IR had assessed the impact of performing this type of work and reporting the results of this work on audit organizational independence.

DFAS IR performed the engagement survey from June 2010 through September 2010. DFAS IR determined that the available data were not audit ready and the work was subsequently terminated. However, DFAS IR provided each site visited with the results of its review to assist with revising existing standard operating procedures. This did not comply with GAGAS. GAGAS 7.49 states if an audit is terminated before it is completed and an audit report is not issued, auditors should document the results of the work to the date of termination and the reason the audit was terminated. Determining whether and how to communicate the reason for terminating the audit will depend on the facts and circumstances and is a matter of professional judgment.

During our review, DFAS IR agreed to stop performing engagement surveys. DFAS IR developed an addendum to Chapter 1210, Planning and Fieldwork Procedures to Determine Auditability, May 2012, to provide guidance and policy on performing additional planning and fieldwork procedures to determine whether to expend resources to complete the full engagement or terminate the engagement. The policy also provided information on auditor responsibilities when an engagement was terminated.

Management Comments on the Finding and Our Response

Management Comments on the Performance of Nonaudit Services Created an Organizational Impairment to Independence

The Director, DFAS, did not agree that the review of the Vendor Pay Erroneous Payment Audit Round Six and Review of MOCAS Erroneous Payments for April 2008 – December 2008 was payment recapture audit work. Specifically she stated that DFAS IR independently determined and executed the objectives, scope, and methodologies of their erroneous pay audit work without DFAS management's influence. In addition, she stated that the two DFAS IR audits in question were traditional audits performed in accordance with GAGAS 1.28. Specifically, in accordance with GAGAS 1.28, the initial objective of erroneous payment identification led to the underlying objective of evaluating controls to determine the reasons for the program's lack of effectiveness or how effectiveness could be improved. In addition, DFAS IR's reported results reflect those objectives were accomplished and DFAS management was responsible for detecting and recovering erroneous payments, using the pre-payment detection tool, and overseeing the associated internal controls in the process. Finally, the Director, DFAS, stated that our reference to GAGAS 3.29j also incorrectly implies that DFAS IR was performing management's assessment of internal controls in the absence of and place of management's own review of internal controls. DFAS management is responsible for and conducted its own assessment of internal controls.

Our Response

We continue to maintain that the DFAS IR audit offices' organizational independence was impaired because they performed OMB Circular A-123, Appendix C, payment recapture audit work on commercial payments, which is a management function and responsibility. On May 24, 2012, we issued a Notice of Concern to the Director, DFAS, recommending that she direct DFAS IR to discontinue performing the work in the post payment review area for commercial payments, to detect overpayments, and to review their current portfolio of work to ensure that DFAS IR was not performing other management functions. On June 8, 2012, we received a response from the Director, DFAS, which concurred with our two recommendations and took immediate corrective action. In addition, during our field work, we interviewed DFAS Indianapolis operations managers from Enterprise Solutions and Standards, Post Pay Review and Analysis, Accounts Receivable, and Accounts Payable, as well as DFAS Columbus operations managers from Contract Reconciliations in order to gain an understanding of DFAS's recapture payment audit program, in particular, the extent of DFAS operations management's efforts to detect erroneous commercial payments. The focus of DFAS operations management was on the prevention of improper commercial payments in the pre-pay environment. Only the DFAS IR auditors performed the routine data mining on commercial payment transactions in the post-pay environment. DFAS operations management relied on DFAS IR work in the post-pay environment for internal control monitoring.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 9. Perform and document an assessment of each completed engagement survey to determine its potential impact on independence.**

Management Comments

The Director, DFAS, disagreed. She stated that Auditing Standards Supplement No. 11, “The Audit Survey-A Key Step in Auditing Government Programs”, (the Supplement) issued in January 1978, supported conducting audit surveys following GAGAS. She said that DFAS IR was recently advised this publication is now obsolete as official Government Accountability Office guidance, but the Government Accountability Office never issued any official rescission of the Supplement. Therefore, DFAS IR had no initial reason to question the merits of conducting a survey as a preliminary process to an audit. Also, she stated that our finding references that the announcement letter did not state DFAS IR would perform the survey in accordance with GAGAS. However, she said that there is no GAGAS requirement that announcement letters reference performing an engagement in accordance with GAGAS. Furthermore, the Director, DFAS, stated that there is no requirement that an engagement termination letter state the work completed was done in accordance with GAGAS. Further, she said that she had a concern regarding that DFAS IR sharing the results of their work was not a violation of GAGAS 7.49. There is nothing in GAGAS that states or even implies that results of work performed cannot be shared with auditees for terminated audits especially when that information helps DFAS management understand the reasons the project was terminated. Finally the termination memorandum informed the auditees DFAS IR would not be moving into an audit.

Our Response

We determined that the engagement survey was a nonaudit service. Since the Supplement’s release in 1978, major revisions to GAGAS were made in 1981, 1988, 1994, 2003, 2007 and most recently December 2011. When determining the acceptability of performing engagement surveys, DFAS IR should have relied upon GAGAS 2007 standards, which were in effect during the time the engagement survey was performed. Further, DFAS IR’s actions clearly demonstrate that the organization did not consider the authoritative nature of GAGAS compared to guidance, nor the GAGAS updates issued after the Supplement’s release.

Our report did not reference a GAGAS requirement when documenting our observation that a GAGAS statement was not included in the project announcement letter or report. We included this information to support our conclusion that the work was performed as a nonaudit service. GAGAS contains independence requirements that audit organizations should follow when performing nonaudit services. As previously noted, we found no evidence in the project files to indicate that DFAS IR assessed the impact of performing the engagement survey or reporting the results of the work on audit organization independence.

GAGAS 2007, 7.49 states if an audit is terminated before it is completed and an audit report is not issued, auditors should document the results of the work to the date of termination and the reason the audit was terminated. Determining whether and how to communicate the reason for terminating the audit will depend on the facts and circumstances and is a matter of professional judgment. The engagement survey report indicated that the work was terminated for the following reasons:

- One DFAS site asked us to stop further review of their Standard Operating Procedures because they acknowledged their procedures did not fully address the Government Accountability Offices 12 pre-payment criteria. In addition, other sites for which we had completed some survey work asked for our results so they could review and address them.

However, DFAS IR provided the results of their work to each site reviewed. When doing this, they created a situation in which they could potentially audit their own work in the future. GAGAS 3.29j states that developing an entity's policies, procedures, and internal controls is a nonaudit service that impairs independence and supplemental safeguards will not overcome independence impairments in this category. We request additional management comments by March 29, 2013.

Noncompliance With GAGAS and AICPA Standards for Performing and Reporting on Agreed-Upon Procedures and Examination Level Attestation Engagements

For two of the projects, DFAS IR failed to comply with GAGAS and AICPA attestation standards incorporated in GAGAS⁶ on criteria, fieldwork, and reporting. Additionally, for both projects, DFAS IR personnel did not follow the policies and procedures established in the Manual for conducting attestation engagements.

The Manual, Chapter 1700, Attestation Engagements, February 2009, was in effect during the work performed and reported in Project Number CO09PRA008CO, Agreed-Upon Procedures: MOCAS Accounts Payable, August 6, 2010 attestation. For Project Number IN10SRA004CO.001, Independent Examination of the Columbus Cash Accountability System-Defense Agencies (CCAS-DA), Phase 2, March 18, 2011; the Manual, Chapter 1700, Attestation Engagements, February 2009, was in effect during planning and fieldwork, but the December 2010 revision, was in effect during the reporting phase. Both the 2009 and 2010 versions of the Manual state that when performing attestation engagements, auditors should be knowledgeable in GAGAS and AICPA standards and competent in applying these standards.

⁶ GAGAS incorporates the AICPA general standards on criteria and the fieldwork and reporting standards for attestation engagements. GAGAS provides additional fieldwork and reporting standards for attestation engagements performed in compliance with GAGAS.

Attestation Engagements Did Not Comply With GAGAS and AICPA General Standards Pertaining to Criteria

For both of the attestation engagements, DFAS IR did not comply with GAGAS and AICPA standards pertaining to the suitability and availability of attestation criteria.

GAGAS 6.03 states:

The AICPA general standard related to criteria is as follows: The practitioner (auditor) must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to all users.

We found no documentation in the project files to show that DFAS IR considered all of the characteristics of suitable criteria. Those characteristics include objectivity, measurability, completeness, and relevance. Further, the project files contained no documentation to show that DFAS IR considered the availability of the criteria during the projects.

We also found no documentation in the project files to indicate that the attestation client⁷ took responsibility for selecting the criteria and determining the appropriateness of the criteria for its purposes. AICPA AT⁸ 101.27 states:

Regardless of who establishes or develops the criteria, the responsible party or the client is responsible for selecting the criteria and the client is responsible for determining that such criteria are appropriate for its purposes.

The project files did not contain any evidence of DFAS management's participation in selecting the criteria used by DFAS IR auditors when conducting their work.

Agreed-Upon Procedure Level Engagement Did Not Comply With GAGAS and AICPA Standards

We noted significant noncompliance with the GAGAS and AICPA standards for Agreed-Upon Procedures engagements. For the Agreed-Upon Procedures: MOCAS Accounts Payable engagement, DFAS IR performed inappropriate procedures. AICPA AT 201.18 states that an example of an inappropriate procedure is obtaining an understanding about a particular subject. For this project, DFAS IR obtained an understanding of DFAS information system controls to review the basic general and application controls of a database.

Further, DFAS IR also developed recommendations for issues found during the work they performed. To identify recommendations was not an appropriate procedure. AICPA AT 201.31 states that an agreed-upon procedures report should be in the form of procedures and findings. Recommendations are not one of the elements of an agreed-upon procedures report.

⁷ For this project, the attestation client was DFAS operations management.

⁸ The prefix AT is used for Statements on Standards for Attestation Engagements and Attestation Engagement interpretations in the AICPA standards.

In addition, the Agreed-Upon Procedures: MOCAS Accounts Payable report contained the procedures performed and the results based on the procedures performed. However, DFAS IR also included in the report the conclusions reached by the auditors and the recommendations made by the auditors. Further, while the report included a modified GAGAS compliance statement, the GAGAS statement included the following:

Those standards require that we plan and perform the agreed-upon procedures to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our agreed-upon procedures. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our agreed-upon procedures.

The terms “sufficient, appropriate evidence” and “conclusions” communicate a level of assurance. However, GAGAS and AICPA standards require that agreed-upon procedures engagements provide no level of assurance. Further, the Manual had incorrect information. Specifically, the Manual, Chapter 1700, Attestation Engagements, Exhibit 1700-3, February 2009, included the applicable terms “sufficient, appropriate evidence” and “conclusions” in the Agreed-Upon Procedures report format.

Examination Level Engagement Did Not Comply With GAGAS and AICPA Fieldwork Standards

During our review of the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2 project, we noted significant noncompliance with GAGAS and AICPA fieldwork requirements. Specifically, the project files did not contain sufficient documentation to enable an experienced auditor having no previous connection with the attestation engagement to understand from the documentation the nature, extent, and the results of procedures performed; the evidence obtained and its source; and the auditor’s significant judgments and conclusions. In addition, DFAS IR’s compliance with significant GAGAS and AICPA standards was not sufficiently documented to clearly demonstrate adherence to the standards.

GAGAS and AICPA fieldwork standards require that auditors develop an overall strategy for conducting the attestation engagement. When developing the strategy, auditors need to have sufficient knowledge to enable them to understand events, transactions, and practices that have a significant effect on the subject matter. Factors to be considered in planning an attestation engagement include the following:

- the criteria to be used,
- preliminary judgments about attestation risk and materiality,
- the nature of the subject matter, and
- conditions that may require modifications to attestation procedures.

DFAS IR auditors documented the criteria to be used in the project files. However, they failed to document that they assessed the attestation risk and materiality for the examination engagement. Attestation risk is defined as the risk that the auditor may unknowingly fail to appropriately modify the attestation report on the subject matter that is materially misstated. Although

DFAS IR provided numerous examples of the auditor's assessment of attestation risk and materiality, the documentation did not sufficiently address GAGAS and AICPA requirements. In addition, DFAS IR could not provide adequate documentation for the assessment of conditions that may require extension or modification of attestation procedures. The documentation provided stated that the review would be "basic" unless DFAS IR identified something that indicated a need to review the area further. However, the term "basic" was not defined. Also, the documentation provided was located in a previously completed project.

Also, DFAS IR did not obtain written acknowledgment or other evidence of DFAS management's responsibilities for the subject matter as it related to the objectives of the engagement. According to GAGAS and AICPA fieldwork standards, an understanding with the entity⁹ should be established regarding the services to be performed for each engagement. Auditors should obtain written acknowledgement or other evidence of the entity's responsibilities for the subject matter as it related to the objectives of the engagement. Examination engagements may be performed on a variety of subject matters to include internal control processes and historical events. Each engagement varies depending on the needs of the users. Examples of management responsibilities that are usually addressed at the beginning of an attestation engagement include:

- management's responsibility for the subject matter,
- management's acknowledgment of their responsibility for determining that the criteria are appropriate for the attestation purposes, and
- availability of all records relevant to the subject matter.

DFAS IR could not provide adequate documentation of other evidence obtained from DFAS management in place of written acknowledgement of management's responsibilities during the examination engagement.

GAGAS 6.07 also requires auditors to communicate the following information during attestation fieldwork:

- the nature, timing, and extent of planned testing and reporting, and
- the level of assurance the auditor will provide.

Documentation in the project files was not adequate to confirm that DFAS IR communicated this information to management during engagement planning.

Attestation Engagement Did Not Comply With GAGAS and AICPA Reporting Standards

Neither of the reports DFAS IR issued for the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2, complied with GAGAS and AICPA reporting standards for an examination-level engagement. In addition, the MOCAS

⁹ For this project, the entity was DFAS operations management.

Accounts Payable Agreed-Upon Procedures engagement was missing a required AICPA reporting element.

For the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2 project, DFAS IR issued two reports. One report had summary information that was restricted, and another report contained detailed information.

The summary report was missing required AICPA reporting statements. Specifically, AICPA reporting standards state that a restricted report should contain a separate paragraph at the end, which includes the following elements:

- a statement indicating that the report is intended solely for the information and use of the specified parties and
- a statement that the report is not intended to be and should not be used by anyone other than the specified parties.

In addition, the summary report did not indicate that certain information had been omitted from the report and the reason the information was omitted. GAGAS 6.51 states if certain pertinent information is prohibited from public disclosure or is excluded from a report due to the confidential or sensitive nature of the information, auditors should disclose in the report that certain information has been omitted and the reason or other circumstances that make the omission necessary.

Further, the reports should have included a required modified GAGAS compliance statement. However, the reports did not include a GAGAS statement. DFAS IR acknowledged that since they had deviated from GAGAS requirements, they should have assessed the significance of the noncompliance, documented that assessment, and included a modified GAGAS compliance statement in the reports.

Finally, for both of the examination and agreed-upon procedures engagement reports, DFAS IR did not include additional required AICPA reporting statements and elements. Because the projects were subject to AICPA standards, the following statements and elements should have been included in the attestation reports. See Table 4.

Table 4. Missing Report Statements in the Examination and Agreed-Upon Procedure Engagement Reports

Project	Missing Reporting Statements and Elements
Agreed-Upon Procedures: MOCAS Accounts Payable, August 6, 2010	<ul style="list-style-type: none"> • A title that includes the word “independent.”
Independent Examination of the Columbus Cash Accountability System –	<ul style="list-style-type: none"> • A statement that the subject matter is the responsibility of the responsible party and identification of the responsible party. • A statement that DFAS IR’s responsibility was to express an opinion of the subject matter based on their examination.

Project	Missing Reporting Statements and Elements
Defense Agencies (CCAS-DA), Phase 2, March 18, 2011	<ul style="list-style-type: none"> • A statement that the examination was conducted in accordance with attestation standards established by the AICPA, and accordingly, included procedures the auditors considered necessary in the circumstances. • A statement that DFAS IR believes the examination provides a reasonable basis for their opinion. • DFAS IR's opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects. • A statement restricting the use of the report to specified parties since a written assertion had not been provided by DFAS management.

Recommendations, Management Comments, and Our Response

We recommend that the Director, DFAS:

- 10. Issue a memo to DFAS operations management that informs the specified parties of the noncompliance with GAGAS and AICPA standards for the two projects.**

Management Comments

The Director, DFAS, agreed stating that she issued a memorandum to the Director, DFAS IR, directing him to inform the Deputy Director, DFAS Operations of the noncompliance with GAGAS and AICPA standards for the two projects.

Our Response

DFAS comments were responsive. The Director, DFAS, issued a memorandum on December 20, 2012 and the Director, DFAS IR, issued a memorandum on January 15, 2013, notifying the Deputy Director, DFAS Operations of the noncompliances with the two projects. No additional comments are needed.

- 11. Review all other attestation engagements completed from July 1, 2010, to present to ensure that those projects complied with GAGAS and AICPA standards. For those that did not comply, notify DFAS operations management of specific instances of noncompliance.**

Management Comments

The Director, DFAS, agreed. She stated that DFAS IR identified two additional attestation engagements completed from July 1, 2010, to present and will review those projects. If they do not comply with GAGAS and AICPA standards, DFAS IR will notify DFAS management.

Our Response

DFAS comments were responsive. DFAS IR will review those assignments by August 1, 2013. No additional comments are needed.

- 12. Revise the DFAS IR Policies and Procedures Manual, Chapter 1700, Attestation Engagements, December 2010, by removing inappropriate terms and phrases such as “to evaluate,” “to review for adequacy and sufficiency,” and the sentence “we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our agreed-upon procedures“ from Exhibit 1700-3, Example Agreed-Upon Procedures Report.**

Management Comments

The Director, DFAS, agreed stating the DFAS IR Policies and Procedures Manual chapters 4, 5, and 6 will replace Chapter 1700 from the previous manual. The new chapters will be revised by February 1, 2013, and will not include the inappropriate terms and phrases.

Our Response

DFAS comments were responsive. No additional comments are needed.

Appendix C. GAGAS Noncompliances Warranting Disclosure Due to Their Importance to the Quality Control System

The DFAS IR audit organization's performance during the audits showed evidence of noncompliance in two additional GAGAS areas: planning and reporting. These two areas of noncompliance were not considered to be significant and did not affect the opinion rendered, but due to their relative importance to the audit organization's system of quality control, they warrant disclosure. For each of the two areas, the auditors did not:

- planning
 - adequately document audit risk and fraud risk for a project, and
- reporting
 - discuss the affect of two scope limitations in a report; and
 - include all of the required elements of a finding in an examination report.

Assessment of Audit Risk and Fraud Risk Require Improvement

The audit documentation for DFAS IR's assessment of audit risk for Project Number CL10PRP006CL, Audit of Internal Controls over the Thrift Savings Plan Voucher Process, February 10, 2011, needed improvement. Both GAGAS 7.07 and 7.11 require auditors to assess audit risk and significance within the context of the audit objectives. Further, GAGAS 7.77 states:

Auditors should prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation, the nature, timing, extent, and results of audit procedures performed, the audit evidence obtained and its source and the conclusions reached, including evidence that supports the auditors' significant judgments and conclusions.

The Manual, Chapter 1270, Preparing Audit Files and Working Papers, December 2010, requires auditors to consider the assessment of audit risk and significance within the context of the audit objectives during audit planning.

We found that working paper references to the audit risk planning session did not provide information on the methodology used by DFAS IR to identify audit risk indicators and the methodology used to consider whether the indicators were insignificant. Although project files indicated that audit risk would continue to be monitored throughout the audit and documented as new exposures arise, documentation was not available to demonstrate that the auditors performed this work. Improvement in assessing audit risk is necessary to provide reasonable assurance that evidence is sufficient and appropriate to support findings and conclusions.

In addition, the audit documentation for DFAS IR's assessment of fraud risk for the Audit of Internal Controls over the Thrift Savings Plan Voucher Process project needed improvement. GAGAS 7.30 states in planning the audit, auditors should assess risks of fraud occurring that is significant within the context of the audit objectives. The Manual, Chapter 1250, Red Flag Indicators and Fraud Scenarios, June 2008, states GAGAS 7.30 recommends that as part of audit planning, audit team members should discuss fraud risks, including factors such as an individual's incentives or pressure to commit fraud, the opportunity for fraud to occur, and rationalizations or attitudes that could allow individuals to commit fraud to determine susceptibility of the program or function to fraud.

For the Thrift Savings Plan Voucher Process project, the documentation of the auditor's assessment of fraud contained the following information:

Team reviewed Thrift Savings Plan process and brainstormed areas with exposure to fraud and abuse. No areas were identified as susceptible to fraud and abuse. However, on an on-going basis the team will continue to be vigilant to areas or activities exposing fraud or abuse.

The working paper reference to the fraud risk discussion did not provide information on the methodology used by DFAS IR to reach their conclusions. For example, there were no areas susceptible to fraud or abuse, or information on potential fraud risks or indicators that were discussed and considered insignificant. Also, there was no evidence in the project files that the team continued to consider indicators of fraud or abuse throughout the project.

The Effect of Scope Limitations Was Not Discussed in a Report

The report for the Transitional Readiness Audit of the Retired and Annuitant (R&A) Pay Conversation to the Government did not discuss the affect of two scope limitations on the audit or the assurance provided. GAGAS 1.12b describes situations when auditors use modified compliance statements such as scope limitations, restrictions on access to records, government officials, or other individuals needed to conduct the audit. When auditors use a modified GAGAS statement, they should disclose in the report the applicable requirement(s) not followed, the reasons for not following the requirements(s), and how not following the requirements affected, or could have affected, the audit or assurance provided. In addition, the Manual, Chapter 1270, Preparing Audit Files and Working Papers, June 2008, states that when auditors do not comply with all applicable GAGAS requirements, they should include a modified GAGAS compliance statement in the audit report. Further, DFAS IR policy requires auditors to determine whether the report identified the standard that was not followed, the reasons(s) why it was not followed, and the effect that not following the standard had on the audit results.

The report contained a modified GAGAS statement for two scope limitations. For those scope limitations, the auditor discussed the reasons for not following GAGAS and the potential affects. However, two additional scope limitations were documented within the report and the auditor did not discuss their affect on the audit or the assurance provided.

The report scope limitations that were not discussed were:

- The scope of the assessment was limited to DFAS in-house planning activities because of concerns over a contractor's obligations and production issues. The remaining areas will be reviewed in a post-transition follow up review.
- Due to the limited scope of the audit, testing the reliability of computer-processed data were limited to reviewing the project schedule in MS project and manually comparing schedule outputs to weekly R&A transition meeting notes and minutes.

The effect of these two scope limitations was not discussed; therefore, the users of the report were not provided with information regarding the scope limitations' impact on the audit or assurance provided.

Examination Reports' Findings Did Not Comply With GAGAS Reporting Standards

For the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2, a sensitive detail and a summary reports were issued. Both reports included a summary of the finding's condition, but not the required elements of criteria, cause and effect. GAGAS 6.15 states that when auditors identify deficiencies they should plan and perform procedures to develop the elements of a finding that are necessary to achieve the engagement objectives. DFAS IR had developed the required elements of findings and provided the information to DFAS management in 10 separately issued Notices of Findings. However, there was no language in either report to guide the reader to this information. As a result, subsequent report users may not have access to the auditor's detailed analysis and conclusions.

Recommendation, Management Comments, and Our Response

- 13. We recommend that the Director, DFAS, issue a memorandum to DFAS IR personnel that communicates the importance of documenting all of the elements of findings when reporting the results of their work and the auditor's assessment of audit risk, fraud risk, and scope limitations.**

Management Comments

The Director, DFAS, agreed. She stated that she issued a memorandum to the Director, DFAS IR, communicating the importance of adequately documenting their findings and the auditor's assessment of audit risk, fraud risk, and scope limitations. She also directed in the memorandum that the results of the quality control reviews be leveraged to evaluate compliance.

Our Response

DFAS comments were responsive. The memorandum was issued to the Director, DFAS IR, on December 20, 2012. No additional comments are needed.

Appendix D. Scope and Methodology

We reviewed the adequacy of the DFAS IR audit organization's compliance with its quality control policies, procedures, and GAGAS. We reviewed eight audits at the DFAS IR Columbus and Cleveland, Ohio, and Indianapolis, Indiana offices.

We reviewed the adequacy of the design of policies and procedures that the DFAS IR audit organization established to provide reasonable assurance of compliance with GAGAS in conducting its audits and attestation engagements. In addition, we reviewed the following policy and guidance document, DFAS IR Policies and Procedures Manual, versions 2008, 2009, 2010.

In performing our review, we considered the requirements of quality control standards and other auditing standards contained in the 2007 Revision of GAGAS issued by the Comptroller General of the United States. GAGAS 3.56 states:

The audit organization should obtain an external peer review sufficient in scope to provide a reasonable basis for determining whether, for the period under review, the reviewed audit organization's system of quality control was suitably designed and whether the audit organization is complying with its quality control system in order to provide the audit organization with reasonable assurance of conforming with applicable professional standards.

We performed this review from August 2011 through September 2012 in accordance with standards and guidelines established in the March 2009 Council of the Inspectors General on Integrity and Efficiency "Guide for Conducting External Peer Reviews of Audit Organizations of the Federal Offices of Inspector General." In performing this review, we assessed, reviewed, and evaluated:

- the adequacy of the design of policies and procedures that the DFAS IR audit organization established to provide reasonable assurance of compliance with GAGAS in the conduct of its audits and attestation engagements;
- staff understanding of quality control policies and procedures;
- independence documentation and records of continuing professional education to verify the measures that enable the identification of independence impairments and maintenance of professional competence;
- independence safeguards for nonaudit services; and
- eight reports and related project documentation to determine whether established policies, procedures, and applicable standards were followed.

We selected 8 reports from a universe of 25 reports issued by the DFAS IR from July 1, 2010, to June 30, 2011. We reviewed the eight projects for compliance with the DFAS IR audit organization's system for quality control for audits, attestation engagements, and nonaudit services.

In selecting the reports, we worked with the DFAS IR audit organization to establish the universe of reports that were issued during the review period. We then selected reports that were representative of the types of reviews completed. The DFAS IR did not issue any financial audit reports during the review period.

The following table identifies the specific reports we reviewed at both audit offices. The “Type of Review” column contains information that was determined by the report GAGAS compliance statement and/or type of review described in the final report.

Audit Office	Report Title, Number, Issue Date	Type of Review
Columbus	Project Number CO10SRC001CO, “Review of MOCAS Erroneous Payments for April 2008-December 2008,” February 11, 2011	Recovery Auditing
	Project Number CO09PRA008CO, “Agreed-Up Procedures: MOCAS Accounts Payable,” August 6, 2010	Agreed-Up Procedures
	Project Number CO10PRS003DFAS.001, “End-to-End Assessment of DFAS Texarkana Operations,” January 20, 2011	Nonaudit Service
Cleveland	Project Number CL08PRP010CL, “Transitional Readiness Audit of the Retired and Annuitant (R&A) Pay Conversion to the Government,” August 30, 2010	Limited Scope Performance Audit
	Project Number CL10PRP006CL, “Audit of Internal Controls over the Thrift Savings Plan Voucher Process,” February 10, 2011	Performance Audit
Indianapolis	Project Number IN09SRC001DFAS, “Vendor Pay Erroneous Payment Audit Round Six,” February 10, 2011	Recovery Auditing
	Project Number IN10PRS005DFAS, “Closeout: Survey of DFAS Certifying Legislation (COL) Standard Operating Procedures,” September 30, 2010	Engagement Survey
	Project Number IN10SRA004CO.001, “Independent Examination of the Columbus Cash Accountability System-Defense Agencies (CCAS-DA), Phase 2 Management Letter,” March 18, 2011	Examination

Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance because we based our review on selective tests. There are inherent limitations in considering the potential effectiveness of any quality control system. Departures from GAGAS can result from misunderstood instructions, mistakes in judgment, carelessness, or other human errors. Projecting any evaluation of a quality control system is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

Defense Finance and Accounting Service Comments



□ 4800 MARK CENTER DRIVE
ALEXANDRIA, VA 22350-3000

□ 8899 EAST 56TH STREET
INDIANAPOLIS, IN 46249

DEFENSE FINANCE AND ACCOUNTING SERVICE

DEC 20 2012

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL, AUDIT POLICY AND
OVERSIGHT, INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE

SUBJECT: Quality Control Review of the Defense Finance and Accounting Service (DFAS)
Audit Organization (Project No. D2011-DIP0AI-0254.000)

Thank you for the opportunity to review and comment on the peer review findings and recommendations. We appreciate you providing a comprehensive assessment of our DFAS Internal Review's (IR) compliance with Generally Accepted Government Auditing Standards (GAGAS) and useful recommendations to further ensure the quality of their audit mission. Attached are our comments, action plans, and recommended changes to your report.

Please direct any comments or questions regarding our response to Mr. Rick Davis, Director, Internal Review, at (571) 372-5930 or Mr. Ed Romesburg, Deputy Director, Columbus and Cleveland Internal Review, at (614) 701-2330.


Teresa A. McKay
Director

Attachment:
As stated

Management Comments
on
Quality Control Review of the Defense Finance and Accounting Service (DFAS) Audit
Organization (Project No. D2011-DIP0AI-0254.000)

1. We non-concur with your determination that the Review of MOCAS Erroneous Payments, Vendor Pay Erroneous Payment Audit Round Six, and the Closeout Survey of DFAS Certifying Officer Legislation (COL) Standard Operating Procedure (SOP) projects were performed as non-audit services and subsequently resulted in an organizational impairment to independence. Our rationale is as follows:

a. DFAS Internal Review (IR) independently determined and executed the objectives, scope, and methodologies of their erroneous pay audit work without DFAS management's influence. Office of Management and Budget (OMB) implementing guidance on the Improper Payments Elimination and Recovery Act of July 2010, OMB Memorandum Number M-11-16, dated April 14, 2011, Subject: Issuance of Revised Parts I and II to Appendix C of OMB Circular A-123, states that a payment recapture audit is not an audit in the traditional sense. The two DFAS IR audits in question were traditional audits performed in accordance with GAGAS, specifically GAGAS 1.28¹. In accordance with GAGAS 1.28, the initial audit objective of erroneous payment identification led to the underlying objective of evaluating Business Activity Monitoring (BAM) and Front End Analysis (FEA) controls to determine the reasons for the programs' lack of effectiveness or how effectiveness could be improved. DFAS IR's reported results reflect those objectives were accomplished and DFAS management was responsible for detecting and recovering erroneous commercial payments, using the pre-payment detection tool, and overseeing the associated internal controls in the process. Your reference to GAGAS 3.29j also incorrectly implies that DFAS IR was performing management's assessment of internal controls in the absence of and in place of management's own review of BAM and FEA controls. DFAS management is responsible for and conducted its own assessment of internal controls. Finally, you expressed no independence concerns about the performance of management functions after reviewing two similar audits in DFAS IR's previous peer review report dated October 31, 2006.

b. Auditing Standards Supplement No. 11, The Audit Survey—A Key Step in Auditing Government Programs, issued January 1978, supported conducting audit surveys following GAGAS. DFAS IR was recently advised this publication is now obsolete as official Government Accountability Office (GAO) guidance, but the GAO never issued any official rescission of Supplement No. 11. Therefore, DFAS IR had no initial reason to question the merits of conducting a survey, such as the Survey for COL SOP project, as a preliminary process to an audit. In addition, your finding references the announcement letter did not state DFAS IR would perform the survey in accordance with GAGAS. However, there is no GAGAS requirement that announcement letters reference performing an engagement in accordance with GAGAS. The survey was a preliminary planning step for a traditional audit performed in accordance with GAGAS 1.28. Furthermore,

¹ Performance audit objectives may vary widely and include assessments of program effectiveness, economy, and efficiency; internal control; compliance; and prospective analyses. These overall objectives are not mutually exclusive. Thus, a performance audit may have more than one overall objective. For example, a performance audit with an initial objective of program effectiveness may also involve an underlying objective of evaluating internal controls to determine the reasons for a program's lack of effectiveness or how effectiveness can be improved.

there is no requirement that an engagement termination letter state the work completed was done in accordance with GAGAS. Another concern we have with your finding is that DFAS IR sharing the results of their work was not a violation of GAGAS 7.49. Your finding correctly states that standard, "Determining whether and how to communicate the reason for the audit was terminated will depend on the facts and circumstances and is a matter of professional judgment." However, there is nothing in GAGAS that states or even implies that results of work performed cannot be shared with auditees for terminated audits especially when that information helps DFAS management understand the reasons the project was terminated. Finally, the termination memorandum informed the auditees DFAS IR would not be moving into an audit.

2. We non-concur with your determination that the Agreed Upon Procedures (AUP) MOCAS Accounts Payable project had Supervision deficiencies related to independence reference reviews whereby "a comparison of the draft and final reports disclosed significant changes which were not verified by an independent party prior to the report's release." Our rationale is that DFAS IR reviewed the released final report (working paper - AS6.a) against the version the Independent Referencer used (working paper - AS5.j) and the only difference found was in the next to the last paragraph above the signature regarding the date the AUP was completed: signed version date is as of August 4, 2010, whereas the Independent Referencer copy was dated May 24, 2010.

Therefore, we recommend the following changes to your report:

- **Page 4, 2nd Paragraph** – Delete the sixth and seventh bullets "Performance of non-audit services created an organizational impairment to independence" and "A non-audit service was reported on as an engagement survey."
- **Page 5, Table 1 and Page 6, Table 2** – Remove "X" under independence, professional judgment and quality control columns for MOCAS Erroneous Payments and Vendor Pay Erroneous Payment Round Six projects. Your incorrect determination that these engagements impaired DFAS-IR's independence led your reviewers to further conclude that these engagements also had deficient supervision and quality control. Also, the Closeout Survey of DFAS COL SOP should be included in Table 1 for consistency with how you are presenting the erroneous pay projects and the "X" under independence and quality control columns should be removed. Lastly, remove the "X" under supervision for the AUP MOCAS Accounts Payable project.
- **Page 11, Table 3** – The Supervisory Deficiencies, AUP MOCAS Accounts Payable states "An independent referencing review was conducted on the draft examination report. However, a comparison of the draft and final reports disclosed *significant changes* which were not verified by an independent party prior to the report's release." We suggest you remove the deficiency related to this project from Table 3. We do not believe this represents a "significant change" requiring verification by an independent party. We also do not believe this represents deficient supervision as shown in Table 3.
- **Page 12-13, Performance of Non-audit Services Created an Organizational Impairment to Independence** – Remove this section in its entirety from your report.

- **Page 13-14, Non-audit Service Reported on as an Engagement Survey and Recommendation 9** – Remove this section and the related Recommendation 9 in its entirety from your report.

3. The following are our comments to the 13 recommendations in the report:

1. Update the DFAS IR Policies and Procedures Manual to include policies and procedures that:

- a. Remove all references to the “International Standards for the Professional Practice of Internal Auditing,” from Chapter 1700, Attestation Engagements, December 2010.**

DFAS Response: Concur. The DFAS IR Policies and Procedures Manual, Attestation Chapters 4, 5, and 6 will replace Chapter 1700 from the previous manual and will make no reference to any standards other than GAGAS and AICPA Statements on Standards for Attestation Engagements (AT) 101 and AT 201. However, GAGAS 5.44b, 5.52b, and 5.62b do allow the possibility of following International Standards for the Professional Practice of Internal Auditing in attestation engagements.

Estimated completion date (ECD): February 1, 2013

- b. Revise Exhibit 1700-4, Agreed-Upon Procedure Completion Checklist, and remove the GAGAS fieldwork and reporting standards that are not applicable.**

DFAS Response: Concur. The DFAS IR Policies and Procedures Manual, AUP Chapter 6 will not include the Exhibit 1700-4 completion checklist. A revised AUP completion checklist will be incorporated as a TeamMate template and will not contain Performance or Financial Audit fieldwork or reporting standards, but rather only those relevant standards from AT 101 and AT 201.

ECD: February 1, 2013

- c. Reference GAGAS 8.36 guidance to address situations where consensus on the auditor’s findings or proposed plans of action is not possible.**

DFAS Response: Concur. GAGAS 8.36 new references are: 7.37 Performance, 4.38 Financial Audits, and 5.37 Attestation Examinations.

- GAGAS 7.37 will be incorporated into DFAS IR Policies and Procedures Manual, Performance Audit Chapter 3. IR will evaluate the validity of all management comments in response to auditors’ findings and recommendations. When a consensus is not possible, IR will document the reasons for disagreement in the report.
- GAGAS 4.38 pertaining to financial audits is not applicable for the IR Policies and Procedures Manual because DFAS IR does not perform these types of audits.

- GAGAS 5.37 will be incorporated into IR Policies and Procedures Manual, Attestations Examination Chapter 4. **Note:** The standard is not applicable to Attestations: Reviews & AUPs.

ECD: February 1, 2013

2. **Establish a 2-year plan to review all audit offices for compliance with internal quality assurance policies and procedures and GAGAS.**

DFAS Response: Concur. DFAS IR will develop a plan to review all audit offices for compliance with internal quality assurance policies and procedures and GAGAS.

ECD: March 1, 2013

3. **Revise the DFAS IR Policies and Procedures Manual, Exhibit 1300-3c, to include specific information on GAGAS and AICPA requirements for performing and reporting attestation engagements.**

DFAS Response: Concur. The DFAS IR Policies and Procedures Manual, Attestation Chapters 4, 5, and 6 will include the specific GAGAS and AICPA requirements for performing and reporting attestation engagements. There is no Exhibit 1300-3c in the current DFAS-IR manual as referenced by the recommendation, however, if Exhibit 1330-3c was the exhibit in question, that Independent Referencing Checklist will reside in a TeamMate template and will be updated to reflect necessary elements for attestations.

ECD: February 1, 2013

4. **Establish and document by February 28, 2013, a quality control monitoring process to ensure that supervision is sufficiently improved to increase compliance with GAGAS, AICPA standards, and the DFAS IR Policies and Procedures Manual.**

DFAS Response: Concur. As part of the plan to review all audit offices for compliance with internal policies and procedures and GAGAS identified in Recommendation 2, IR will include test aspects to assess the quality of supervision provided by audit managers and the results will be used to hold them accountable in accordance with their performance plans.

ECD: March 1, 2013

5. **Issue a memorandum to DFAS IR managers emphasizing the importance of effective supervision when evaluating Manager's performance.**

DFAS Response: Concur. I issued a memorandum to the Director, IR emphasizing the importance of effective supervision when evaluating manager's performance and directed the results of the quality control reviews be leveraged to evaluate IR managers' performance.

ECD: Complete

-
- 6. Monitor and evaluate DFAS IR managers' training for FYs 2013 and 2014 and identify areas that may need improvement, based on the results of this review.**

DFAS Response: Concur. DFAS IR will use the results of their FY 2013 and 2014 quality control testing described in Recommendation 2 to identify areas where audit managers may need additional training or development to ensure continued compliance with internal policies and procedures, GAGAS, and AICPA standards.

ECD: October 1, 2015

- 7. Issue a memorandum to the DFAS IR staff that communicates the importance of documenting the consideration of potential independence impairments prior to performing future non-audit services.**

DFAS Response: Concur. I issued a memorandum to the Director, IR communicating the importance of documenting the consideration of potential independence impairments prior to performing future non-audit services in accordance with DFAS IR Policies and Procedures Manual, Non-audit Services Chapter 2.

ECD: Complete

- 8. Update the DFAS IR Policies and Procedures Manual to require:**

- a. Documentation of the impact of changing project types, and if a substantial amount of work is completed, consideration of GAGAS and AICPA standards and DFAS IR policies and procedures.
- b. Written approval of all project type changes by the Director, DFAS IR.
- c. Written notification to audit clients regarding the decision to change the project type, to include any changes in applicable GAGAS and AICPA standards, and the level of assurance provided.

DFAS Response: Concur. The DFAS IR Policies and Procedures Manual, General and Administrative Chapter 1 will include all of the recommended elements in 8a, 8b, and 8c for any change in project type.

ECD: February 1, 2013

- 9. Perform and document an assessment of each completed engagement survey to determine its potential impact on independence.**

DFAS Response: Non-Concur and recommend deleting this recommendation per comments above.

- 10. Issue a memo to DFAS operations management that informs the specified parties of the noncompliance with GAGAS and AICPA standards for the two projects.**

DFAS Response: Concur. I issued a memorandum to the Director, IR directing him to inform the Deputy Director, DFAS Operations of the noncompliance with GAGAS and AICPA standards for the Agreed-Upon Procedures: MOCAS Accounts Payable and the Independent Examination of the Columbus Cash Accountability System – Defense Agencies (CCAS-DA), Phase 2.

ECD: Complete

- 11. Review all other attestation engagements completed from July 1, 2010, to present to ensure that those projects complied with GAGAS and AICPA standards. For those that did not comply, notify DFAS operations management of specific instances of noncompliance.**

DFAS Response: Concur. DFAS IR identified two additional attestation engagements completed from July 1, 2010, to present and will review those projects to ensure they complied with GAGAS and AICPA standards. If they did not comply, DFAS IR will notify DFAS management of the noncompliance.

ECD: August 1, 2013

- 12. Revise the DFAS IR Policies and Procedures Manual, Chapter 1700, Attestation Engagements, December 2010, by removing inappropriate terms and phrases such as “to evaluate,” “to review for adequacy and sufficiency,” and the sentence “we believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our agreed-upon procedures” from Exhibit 1700-3, Example Agreed-Upon Procedures Report.**

DFAS Response: Concur. The DFAS IR Policies and Procedures Manual, Attestation Chapters 4, 5, and 6, will replace the Chapter 1700 from the previous manual. Chapters 4, 5, and 6 will not include the inappropriate terms and phrases listed in the recommendation.

ECD: February 1, 2013

- 13. We recommend that the Director, DFAS, issue a memorandum to DFAS IR personnel that communicates the importance of documenting the detailed results of findings when reporting the results of their work and the auditor's assessment of audit risk, fraud risk, and scope limitations.**

DFAS Response: Concur. I issued a memorandum to the Director, IR communicating the importance of adequately documenting their findings in final reports and auditor's assessment of audit risk, fraud risk, and scope limitations and directed the results of the quality control reviews be leveraged to evaluate compliance.

ECD: Complete



Inspector General Department of Defense