



Oversight

Report



PERFORMANCE OF EXTERNAL QUALITY CONTROL REVIEWS
BY MILITARY DEPARTMENT AUDIT AGENCIES

Report Number D-2000-6-009

September 20, 2000

Office of the Inspector General
Department of Defense

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Acronyms

AFAA

Air Force Audit Agency

AAA

Army Audit Agency

NAS

Naval Audit Service

PCIE

President's Council on Integrity and Efficiency



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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September 20, 2000

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY
AUDITOR GENERAL, DEPARTMENT OF THE NAVY
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Evaluation Report on Performance of External Quality Control Reviews by
Military Department Audit Agencies (Report No. D-2000-6-009)

We are providing this report for your information and use. No written response to this report was required, and none was received. Therefore, we are publishing this report in final form.

We appreciate the courtesies extended to the evaluation staff. Questions should be directed to Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) (wberry@dodig.osd.mil) or Mr. M. Thomas Heacock at (703) 604-8756 (DSN 664-8756) (mheacock@dodig.osd.mil). See Appendix B for the report distribution. The evaluation team members are listed inside the back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman".

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-6-009
(Project No. D2000OA-0095)

September 20, 2000

Performance of External Quality Control Reviews by Military Department Audit Agencies

Executive Summary

Introduction. The Government auditing standards issued by the Comptroller General of the United States require organizations conducting audits in accordance with Government auditing standards to undergo an external quality control review at least once every 3 years by an organization not affiliated with the organization being reviewed. The external quality control review should determine whether the organization's internal quality control system is in place and operating effectively to provide reasonable assurance that established auditing standards were followed. Prior to FY 1999, the Office of the Inspector General, DoD, conducted external quality control reviews of the Military Department audit agencies. However, during the September 25, 1998, DoD Audit Chiefs' Council meeting, it was agreed that the Military Department audit agencies would conduct external quality control reviews on each other in FY 1999. In addition, the Council agreed that the agencies would use the President's Council on Integrity and Efficiency external quality control review guide to perform the reviews.

Objectives. The objectives of the evaluation were to determine whether the Military Department audit agencies' process for conducting external quality control reviews of each other, as established by the DoD Audit Chiefs' Council, was working as planned and to identify the types of findings being reported. Specifically, we determined whether reliance could be placed on the external quality control review results to support the Inspector General, DoD, responsibilities for oversight of Military Department audit agencies.

Results. The Military Department audit agencies successfully implemented an external quality control review process. The results of the FY 1999 reviews indicated that, in each case, the system of quality control was designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency and each organization's internal quality control system was operating effectively. We can rely on the external quality control review results in supporting the Office of the Inspector General, DoD, oversight responsibilities.

Management Comments. We provided a draft of this report on August 14, 2000. No written response was required, and none was received. Therefore, we are publishing this report in final form.

Table of Contents

Executive Summary	i
Introduction	
Background	1
Objectives	2
Finding	
External Quality Control Reviews	3
Appendixes	
A. Evaluation Process	
Scope	7
Methodology	7
Prior Coverage	8
B. Report Distribution	9

Background

Government Auditing Standards. Government auditing standards issued by the Comptroller General of the United States require that organizations conducting Government audits have an appropriate internal quality control system in place and undergo an external quality control review. Organizations conducting audits should undergo an external quality control review at least once every 3 years by an organization not affiliated with the organization being reviewed. The external quality control review should determine whether the organization's internal quality control system is in place and operating effectively to provide reasonable assurance that established auditing standards were followed. An external quality control review under the Government auditing standards should meet the following requirements.¹

- Reviewers should be qualified and have current knowledge of the type of work to be reviewed and the applicable auditing standards.
- Reviewers should be independent of the audit organization being reviewed, its staff, and its auditees whose audits are selected for review.
- Reviewers should use sound professional judgment in conducting and reporting the results of the external quality control review.
- Reviewers should select audits that provide a reasonable cross-section of the audits conducted in accordance with the Government auditing standards or select audits that provide a reasonable cross-section of the organization's audits, including one or more audits conducted in accordance with Government auditing standards.
- The review should include a review of the audit reports, working papers, and other necessary documents, as well as interviews with the reviewed organization's professional staff.
- A written report should be prepared communicating the results of the external quality control review.
- External quality control review procedures should be tailored to the size and nature of an organization's audit work.

President's Council on Integrity and Efficiency Review Guide. The President's Council on Integrity and Efficiency (PCIE), "Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of Inspector General," April 1997, (Review Guide) presents the standards and detailed guidance for conducting external quality control reviews of the audit operations of audit organizations. The Review Guide was developed to promote consistency in conducting the reviews. An external review requires

¹ External quality control reviews conducted through or by the President's Council on Integrity and Efficiency meet these requirements.

considerable professional judgment on the part of the review team. The guidance contained in the PCIE Review Guide is advisory in nature and is not intended to supplant the review team's professional judgment on the approach to take or the specific procedures to be performed in specific reviews. The PCIE external quality control review program is intended to be positive and constructive, rather than negative or punitive.

DoD Audit Chiefs' Council. The DoD Audit Chief's Council is composed of the heads of the DoD audit organizations. The organizations include the office of the Assistant Inspector General for Auditing, DoD; the Defense Contract Audit Agency; the Army Audit Agency (AAA); the Naval Audit Service (NAS); and the Air Force Audit Agency (AFAA). The council meets periodically under the leadership of the Inspector General, DoD, to discuss audit issues and matters that affect the DoD audit community. The September 25, 1998, DoD Audit Chiefs' Council meeting established that Military Department audit agencies would conduct external quality control reviews on each other in FY 1999. In addition, the Council agreed that the agencies would use the PCIE Review Guide to perform external quality control reviews.

Review Schedule. The Military Department audit agencies agreed on the following scheduling option for FY 1999.

- The AAA would review the NAS
- The NAS would review the AFAA.
- The AFAA would review the AAA.

Objectives

The objectives of the evaluation were to determine whether Military Department audit agencies' process for conducting external quality control reviews of each other, as established by the DoD Audit Chiefs' Council, was working as planned and to identify the types of findings being reported. Specifically, we determined whether reliance could be placed on the external quality control review results to support the Inspector General, DoD, responsibilities for oversight of Military Department audit agencies.

External Quality Control Reviews

The Military Department audit agencies successfully implemented an external quality control review process. Using the PCIE Review Guide, review teams completed assessments of the AAA, NAS, and AFAA. The results of the FY 1999 reviews indicated that, in each case, the system of quality control was designed in accordance with the quality standards established by the PCIE and that each organization's internal quality control system was operating effectively. We can rely on the audit agencies' external quality control review results to support the Office of the Inspector General, DoD, oversight responsibilities.

Quality Control Review Process

The audit agencies successfully implemented an external quality control review process. Using the PCIE Review Guide, review teams completed assessments of the AAA, NAS, and AFAA. In addition, discussions with personnel involved indicated that, overall, the process worked well. However, Government auditing standards do not allow the audit agencies to rotate external quality control reviews among each other.

PCIE Review Guide Checklists. The audit agencies used the PCIE Review Guide for the external quality control review as agreed to at the September 25, 1998, DoD Audit Chiefs' Council meeting. The review approach advocated by the PCIE Review Guide is to:

- gain an understanding of the reviewed organization's audit operation and its internal quality control system;
- gain an understanding of the organization's internal quality control program, including a review of any internal reports;
- use the knowledge obtained from the preceding steps;
- select the offices and audits to be reviewed and the nature and extent of the tests to perform; and
- review functional areas and individual audits.

To meet the objectives described above, the PCIE Review Guide contains several checklists as guidance, as follows:

- Appendix A is a questionnaire designed to obtain general information about an audit organization and its internal quality control system.
- Appendix B contains guidance to help document the review team's understanding and to evaluate the adequacy and quality of the audit organization's policies and procedures.

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- Appendix C contains guidance on assessing the design of the internal quality control program.
 - Appendix D contains general guidance on reviewing internal quality control reports.
 - Appendix F is a checklist for reviewing individual performance audits.

Augmentation of Checklists. To assist in their reviews, the audit agencies' review teams augmented the checklists with additional steps and references from each audit agency's policies and procedures. For example, for the AAA external quality control review of the NAS, the AAA added steps to the PCIE Review Guide checklist for individual NAS performance audits. Those steps were added to the review of NAS quality control and asked questions such as whether the draft report was referenced prior to issuance and whether the referencer was independent. In addition, specific citations on quality control from the Naval Audit Handbook were included in the checklist.

Satisfaction with the Process. Discussions with personnel from the audit agencies revealed that the external quality control review process worked well. We held discussions with 13 personnel from the audit agencies who were involved in conducting the reviews, and they expressed overall satisfaction with the external quality control review process. Items that personnel stated worked particularly well included the following.

- The memorandums of understanding between audit agencies provided the rules for the external quality control reviews.
- Pre-planning meetings between the audit agencies also assisted in establishing the rules for the review. Conducting presentations on using the PCIE Review Guide and experiences from prior external quality control reviews also helped.
- Obtaining as much information in advance of the reviews enabled the review teams to incorporate specific sentences and references from the reviewed agencies' policies and procedures into the PCIE Review Guide checklists.
- Using point papers during the review. At on-site exit conferences, the visiting auditors provided the site manager with a point paper that summarized all the issues.
- The external quality control reviews enabled the personnel involved to gain an understanding of another audit organization's methodology and how other personnel were working.

Rotation of Assignments. The Government auditing standards do not allow audit agencies to rotate external quality control reviews among each other because an audit organization is not permitted to review the organization that conducted its most recent external quality control review. The Government auditing standards requirement is intended to ensure that independence is

maintained both in appearance and fact. With only three organizations involved, assignments cannot be rotated. For example, the NAS cannot review the AAA for the FY 2002 external quality control review because the AAA reviewed the NAS for the FY 1999 review. As such, the NAS would have to review the AFAA again in FY 2002. We agree that there was a conflict between the Government auditing standard and the external quality control review plan. However, the DoD Audit Chiefs can reassess the external quality control review plan before the scheduled FY 2002 reviews and change the plan if necessary.

Types of Findings Reported

For each of the three reviews, the review teams reported that the quality control system was designed in accordance with the quality standards established by the PCIE. Further, the review teams reported that each organization's internal quality control system was operating effectively to provide reasonable assurance that audit personnel were following established policies, procedures, and applicable auditing standards.

The review teams also made observations and suggested actions to the audit agencies on certain areas to strengthen their systems of quality control. Generally, the audit agencies took action to implement the teams' review suggestions, except that the AFAA had not established a formal system to track all open recommendations from internal quality control reviews. AFAA Instruction 65-105, "Internal Quality Control Review Program," January 14, 2000, requires the establishment of such a system. However, the AFAA completed action to establish a follow-up system during our review.

Reliance on External Quality Control Reviews

We can rely on the audit agencies' external quality control review results in supporting the Office of the Inspector General, DoD, oversight responsibilities. Working papers documented the work performed and conclusions reached, and there were no indications that any significant deficiencies were found but not reported. In addition, the review teams used the PCIE Review Guide checklists. Also, memorandums of understanding were prepared, there were no indications of any impairment to independence, experienced audit staff were assigned to the review, and a reasonable cross-section of audit reports was chosen to review.

Memorandums of Understanding. The audit agencies prepared memorandums of understanding to establish the framework for the reviews. Items outlined in the memorandums were the contact persons, the review schedule and coordination, the scope of the review, the results report process, and retention of and access to the working papers.

Working Papers and Reports. Each of the review teams prepared working papers to document the work performed and the conclusions reached for the review, and there was no indication in the working papers that any significant deficiencies were found but not reported. In addition, report conclusions were

supported by and referenced to the working papers. We did not retest any of the results because the review of the working papers allowed us to place reliance on the review results.

Impairment to Independence. There were no indications that the audit agencies had any impairments to independence. According to the PCIE Review Guide, the review team members should meet the independence standards of the Government auditing standards. In addition, former employees employed within the past 2 years of the organization being reviewed should generally not be selected to be part of the review team. Based on the impairments listed in the Government auditing standards, nothing came to our attention to indicate that the agencies had any impairments to independence. In addition, none of the agency review team members had been employed by the organization being reviewed for the last 2 years.

Experience of Review Staff. An experienced audit staff was assigned by the Military Department audit agencies to conduct the external quality control reviews. Each review team had seven to eight personnel who were mainly high graded operational auditors with many years of experience. For example, two members of the NAS review team had 27 and 20 years of auditing experience, respectively.

Reasonableness of Reports Selected. The Military Department audit agencies selected a reasonable cross-section of audit reports to review. Each review team selected six to eight audit reports to review as well as one to two internal quality control reports to review. The following criteria were used to select the audit reports to review.

- The location and size of the audit offices. Larger offices where working papers would be stored and numerous audits conducted were selected.
- The number of findings and recommendations. Audit projects with more significant results were selected.
- Audit identified potential monetary benefits. Audits that identified areas where funds could be put to other uses were selected.
- The amount of time charged to the project. Larger, more significant audits were chosen.

Conclusion

Overall, the Military Department audit agencies' external quality control reviews during FY 1999 worked well. As such, we have determined that we can rely on the results of the reviews to support our oversight responsibilities.

Appendix A. Evaluation Process

Scope

We based our review on the Government auditing standards relating to quality control, the PCIE Review Guide for external quality controls, and DoD policies and procedures in force from 1991 through 1999. In addition, we reviewed FY 1999 external quality control review reports of the Military Department audit agencies, pre-planning meeting notes, and memorandums of understanding. Each audit agency review team selected six to eight audit reports and one to two internal quality control reports to review. We reviewed all working papers supporting those reviews. We also discussed the external quality control review process with various personnel involved to determine whether there were any problems associated with or ways to improve the process.

Methodology

To identify the types of external quality control review findings being reported, we obtained the FY 1999 Military Department audit agencies' external quality control review reports. To determine whether the process for conducting external quality control reviews was working as planned and whether reliance could be placed on the results, we discussed the process with various personnel and reviewed the audit agencies' working papers to determine whether the PCIE Review Guide was followed and whether any significant deficiencies were found but not reported. We did not retest the Military Department audit agencies' work performed for the external quality control review. In addition, we followed up with the audit agencies to determine whether the suggestions made by the review teams to improve internal quality control systems were implemented.

Use Of Computer-Processed Data. We did not use computer-processed data to perform this evaluation.

Evaluation Dates and Standards. We performed this evaluation from February through July 2000, in accordance with standards issued and implemented by the Inspector General, DoD.

Management Control Program Review. The management controls over the Military Department audit agencies' process for conducting external quality control reviews of each other were adequate. We identified no material management control weaknesses. One of the methods an organization uses to determine whether it has any management control deficiencies is the consideration of inspections and other independent review reports. For the FY 1999 Statements of Assurance on Management Controls, the Military

Department audit agencies considered the results of the external quality control reviews when evaluating the adequacy and effectiveness of their management controls.

Contacts During the Evaluation. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

Prior Coverage

No prior coverage has been conducted on the subject during the last 5 years.

Appendix B. Report Distribution

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Auditor General, Department of the Air Force

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Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Evaluation Team Members

The Deputy Assistant Inspector General for Audit Policy and Oversight, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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