



DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
OFFICE OF THE DEPUTY AUDITOR GENERAL
POLICY AND OPERATIONS MANAGEMENT
3101 PARK CENTER DRIVE
ALEXANDRIA, VA 22302-1596

SAAG-PMZ

12 June 2008

MEMORANDUM FOR Assistant Auditor General for Plans, Policy, and Resources; Naval Audit Service; 1006 Beatty Place SE; Washington Navy Yard, DC 20374-5000

SUBJECT: Letter of Comments on the Fiscal Year 2008 External Quality Control Peer Review of the Naval Audit Service, Report: A-2008-0115-PMZ

1. We reviewed the system of quality control for the audit function of the Naval Audit Service in effect for the year ended 30 September 2007 and issued our report dated 15 May 2008. Our formal report concludes that the system of quality control for the audit function of the Department of the Navy was designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency. We found reasonable assurance that Naval Audit Service 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 didn't warrant inclusion in the formal report.
2. The purpose of our review was to report whether the Naval Audit Service's internal quality control system was:
 - Designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency.
 - 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.

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.

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4. During our review, we didn't identify any reportable conditions for our report dated 15 May 2008. 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. The results of our review are in enclosure 1, and your verbatim comments are in enclosure 2.

5. If you have any questions please contact Jo Spielvogel at commercial 703-681-4288 or DSN 761-4288, or e-mail at jo.spielvogel@us.army.mil.

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

FOR THE AUDITOR GENERAL:

2 Encls



BELINDA A. TINER
Deputy Auditor General
Policy and Operations Management

EXTERNAL PEER REVIEW OF NAVAL AUDIT SERVICE LETTER OF COMMENTS

What We Reviewed

We conducted an external peer review of the Naval Audit Service. We did the review to assess whether its internal quality control system provided reasonable assurance that Navy auditors complied with applicable generally accepted government auditing standards (GAGAS), DOD Inspector General (DODIG) Internal Audit Manual, and internal Naval Audit policies and procedures.

We conducted our review from January to 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 Naval Audit established. We interviewed Navy auditors and specialists, reviewed internal audit-related policies and procedures, and applied checklists from the PCIE Guide. These tests included a review of 5 performance audits, 1 financial audit, and 1 agreed-upon procedure attestation engagement from 38 reports issued from 1 April to 30 September 2007. We also selected one quality assurance report from the three quality assurance reports issued during FY 07.

We didn't review oversight of contracted audit work or non-audit services since Naval Audit didn't contract for audit work during FY 07 nor did it perform non-audit services that related to the projects that we selected for review.

We visited the Headquarters, Naval Audit Service and its two field offices located in San Diego, California and Norfolk, Virginia. The projects we reviewed covered work performed by Navy auditors at the three locations.

Overall Results

Overall, we concluded that Navy auditors generally complied with GAGAS, DODIG, and Naval Audit Service policies and procedures and its reports provided accurate and supported conclusions. Our review included nine major areas of emphasis from the PCIE Guide. We found no deficiencies in four of the nine areas, but identified some issues in five areas—*independence, supervision, documentation, reporting, and quality control process for projects*—where Naval Audit could strengthen its quality control system. Naval Audit Service agreed with the suggestions in the report and had either taken or planned to take actions to address all of the issues we identified. (Enclosure 2 provides details of the actions and specific target dates.)

We discuss the results of our review in these nine areas—listed in the order of the PCIE Guide:

- Competence.
- Professional judgment.
- Quality assurance program.
- Independence.
- Planning.
- Supervision.
- Documentation.
- Reporting.
- Quality control process for projects.

Competence

We found reasonable assurance that Naval Audit Service personnel collectively possess adequate professional competence, in compliance with GAGAS and internal policies and procedures. Government auditing standards for competence state that the staff assigned to an audit or attestation engagement should collectively possess adequate professional competence for the tasks required. The Naval Audit Handbook states that all audits will have qualified people on audits and applies this criterion to individual auditors, the audit team as a whole, and outside experts. Naval Audit ensures competence standards are complied with by following Office of Personnel Management requirements for staff qualifications when hiring new staff, providing for continuing professional education of its auditors, and developing and communicating policy and procedures for auditors.

Staff Qualifications

Government auditing standards require that audit organizations have a process for recruiting and hiring staff to assist the organization in maintaining a workforce that has adequate competence. We reviewed the educational background for a sample of newly hired auditors and one specialist. Naval Audit hiring practices ensured that auditors and specialists met the educational requirements established by the Office of Personnel Management. We sampled 28 of the 108 auditors that Naval Audit hired during FYs 06 and 07 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 personnel records for one specialist—an attorney—and found the attorney met the education requirement.

Continuing Professional Education

Our review showed that Naval Audit followed GAGAS requirements for continuing professional education of its auditors. We also found that Naval Audit implemented corrective actions to correct issues identified during the FY 05 external peer review and its own internal quality control reviews on training and academic degrees and certifications in FY 07. Auditors performing work under GAGAS are required to maintain their professional competence through continuing professional education. 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 100 of about 350 Navy auditors and validated the data recorded in the Defense Audit Management Information System for training received during FYs 06 and 07. Our review included nearly 3,000 training documents maintained centrally at the Naval Audit headquarters. We found:

- 94 auditors met required continuing education for the 2-year period.
- 6 auditors either started or left employment during the 2-year period. The amount of continuing professional education these six employees received during employment with Naval Audit was appropriate relative to the time they worked.

In addition, through the interviews we conducted, we determined that most employees were generally aware of required Naval Audit training documentation and the processes and requirements for continuing professional education.

Policies and Procedures

Our review showed that Naval Audit developed and communicated its internal policies and procedures as required by GAGAS. We interviewed 43 auditors during our site visits and found auditors had access to electronic documents or had a hardcopy of the Government Auditing Standards, Naval Audit Handbook, and Naval Audit Management Handbook and were generally familiar with their content.

Professional Judgment

We found that Navy auditors generally used sound judgment in deciding the extent of work and materiality in conducting tests and procedures. Also, the auditors showed sound judgment in evaluating and reporting the audit results. 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. If auditors state they are performing their work in accordance with GAGAS, they should justify any departures from the standards.

In addition, we evaluated two issues found during our FY 05 external peer review. The first issue concerned instances when Navy auditors added or modified files to working papers after the team announced the audits selected for peer review. To correct this problem, Naval Audit leaders established controls to:

- Restrict access to working papers associated with the peer review.
- Make working papers “read-only” on the day of report publication.

The second issue concerned a supervisor who backdated reviews of working papers. To correct this, Naval Audit took action to reemphasize its restriction for backdating documents and brief auditors on the ethical issues found during the FY 05 peer review.

During our current review, we determined that the additional controls were effective. We reviewed more than 200 working papers for 7 projects and didn’t find any instances of backdated documents or posting of working papers to the project files after the report was published. For post-project files, Naval Audit established a clearly identifiable folder on the server where files could be added after publication of the report.

Quality Assurance Program

The Naval Audit Service Plans, Policy, and Resources Directorate established an effective internal quality assurance program. It designed its program to provide reasonable assurance to management by determining if auditors complied with GAGAS and Naval Audit policies. We reviewed the program in place at the time of our review and associated policies and procedures in Chapter 2 of the Naval Audit Handbook. We also compared the handbook to GAGAS. We found the policies and procedures were adequate and key aspects of the quality assurance program were in place and operating.

We reviewed one of the three quality control reviews published in FY 07—Quality Control Review for Audit Supervision. The review had necessary documentation

to indicate the quality assurance team performed work necessary to satisfy the review objectives. Specifically it had:

- An approved review program that covered each of the five Naval Audit directorates, with one audit selected for each directorate, and provided evaluation criteria from the Naval Audit Handbook.
- Working papers to support the review report. The review working papers appropriately documented the review of the audit working papers and supported the results shown in the review report.
- A report detailing review findings and recommendations. Some of the issues the quality control review team commented on related to supervision and were also found by the external peer review we conducted in FY 05. The findings and recommendations from the review were provided to senior Naval Audit managers.

We also determined that Naval Audit tracked the implementation of the recommendations made as a result of its quality assurance reviews.

Independence

Naval Audit Service policy and guidance sufficiently addressed standards and procedures relating to auditor independence as required by GAGAS. Based on interviews we conducted, most personnel were aware of the internal policy. Our review of six audits and one attestation engagement showed the prescribed procedures were followed. Working paper files for the 7 projects we reviewed contained personal impairment statements for 54 of 57 auditors (about 95 percent) that either worked on the project or were assigned as the independent referencer. Auditors generally prepared the statements in a timely manner. In addition, at the kick-off, 90-day, and 240-day in-process meetings, Naval Audit policy required project managers to state in briefing charts that auditors completed a personal impairment statement. Our review showed that project managers complied with the new policy on each project. However, we found that:

- 10 (19 percent) of 54 statements didn't have original signatures. Either the auditor didn't sign the form or the auditor's name was typed in place of the signature.
- 9 (17 percent) of 54 statements weren't dated by the auditor.
- No statement had evidence of supervisory review. We found evidence of supervisory action only when an auditor stated there was a potential personal impairment. On 6 April 2007, the Naval Audit Service changed its personal impairment statement form. The statement now directs supervisors to review and sign the form. The projects we reviewed predated this requirement.

We suggest that Naval Audit leadership remind auditors to use the updated personal impairment statement form, provide original signatures and dates, and properly document the supervisory review. We also suggest that Naval Audit perform a quality control review for this area.

Planning

Naval Audit Service's policy and guidance adequately addressed standards and procedures relating to planning an audit. Our review of six audits and one attestation engagement showed that auditors generally adhered to the policies and procedures outlined in the Naval Audit Handbook in developing audit program guides and performing other planning efforts. Audit programs are used to ensure that audit objectives are accomplished and should be prepared for each audit. The programs should include documentation of key decisions about the audit objectives, scope, and methodology, and the auditor's basis for these decisions.

The auditors assigned to each of the projects we reviewed adhered to applicable standards, policies, and procedures when they:

- Developed audit programs.
- Communicated with the audited entities.
- Approved programs and subsequent changes and modifications.

The audit programs were adequate as to the nature and scope of work to be performed, and to answer the stated audit objectives, identify scope and methodology, and provide for execution of the project in a timely manner. Audit plans also satisfied the audit requester's need for information and provided for collection of sufficient background information, including prior audit reports and regulatory requirements, and where appropriate, steps to test for fraud and data reliability.

During the FY 05 Peer Review of the Naval Audit Service, we had comments regarding the approval and review process in the planning of the audit projects. Naval Audit managers took adequate corrective actions to address these issues. Specifically, Naval Audit changed its policy and procedures to require that:

- Audit directors approve audit programs before the start of the audit verification phase. The projects we reviewed had appropriate approvals.
- Independent referencers review whether audit programs and changes were approved by the appropriate person. This process was part of the referencer guide sheet and annotated by the referencer. The projects that had a referencer guide sheet had the box checked "yes."

Supervision

Naval Audit Service established adequate policies and procedures regarding supervision to comply with GAGAS and establish quality controls. Our review of six audits and one attestation engagement showed that Navy auditors followed GAGAS standards and generally followed internal policies and procedures. Specifically, we found that:

- Project managers completed a “Supervisory Review Log” or an index working paper to document supervision. Additionally, we found auditors used taskers and e-mail messages to show evidence of supervision.
- Auditors used summary working papers to show they completed work.
- Supervisors provided timely and adequate instructions to auditors.

We identified some areas where improvements were needed to fully comply with Naval Audit policies. Specifically:

- 47 (18 percent) of the 261 working papers we reviewed had documentation that supervisory reviews weren’t timely. Supervisory reviews were documented as occurring more than 90 days after the working paper was prepared. This issue was found for six of the seven projects. Naval Audit policy states that the appropriate supervisor will review, sign, and date auditor-prepared working papers within 90 days of completion.
- 29 (11 percent) of the 261 working papers and other documents in the files we reviewed showed that facts and figures in the draft and final report sometimes weren’t properly cross-referenced with supporting working papers. Rather, the report referenced source or supporting documents that didn’t have a documented purpose, source, scope, conclusion, or evidence of supervisory review. This issue was found for four of seven projects we reviewed. As defined in the Naval Audit Handbook, working papers should contain a purpose, source, scope, conclusion, and evidence of supervisory review. Naval Audit policy also states that facts and figures in draft and final reports and related working paper summaries must be cross-referenced to, and highlighted or annotated on, underlying working papers.
- 19 (7 percent) of the 261 working papers we reviewed didn’t have any evidence of supervisory review, although they were used to support the audit report. This issue was found for four of seven projects we reviewed. Naval Audit policy states that all auditor-prepared working papers be reviewed by the appropriate supervisor and, as a minimum, the working papers should record who did the review and when it was done.
- 7 (3 percent) of the 261 working papers we reviewed had a documented date of the supervisory review that was before the documented date the working paper was prepared. This issue was found on three of seven projects.

- 5 (71 percent) of the 7 projects we reviewed had team leader reviews of critical working papers. Only three of the five projects had documented evidence of the project managers' subsequent review of the critical working papers. Naval Audit policy defines critical working papers as those related to potential audit findings and significant briefings. The policy states that critical working papers must be reviewed by the project manager or audit director. The audit director was required to document approval if the project manager delegates review of non-critical working papers to a team leader. Naval Audit recently changed its policy and guidance and now allows team leaders to perform initial working paper reviews without formal delegation. However, the project manager—or higher level supervisor—must still review all working papers.
- 2 (29 percent) of the 7 projects we reviewed didn't have documentation that survey and verification phase programs were prepared, reviewed, and approved in a timely manner. The survey or audit programs were dated as prepared and approved more than 10 months after survey start date. Naval Audit policy states that auditors should prepare a survey program early in the survey and a verification phase program before beginning work in that phase of each engagement.

Although we didn't evaluate for each working paper we selected, we found that better documentation was needed for responses to supervisory comments, and supervisor's acceptance of actions taken in response to supervisory comments. Naval Audit policy states that project managers will prepare a working paper review sheet (or similar automated form) to note comments, auditor's actions on the comments, and supervisor's acceptance of the action.

Supervisory reviews of working papers are important to ensure quality and timely performance of work. The issues we found during our review were observations made during the three prior external peer reviews in FYs 99, 02, and 05. Naval Audit took steps to identify and correct issues with supervisory review when it performed internal quality control reviews in FYs 04 and 07. The actions that Naval Audit took showed the difficulty audit organizations have in regards to ensuring proper supervisory review. We suggest that Naval Audit leadership provide refresher training to project managers and audit directors. Once the project managers and audit directors are trained, Naval Audit leadership should consider adding specific job objectives to hold project managers and audit directors accountable for improving supervisory reviews.

Documentation

Naval Audit Service policy and guidance sufficiently addressed standards and procedures relating to documenting audit work. We reviewed 6 audits and 1 attestation engagement by selecting 210 working papers and tracing them to the reports. We found:

- Working papers that contained sensitive information were appropriately identified and marked with “For Official Use Only.”
- Working papers provided the required source, purpose, scope and methodology, criteria, and conclusions or results.
- Auditors reported significant findings disclosed during the project.
- Auditors gathered sufficient evidence to support conclusions.
- Auditors referenced supporting working papers on reports and programs.

However, improvements were needed to fully comply with Naval Audit policy. Specifically:

- Of the 210 working papers we reviewed, 20 didn’t contain basic labeling information to properly identify preparer or project. We also identified issues in documenting index numbers.
- Of the eight reports we reviewed, four weren’t completely or correctly referenced to supporting working papers before the reports were published. Specific issues with each report follow:
 - **Report A.** Four numbers in the report didn’t agree with the numbers in supporting working papers. The audit director for the project stated three of the numbers were missed by the auditors and the independent referencer, and one number was changed by the editor. These errors were minor and didn’t impact the overall information presented in the report. Action was immediately taken to add the information to the project’s post publication folder.
 - **Report B.** Auditors made seven changes to the costs of various construction projects after the report was independently referenced. The project manager explained the net increase of \$1.6 million in construction costs on a spreadsheet that was placed in the post-publication folder 54 days after the report was published. The spreadsheet wasn’t completely cross-referenced with supporting working papers. The project manager stated the spreadsheet was added late because she had been reassigned and in travel status.
 - **Report C.** Auditors decreased an amount in the report by \$3.2 million—related to funding of medical supplies—but didn’t reference the decrease to a supporting working paper. The decrease appeared in a report footnote that claimed it occurred after the work was concluded but a reference wasn’t placed in the post publication folder. We later found the amount in a response to a recommendation in the report.

- **Report D.** Auditors referenced two working papers to support the work performed and period of the project. Neither of the referenced working papers supported the report's statements.

None of the 36 working papers we reviewed were properly cross-referenced in accordance with Naval Audit Handbook requirements. We generally found references on the project programs and reports to lead to supporting working papers. However, working papers didn't reference audit reports or project programs as required by the Handbook. Some working papers had highlighting, but auditors didn't identify the meaning of the highlighting. The referencing process used by the Navy auditors is sufficient to meet GAGAS and DODIG requirements, but the Naval Audit Service should revise its Handbook to more clearly reflect this process. The Naval Audit Handbook specifically states:

- A majority of working papers should be cross-referenced with the draft report, final report, and program.
- The independent referencer should ensure that the draft report and related programs are cross-referenced.

Naval Audit Service should stress the importance of cross-referencing during its regular training classes.

Reporting

Naval Audit Service policy and guidance adequately addressed reporting requirements of GAGAS. We reviewed seven projects that included eight published reports (one project had two reports) and found that Navy auditors substantially complied with reporting standards in GAGAS and Naval Audit internal policies and procedures. However, for five of the eight reports, auditors didn't fully comply with specific GAGAS requirements and Naval Audit Service policy listed below.

We found that:

- Four of the eight reports we reviewed didn't clearly state why the audits were undertaken. GAGAS requires that auditors explain why the audit organization undertook the assignment and state what the report is to accomplish and why the subject matter is important.
- Two of the eight reports we reviewed showed auditors relied upon computer-processed data to make conclusions, but the reports didn't mention whether or not auditors established that the data was reliable.
 - For one report, we couldn't locate any documentation showing auditors tested the reliability of data.

- For the other report, we found that auditors documented the steps they used to evaluate reliability of data and the working papers asserted that the data was reliable. However, we believe the auditors didn't fully document that conclusion.

The Naval Audit Handbook requires a discussion on what is known about the quality of quantitative data used in the report; an assessment of data quality for a finding or conclusion that relies on computer products or outputs as principal support for the finding or conclusion.

- Two of the eight reports we reviewed showed auditors didn't evaluate or didn't clearly identify an evaluation of internal controls—to include the scope of internal controls reviewed. GAGAS requires a statement on the internal controls existing at the time of the audit or attestation examination and the controls that auditors evaluated.
- Four of the eight reports we reviewed weren't published in a timely manner. Naval Audit established a goal of 295 days from entrance conference to report publication. Although these goals weren't met for the four reports, Navy auditors discussed audit results with command throughout engagement and before releasing the draft report. The following table shows that, although four reports weren't published in time to meet Naval Audit's established goal, we found evidence that Navy auditors briefed command personnel in a timely manner.

Report	Number of Days from Entrance to Report Publication	Days from Entrance to Brief Command
1	684	215
2	501	88 (one site of this multi-location audit and other sites had timely exit briefings)
3	548	283
4	414	132

To correct these issues, we suggest that Naval Audit Service:

- Modify the Naval Audit Handbook to require auditors to specify why Naval Audit conducted the engagement within the reports.
- Provide refresher training or guidance to supervisors on requirements for reporting on the reliability of computer-processed data and internal controls.

Conduct a quality assurance review of report timeliness to identify potential trends during survey, verification, and publication phases of projects to identify reasons for not meeting planned timeliness goals. Naval Audit has already taken action to improve the efficiency of its reporting process through its Lean Six

Sigma initiative. On 20 December 2007, it issued a report that had 14 recommendations to improve future timeliness of reporting audit results.

Quality Control Process for Projects

Naval Audit Service policy and guidance contain quality control steps and procedures to aid the organization in conducting quality audits and attestation engagements and producing quality products. For example, paragraph 511 of the Naval Audit Handbook is dedicated to referencing. This paragraph defines referencing, specifies Naval Audit procedures, gives the characteristics of a reviewer, and defines the process the reviewer should use.

Although the controls and procedures provided assurance that Naval Audit conducted quality audits and produced quality products, these quality control procedures sometimes weren't followed. During our review of seven projects and eight published reports (one project had two reports), we determined that:

- Five of the eight reports showed that referencers didn't identify (on their referencing sheets) that working papers weren't reviewed by supervisors. Referencers should document these deficiencies to ensure accuracy, integrity, and validity in reporting. The referencer guide sheet contains a general question related to supervisory review of working papers, but didn't specifically require referencers to look for evidence of supervisory review in all working papers cross-referenced to the audit report as supporting documentation.
- Three of the seven projects showed that editors didn't document the use of editor checklists or comparable guide sheets in the working paper folders. The Naval Audit Handbook requires editors to use guide sheets to perform reviews of draft reports. Once the editor completes the review and guide sheet, the editor should file the sheets in the working papers. Our discussions with Navy auditors showed that editorial guide sheets weren't yet developed for attestation engagements and letter reports.
- Three of the seven projects didn't have a copy of the cross-referenced final report. In addition, four of the seven project files didn't contain a control/summary working paper section organized or hyperlinked to the cross-referenced final report. We also identified the issue during the FY 05 external peer review.
- Six of the eight reports didn't have some original signatures where required. The Naval Audit referencing certification form has a requirement for a minimum of 10 signatures. We identified that 6 project certification forms didn't have 15 original signatures of the minimum 60 signatures as required.

To fully comply with Naval Audit policy, we suggest the following:

- Modify the referencer guide sheet to require referencers to determine if working papers that were cross-referenced with the audit report have evidence of supervisory review.
- Remind editors of responsibilities for documentation requirements of policy to complete and file appropriate documentation within working papers.
- Ensure that Naval Audit project managers include a signed copy of the referencing certification document and a cross-referenced copy of the final report in the working paper folders.

Naval Audit Services already took action to address some of these concerns. On 17 December 2007, Naval Audit notified all personnel of a policy update regarding referencing procedures and certifications. The update established use of a modified referencing certification form that required the:

- Executive Assistant to the Assistant Auditor General to assert that the final report was cross-referenced and significant changes from the draft report were independently referenced.
- Administrative Assistant to the Assistant Auditor General to assert that the referencer was trained and that all required referencing documents were completed in their entirety.

VERBATIM COMMENTS



DEPARTMENT OF THE NAVY
NAVAL AUDIT SERVICE
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7510
23 May 2008

MEMORANDUM FOR THE AUDITOR GENERAL, ARMY AUDIT AGENCY

Subj: **COMMENTS ON ARMY AUDIT AGENCY PEER REVIEW OF NAVAL
AUDIT SERVICE (A-2008-0000-PMZ)**

Ref: (a) Memorandum for Assistant Auditor General for Plans, Policy, and Resources
– Letter of Comments on the Fiscal Year 2008 External Quality Control Peer
Review of the Naval Audit Service, Report: A2008-000-PMZ, dated 2 May 2008

Encl: (1) Naval Audit Service Response to Army Audit Agency Letter of Comments

1. We have reviewed the Letter of Comments and are pleased the Army Audit Agency (AAA) concluded that the Naval Audit Service system of quality control was designed in accordance with the quality standard established by the President's Council on Integrity and Efficiency, and that AAA found reasonable assurance that the Naval Audit Service complied with the system of quality control and conducted audits in compliance with professional auditing standards and internal policies.
2. In the Letter of Comments, AAA did not identify any reportable conditions, but noted some instances where the Naval Audit Service could strengthen its quality control system. We appreciate the peer review team identifying areas that could benefit from additional management attention. We have either taken or plan to take actions to address all of the issues identified and, as requested, have provided specific target completion dates and actions taken in Enclosure (1).
3. We appreciate the professionalism demonstrated by the peer review team and the thoroughness of their review.
4. If you have any questions or would like additional information, please contact Vicki McAdams, Director, Policy and Oversight, at vicki.mcadams@navy.mil or (202) 433-5854; or Samuel Chason, Assistant Auditor General for Plans, Policy, and Resource Management, at samuel.chason@navy.mil (202) 433-5706.

A handwritten signature in cursive script, reading "Samuel E. Chason".

SAMUEL CHASON
Assistant Auditor General
Plans, Policy and Resource Management

Enclosure 2

Enclosure 2

Naval Audit Service Response to Army Audit Agency Letter of Comments

Independence

Suggestion 1. That the Naval Audit leadership remind auditors to use the updated personal impairments statement forms, provide original signatures and dates, and properly document the supervisory review.

Naval Audit Service Response. Concur. The Naval Audit Service Handbook has been revised to specifically state that each personal impairments statement must be signed with an original signature (as opposed to a typed signature). Also, the Referencing Guide Sheet has been revised so the referencer must now indicate whether or not all personal impairments statements are signed with an original signature.

In a 2008 Peer Review Lessons Learned document e-mailed to the staff on 23 May, auditors were reminded of the requirement to use the updated personal impairments statement, which includes a block for supervisory review, and to include an original signature on the form. Action on this suggestion is complete.

Suggestion 2. Naval Audit Service perform a quality control review for this area.

Naval Audit Service Response. Concur. The Naval Audit Service will incorporate a review of personal impairments statements into its upcoming annual quality control of review of supervision. This quality control review will be initiated during Fiscal Year 2009. The target completion date for this suggestion is 30 September 2009.

Supervision

Suggestion 3. We suggest that the Naval Audit leadership provide refresher training to project managers (PMs) and audit directors (ADs).

Naval Audit Service Response. Concur. The Naval Audit Service intentionally makes our internal policies and procedures very stringent in order to ensure compliance with the less restrictive Generally Accepted Government Auditing Standards (GAGAS) requirements. We maintain a vigorous internal quality assurance program to ensure our staff is aware of and follows these policies and procedures. We consider our efforts successful since, as noted in the draft peer review report, Naval Audit Service policies and procedures were adequate to comply both with GAGAS and our more stringent quality controls.

That being said, we agree there is still opportunity to improve in the areas of audit supervision and cross-referencing. Therefore, a series of Town Hall meetings will be held with all PMs and ADs in order to stress the results of this peer review, as well as

the results of recently completed quality control reviews. The Town Hall meetings will include a discussion of Naval Audit Service Handbook requirements for supervision. Additionally, the requirements for supervision will be incorporated into and stressed during the ongoing classes on referencing and cross-referencing. The target completion date for this suggestion is 31 December 2008.

Suggestion 4. Once trained, Naval Audit leadership should consider adding specific job objectives to hold PMs and ADs accountable for improving supervisory reviews.

Naval Audit Service Response. Concur. The Naval Audit Service National Security Personnel System (NSPS) objectives have been revised to include a requirement that PMs and ADs ensure compliance with Naval Audit Service Handbook requirements for timely reviews of work papers, documenting and responding to supervisory comments, approval of the survey and audit program, and accurately cross-referencing the draft and final report. Action on this suggestion is complete.

Documentation

Suggestion 5. The Naval Audit Service should revise its Handbook to more clearly reflect the cross-referencing procedures used.

Naval Audit Service Response. Concur. Naval Audit Service Handbook section 509 has been revised to clarify and accurately reflect Naval Audit Service cross-referencing procedures. This section now states:

Cross-referencing at each step is essential to ensure that the auditor's position is supported. This reduces the risk of issuing a defective final report. At a minimum:

- Work papers should be cross-referenced to other related working papers (where directed or determined appropriate by the PM and/or AD);
- The audit program steps should be cross-referenced to the work papers documenting completion of the steps;
- Summary work papers should be cross-referenced to the underlying work papers that were rolled up into the summary work paper, and each underlying work paper should be cross-referenced to any source documents discussed in the work paper;
- The draft report should be cross-referenced to the supporting work papers. All facts and figures in the draft report and related working paper summaries must be cross-referenced to, and highlighted or annotated on, underlying working papers.
- Unless specifically directed by the responsible AAG, final report information cross-referenced will be limited to:
 - The auditor's summary of management's responses;
 - The audit team's comments on the management response; and
 - Any new information added or substantive changes made during the

utilization, editing, or review process.

Suggestion 6. Naval Audit Service should stress the importance of cross-referencing during its regular training classes.

Naval Audit Service Response. Concur. Since January 2008, a separate class on cross-referencing has been taught as part of the ongoing class on report writing and referencing. To date, 180 auditors have received the training. Action on this suggestion is ongoing.

Reporting

Overall Naval Audit Service Comment on “Reporting” Section. During e-mail correspondence with the Army Audit Agency on 16 May 2008, the Naval Audit Service requested and Army Audit Agency agreed to adjust the statement in this section that “Auditors didn’t fully comply with GAGAS and Naval Audit policy regarding report content and timeliness.” This statement is very broad, and not accurate. As evidenced by the unmodified opinion language included in the draft Letter of Comments, the Naval Audit Service did meet GAGAS. The issues discussed in this section related to specific, detailed GAGAS requirements that were not always met or, in the case of timeliness, represented one instance in which we satisfied GAGAS but not our more stringent Naval Audit Service policies. While we take these issues seriously, they are not material enough to warrant the statement that “auditors didn’t fully comply with GAGAS.” Therefore, in the 16 May 2008 correspondence, Army Audit Agency agreed to adjust the wording in the final report to state: “Auditors didn’t fully comply with the specific GAGAS requirements listed below and/or Naval Audit policy.”

Suggestion 7. Modify the Naval Audit Service Handbook to require auditors to specify why Naval Audit conducted the engagement within the reports.

Naval Audit Service Response. Concur. Per the GAGAS requirement and our Naval Audit Service Handbook policy, our audit objectives are written to clearly state what the audit set out to accomplish (i.e., why we conducted the engagement). Regarding the peer review comment that the report should state “why the subject matter is important,” while the Objectives section of some of the reviewed reports may not have included a specific statement about this, taken as a whole each report conveys the importance of the issues audited.

In order to more explicitly adhere to the 2007 Yellow Book language regarding report contents, the Naval Audit Service Handbook has been modified to state, “Auditors should communicate audit objectives in the audit report in a clear, specific, neutral, and unbiased manner that includes relevant assumption, including why the organization undertook the assignment and the underlying purpose of the audit and resulting report.” A step to check for this specific requirement has also been added to the editor guide sheet. Because the July 2007 edition of the Yellow Book no longer contains a requirement to explain “why the subject matter is important,” a Handbook

modification addressing that issue is not necessary. Action on this suggestion is complete.

Suggestion 8. Provide refresher training or guidance to supervisors on requirements for reporting on the reliability of computer-processed data and internal controls.

Naval Audit Service Response. Concur. The Director, Policy and Oversight will develop training slides on the requirements for assessing computer-processed data and reviewing internal controls. This training will be incorporated into the ongoing organizational referencing training. The target completion date for this suggestion is 31 December 2008.

Suggestion 9. Conduct a quality assurance review of report timeliness to identify potential trends during survey, verification, and publication phases of projects to identify reasons for not meeting planned timeliness goals.

Naval Audit Service Response. Concur in principle. As the peer review report notes, for the reports reviewed, the Naval Audit Service auditors discussed the results with the command throughout the engagement and prior to issuing the draft report, meeting the Yellow Book requirement for timely communication. The goal of publishing a report within 295 days of the entrance conference is an overall organizational goal, and may not be achieved on all engagements. The Handbook has been clarified to make this clear. The Audit Service recognizes the importance of streamlining the reporting process whenever possible, and, as the peer review report notes, has already taken action in this area. Specifically, the reporting process was the subject of a Lean Six Sigma project published on 20 December 2007. The report had 14 recommendations on how to improve future timeliness of reporting audit results. Implementation of the recommendations should improve efficiency and help achieve the overall reporting goal. Due to the recent publication of the Lean Six Sigma report, an additional comprehensive quality assurance review of report timeliness is not warranted at this time. However, a quality assurance review that includes a review of selected aspects of the reporting process will be considered for Fiscal Year 2009. The target completion date for this suggestion is 30 September 2009.

Quality Control Process for Projects

Suggestion 10. Modify the referencer guide sheet to require referencers to determine if working papers that were cross-referenced with the audit report have evidence of supervisory reviews.

Naval Audit Service Response. Concur. The referencing guide sheet was revised on 12 May 2008 to require referencers to determine if work papers that had cross-references to them in the audit report reflect evidence of supervision. Action on this suggestion is complete.

Suggestion 11. Remind editors of responsibilities for documentation requirements of policy to complete and file appropriate documentation within working papers.

Naval Audit Service Response. Concur in principle. The editing staff does not have access to work paper folders, and they are not responsible for ensuring that editor guide sheets are included in the work papers. The audit team has sole responsibility for ensuring the work papers are complete at the time of publication. The peer reviewers noted there were no editor guide sheets for three of the audits reviewed, because guide sheets are currently only prepared for standard performance audit reports. The senior editor will work on developing a guide sheet for use on attestation reports, letter reports, opinion reports, etc. The responsibility for including this document in the work papers will remain with the audit team. The target completion date for this suggestion is 30 August 2008.

Suggestion 12. Ensure that Naval Audit PMs include a signed copy of the referencing certification document and a cross-referenced copy of the final report in the work paper folders.

Naval Audit Service Response. Concur. On 17 December 2007, an all-hands e-mail was sent to the staff, implementing procedures to ensure that all referencing forms are completed in their entirety and included in the work papers, and the final report is cross-referenced, referenced where applicable, and included in the work papers. Under the new policy, the Assistant Auditor General (AAG) Administrative Assistant is now required to certify on the referencing certification form that he/she has reviewed the referencing folder to ensure all referencing forms are completed in their entirety and filed in the work paper referencing folder. The AAG Executive Assistant or other designee must certify as part of the referencing certification form that he/she has reviewed the final report to ensure that it has been cross-referenced in accordance with Naval Audit Service policy, and all substantive changes to the utilization draft report made subsequent to referencing as a result of utilization, editing, front office review, or other circumstances have been referenced. Action on this suggestion is complete.