



DEC -2 2009

Report Number: A-07-09-01067

The Honorable Gordon S. Heddell
Inspector General
U.S. Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202

Dear Mr. Heddell:

The enclosed report presents the results of our External Quality Control Review of the Audit Organization of the U.S. Department of Defense, Office of Inspector General. Your response to the draft report is included as Appendix B, and excerpts are incorporated into the relevant section of the report.

We agree with your proposed corrective actions in response to the recommendation. We thank you and your staff for the assistance and cooperation extended to us during our review.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact Joseph E. Vengrin, Deputy Inspector General for Audit Services, at (202) 619-3155 or through email at Joseph.Vengrin@oig.hhs.gov.

Sincerely,

Daniel R. Levinson

Daniel R. Levinson
Inspector General

Enclosure

**REPORT ON THE EXTERNAL QUALITY CONTROL REVIEW
OF THE AUDIT ORGANIZATION OF THE
U.S. DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR GENERAL**

We have reviewed the system of quality control for the audit organization of the U.S. Department of Defense (DoD), Office of Inspector General (OIG), in effect for the year ended March 31, 2009. A system of quality control encompasses DoD OIG's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with *Government Auditing Standards*. The elements of quality control are described in *Government Auditing Standards*. DoD OIG is responsible for designing a system of quality control and complying with it to provide DoD OIG with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and DoD OIG's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed DoD OIG personnel and obtained an understanding of the nature of the DoD OIG audit organization and the design of DoD OIG's system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with DoD OIG's system of quality control. The engagements selected represented a reasonable cross-section of DoD OIG's audit organization, with emphasis on higher-risk engagements. Prior to concluding the review, we reassessed the adequacy of the scope of the peer review procedures and met with DoD OIG management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for DoD OIG's audit organization. In addition, we tested compliance with DoD OIG's quality control policies and procedures to the extent we considered appropriate. These tests covered the application of DoD OIG's policies and procedures on selected engagements. Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Our scope and methodology appear in Appendix A.

In our opinion, the system of quality control for the audit organization of DoD OIG in effect for the year ended March 31, 2009, was suitably designed and complied with to provide DoD OIG with reasonable assurance of performing and reporting in conformity with applicable

professional standards in all material respects. Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*. DoD OIG has received a peer review rating of *pass*.

As is customary, however, we noted matters that warrant your attention, although they were not considered to be of sufficient significance to affect our opinion expressed in this report. These matters are described in the “Findings and Recommendation” section below.

In addition to reviewing its system of quality control to ensure adherence with *Government Auditing Standards*, we applied certain limited procedures in accordance with guidance established by CIGIE related to DoD OIG’s monitoring of engagements performed by Independent Public Accountants (IPA) under contract where the IPA served as the principal auditor. It should be noted that monitoring of engagements performed by IPAs is not an audit and therefore is not subject to the requirements of *Government Auditing Standards*. The purpose of our limited procedures was to determine whether DoD OIG had controls to ensure IPAs performed contracted work in accordance with professional standards. However, our objective was not to express an opinion, and accordingly we do not express an opinion, on DoD OIG’s monitoring of work performed by IPAs.

FINDINGS AND RECOMMENDATION

Since its previous external quality control review, DoD OIG has continued to improve its system of quality control. Specifically, DoD OIG trained staff members on issues identified in the previous review, updated audit policies and procedures to provide further guidance for auditors, and increased the number of internal quality assurance reviews.

However, we identified three areas in which DoD OIG could make additional improvements to its system of quality control. First, DoD OIG did not always comply with applicable standards concerning supervisory review. Second, DoD OIG did not prepare some of its audit documentation in sufficient detail to enable an experienced auditor to understand the source of the audit evidence or the conclusions reached. Third, DoD OIG did not disclose in one report a significant assumption that it made during the audit. These conditions occurred because DoD OIG did not always adhere to its policies and procedures. There was no indication, however, that these findings affected the reliability of any of the audit reports that we reviewed.

Finding 1. Audit Supervision

Government Auditing Standards, paragraph 7.52, states: “Audit supervisors or those designated to supervise auditors must properly supervise audit staff.” Paragraph 7.53 states: “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.”

DoD OIG’s policies and procedures addressed the importance of properly supervising audit staff. However, for 2 of the 10 audits that we reviewed, DoD OIG supervisors did not fully comply with applicable standards. One audit report had more than one exception.

- The audit documentation for one audit did not always indicate that supervisory review had taken place. Specifically, some working papers did not include signatures or dates showing that supervisors had reviewed the work performed.
- For two audits, supervisors approved some audit documentation that did not comply with applicable standards. For one of these audits, a supervisor approved (1) summary-level working papers that lacked the required sources of evidence and (2) an audit plan that lacked the required audit objective and scope. For the other audit, a supervisor approved summary-level working papers that lacked the required sources of evidence. DoD OIG subsequently issued a draft report containing inaccurate information on this audit. However, after an independent referencing reviewer noted the deficiencies, DoD OIG made the necessary corrections to the final report.

Additionally, DoD OIG’s policies and procedures required that supervisors review working papers within “30 working days or 45 calendar days from the date that the preparer signed the document (electronic or hardcopy signature).” *Government Auditing Standards* do not impose specific timeframes for supervisory review. Thus, although DoD OIG did not meet its own timeframes for 7 of the 10 audits that we reviewed, this condition did not represent a departure from applicable auditing standards.

Finding 2. Audit Documentation

According to *Government Auditing Standards*, paragraph 7.77:

Auditors must prepare audit documentation related to planning, conducting, and reporting for each audit. 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. Auditors should prepare audit documentation that contains support for findings, conclusions, and recommendations before they issue their report.

DoD OIG’s policies and procedures addressed the importance of preparing audit documentation pursuant to applicable standards. However, for 3 of the 10 audits that we reviewed, DoD OIG did not always prepare audit documentation in sufficient detail to enable an experienced auditor to understand the source of the audit evidence or the conclusions reached.

- One audit report contained condition statements that were referenced to a summary working paper that did not include any further references.
- The audit documentation did not support the condition statements in two audit reports. Although the conditions were referenced to a presentation slide and an email, these working papers did not contain analyses that supported the conclusions reached regarding the findings.

During our review, DoD OIG officials provided further explanations and/or additional documentation that supported the findings and conclusions in these three reports.

Finding 3. Report Content

Government Auditing Standards, paragraph 8.13, states: “In reporting audit methodology, auditors should explain how the completed audit work supports the audit objectives, including the evidence gathering and analysis techniques, in sufficient detail to allow knowledgeable users of their reports to understand how the auditors addressed the audit objectives. . . . Auditors should identify significant assumptions made in conducting the audit”

DoD OIG’s policies and procedures addressed the importance of disclosing significant assumptions in its reports. However, for 1 of the 10 audits that we reviewed, DoD OIG made a significant assumption during the audit but did not disclose the assumption in the report. Specifically, DoD OIG developed an average cost rate from a few units tested and then applied that rate to all units reviewed.

Need for Additional Improvements in the System of Quality Control

Although the DoD OIG system of quality control had improved since the prior external quality control review, DoD OIG did not always follow its own policies and procedures with respect to audit supervision, audit documentation, and report content. With additional improvements in these areas, DoD OIG could further enhance its system of quality control.

Recommendation

We recommend that DoD OIG continue to improve its system of quality control, including audit supervision, audit documentation, and report content, by ensuring compliance with audit standards and its policies and procedures.

Department of Defense, Office of Inspector General, Comments

In written comments on our draft report, DoD OIG stated that it would continue to improve its system of quality control and described the actions underway and planned in the areas of supervision, audit documentation, and reporting. DoD OIG’s comments are included as Appendix B.

SCOPE AND METHODOLOGY

We tested compliance with the U.S. Department of Defense (DoD), Office of Inspector General (OIG), audit organization's system of quality control to the extent we considered appropriate. These tests included a review of 10 of 130 audit reports issued during the period April 1, 2008, through March 31, 2009, and semiannual reporting periods ending September 2008 and March 2009. We also reviewed two internal quality control reviews performed by DoD OIG.

In addition, we reviewed DoD OIG's monitoring of one engagement performed by Independent Public Accountants (IPA) for which the IPA served as the principal auditor during the period April 1, 2008, through March 31, 2009. During the period, DoD OIG contracted for certain engagements that were to be performed in accordance with *Government Auditing Standards*.

We visited the Denver, Colorado, and Arlington, Virginia, offices of DoD OIG. We sent questionnaires to selected staff members to determine the extent to which DoD OIG's quality control and assurance policies and procedures were effectively communicated to staff and to obtain staff views about a number of factors related to the agency's adherence to those policies and procedures. We also reviewed the training records of selected employees to determine whether they had obtained the required continuing professional education credits and whether they collectively possessed the knowledge and skills needed to conduct audits.

REVIEWED ENGAGEMENTS PERFORMED BY THE U.S. DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR GENERAL

1. "Effect of Payments Into Boeing Pension Funds on Economic Price Adjustment Clauses in DoD Contracts," Report No. D-2008-099, May 28, 2008.
2. "Expeditionary Fire Support System and Internally Transportable Vehicle Programs," Report No. D-2009-041, January 14, 2009.
3. "Requiring Radio Frequency Identification in Contracts for Supplies," Report No. D-2008-135, September 29, 2008.
4. "Management of Incremental Funds on the Air Force Research, Development, Test and Evaluation Contracts," Report No. D-2008-079, April 8, 2008.
5. "Obligation of Funds for Ship Maintenance and Repair at the U.S. Pacific Fleet Maintenance Activities," Report No. D-2009-025, November 26, 2008.
6. "Internal Controls Over the Department of the Navy Cash and Other Monetary Assets Held in the Continental United States," Report No. D-2009-029, December 9, 2008.
7. "Fiscal Year 2007 DoD Purchases Made Through the U.S. Department of Veterans Affairs," Report No. D-2009-043, January 21, 2009.

8. "Procurement and Use of Nontactical Vehicles at Bagram Air Field, Afghanistan," Report No. D-2009-007, October 31, 2008.
9. "Controls Over Excess Defense Articles Provided to Foreign Governments," Report No. D-2009-052, February 13, 2009.
10. "Independent Auditor's Report on the United States Marine Corps General Fund Fiscal Year 2008 and Fiscal Year 2007 Basic Financial Statements," Report No. D-2009-013, November 8, 2008.

**REVIEWED INTERNAL QUALITY CONTROL REVIEWS
PERFORMED BY THE U.S. DEPARTMENT OF DEFENSE,
OFFICE OF INSPECTOR GENERAL**

1. Internal quality assurance review of "Compiling and Recording Financial Adjustments Related to DoD Commercial Payments," Report No. D-2006-013.
2. Internal "quick look" review of "The America Supports You Program," Project No. D-2007-D000CH-0213.000.

REVIEWED MONITORING FILE FOR CONTRACTED ENGAGEMENT

"Defense Civilian Pay System Controls Placed in Operation and Tests of Operating Effectiveness for the Period October 1, 2007, Through March 31, 2008," Report No. D-2008-139, September 30, 2008.

DEPARTMENT OF DEFENSE,
OFFICE OF INSPECTOR GENERAL, COMMENTS



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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OCT 30 2009

The Honorable Daniel R. Levinson
Inspector General
U.S. Department of Health and Human Services
330 Independence Avenue, S.W.
Room 5700, Cohen Building
Washington, DC 20201

Dear Mr. Levinson:

This is in reply to your letter of October 8, 2009, which provided the draft report on the external quality control review of the Department of Defense Office of Inspector General audit organization.

We appreciate the in-depth review that your staff performed on our quality control system. We appreciate the quality and the professionalism of the peer review team and their assistance to our organization. Their suggestions will further enhance our ability to maintain full compliance with generally accepted government auditing standards.

We are pleased that you determined that our quality control system was sufficiently designed and that we complied with our adopted policies and procedures which provided reasonable assurance that we conformed with auditing standards. We are also pleased to have received a peer review rating of pass. We will address the conditions that you identified as needing attention. Our comments to the draft report are enclosed.

If you have any questions on our comments to the official draft report, please contact me or have your staff contact Ms. Mary Ugone, Deputy Inspector General for Auditing, at (703) 604-8900.

Sincerely,

A handwritten signature in cursive script that reads "Gordon S. Heddell".

Gordon S. Heddell

Enclosure

As stated

Comments to U.S. Department of Health and Human Services Findings and Recommendation on the draft "Report on the External Quality Control Review of the Audit Organization of the U.S. Department of Defense, Office of Inspector General"

Recommendation. We recommend that DoD OIG continue to improve its system of quality control, including audit supervision, audit documentation, and report content, by ensuring compliance with audit standards and its policies and procedures.

DoD OIG Response. We will continue to improve our system of quality control.

Supervision. We will continue to improve compliance with the supervision standard. Specifically, we have reassigned a senior staff member to the Quality Assurance, Policy, and Electronic Documentation Division (QAPED) to focus exclusively on reviewing supervision within the Office of Audits for the next 15 months. In addition, for those projects being performed in Afghanistan and Iraq, we have assigned additional supervisory personnel and developed a Document Tracking Sheet.

In Summer 2009, we added an "on-the-ground" Program Director with overall supervisory and management responsibility for all audits conducted in Afghanistan and Iraq. We also added a Project Manager/Leader in each country who is responsible for the specific audits conducted in their respective countries. Additional oversight is being provided by the Joint and Southwest Asia Operations Technical Director, who conducts bi-weekly conferences with the field offices and reviews audit operations periodically by conducting site visits to the Afghanistan and Iraq field offices.

The audit teams deployed in Southwest Asia are now required to have a Document Tracking Sheet for each working paper until we transition to Teammate, which electronically provides for document tracking. The Document Tracking Sheet provides a method for supervisors not collocated with the audit team to show evidence of review, which will improve the turn around time for working paper reviews as the entire process can be conducted electronically. Previously, the reviewer had to be in the same location of the working paper files and manually sign off on the working paper.

Audit Documentation. We will continue to improve compliance with the audit documentation standard. Specifically, QAPED is in the process of providing the in-house courses "Project Documentation" and "Cross Referencing and Independent Reference Review" to all field office personnel. We anticipate completing this effort by January 2010. In addition, QAPED developed and began teaching a class on internal controls in FY 2009. During FY 2009, QAPED trained 277 staff and anticipates providing the internal control class to all audit staff by January 2010. During FY 2010, we will emphasize the need for Program Directors and Project Managers to attend "Project Documentation" and "Cross Referencing and Independent Reference Review" if they have not done so in the past 2 fiscal years.

For staff deployed to Southwest Asia, QAPED provided those three in-house training courses in Qatar in September 2009. During the same visit, QAPED staff reviewed ongoing projects from

the Iraq field office to ensure compliance with all standards. In addition, a QAPED senior auditor spent 8 weeks in Afghanistan during July to September 2009 and reviewed audit documentation for their ongoing assignments.

Reporting. We will continue to improve compliance with the reporting standard. Specifically, QAPED will continue to conduct technical reviews of draft reports with emphasis on reviewing the scope and methodology described in Appendix A. The "Checklist for Technical Review of Draft Report," includes questions to evaluate the description in the audit report regarding the kinds and sources of evidence used, problems with the evidence, and any scope limitations or constraints imposed on the auditors. Although QAPED no longer performs technical reviews of final reports, QAPED will review a sample of issued final reports to determine whether there were any systemic issues that were not addressed in the review of draft reports. Final report technical reviews are now performed by the Audit directorates prior to the issuance of the final report.