

Naval Audit Service



Peer Review Report



Letter of Comments on the Fiscal Year 2008 External Quality Control Peer Review of the Air Force Audit Agency

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P2009-0002

8 October 2008

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MEMORANDUM FOR AUDITOR GENERAL OF THE AIR FORCE

Subj: **LETTER OF COMMENTS ON THE FISCAL YEAR 2008 EXTERNAL QUALITY CONTROL PEER REVIEW OF THE AIR FORCE AUDIT AGENCY (PEER REVIEW REPORT P2009-0002)**

Ref: (a) Air Force Audit Agency (AFAA)/Naval Audit Service (NAVAUDSVC)
Memorandum of Understanding of 18 Dec 07
(b) Secretary of the Navy Instruction 7510.7F, "Department of the Navy Internal Audit"

1. We have completed our review of the system of quality control for the audit function of the Air Force Audit Agency in effect for the year ended September 2007. We are concurrently issuing our Opinion Letter report. The purpose of our review was to report whether the Air Force Audit Agency's internal quality control system was in compliance with Generally Accepted Government Auditing Standards (GAGAS) and:

- Designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency, and
- Complied with for the year reviewed to provide reasonable assurance of material compliance with professional auditing standards in the conduct of its audits.

We conducted our review in conformance with standards and guidelines established by the President's Council on Integrity and Efficiency and in accordance with the Memorandum of Understanding signed in December 2007.

2. Our Opinion Letter report concludes that the system of quality control for the audit function of the Department of the Air Force was designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency. We found reasonable assurance that Air Force Audit Agency personnel complied with the system of quality control and conducted audits in compliance with professional auditing standards and internal policies. This letter contains observations regarding issues that did not warrant inclusion in the formal report.

Subj: **LETTER OF COMMENTS ON THE FISCAL YEAR 2008 EXTERNAL
QUALITY CONTROL PEER REVIEW OF THE AIR FORCE AUDIT AGENCY
(PEER REVIEW REPORT P2009-0002)**

3. There are inherent limitations that should be recognized in considering the potential effectiveness of any system of quality control. In the performance of most control procedures, departures can result from misunderstanding of instructions, mistakes in judgment, carelessness, or other personal factors. Projecting any evaluation of a system of quality control to future periods is subject to the risk that one or more procedures may become inadequate because of changes in conditions or because the degree of compliance with procedures may deteriorate.

4. During our review, we did not identify any reportable conditions for our report. A reportable condition for peer review purposes represents a deficiency in the design or operation of the reviewed organization's internal control that could adversely affect the organization's ability to comply with applicable auditing standards and established auditing policies and procedures. We did, however, note areas where Air Force Audit Agency could strengthen its quality control system. The results of our review and recommendations related to the issues noted are in the enclosed Letter of Comments. -

5. Your official responses of 22 September 2008 (Appendix 1) concurred with the Letter of Comments observations and recommendations, and indicated corrective actions were planned. All recommendations are open and are subject to monitoring in accordance with reference (b). If the planned corrective actions will take more than 1 year to complete, establish interim dates for the completion of major segments of the planned corrective actions. A written status report on actions taken should be sent to Assistant Auditor General for Manpower and Reserve Affairs, Mr. Jonathan Kleinwaks, jonathan.kleinwaks@navy.mil, with a copy to the Director of Policy, at Vicki.McAdams@navy.mil, within 30 days after the target completion date. Please submit correspondence in electronic format (Microsoft Word or Adobe Acrobat file), and ensure that it is on letterhead and includes a scanned signature.

6. If you have any questions please contact Carl "Marty" Grenn, Audit Director, at commercial (202) 433- 3675 or email at carl.grenn@navy.mil.

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(PEER REVIEW REPORT P2009-0002)**

7. Thank you for the courtesies and cooperation extended to us during the review.



JONATHAN KLEINWAKS
Assistant Auditor General
Manpower and Reserve Affairs Audits

Copy to:
DoDIG (AIG/APO)

Letter of Comments

What We Reviewed

We conducted an external peer review of the Air Force Audit Agency (AFAA). The purpose of our review was to assess whether its internal quality control system provided reasonable assurance that AFAA Auditors complied with applicable generally accepted - government auditing standards (GAGAS), Department of Defense Inspector General (DoDIG) Internal Audit Manual, and internal AFAA policies and procedures. We conducted this performance audit in accordance with GAGAS. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted our review from January through April 2008 in accordance with the President's Council on Integrity and Efficiency Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General (PCIE Guide), dated April 2005. We reviewed the system of quality control that AFAA established. We interviewed AFAA auditors and specialists, reviewed internal audit-related policies and procedures, and applied checklists from the PCIE Guide. These tests included a review of 5 centrally directed audits, and 1 local audit,¹ from a universe of 46 centrally directed audit reports and 636 local reports issued from 1 April to 30 September 2007. AFAA had four quality assurance reviews in progress at the time of our peer review. We did not review those because they had not been completed. AFAA had published one other quality assurance report during the 6-month period, which we reviewed.

AFAA did not contract for audit work during Fiscal Year 2007 nor did it perform nonaudit services.

We visited the Headquarters, AFAA located in Arlington, VA, and its three directorate offices located in Moreno Valley, CA; San Antonio, TX; and Dayton, OH. The projects we reviewed were issued from these four locations.

¹ The reports were judgmentally selected based on various risk factors (i.e., monetary benefits, duration of audits, number of field activities visited, etc.).

We met with the Auditor General of the AFAA on 2 June 2008 and discussed the audit results.

Overall, we concluded that AFAA auditors generally complied with GAGAS, DoDIG, and AFAA policies and procedures; and its reports provided accurate and supported conclusions. Our review included eight major topics of emphasis from the PCIE Guide²:

- Independence;
- Professional Judgment;
- Competence;
- Audit Planning;
- Supervision;
- Evidence and Audit Documentation;
- Reports on Performance Audits; and
- Quality Control Process - for Each Audit.

We also looked at the overall AFAA Quality Assurance Program as directed by the PCIE Guide.

We found no deficiencies in one of the eight topics we reviewed (professional judgment), but identified some issues in the other seven topics – independence, competence, audit planning, supervision, evidence and audit documentation, reports on performance audits, and quality control process for each audit – where AFAA could strengthen its quality control system. Details follow.

Independence

AFAA policy and guidance sufficiently addressed standards and procedures relating to auditor independence as required by GAGAS. Our review of five centrally directed audits and one local audit showed the prescribed procedures were generally followed. Work paper files for the 6 projects we reviewed contained independence statements for 34 of 39 auditors (about 87 percent) that either worked on the project or were assigned as

² The PCIE guide included a ninth topic, nonaudit services; however, as noted, AFAA did not perform any nonaudit services during the scope of our review period.

the independent referencer. Auditors generally prepared the statements in a timely manner, and all signed statements were dated, and had original signatures.

However, we found that:

- Five personnel (about 13 percent) did not prepare an independence statement. The five consisted of four auditors (one referencer, one staff auditor, and two Associate Directors), and one statistician;
- Current AFAA policy does not require Assistant Auditors General and Deputy Assistant Auditors General to prepare independence statements. However, we concluded that they influence the report, and therefore should prepare an independence statement;
- Three independence statements were signed anywhere from 28 days to 13 months after the start of work. AFAA Instruction (AFAAI) 65-103, Chapter 8.4.2.3 states: “Before performing or assisting on an audit assignment, auditors and supervisors must complete an independence statement certifying they have no relationships and beliefs that might cause them to limit the extent of the inquiry, limit disclosure, or slant audit findings in any way;”
- The AD certified a review of each team member’s signature on the single team independence statement anywhere from 5 to 17 months after the start of audit work in two of the six audits. AFAAI 65-103, Chapter 8.4.2.3 states that supervisors will resolve all potential impairments before granting approval to an auditor to start the assignment;
- Two referencers did not charge time to DAMIS for the audits they referenced. Not charging hours to DAMIS is a repeat item from our 2005 Peer Review (see Recommendation 2);
- In two instances, a box on an independence statement indicating that there was no personal impairment was not checked, even though the form was signed and dated;
- In three audits we reviewed, older forms (which did not include certification of the Associate Director) other than the current form available at the start of the audit, were used; and
- Independence of the statistician/technical expert was not always certified by the Associate Director.

Followup on Fiscal Year 2005 Peer Review

We made recommendations (1 and 2) in this area in the Fiscal Year (FY) 2005 Peer Review report. AFAA concurred with Recommendations 1 and 2, and took or planned the following corrective actions.

Recommendation 1: AFAA, in accordance with AFAAI 65-103, establish controls to ensure that, before performing or assisting on an audit, all assigned personnel complete, sign, and date independence statements, and that supervisors certify them prior to the individuals starting audit work.

A revision of AFAAI 65-103 (8.4.2.3) requires all audit participants to sign an independence statement before an audit, and independence templates were updated.

The AFAA Director of Operations addressed requirements for all personnel working on the audit to sign an independence statement, as evidenced by the issued memorandum dated 30 September 2005 addressing the results of the 2005 Peer Review.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 2: AFAA require all members of the audit team, including the independent referencer, working on audit assignments to charge DAMIS for hours worked on those assignments.

According to AFAA, AFAAI 65-103 is currently in draft. This instruction will require all team members to document in DAMIS the time spent on the project. Therefore, we consider the recommendation as not being implemented. As noted above, we found this condition still existed, and are making a recommendation regarding this issue.

Recommendations

We recommend that AFAA:

Recommendation 1. Update the portion of the independence statement used for the statistician/technical expert to include a space for certification of the individual's independence by a supervisor.

AFAA response to Recommendation 1. Concur. We will update the independence statement to include supervisory approval for statistician/technical experts. (ECD: 31 December 2008)

Recommendation 2. Require all personnel who review or have the appearance to influence the report, including (but not limited to) the Assistant Auditor General, Deputy Assistant Auditor General, referencer, etc., to sign an independence statement, and check the appropriate box to indicate their independence or lack thereof.

AFAA response to Recommendation 2. Concur. We will update guidance to ensure proper independence statement completion including statements for Deputy Assistant Auditors General and Assistant Auditors General. All other significant project participants, including referencers, are already required to complete independence statements. To reemphasize this area, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to full completion of independence statements by all project participants. (ECD: 31 December 2008)

Recommendation 3. Include the requirement for the referencer to charge hours to DAMIS in AFAAI 65-103 (Management Handbook).

AFAA response to Recommendation 3. Concur. We included this change in our updated guidance. To add emphasis, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to referencers charging time in DAMIS. We have also added this requirement to our Quality Assurance Review checklist. (ECD: 31 December 2008)

Recommendation 4. Require use of the most up-to-date independence statement form.

AFAA response to Recommendation 4. Concur. The requirement to use current, updated forms already exists; however, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to the need to download and use current, updated templates during audit applications. (ECD: 31 December 2008)

Recommendation 5. Establish controls and provide oversight to ensure that ADs verify that an independence statement is signed by each team member prior to the start of audit work.

AFAA response to Recommendation 5. Concur. Controls and oversight for this area are already established; however, the Director of Operations will issue

a memorandum stressing the importance of complying with guidance related to the requirement to sign an independence statement prior to starting work on a project – with special emphasis on individuals joining the team after project start. (ECD: 31 December 2008)

Naval Audit Service (NAVAUDSVC) comment on responses to Recommendations 1 through 5. Actions planned satisfy the intent of the recommendations.

Professional Judgment

Reviews of all work paper files provided and interviews conducted for the six audits reviewed, showed that AFAA generally used sound professional judgment. For professional judgment, GAGAS requires auditors to exercise reasonable care and diligence and to observe the principles of serving the public interest and maintaining the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work.

In order to verify professional judgment we:

- Reviewed the AFAA handbook requirements and then read all summaries and most of the work papers for the jobs we reviewed;
- Paid particular attention to the planning and report writing phases of the audit work;
- Interviewed the Assistant Auditor General, Deputy Assistant Auditor General, Associate Director, Program Director, and Audit Manager (as available) for the jobs we reviewed;
- Reviewed the audit review record and followed the progression of the audit through the comments of the supervisory review of subordinates' work papers; and
- Reviewed project plan reports, assignment notices, audit programs, go/no-go briefings, finding outlines, summary work papers, cross-referenced reports, and independent referencer certifications;

Competence

We found reasonable assurance that AFAA personnel collectively possess adequate professional competence, in compliance with GAGAS and internal policies and

procedures. Government auditing standards for competence state that staff assigned to an audit or attestation engagement should collectively possess adequate professional competence for the tasks required. AFAA ensures competence standards are complied with by following Office of Personnel Management (OPM) requirements for staff qualifications when hiring new staff, providing for continuing professional education (CPE) of its auditors, and developing and communicating policy and procedures for auditors.

Our review showed that AFAA developed and communicated its internal policies and procedures as required by GAGAS. During our site visits, we found auditors had access to electronic documents or had a hardcopy of the Government Auditing Standards, and AFAA Handbooks, and were generally familiar with their content.

Additionally, AFAA's competence was evaluated with consideration given to the findings of the previous AFAA Peer Review of 2005 and the AFAA Training Program Handbook, AFAAI 36-107. We found the AFAA training guidance for new hires was not yet updated to comply with April 2005 GAGAS guidance.

We found opportunities for improvement in the area of CPE (see below).

Staff Qualifications

Government auditing standards require that audit organizations have a process for recruiting and hiring of staff to assist the organization in maintaining a sufficiently competent workforce. We reviewed the educational background for a sample of newly hired auditors and four specialists. AFAA hiring practices ensured auditors and specialists met the educational requirements established by OPM. We sampled 7 of the 60 auditors that AFAA hired during Calendar Years (Cys) 2005 and 2006³ and found each auditor had a degree in accounting or a degree in a related field that included at least 24 credit hours in accounting. We also reviewed the official published biographies for four specialists – statisticians – and found they met the education requirement.

CPE

Our review showed that AFAA generally followed GAGAS requirements for CPE of its auditors. We also found AFAA implemented corrective actions to correct issues identified during the FY 2005 external peer review and its own internal quality control reviews on training and academic degrees and certifications in Fiscal Year 2007. AFAA has shown notable improvement in this area since 2005, and should be commended for its hard work and results. Although we recognize that AFAA considers the error rates we found to be acceptable, opportunities for improvement still exist.

³ We verified educational requirements for all seven of the new hires who were part of the statistically selected sample explained in footnote 4.

Auditors performing work under GAGAS are required to maintain their professional competence through CPE. Every 2 years, each auditor should complete at least 80 hours of continuing education that directly enhances the auditor's professional proficiency to perform audits or attestation engagements. At least 24 of the 80 hours of the continuing education should be in subjects directly related to Government auditing, the Government environment, or the specific or unique environment in which the audited entity operates. At least 20 of the 80 hours should be completed in any 1 year of the 2-year period.

We sampled 111 of 664 AFAA auditors⁴ onboard as of 22 January 2008, and validated the data recorded in the Defense Audit Management Information System (DAMIS) for training received during -CYs 2005 and 12006. Our review included documentation for 1,900 training courses maintained at the various AFAA offices. The sample showed the 111 auditors completed 1,900 courses, with only 3 courses lacking training documentation. We project that no more than 24 or 0.31 percent of 7,622 CPE courses were not properly documented (95 percent confidence level).

Additionally, we identified CPE deficiencies, shown below, based on training records in DAMIS and the actual training documentation.

- Six-hundred and fifty-three (98.3 percent) of 664 auditors, met the minimum training requirements per AFAA training records. However 11 (1.7 percent) did not meet at least one of the following:
 - Three auditors did not meet the 80-hour requirement;
 - Four auditors did not meet the 20-hour requirement for 2005 (one of these four auditors also did not meet the 80-hour requirement); and
 - Five auditors did not meet the 20-hour requirement for 2006.

GAGAS also requires audit agencies to have procedures in place to record and monitor the CPE hours of its auditors. This helps ensure that the agency is meeting the minimum CPE training requirements. Although we found DAMIS to be reliable, we observed several user input errors in DAMIS that may have affected the ability of DAMIS to accurately track CPE hours and weakened oversight controls over the CPE process. DAMIS had overstatement errors due to auditors entering duplicative data (13 courses) and auditors not cancelling courses (19 courses) in DAMIS. These DAMIS errors were not counted as discrepancies in the sample testing of DAMIS and did not impact the CPE deficiencies identified above. The DAMIS errors were corrected before the discrepancies were identified. DAMIS also had understatement errors due to auditors not showing courses as completed in DAMIS. Documentation was subsequently provided for 36

⁴ Sample was statistically selected based on probability proportionate to size with a 95 percent confidence level.

courses completed in CYs 2005 and 2006, which were not listed in the CYs 2005 and 2006 DAMIS data file that was generated in January 2008. AFAA personnel informed us that these DAMIS input errors were likely caused by permitting individual auditors to initiate data entry into the DAMIS system.

Followup on Fiscal Year 2005 Peer Review

We made recommendations (11 through 15) in this area in the FY 2005 Peer Review report. AFAA concurred with Recommendations 11 through 15 and took or planned the following corrective actions.

Recommendation 11: AFAA verify DAMIS training module information for all auditors, to support individual auditor training documentation, and correct any inaccuracies (including inaccurate CLPs [continuous learning points], CEUs [continuing education units], and duplicate and negative hours) in recorded CPE hours.

In addition to publishing policy letters on CLPs and CEUs for recording hours, AFAA issued a memorandum dated 31 January 2006 requiring all AFAA personnel to reconcile calendar year 2005 DAMIS training data. This control was effective as evidenced by our 2008 field work results.

Recommendation 12: AFAA should establish controls to ensure DAMIS training module information remains accurate and up-to-date.

AFAA has a draft revised regulation AFAAI 36-107 that requires personnel annually to verify the accuracy and completeness of DAMIS training information; AFAA officials informed us it will be published shortly. As noted above, we found minor inaccuracies in training information in DAMIS. Therefore, we are making a recommendation regarding this issue. The revised completion date is 31 December 2008.

Recommendation 13: AFAA should conduct a quality assurance review on DAMIS training module information in FY 2006 after corrections are made, and new controls are in place and operating.

According to AFAA, they are currently performing a functional review of DAMIS and have issued a draft report to address corrective actions. However, this recommendation has not yet been closed. As noted above, we found inaccuracies in training information in DAMIS. Therefore, we are making a recommendation regarding this issue. The revised completion date is 30 September 2008.

Recommendation 14: AFAA should clarify to AFAA auditors the proper calculation of CLP and CEU hours.

The command stated that revised regulation AFAAI 36-107 clarifying the procedure for converting CLP and CEU hours is in draft and not yet published in final. In addition, they are awaiting the results of a new Training Program Process Action Team, and other Department of Resources and Training DORT revisions. Therefore, we cannot verify the implementation of these corrective actions.

The AFAA Director of Operations addressed requirements for CPE documentation, as evidenced by the issued memorandum dated 30 September 2006 addressing the results of 2005 Peer Review.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 15: AFAA should not allow negative hour postings to the DAMIS training module.

AFAA issued a memorandum dated 31 January 2006 addressing the results of 2005 Peer Review regarding negative hour postings. This control was effective as evidenced by our 2008 field work results.

Recommendations

We recommend that AFAA:

Recommendation 6. Reemphasize controls already established to improve reliability of DAMIS training module information as compared to supporting training documentation for all auditors, correct any inaccuracies (including duplicates, cancellations, and unrecorded training) and obtain any missing training documentation.

Recommendation 7. Reemphasize controls to ensure that the DAMIS training module information remains accurate and up to date.

AFAA response to Recommendations 6 and 7. Concur. Current statistics indicate only 24 of 7,622 CPE completed courses (0.31 percent) may not have proper documentation; 11 of 664 auditors (1.65 percent) had CPE deficiencies; and minor database errors existed. Accordingly, we believe most statistics are well within a tolerable error level. To continue our emphasis on CPE reporting accuracy, the Director of Operations will issue a

memorandum stressing the importance of complying with proper CPE reporting and documentation. (ECD: 31 December 2008)

NAVAUDSVC comment on responses to Recommendations 6 and 7.
Actions planned satisfy the intent of the recommendations.

Recommendation 8. Perform quarterly reviews (vs. annual) of DAMIS CPE deficiencies and ensure that minimum CPE requirements are met by all auditors.

AFAA response to Recommendation 8. Concur with intent. As an alternative, we will require a semiannual review of DAMIS CPE deficiencies. We believe this frequency will best use our resources. In addition, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to our annual review and validation of DAMIS-reported CPE. (ECD: 31 December 2008)

NAVAUDSVC comment on response to Recommendation 8. In subsequent communication, AFAA clarified that they would require a semiannual review of DAMIS CPE deficiencies, as well as an annual review and validation of DAMIS reported CPE. We agree that this timeframe is sufficient. Actions planned satisfy the intent of the recommendation.

Recommendation 9. Revise AFAA Training Manual to comply with GAGAS CPE requirements for new hires.

AFAA response to Recommendation 9. Concur. We updated our guidance to meet GAO requirements; however, the final draft is held up due to Air Force publication changes. Our goal is to publish final guidance by 31 December 2008. In the interim, we determined that all new individuals hired on or after 1 January 2007 have no CPE deficiencies. (ECD: 31 December 2008)

NAVAUDSVC comment on response to Recommendation 9.
Actions planned satisfy the intent of the recommendation.

Audit Planning

Reviews of work paper files provided and interviews conducted for the six audits reviewed showed that AFAA generally used proper planning techniques to design its audits. AFAA guidance adequately addressed standards and procedures relating to planning an audit.

We reviewed the Planning Assignment Notices, which identify the objective and background; the Proposed Audit forms, which identify the background, scope/objectives, and potential benefits; the Preliminary Research Plans, which identify audit steps; the Project Plan Reports (the DAMIS run); the Audit Planning Announcement Memos; the Centrally Directed Audit (CDA) Programs; and various other planning documents.

We found three discrepancies during our review of audit planning for six AFAA reports reviewed (excluding the Quality Assurance Report). Two reports did not have a fraud risk assessment. For a third report, the fraud risk assessment was not documented. AFAA Instruction 65-102 states that for the go/no go briefing “the audit manager and program manager should...provide a preliminary assessment of the effectiveness of established controls, including an assessment of the chances for abuse or illegal acts (fraud) occurring.” Further, this instruction states that the Audit Manager’s Fraud Risk Assessment will be included in every CDA Audit Program.

Recommendation

Recommendation 10. We recommend that AFAA improve controls and provide oversight to ensure fraud risk assessments are prepared in accordance with AFAAI 65-102.

AFAA response to Recommendation 10. Concur. We currently review this item in each Quality Assurance Review and will continue to validate the completion of fraud risk assessments during the planning phase as one of our checklist items. In addition, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to proper fraud risk assessment completion and documentation. (ECD: 31 December 2008)

NAVAUDSVC comment on response to Recommendation 10.
Actions planned satisfy the intent of the recommendation.

Supervision

AFAA established sufficient policies and procedures regarding supervision to comply with GAGAS and establish quality controls. Our review of six audits and one Quality Assurance report showed that AFAA auditors followed GAGAS standards and generally followed internal policies and procedures. Specifically, we found:

- Project managers completed an “Audit Review Record” or a work paper index to document supervision. Additionally, we found auditors used email messages to show evidence of supervision; and
- Auditors used summary work papers to show they completed work.

We reviewed 979 work papers for 6 audits and determined that 730 required a supervisory review.⁵ We identified some areas where improvements were needed to fully comply with AFAA policies. Issues with 730 work papers included:

- Seventy working (9.6 percent) papers were not on the master index;
- Eighty work papers (10.9 percent) did not have documentation of supervision;
- AFAA Policy does not specify timeliness for review of working papers. We found 43 working papers (5.9 percent) were reviewed 90 days after preparation;
- Of the 730 working papers that required a supervisory review, 171 working papers (23.4 percent) were critical working papers containing information cross-referenced from the report to the working papers. For those 171, we determined:
 - Sixty-three were not in the index;
 - Forty-seven had no evidence of supervisory review; and
 - Forty-four both lacked documentation of supervisory review and were not on the index;
- Although we did not evaluate responses to supervisory comments for every working paper selected, we found that better documentation was needed, in some cases, for responses to supervisory comments, and supervisor’s acceptance of actions taken in response to supervisory comments; and
- On one audit, the supervisor did not document acceptance of the subordinate’s responses to the supervisor’s reviews. This is a repeat of a condition that was found during the 2005 Peer Review.

Followup on Fiscal Year 2005 Peer Review

We made recommendations (3 and 4) in this area in the Fiscal Year 2005 Peer Review report. AFAA concurred with Recommendations 3 and 4 and took or planned the following corrective actions.

⁵ We determined that the other 243 (25 percent) were administrative-type work papers that were not required have supervisory review.

Recommendation 3: In order to avoid an actual or the appearance of a conflict of interest, restrict the function of the independent referencer to an auditor who is truly independent of the work to be reviewed.

AFAAIs 65-101 (4.8.2), and 65-102 (4.9.2) were revised to require that report referencers be independent of the project they are assigned to reference.

The Director of Operations addressed independent referencing, as evidenced by the issued memorandum dated 30 September 2005 addressing the 2005 peer review results.

A statement was added to AFAA's FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 4: Establish controls to ensure supervisors comply with existing AFAA Instruction 65-103.

AFAAIs 65-101 (1.3.1.8) and 65-102 (1.3.2.8) were revised to require second-level supervisors (office chiefs and Associate Directors) to review selected working papers and complete a checklist. Each checklist includes steps to verify supervisory reviews of the work papers. In addition, AFAAIs 65-101, 65-102, and 65-103 were revised to reinforce following GAGAS and AFAA polices and procedures, including those for gathering evidence and preparing working papers.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendations

We recommend that AFAA:

Recommendation 11. Establish and monitor the implementation of a measure of timeliness for reviewing working papers, and a method for follow-up.

AFAA response to Recommendation 11. Concur. The Director of Operations will establish and include a measurement in the appropriate guidance. For follow-up purposes, we will add the identified metric to the applicable Quality Assurance Review checklist. (ECD: 31 December 2008)

Recommendation 12. Improve controls and provide oversight to ensure that the master index lists all work papers as required by AFAAI 65-102.

AFAA response to Recommendation 12. Concur. The AFAA Electronic Working Paper Configuration Control Team will review our current file indexing process and consider using either sub-indexes to list all working papers or identify a more appropriate method. (ECD: 31 March 2009)

Recommendation 13. Improve controls and provide oversight to ensure that all working papers have evidence of supervision.

AFAA response to Recommendation 13. Concur. The Director of Operations will issue a memorandum stressing the importance of complying with guidance related to proper documentation of supervisory working paper reviews. (ECD: 31 December 2008)

Recommendation 14. Improve controls and provide oversight to ensure that reviewers of working papers “close the loop” and document acceptance of preparers’ comments in writing.

AFAA response to Recommendation 14. Concur. We will add policy guidance concerning proper supervisory documentation to preparers’ comments. In addition, the Director of Operations will issue a memorandum stressing the importance of properly documenting supervisory reviews of preparers’ responses to supervisory comments. (ECD: 31 December 2008)

NAVAUDSVC comment on responses to Recommendations 11 through 14. Actions planned satisfy the intent of the recommendations.

Evidence and Audit Documentation

Evidence and audit documentation in work papers and spreadsheets were generally adequate and contained “sufficient, competent, and relevant evidence to afford a reasonable basis for the auditors’ findings and conclusions,” as required by GAGAS and AFAA policies.

Upon review of the above-noted reports, and verification that hyperlinks to summary work papers, supporting work papers, and Excel spreadsheets were proper, we

determined that with a few exceptions the links were functioning properly, and sufficient evidence existed to fully support the report results and findings/conclusions. We verified and determined that hyperlinks within the independently referenced reports tied back to summary work papers, supporting work papers, and Excel spreadsheets. Although we identified minimal nonworking hyperlinks, these were insignificant and immaterial.

Although we found that AFAA auditors generally gathered sufficient evidence to support conclusions, on one report, at least five key facts and figures were not supported by source documentation. Statements inserted in emails from the auditee were relied on instead. This was not in violation of any requirement as explained in the Quality Control Process section below. Ultimately, we concluded that this was an isolated practice and determined to be the best available evidence.

Followup on Fiscal Year 2005 Peer Review

We made recommendations (5 through 7) in this area in the Fiscal Year 2005 Peer Review report. AFAA concurred with Recommendations 5 through 7 and took or planned the following corrective actions.

Recommendation 5: AFAA, in accordance with AFAAI 65-103, establish controls to ensure adherence to GAGAS and AFAA policies and procedures for evidence and audit documentation to ensure that work papers are timely and properly prepared, and include the required GAGAS and AFAA elements.

AFAAIs 65-101 and 65-102 were revised to require that second-level supervisors (office chiefs and associate directors) review selected working papers and complete the checklist.

The AFAA/Director of Operations addressed review of working papers, as evidenced by the issued memorandum dated 30 September 2005 addressing the results of 2005 Peer Review.

AFAAI 65-102 (2.6.3.13) was revised to clarify the requirements of documentation sampling methodology.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 6: AFAA should establish controls to ensure proper cross-referencing of audit documents (e.g. survey program, go/no go briefing, summary work papers, data reliability, etc.) to supporting source documents.

AFAAIs 65-101 and 65-102 were revised to require second-level supervisors (office chiefs and associate directors) to verify, for selected working papers, that auditors/audit managers properly cross-reference from the report to summary working papers and from summary working papers to supporting working papers.

The AFAA Director of Operations addressed requirements for cross-referencing as evidenced by the issued memorandum dated 30 September 2005 addressing the results of the 2005 Peer Review.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Changes were made to curricula to add training on working paper standards.

Recommendation 7: AFAA conduct a quality assurance review on cross-referencing, since this a repeat condition.

Instead of conducting a quality assurance review of cross-referencing, Headquarters AFAA/Director of Operations stated that they would emphasize cross-referencing in each quality assurance review scheduled for FY 2006.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Reports on Performance Audits

The AFAA reporting process for the six audits we reviewed was proper and followed in accordance with GAGAS and AFAA policies. We determined this by reviewing the working papers, supporting documentation, draft reports, and final reports. The final reports contained the appropriate report contents, and met the standards for report issuance and distribution. The audit reports were objective, convincing, concise, clear, and complete. The reports clearly explained the audits' objectives, scopes, and methodologies, and provided the audit results, findings, conclusions, and recommendations. A statement about the auditors' compliance with GAGAS was included, tests on internal controls were noted, findings were discussed with responsible officials, and management responses are included in the reports.

However, on one report, the AFAA report Executive Summary used an incorrect evaluation statement of the auditee's comments regarding potential monetary benefits. The auditee's comments said potential monetary benefits existed but could not be

determined, yet AFAA stated that potential monetary benefits were agreed to (in the Executive Summary). We looked at other audits within the universe of audits provided by AFAA (conducted within the peer review scope time period) and found two other reports had a similar condition.

Timeliness of the audits was reviewed, but an opinion could not be rendered because AFAA guidance does not mandate measurements for timeliness.

However, we saw evidence that the audit staff regularly kept senior management at the audited activities informed of their audit progress.

Recommendation

We recommend that AFAA:

Recommendation 15. Improve controls and provide oversight to ensure management's responses regarding PMB [Potential Monetary Benefits] are properly reported, especially when management states that the PMB is not readily measurable.

AFAA response to Recommendation 15. Concur. The Directorate of Operations report reviewer added this item to the final report review checklist. We also added this item to our Quality Assurance Review checklists. Finally, the Director of Operations will issue a memorandum stressing the importance of consistent PMB presentation in final reports. (ECD: 31 December 2008)

NAVAUDSVC comment on response to Recommendation 15.
Actions planned satisfy the intent of the recommendation.

Quality Control Process

The quality control process generally met GAGAS and AFAA requirements regarding reports on performance audits. We reviewed Independent Referencer Review Records and Referencing Certifications; traced amounts, conclusions etc. to supporting work papers and documents; and reviewed working papers, supporting documentation, draft reports, and final reports. In our opinion, the audit reports were objective, convincing, concise, clear, and complete. The final report contained the appropriate report elements, and met the standards for report issuance and distribution.

However, we noted some issues described below that do not affect our opinion on meeting of standards, but warrant attention. These matters do not merit a

recommendation since they were considered minor in nature or represent an alternative business practice for management's consideration.

On one audit, e-mails were relied on as source documentation for at least five key facts and figures. On this same audit, the referencer did not sign off on the Summary of Audit Results.

Also, AFAA seldom uses titles or indexing (working paper numbering) on their working papers. Further, subfolders do not contain indexes. In some instances, the audit review record (supervisory review log) did not link to the working papers. These issues make it very difficult to follow review records and master indexes (Project Folder Index, or PFI) to supporting work papers, and make it difficult for supervisors to ensure they have reviewed all work.

Followup on Fiscal Year 2005 Peer Review

We made recommendations (8 through 10) in this area in the Fiscal Year 2005 Peer Review report. AFAA concurred with Recommendations 8 through 10 and took or planned the following corrective actions.

Recommendation 8: AFAA, in accordance with AFAAI 65-103, should establish controls to ensure that, when submitting centrally directed audit program (CDAP) Response Sheets, team chiefs include signed statements certifying that the information on the CDAP Response Sheet was independently referenced to supporting working papers.

The AFAA Director of Operations addressed requirements for cross-referencing, as evidenced by the issued memorandum dated 30 September 2005 addressing the results of 2005 Peer Review.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 9: AFAA, in accordance with AFAAI 65-101, establish controls to ensure that auditors and referencers sign the certification of referencing statement, which should be verified by the supervisor and require audit reports to be re-referenced when facts and dollar amounts (especially potential funds available for other use) are significantly changed.

AFAA responded that they will add steps in the installation-level working papers review checklist for office chiefs to verify that the team chief, auditor, and

independent referencer sign the referencing certification statement on the Independent Referencer Review Record.

The AFAA Director of Operations addressed requirements for cross-referencing, as evidenced by the issued memorandum dated 30 September 2005 addressing the results of 2005 Peer Review.

A statement was added to the AFAA FY 2006 Operations Review Plan that quality assurance reviews will emphasize independence, supervision, evidence and audit documentation, and independent referencing.

Recommendation 10: AFAA should require referencers and QA [quality assurance] personnel to use separate and correct AFAA forms to document their work.

AFAAI 65-105 was revised to require internal quality control teams to use the Independent Review (IR) Review Record to document independent referencing and certify referencing results.

Quality Assurance Program

We reviewed the quality assurance program in place at the time of our review and associated policies and procedures in AFAAI 65-105, "Internal Quality Control Program." We also compared this instruction to GAGAS quality control and assurance standards. We concluded that the AFAA Operations Directorate established an effective internal quality assurance program. We found the policies and procedures were sufficient, and key aspects of the quality assurance program were in place and were operating. The program design provides reasonable assurance to management by determining if auditors complied with GAGAS and AFAA policies. AFAA conducts approximately four quality assurance reviews every year; however, at the time of our review, only one quality assurance report was published. Additionally, every directorate undergoes a quality assurance review once every 3-year cycle. Quality assurance reviews are performed by experienced AFAA staffers that are independent from the audit teams and directorates they review. Further, AFAA has an acceptable method of disseminating results that shares common deficiencies with the organization as a whole.

We also reviewed the one completed AFAA quality control review published between 01 April and 30 September 2007. We received six QA reports from AFAA for the time period FYs 2006 through 2008. Four of them were ongoing, so they could not be reviewed. One of QAs was published in December 2006, so it was outside of our scope. The quality assurance review objective was to review three reports to determine whether audit fieldwork and reporting met GAGAS, and three additional reports to determine if they complied with AFAA independent referencing guidance. Our review of this quality

assurance review showed that AFAA met GAGAS and internal handbook standards. Further, we found that AFAA satisfactorily met requirements of PCIE Appendix C (Quality Assurance Program). Specifically:

- The quality assurance team performed all the work necessary to satisfy the review objectives.
 - Planning, Application, and Reporting Checklists were present and appeared adequately utilized.
 - The Independent Referencing Checklist was present and appeared adequate.
- The documentation indicates that the review was properly supervised.
- The findings and recommendations were supported by adequate documentation.
- The responsible official provided written comments for each recommendation setting forth the corrective action already taken or proposed.

Other Matters for Consideration:

- Although we recognize that AFAA has its own audit practices, processes, policies, and management preferences, we identified the following areas for consideration as alternatives to improve operations and efficiencies:
- Centralize the CPE confirmation processes so that AFAA Headquarters Office of the Director of Operations, Resources and Training, reviews all CPE, and uploads adequate supporting documentation in DAMIS before CPE credit is entered and confirmed in DAMIS.
- Although no specific condition was reported, improvements could be made in the area of working paper organization and are being brought to the attention of AFAA management, and also was noted in the Quality Control Process section above.
- Include titles and indexes on work papers in addition to indexes for subfolders. Also ensure audit personnel are aware that audit review records entries should link to work papers.

AFAA response to Other Matters for Consideration. We appreciate the additional insights provided as matters of consideration, and we will take these items under review for future improvements.

Appendix 1:

Management Response from Air Force Audit Agency to Naval Audit Service Letter of Comments



DEPARTMENT OF THE AIR FORCE
AIR FORCE AUDIT AGENCY

22 September 2008

MEMORANDUM FOR ASSISTANT AUDITOR GENERAL FOR MANPOWER AND
RESERVE AFFAIRS AUDITS, NAVAL AUDIT SERVICE
ATTN: MR JONATHAN KLEINWAKS

FROM: HQ AFAA/DO
1126 Air Force Pentagon
Washington DC 20330-1126

SUBJECT: Response to Draft Letter of Comments, 2008 Peer Review of the Air Force Audit
Agency

We have reviewed your draft letter of comments pertaining to the 2008 peer review of the
Air Force Audit Agency and concur with your findings and recommendations. Our response is
attached.

We express our thanks to your staff who conducted this review in a professional and
effective manner. Should you have questions, please have your staff contact Ms. Deborah
Jeffries at (703) 696-7727 or Victoria Coffin at (703) 696-7440.

Michael V. Barbino
MICHAEL V. BARBINO
Assistant Deputy Auditor General

Attachment:
AFAA Review Comments

FOIA (b)(6)

RESPONSES TO RECOMMENDATIONS IN 22 AUGUST DRAFT REPORT, LETTER OF
COMMENTS ON THE FISCAL YEAR 2008 EXTERNAL QUALITY
CONTROL PEER REVIEW OF
THE AIR FORCE AUDIT AGENCY
(N2008-NPR000-0098.001)

AFAA Comments. We concur with the observations and recommendations and provide the following comments and estimated completion dates (ECDs):

a. Recommendation 1. Concur. We will update the independence statement to include supervisory approval for statistician/technical experts. (ECD: 31 December 2008)

b. Recommendation 2. Concur. We will update guidance to ensure proper independence statement completion including statements for Deputy Assistant Auditors General and Assistant Auditors General. All other significant project participants, including referencers, are already required to complete independence statements. To reemphasize this area, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to full completion of independence statements by all project participants. (ECD: 31 December 2008)

c. Recommendation 3. Concur. We included this change in our updated guidance. To add emphasis, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to referencers charging time in DAMIS. We have also added this requirement to our Quality Assurance Review checklist. (ECD: 31 December 2008)

d. Recommendation 4. Concur. The requirement to use current, updated forms already exists; however, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to the need to download and use current, updated templates during audit applications. (ECD: 31 December 2008)

e. Recommendation 5. Concur. Controls and oversight for this area are already established; however, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to the requirement to sign an independence statement prior to starting work on a project – with special emphasis on individuals joining the team after project start. (ECD: 31 December 2008)

f. Recommendations 6 and 7. Concur. Current statistics indicate only 24 of 7,622 CPE completed courses (0.31%) may not have proper documentation; 11 of 664 auditors (1.65%) had CPE deficiencies; and minor database errors existed. Accordingly, we believe most statistics are well within a tolerable error level. To continue our emphasis on CPE reporting accuracy, the Director of Operations will issue a memorandum stressing the importance of complying with proper CPE reporting and documentation. (ECD: 31 December 2008)

g. Recommendation 8. Concur with intent. As an alternative, we will require a semiannual review of DAMIS CPE deficiencies. We believe this frequency will best use our resources. In addition, the Director of Operations will issue a memorandum stressing the

importance of complying with guidance related to our annual review and validation of DAMIS-reported CPE. (ECD: 31 December 2008)

h. Recommendation 9. Concur. We updated our guidance to meet GAO requirements; however, the final draft is held up due to Air Force publication changes. Our goal is to publish final guidance by 31 December 2008. In the interim, we determined that all new individuals hired on or after 1 January 2007 have no CPE deficiencies. (ECD: 31 December 2008)

i. Recommendation 10. Concur. We currently review this item in each Quality Assurance Review and will continue to validate the completion of fraud risk assessments during the planning phase as one of our checklist items. In addition, the Director of Operations will issue a memorandum stressing the importance of complying with guidance related to proper fraud risk assessment completion and documentation. (ECD: 31 December 2008)

j. Recommendation 11. Concur. The Director of Operations will establish and include a measurement in the appropriate guidance. For follow-up purposes, we will add the identified metric to the applicable Quality Assurance Review checklist. (ECD: 31 December 2008)

k. Recommendation 12. Concur. The AFAA Electronic Working Paper Configuration Control Team will review our current file indexing process and consider using either sub-indexes to list all working papers or identify a more appropriate method. (ECD: 31 March 2009)

l. Recommendation 13. Concur. The Director of Operations will issue a memorandum stressing the importance of complying with guidance related to proper documentation of supervisory working paper reviews. (ECD: 31 December 2008)

m. Recommendation 14. Concur. We will add policy guidance concerning proper supervisory documentation to preparers' comments. In addition, the Director of Operations will issue a memorandum stressing the importance of properly documenting supervisory reviews of preparers' responses to supervisory comments. (ECD: 31 December 2008)

n. Recommendation 15. Concur. The Directorate of Operations report reviewer added this item to the final report review checklist. We also added this item to our Quality Assurance Review checklists. Finally, the Director of Operations will issue a memorandum stressing the importance of consistent PMB presentation in final reports. (ECD: 31 December 2008)

Other Matters for Consideration:

AFAA Response: We appreciate the additional insights provided as matters of consideration, and we will take these items under review for future improvements.

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