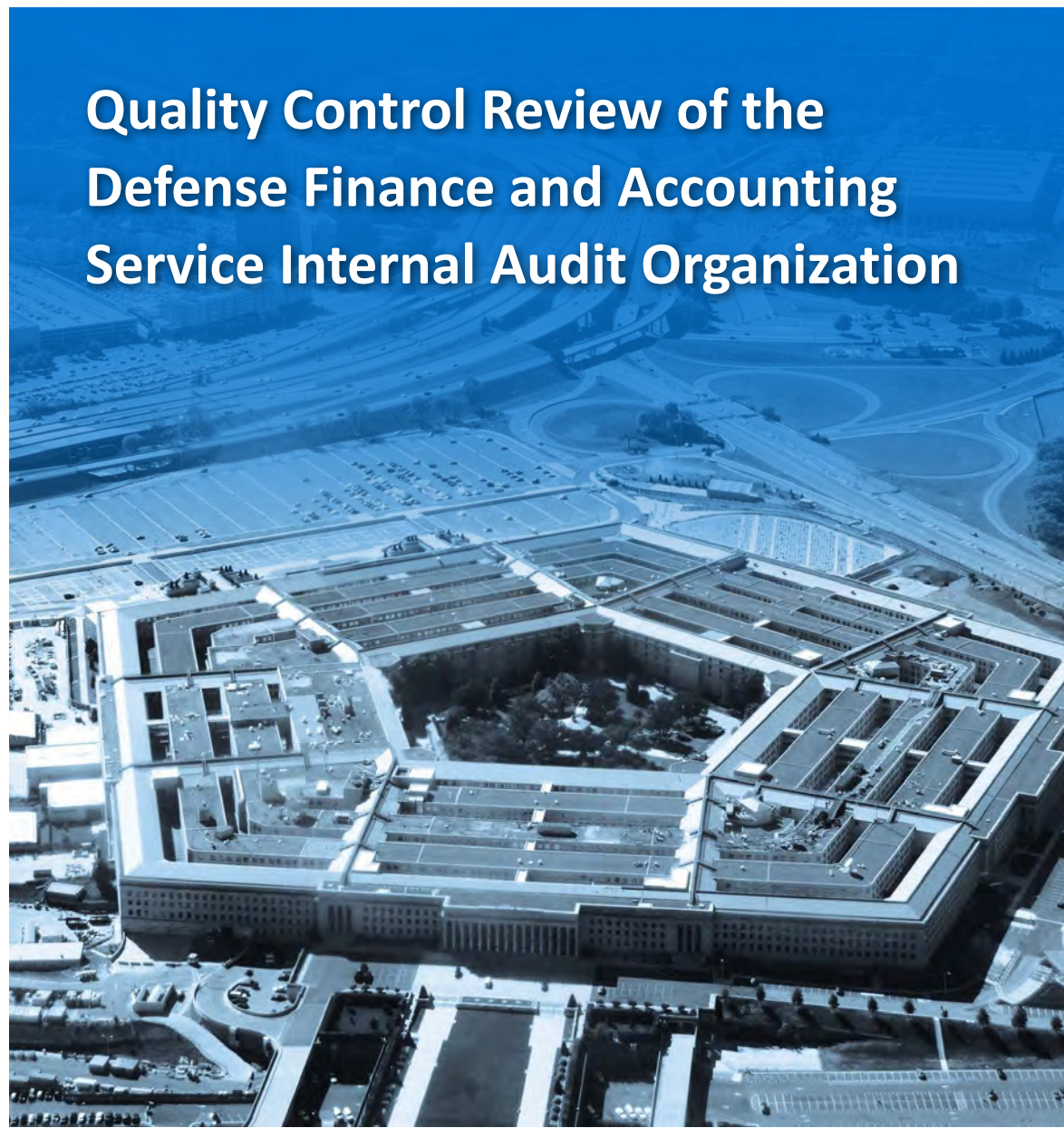




# INSPECTOR GENERAL

*U.S. Department of Defense*

DECEMBER 1, 2014



## Quality Control Review of the Defense Finance and Accounting Service Internal Audit Organization

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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

December 1, 2014

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE**

**SUBJECT: Quality Control Review of the Defense Finance and Accounting Service Internal Audit Organization (Report No. DODIG-2015-043)**

We are providing this report for your review and comment. We reviewed the system of quality control for the internal audit organization, Defense Finance and Accounting Service Office of Internal Review (DFAS IR), in effect for the period ended June 30, 2014. The generally accepted government auditing standards (GAGAS) require that an audit organization performing audits and/or attestation engagements in accordance with GAGAS have an appropriate internal quality control system in place and undergo an external peer review at least once every 3 years by reviewers independent of the audit organization being reviewed. As the organization that has audit policy and oversight responsibilities for audits in the DoD, we conducted the external quality control review of the DFAS IR audits and attestations. Our quality control review was conducted in accordance with the Council of the Inspectors General on Integrity and Efficiency (CIGIE) Quality Standards

An audit organization's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance of meeting the objectives of quality control. We tested the DFAS IR system of quality control for audits to the extent considered appropriate.

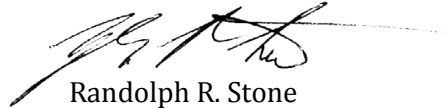
Federal audit organizations can receive a rating of pass, pass with deficiencies, or fail. In our opinion, except for the deficiencies described in Appendix A, the system of quality control for the internal audit function of DFAS in effect for the period ending June 30, 2014, was designed in accordance with quality standards established by GAGAS. Accordingly, we are issuing a pass with deficiencies on the DFAS IR quality control system for the review period ended June 30, 2014.

Appendix A contains deficiencies that provide for the basis for the opinion rendered, and Appendix B contains other findings that warrant disclosure where DFAS IR can improve its quality control system. Appendix C contains a summary of the results of our interviews with the DFAS IR audit staff. Appendix D contains the scope and methodology of the review.

We considered management comments on a draft of this report when preparing the final report. DoD Directive 7650.3 requires that recommendations be resolved promptly. Comments from the Director, Defense Finance and Accounting Service, were generally responsive; however, comments on Recommendation 4a were only partially responsive. Therefore, we request additional comments on Recommendation 4a by December 17, 2014.

Please send a PDF file containing your comments to the email address provided below. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please provide comments to the final report by December 17, 2014. For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877) or [Carolyn.Davis@dodig.mil](mailto:Carolyn.Davis@dodig.mil).

A handwritten signature in black ink, appearing to read 'R. Stone', with a long horizontal flourish extending to the right.

Randolph R. Stone  
Deputy Inspector General  
Policy and Oversight

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# Introduction

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## Defense Finance and Accounting Service

The Defense Finance and Accounting Service (DFAS) is the world's largest finance and accounting operation. DFAS pays 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 2013, DFAS:

- processed 161.8 million pay transactions (6.6 million people/accounts),
- made 6 million travel payments,
- paid 10.3 million commercial invoices,
- maintained 270.4 million General Ledger accounts,
- managed \$700 billion in Military Retirement and Health Benefits Funds,
- made \$579 billion in disbursements,
- managed \$403 billion in Foreign Military Sales (reimbursed by foreign governments), and
- accounted for 1,232 active DoD appropriations.

## DFAS Internal Review Organization

DFAS Office of 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, DFAS IR, reports directly to the Principal 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

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### Deficiencies that Provide the Basis for the Opinion Rendered

With the exception of a few areas, the DFAS IR's system of quality control was suitably designed. Generally accepted government auditing standards (GAGAS) 3.84 requires that each audit organization document its quality control policies and procedures and communicate those policies and procedures to its personnel. DFAS IR established its quality control system in its DFAS IR Audit Manual. We identified areas in the Audit Manual that needed improvement:

- assessing the impact of performing nonaudit services,
- applying safeguards to eliminate or reduce threats to independence,
- accessing and updating audit documentation<sup>1</sup> after report issuance,
- obtaining sufficient and appropriate audit evidence, and
- performing agreed-upon procedure (AUP) engagements.

### Assessing the Impact of Performing Nonaudit Services

In accordance with GAGAS 2.13, when audit organizations provide nonaudit services to entities for which they also provide GAGAS audits, they should assess the impact that providing those nonaudit services may have on the independence of the auditor and the audit organization and respond to any identified threats to independence. Based on our review, we determined that DFAS IR did not properly assess the impact of providing nonaudit services, nor did they adequately respond to identified threats to independence (see additional details in the Applying Safeguards to Eliminate or Reduce Threats to Independence section).

Furthermore, DFAS IR did not maintain a listing of nonaudit services that impacted the current review period. GAGAS 3.43 states that nonaudit services provided by auditors can impact independence in mind and in appearance in periods subsequent to the period in which the nonaudit service was provided. Therefore, it is imperative that audit staff be aware of any nonaudit services provided. The failure to properly assess the impact of nonaudit services on current and future work and the failure to adequately respond to identified threats to independence could result in independence impairments in both current and subsequent periods.

Additionally, we determined that DFAS IR's policies and procedures related to nonaudit services did not include additional requirements as outlined in the DoD

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<sup>1</sup> The term audit documentation refers to working papers in performance audits and attestation engagements.



Manual (DoDM) 7600.07-M, “DoD Audit Manual,” February 13, 2009, Enclosure 9, “Conducting Nonaudit Services.” Specifically, the DFAS IR policies and procedures did not include specific requirements for performing nonaudit services that are not expressly prohibited by GAGAS. DoDM 7600.07-M, Enclosure 9, identifies those types of nonaudit services as “Other than Routine Nonaudit Services.”

## Recommendations, Management Comments, and Our Response

### ***Recommendation 1***

**We recommend that the Director, DFAS:**

- (a) Revise the DFAS IR Audit Manual to provide required guidance on the performance of nonaudit services, including the additional requirements in DoDM 7600.07-M, Enclosure 9, “Conducting Nonaudit Services” for “Other than Routine Nonaudit Services.”**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will incorporate the additional nonaudit services requirements from DoDM 7600.07-M Enclosure 9, “Conducting Nonaudit Services,” for “Other than Routine Nonaudit Services” into Chapter 2 of the IR Audit Manual.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

- (b) Maintain a list of nonaudit services performed along with the time period of the service to assist in making sound decisions on services to accept.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR established a list of nonaudit services with the time period performed to record and track those services. The list of nonaudit services is available for all audit staff to review so they are aware of which nonaudit services DFAS IR performed.

#### *Our Response*

DFAS are responsive. No additional comments are needed.

## Applying Safeguards to Eliminate or Reduce Threats to Independence

GAGAS 3.02 states, “in all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.”

GAGAS 3.04 states in part “that auditors and audit organizations maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties.” For two of the eight engagements, DFAS IR did not apply appropriate safeguards designed to eliminate or reduce threats to independence to an acceptable level in accordance with GAGAS 3.16.

In Project No. C012PRC010TX, we determined that DFAS IR did not apply the appropriate safeguards to eliminate multiple independence threats or reduce them to an acceptable level in accordance with GAGAS 3.16. In this engagement, the Deputy Director, Columbus, and the Audit Client Executive documented a threat to independence because they provided direction in a nonaudit service (IR End-to-End Assessment of DFAS Texarkana Operations). The DFAS IR Director did not apply appropriate safeguards when he decided to mitigate the threats to independence by having the Deputy Director, Columbus, and the Audit Client Executive oversee each other’s decisions. During the performance of the audit, the Audit Client Executive documented a second threat to independence because she was planning to transfer to the DFAS supporting component that was directly related to the subject of the audit. The DFAS IR Director documented that he would assess the direction of the audit and make all final decisions on the direction of the audit; however, we did not find evidence to support that assertion.

Lastly, for Project No. 13INAA005, AUP engagement, a DFAS IR auditor performed procedures on the debt portion of the AUP engagement despite identifying and reporting both a familiarity and undue influence threat on his independence statement. DFAS IR management concurred with the auditor’s assessment, and the Audit Manager decided to eliminate the threat to independence by documenting that the auditor would not work on the debt portion of the assignment. However, the attest documentation showed that the auditor participated in performing procedures related to debt cycles. During our site visit, the Audit Manager clarified his written statement by stating that his written statement was *intended* to indicate that the auditor would not be performing any procedures where specific debt transactions were assessed that related to the familiarity and undue influence threats. We don’t know how the Audit Manager would be able to differentiate the debt transactions that related to the familiarity and undue influence threats and those that did not. We determined that DFAS IR management did not apply appropriate safeguards.

## Recommendations, Management Comments, and Our Response

### **Recommendation 2**

We recommend that the Director, DFAS:

- (a) Revise the DFAS IR Audit Manual to include examples of appropriate ways to mitigate, reduce, or eliminate threats to independence.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will incorporate examples of appropriate ways to mitigate, reduce, or eliminate threats to independence into the IR Audit Manual.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

- (b) Provide training on the execution and implementation of the GAGAS Conceptual Framework Approach to Independence.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will provide training to all audit staff on the proper execution and implementation of the GAGAS Conceptual Framework Approach to Independence.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

## Accessing and Updating Audit Documentation after Report Issuance

GAGAS 3.92 states,

when performing GAGAS audits, audit organizations should have policies and procedures for the safe custody and retention of audit documentation for a time sufficient to satisfy legal, regulatory, and administrative requirements for records retention . . . . For audit documentation that is retained electronically, the audit organization should establish effective information systems controls concerning accessing and updating the audit documentation.

We observed that DFAS IR did not have policies and procedures for handling changes to audit documentation after audit report issuance. DoDM 7600.07-M, Enclosure 13, "Audit Documentation," states that to ensure the integrity of the audit data, DoD audit organizations should develop policies and procedures for handling

changes to audit documentation after they issue the audit report. DFAS IR audit staff edited or created audit documentation after the final report was issued as shown in Table 1.

*Table 1. Audit Documentation Edited or Created after Final Report Issuance.*

Project Number	Total Audit Documents	Non-Administrative Audit Documents Dated After Final Report Date	Administrative Audit Documents Dated After Final Report Date	Total Audit Documents Dated After Final Report Date
13INAA005*	453	22	35	57
IN12PRS004DFAS	1,103	8	38	46
13INAA012*	153	37	34	71
13INPA008	573	8	6	14
CO12PRC010TX	414	4	4	8
13COPA001	372	0	7	7
13COPA003	264	2	7	9
CL12PRA009DFAS	881	2	19	21

\*See additional details in the Performing Agreed-Upon Procedures, Dating of Agreed-Upon Procedure Reports section in this appendix.

GAGAS 3.92 states in part, “For audit documentation that is retained electronically, the audit organization should establish effective information systems controls concerning accessing and updating the audit documentation.”

## Recommendations, Management Comments, and Our Response

### **Recommendation 3**

**We recommend that the Director, DFAS:**

- (a) Revise the DFAS IR Audit Manual in accordance with DoDM 7600.07, Enclosure 13, “Audit Documentation” to include requirements for accessing and updating audit documentation after the final audit report is issued whether the audit documentation is in electronic, or hardcopy, or any other media.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will incorporate into the DFAS IR Audit Manual the requirements for assessing and updating audit documentation after the final audit report is issued whether the audit documentation is in electronic, hardcopy, or any other media in accordance with DoDM 7600.07-M, “Audit Policies,” Enclosure 13, “Audit Documentation.”

*Our Response*

DFAS comments are responsive. No additional comments are needed.

**(b) Provide training consistent with the requirements of DoDM 7600.07, Enclosure 13, “Audit Documentation” for accessing and updating audit documentation after the final audit report is issued.**

*DFAS Comments*

The Director, DFAS agreed. DFAS IR will provide training to all audit staff on the requirements for assessing and updating audit documentation after the final audit report is issued consistent with the requirements of DoDM 7600.07-M, “Audit Policies,” Enclosure 13, “Audit Documentation.”

*Our Response*

DFAS comments are responsive. No additional comments are needed.

## Obtaining Sufficient and Appropriate Evidence

GAGAS 6.56 states that auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions. In two of the six performance audits selected, inappropriate or insufficient evidence was used to support reported findings.

*Consideration of Audit Risk*

For Project No. CL12PRA009DFAS, the audit staff used a minimum sample size for each of the nine samples without considering audit risk. The impact to the engagement was that the audit staff may have reached incorrect or improper conclusions (GAGAS 6.71b). GAGAS 6.71b states, in part, “evidence is not sufficient or not appropriate when (1) using the evidence carries an unacceptably high risk that it could lead the auditor to reach an incorrect or improper conclusion.” Because the audit staff did not appropriately assess audit risk when selecting the sampling parameters, there is no assurance that the staff obtained sufficient and appropriate evidence to support the reported findings and conclusions in relation to the audit objectives in accordance with GAGAS 6.10. GAGAS 6.10 states, in part, “...auditors should design the methodology to obtain reasonable assurance that the evidence is sufficient and appropriate to support the auditors’ findings and conclusions in relation to the audit objectives and to reduce audit risk to an acceptable level.”

For Project No. IN12PRS004DFAS, the audit staff did not perform a comprehensive assessment of audit risk. The staff did not appropriately identify the sources of audit evidence, within the context of the audit objective, and determine the amount

and type of evidence needed given audit risk and significance. This led to the audit staff performing procedures outside the scope of the audit. For example, one audit procedure required the audit staff to verify supporting documents for death gratuity payments at DFAS. In addition to verifying the supporting documents, the audit staff performed unnecessary verifications at the military commands and Department of Veterans Affairs. GAGAS 6.09 states in part,

the scope defines the subject matter that the auditors will assess and report on, such as a particular program or aspect of a program, the necessary documents or records, the period of time reviewed, and the locations that will be included.

In performing unrelated procedures, the audit staff utilized inappropriate audit evidence and wasted audit resources.

### *Reliance on Computer-Processed Data*

For Project No. CL12PRA009DFAS, the audit staff determined that they did not need to assess the reliability of computer-processed data. The audit staff used journal voucher logs to materially support the findings, conclusions, and recommendations, but the staff did not assess the sufficiency and appropriateness of journal voucher logs in accordance with GAGAS 6.66. GAGAS 6.66 states, in part, “auditors should assess the sufficiency and appropriateness of computer-processed information regardless of whether this information is provided to auditors or auditors independently extract it.” The July 2009 Government Accountability Office (GAO) Report No. GAO 09-680G, “Assessing the Reliability of Computer-Processed Data,” states, “you should assess reliability if the data to be analyzed are intended to materially support your findings, conclusions, or recommendations.” Further, “in your audit plan, you should discuss briefly how you plan to assess data reliability, as well as any limitations that may exist because of shortcomings in the data.” When the audit staff decided not to assess the reliability of computer-processed data, they did not obtain appropriate evidence to support their findings and conclusions.



## Recommendations, Management Comments, and Our Response

### **Recommendation 4**

We recommend that the Director, DFAS:

- (a) Revise the DFAS IR Audit Manual to add procedures on how to effectively develop and implement audit risk assessments.**

#### *DFAS Comments*

The Director, DFAS partially agreed. DFAS IR will review the IR Audit Manual and determine whether additional procedures are necessary on how to effectively develop and implement audit risk assessments. DFAS IR asserted that our review was based on older versions (2013 and 2012) of the IR Audit Manual and did not identify audit risk assessment concerns for audits planned using current risk assessment procedures in the February 28, 2014 IR Audit Manual.

#### *Our Response*

The Director's comments are partially responsive. Our findings took into consideration the current version of the IR Audit Manual which had the same procedures for audit risk as the prior version of the IR Audit Manual dated June 28, 2013. Because the procedures in the current version are the same as those in the prior version, we evaluated those procedures for audits issued for the period in effect (July 1, 2013 to June 30, 2014) on which our findings are based. We request that DFAS reconsider its position and provide additional comments.

- (b) Provide training on the documentation of audit risk.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will provide training to all audit staff on the proper documentation of audit risk to demonstrate compliance with GAGAS 6.07 and the DFAS IR Audit Manual.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

## Performing Agreed-Upon Procedure Engagements

We selected two Agreed-Upon Procedure (AUP) engagements for our review. We identified significant noncompliances in conducting and reporting of these engagements in the areas of understanding the auditor's role in performing an AUP engagement, the dating of the report, and obtaining a management representation letter.

### *Auditor's Role in Performing an AUP Engagement*

For Project No. 13INAA005, the audit staff assumed the role of DFAS management by inappropriately making decisions about the procedures that were specified in the engagement. The true universe of the population within the scope period was unknown; therefore, DFAS management could not establish appropriate sampling parameters for DFAS IR to execute. The American Institute of Certified Public Accountants (AICPA) AT<sup>2</sup> 201.16 states the practitioner (auditor) should not agree to perform procedures that are overly subjective and thus possibly open to varying interpretations. Examples of appropriate procedures include the execution of a sampling application after agreeing on relevant parameters (AT 201.17). DFAS IR and DFAS management failed to agree on relevant sampling parameters before executing the sampling application.

### *Dating of AUP Reports*

AICPA AT 201.34 states that the date of completion of the AUPs should be used as the date of the practitioner's report. For both AUP engagements, the DFAS IR audit staff dated the final report as of the last day of performance of the procedures. As a result, a significant number of documents were prepared, edited, and/or reviewed after the report date (see additional details in the Accessing and Updating Audit Documentation after Report Issuance section in this appendix). Additionally, there is a significant gap between the report date and the date of issuance as shown in Table 2.

*Table 2. Time Elapses Between Report Date and Date of Issuance*

Project Number	Report Date	Date of Issuance
13INAA012	December 10, 2013	January 17, 2014
13INAA005	August 27, 2013	September 18, 2013

For any AUP engagement, the procedures agreed upon should include the time necessary to assess and report on the procedures. If reporting is not explicitly stated within the AUP, then it should be implied as part of performance of the AUP. Therefore, the date of the practitioner's report should reflect any time necessary for reporting on the procedures.

### *Obtaining a Management Representation Letter*

For Project No. 13INAA012, the auditors did not obtain written representations from DFAS management in accordance with AT 601.11. AT 601.11 states that

<sup>2</sup> The prefix AT is used for Statements on Standards for Attestation Engagements and Attestation Engagement interpretations in the AICPA standards.

as part of performing an engagement, the practitioner should obtain from the responsible party a written assertion about compliance with specified requirements or internal control over compliance. The DFAS IR audit staff did not obtain written representations from the responsible party, DFAS management, even though a written assertion was required to conduct the AUP engagement.

## Recommendations, Management Comments, and Our Response

### **Recommendation 5**

**We recommend that the Director, DFAS:**

- (a) Revise the DFAS IR Audit Manual, dated February 28, 2014, Chapter 6, “Agreed-Upon Procedures Attestations,” to include guidance that for any AUP engagement, the procedures agreed upon should include the time necessary to assess and report on the procedures.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will incorporate into Chapter 6 of the IR Audit Manual guidance that for any AUP engagement, the procedures agreed upon should include the time necessary to assess and report on the procedures.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

- (b) Update the DFAS IR Audit Manual, dated February 28, 2014, Chapter 6, “Agreed-Upon Procedures Attestations,” to provide additional guidance on Compliance Attestation engagements and the requirement to obtain written representations from the responsible party in accordance with AT 601.68.**

#### *DFAS Comments*

The Director, DFAS agreed. DFAS IR will incorporate into the IR Audit Manual guidance on AUP Compliance Attestation engagement, and the requirement to obtain written representations from the responsible parties in accordance with AT 601.68 into the IR Audit Manual.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

- (c) Provide training to all DFAS IR audit staff on performing and reporting on AUP engagements conducted in accordance with GAGAS.**

*DFAS Comments*

The Director, DFAS agreed. DFAS IR will provide training to all audit staff on properly performing and reporting on AUP engagements in accordance with GAGAS and the DFAS IR Audit Manual.

*Our Response*

DFAS comments are responsive. No additional comments are needed.

## Appendix B

### Other Findings that Warrant Disclosure

We identified areas of concern that showed evidence of noncompliance in some additional areas. However, these areas of noncompliance were not considered to be significant and did not affect the opinion rendered, but due to the relative importance to the audit organization's system of quality control, they warrant disclosure.

### Reliance on the Work of Other Auditors

GAGAS 6.40 states that auditors should determine whether other auditors have conducted, or are conducting, audits of the program that could be relevant to the current audit objectives. Furthermore, in accordance with GAGAS 6.41, if auditors use the work of other auditors, they should perform procedures that provide a sufficient basis for using that work. For Project No. 13INPA008, the audit staff placed reliance on an audit performed by an external auditing firm. However, the staff did not obtain evidence concerning the qualifications and independence of the external auditing firm. Also, the staff did not document that the scope, quality, and timing of the audit work performed by the external auditing firm could be relied upon as required by GAGAS 6.41. Moreover, the audit staff did not adhere to DFAS IR's Audit Manual, dated June 28, 2013, Section 3.20, which states, in part, the audit staff

**must** obtain evidence concerning the other auditors' qualifications, independence, and should determine whether the scope, quality, and timing of the audit work performed by the other auditors is adequate for reliance in the context of the current audit objectives... Working papers **must** support the reliance of other's work or not, as applicable to the objectives of the audit.

The failure of the DFAS IR audit staff to obtain evidence concerning the other auditors' qualifications and independence could result in DFAS IR relying on inadequate audit work.

### Recommendations, Management Comments, and Our Response

#### ***Recommendation 6***

**We recommend that the Director, DFAS IR, issue a memorandum to DFAS IR personnel reinforcing the GAGAS and DFAS IR Audit Manual requirements when using the work of other auditors.**

### *DFAS Comments*

The Director, DFAS IR, agreed. The Director DFAS IR, issued a memorandum to DFAS IR audit staff reinforcing the GAGAS and DFAS IR Audit Manual requirements when using the work of others.

### *Our Response*

DFAS comments are responsive. No additional comments are needed.

## **Omission of Performance Aspects from Performance Audit Objectives**

GAGAS 6.08 states that the objectives are what the audit is intended to accomplish. The audit objectives identify the audit subject matter and performance aspects to be included, and may also include the potential findings and reporting elements that the auditors expect to develop. The specific objective of Project No. CO12PRC010TX was to “determine the effect the lack of segregation of duties and system management controls has on the DFAS Texarkana Vendor Pay and Payroll functions.” Based on our review, we determined that the objective was a preconceived conclusion from work previously performed. DFAS IR did not develop an objective that met the criteria of GAGAS 6.08 as the audit staff did not identify the performance aspects to be included. This potentially resulted in the staff expending audit resources that could have been put to better use. Additionally, this is contrary to DFAS IR’s Audit Manual, dated June 28, 2013, Section 3.07, which states the audit objectives “**must** identify the subject of the audit matter and the performance aspects to be reviewed.” The Audit Manual further states, in Section 3.07.01, that “to clearly communicate expectations, the audit objectives **must** be answerable, identifying the audit subject, performance aspect reviewed, and the finding and reporting elements the auditors expect to develop.”



## Recommendations, Management Comments, and Our Response

### **Recommendation 7**

**We recommend that the Director, DFAS IR, issue a memorandum to DFAS IR personnel reiterating the GAGAS and DFAS IR Audit Manual requirements that the audit objectives identify both the subject matter and the performance aspects.**

#### *DFAS Comments*

The Director, DFAS IR, agreed. The Director, DFAS IR, has issued a memorandum to DFAS IR personnel reiterating the GAGAS and DFAS IR Audit Manual requirements that the audit objectives identify both the subject matter and the performance aspects.

#### *Our Response*

DFAS comments are responsive. No additional comments are needed.

## Inconsistencies in Reporting on Internal Controls

GAGAS 7.09 states that auditors should include in the report a description of the audit objectives and the scope and methodology used for addressing the audit objectives. GAGAS 7.11 states that auditors should describe the scope of the work performed and any limitations, including issues that would be relevant to likely users, so that they could reasonably interpret the findings, conclusions, and recommendations in the report without being misled. The DFAS IR audit staff stated that “policies, procedures, risks, and internal controls for acquisitions (capitalized and non-capitalized) . . . for all asset transactions between January 1, 2013 and July 31, 2013” would be included as part of the audit scope for Project No. 13INPA008. This led users of the report to believe that internal controls were included and assessed during performance of the audit. However, the report further states that the audit staff did not assess internal controls. Auditors should communicate the audit objectives, scope, and methodology in a clear, specific, and unambiguous manner, and the audit objectives, scope, and methodology should be consistent with content throughout the report.

## Recommendations, Management Comments, and Our Response

### ***Recommendation 8***

**We recommend that the Director, DFAS IR, revise the DFAS IR Audit Manual, dated February 28, 2014, to include procedures to ensure consistency in reporting between the audit objective, scope of audit, audit methodology, and other report content.**

### ***DFAS Comments***

The Director, DFAS IR, agreed and will incorporate additional procedures to ensure consistency in reporting between the audit objectives, scope, methodology, and other report content into Chapter 3 of the IR Audit Manual.

### ***Our Response***

DFAS comments are responsive. No additional comments are needed.

## Appendix C

### Summary of the Results of Our Interviews

We interviewed DFAS IR staff members of various organizational levels to determine their knowledge of DFAS IR audit policies and GAGAS general, fieldwork, and reporting standards. Table 3 contains a summary of the results of the responses received.

*Table 3. Summary of Interview Results*

Areas Pertaining to DFAS Internal Review Audit Policies and GAGAS Standards	Staff Responses to Questions
Awareness of DFAS IR Audit Policies	The staff stated they were aware of the audit policies.
Compliance with GAGAS	The staff stated that their work complied with GAGAS standards.
Independence	Several of the audit staff expressed concerns with a potential independence impairment related to a disagreement with DFAS IR management. We reviewed those concerns and determined that DFAS IR management appropriately documented the disagreement. However, based on our review of project documentation, we identified issues related to documenting safeguards to eliminate or reduce threats to independence (see Appendix A).
Competence	Staff responses indicated that the competency requirement was fulfilled.
Quality Control and Assurance	The staff members were knowledgeable about quality control and assurance procedures.
Planning (Risk Assessments)	The staff involved with planning stated that they completed risk assessments for audits.
Supervision	The staff stated that they received or provided adequate supervision.
Audit Documentation	The staff stated that the audit documentation was adequate.
Evidence	The staff stated that the evidence was adequate.
Reporting (Timeliness)	The staff stated that the reports were generally timely.

## Appendix D

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### Scope and Methodology

We reviewed the adequacy of the DFAS IR audit organization's compliance with its quality control policies, procedures, and GAGAS. In performing our review, we considered the requirements of quality control standards contained in the December 2011 Revision of GAGAS issued by the Comptroller General of the United States. GAGAS 3.96 states:

The audit organization should obtain an external peer review at least once every 3 years that is 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 March 2014 to September 2014 in accordance with standards and guidelines established in the March 2009, Updated November 2012, CIGIE Guide for Conducting External Peer Reviews of the Audit Organizations of Federal Offices of Inspector General. We performed this review in accordance with the Quality Standards for Inspections and Evaluations. In performing this review, we assessed, reviewed, and evaluated audit documentation, interviewed DFAS IR audit staff, and reviewed DFAS IR policies that were published February 28, 2014, June 28, 2013, and the archived DFAS IR Audit Manual.

We judgmentally selected 8 reports from a universe of 13 reports issued by the DFAS IR from July 1, 2013 through June 30, 2014. 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.

Table 4 identifies the specific reports reviewed. The Type of Review column contains information that was determined by the report's GAGAS compliance statement and/or the type of review described in the final report.




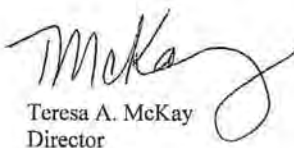
Table 4. Reports Reviewed

Project Number	Audit Office	Report Title and Issue Date	Type of Review
13INAA005	Indianapolis	Defense Military Pay Offices Agreed-Upon Procedures, August 27, 2013	Agreed-Upon Procedures
IN12PRS004DFAS	Indianapolis	Death Gratuity Payment Effectiveness, October 31, 2013	Performance
13INAA012	Indianapolis	Account Management & Provisioning System Role-Based Access Control Packages Agreed-Upon Procedures, December 10, 2013	Agreed-Upon Procedures
13INPA008	Indianapolis	Audit of I&T Infrastructure Management, February 10, 2014	Performance
CO12PRC010TX	Columbus	Audit of DFAS Texarkana Vendor Pay and Payroll, November 19, 2013	Performance
13COPA001	Columbus	General Accounting and Finance System E-Adjustments Audit, November 27, 2013	Performance
13COPA003	Columbus	Centralized Offset Program (COP) Audit, January 7, 2014	Performance
CL12PRA009DFAS	Cleveland	DFAS Journal Voucher (JV) 2012 Audit, January 21, 2014	Performance

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. In performing most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other human factors. Projecting any evaluation of a quality control system into the future 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.

## Management Comments

### Defense Finance and Accounting Service Comments

		
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<b>DEFENSE FINANCE AND ACCOUNTING SERVICE</b>		<b>NOV 07 2014</b>
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) Internal Audit Organization (Project No. D2014-DAP0CM-0130.000)		
<p>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 to your report.</p> <p>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 Audit, at (614) 701-2330.</p> <div style="text-align: right;"> Teresa A. McKay Director</div> <p>Attachment: As stated</p>		
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## Defense Finance and Accounting Service Comments (cont'd)

**Management Comments  
on  
Quality Control Review of the DFAS Internal Audit Organization (Project No. D2014-DAP0CM-0130.000)**

The following are our comments to the 8 recommendations in the report:

**1. We recommend that the Director, DFAS:**

**a. Revise the DFAS IR Audit Manual to provide required guidance on the performance of nonaudit services, including the additional requirements in DoDM 7600.07-M, Enclosure 9, "Conducting Nonaudit Services" for "Other than Routine Nonaudit Services."**

**DFAS Response:** Concur. DFAS IR will incorporate the additional nonaudit services requirements from DoDM 7600.07-M, Enclosure 9, "Conducting Nonaudit Services" for "Other than Routine Nonaudit Services" into Chapter 2 of the IR Audit Manual.

**Estimated completion date (ECD):** January 31, 2015

**b. Maintain a list of nonaudit services performed along with the time period of the service to assist in making sound decisions on services to accept.**

**DFAS Response:** Concur. DFAS IR established a list of nonaudit services with the time period performed to record and track those services. The list of nonaudit services is available for all audit staff to review so they are aware which nonaudit services DFAS IR performed.

**ECD:** Complete

**2. We recommend that the Director, DFAS:**

**a. Revise the DFAS IR Audit Manual to include examples of appropriate ways to mitigate, reduce, or eliminate threats to independence.**

**DFAS Response:** Concur. DFAS IR will incorporate examples of appropriate ways to mitigate, reduce, or eliminate threats to independence into Chapter 1 of the IR Audit Manual.

**ECD:** January 31, 2015

## Defense Finance and Accounting Service Comments (cont'd)

**b. Provide training on the execution and implementation of the GAGAS Conceptual Framework Approach to Independence.**

**DFAS Response:** Concur. DFAS IR will provide training to all audit staff on the proper execution and implementation of the GAGAS Conceptual Framework Approach to Independence.

**ECD:** January 31, 2015

**3. We recommend that the Director, DFAS:**

**a. Revise the DFAS IR Audit Manual in accordance with DoDM 7600.07, Enclosure 13, "Audit Documentation" to include requirements for accessing and updating audit documentation after the final audit report is issued whether the audit documentation is in electronic, or hardcopy, or any other media.**

**DFAS Response:** Concur. DFAS IR will incorporate the requirements for accessing and updating audit documentation after the final audit report is issued from DoDM 7600.07-M, Enclosure 13, "Audit Documentation" into Chapter 1 of the IR Audit Manual.

**ECD:** January 31, 2015

**b. Provide training consistent with the requirements of DoDM 7600.07, Enclosure 13, "Audit Documentation" for accessing and updating audit documentation after the final audit report is issued.**

**DFAS Response:** Concur. DFAS IR will provide training to all audit staff on the requirements for accessing and updating audit documentation after the final audit report is issued from DoDM 7600.07-M, Enclosure 13, "Audit Documentation."

**ECD:** January 31, 2015

**4. We recommend that the Director, DFAS:**

**a. Revise the DFAS IR Audit Manual to add procedures on how to effectively develop and implement audit risk assessments.**

**DFAS Response:** Partially Concur. DFAS IR will review the IR Audit Manual and determine whether additional procedures are necessary on how to effectively develop and implement audit risk assessments. The two audit examples the peer review based the finding on were audits planned using a prior version of the IR Audit Manual that had not yet included the latest DFAS IR audit risk assessment procedures. The peer review did not identify audit risk assessment concerns for audits planned using current risk assessment procedures in the IR Audit Manual.

**ECD:** January 31, 2015

## Defense Finance and Accounting Service Comments (cont'd)

### **b. Provide training on the documentation of audit risk.**

**DFAS Response:** Concur. DFAS IR will provide training to all audit staff on the proper documentation of audit risk to demonstrate compliance with GAGAS 6.07 and the DFAS IR Audit Manual.

**ECD:** January 31, 2015

### **5. We recommend that the Director, DFAS:**

#### **a. Revise the DFAS IR Audit Manual, dated February 28, 2014, Chapter 6, "Agreed-Upon Procedures Attestations," to include guidance that for any AUP engagement, the procedures agreed upon should include the time necessary to assess and report on the procedures.**

**DFAS Response:** Concur. DFAS IR will incorporate guidance that for any AUP engagement, the procedures agreed upon should include the time necessary to assess and report on the procedures into Chapter 6 of the IR Audit Manual.

**ECD:** January 31, 2015

#### **b. Update the DFAS IR Audit Manual, dated February 28, 2014, Chapter 6, "Agreed-Upon Procedures Attestations," to provide additional guidance on Compliance Attestation engagements and the requirement to obtain written representations from the responsible party in accordance with AT 601.68.**

**DFAS Response:** Concur. DFAS IR will incorporate additional guidance for AUP Compliance Attestation engagements, and the requirement to obtain written representations from the responsible parties in accordance with AT 601.68 into Chapter 6 of the IR Audit Manual.

**ECD:** January 31, 2015

#### **c. Provide training to all DFAS IR audit staff on performing and reporting on AUP engagements conducted in accordance with GAGAS.**

**DFAS Response:** Concur. DFAS IR will provide training to all audit staff on properly performing and reporting on AUP engagements in accordance with GAGAS and the DFAS IR Audit Manual.

**ECD:** January 31, 2015

### **6. We recommend that the Director, DFAS IR issue a memorandum to DFAS IR personnel reinforcing the GAGAS and DFAS IR Audit Manual requirements when using the work of others.**

## Defense Finance and Accounting Service Comments (cont'd)

**DFAS Response:** Concur. The Director, DFAS IR issued a memorandum to the DFAS IR audit staff reinforcing the GAGAS and DFAS IR Audit Manual requirements when using the work of others.

**ECD:** Complete

7. **We recommend that the Director, DFAS IR, issue a memorandum to DFAS IR personnel reiterating the GAGAS and DFAS IR Audit Manual requirements that the audit objectives identify both the subject matter and the performance aspects.**

**DFAS Response:** Concur. The Director, DFAS IR issued a memorandum to the DFAS IR audit staff reiterating the GAGAS and DFAS IR Audit Manual requirements that the audit objectives identify both the subject matter and the performance aspects.

**ECD:** Complete

8. **We recommend that the Director, DFAS IR, revise the DFAS IR Audit Manual, dated February 28, 2014, to include procedures to ensure consistency in reporting between the audit objective, scope of audit, audit methodology, and other report content.**

**DFAS Response:** Concur. DFAS IR will incorporate additional procedures to ensure consistency in reporting between the audit objectives, scope, and methodology, and other report content into Chapter 3 of the IR Audit Manual.

**ECD:** January 31, 2015

# **Whistleblower Protection**

## **U.S. DEPARTMENT OF DEFENSE**

*The Whistleblower Protection Enhancement Act of 2012 requires the Inspector General to designate a Whistleblower Protection Ombudsman to educate agency employees about prohibitions on retaliation, and rights and remedies against retaliation for protected disclosures. The designated ombudsman is the DoD Hotline Director. For more information on your rights and remedies against retaliation, visit [www.dodig.mil/programs/whistleblower](http://www.dodig.mil/programs/whistleblower).*

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