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Inspector General
United States Department of Defense

Oversight Review October 9, 2008

Quality Control Review of Naval Audit Service's Special Access Program Audits

Report No. D-2009-6-001

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Acronyms

AAA	Army Audit Agency
GAS	Government Auditing Standards
IG	Inspector General
NAS	Naval Audit Service
PCIE	President's Council on Integrity and Efficiency
SAP	Special Access Programs

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

OCT - 9 2008

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Quality Control Review of Naval Audit Service's Special Access Program Audits (Report No. D-2009-6-001)

We are providing this report for your information and use. We reviewed the Naval Audit Service's (NAS) system of quality control over Special Access Programs (SAP) audits for the two years ended September 30, 2007. The Government Auditing Standards (GAS) requires that an audit organization performing audits and/or attestation engagements in accordance with GAS should have an appropriate internal quality control system in place and undergo an external peer review at least once every three years by reviewers independent of the audit organization being reviewed. As the organization that has audit policy and oversight responsibilities for audits in the DoD, we conducted the external quality control review of the NAS's SAP audits in conjunction with the Army Audit Agency's (AAA) review of the NAS non-SAP audits.

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

In our opinion, the system of quality control for the audit function of NAS SAP in effect for the period ended September 30, 2007 was designed in accordance with quality standards established by GAS. Further, the internal quality control system was operating effectively to provide reasonable assurance that SAP audit personnel were following established policies, procedures, and applicable auditing standards. Accordingly, we are issuing an unmodified opinion on your SAP audit quality control system for the review period ended September 30, 2007.

Appendix A contains comments, observations, and recommendations where NAS can improve its quality control system. Appendix B contains scope and methodology of the review and Appendix C provides the full text of management comments in response to the draft report. Questions should be directed to Mr. Robert Kienitz at (703) 604-8754 (DSN 664-8754), Robert.Kienitz@dodig.mil.

Carolyn R. Davis

Carolyn R. Davis
Assistant Inspector General
for Audit Policy and Oversight

Appendix A. Comments, Observations, and Recommendations

We are issuing an unmodified opinion because we determined that the NAS quality control system is adequately designed and functioning as prescribed. The concerns we identified with the findings, conclusions, or recommendations during our review of the selected NAS audit reports were not cumulatively significant enough to indicate that material deficiencies existed in the NAS quality control system for complying with GAS. Because of the timeframe of the audit reports in our review, we measured the audits for compliance with the 2003 revision of the GAS and the July 2006 NAS Audit Handbook. We identified issues that are still applicable even when we apply the updated 2007 revision of GAS and the May 2008 NAS Audit Handbook.

Although the concerns we identified did not affect our overall opinion, there were areas where NAS could improve the quality control process. We originally judgmentally selected three audit reports issued during a two year time period ending September 30, 2007; however, we were only able to review two of the audit reports because of additional security requirements for one of the reports in the original sample. We tested the reports for compliance with GAS and NAS audit policies in nine areas to include independence, professional judgment, competence, audit planning, supervision, evidence and audit documentation, reporting, non-audit services, and quality control. We identified minor discrepancies in three of the nine areas in our review in applying NAS audit policy relating to:

- audit planning,
- evidence and documentation, and
- quality control.

Audit Planning. GAS 7.41 (2003 Revision) states that a written audit plan should be prepared for each audit. The form and content of the written audit plan will vary among audits but should include an audit program or project plan, a memorandum, or other appropriate documentation of key decisions about the audit objectives, scope, and methodology and of the auditors' basis for those decisions. It should be updated as necessary, to reflect any significant changes to the plan made during the audit. In addition, GAS 7.42 states that documenting the audit plan is an opportunity for the auditors to supervise audit planning.

NAS Audit Handbook (July 2006, Section 406) requires that a survey plan/program will be developed early in the audit to gather the information that will, in turn, comprise the content of the formal survey debrief. NAS Audit Handbook (July 2006, Section 415, paragraph 2) requires that the responsible Associate Director must approve the audit program before the start of the audit verification phase.

We found that NAS did not adequately plan for one of the two audits in our review. One audit in the review was an audit assist, and an audit plan had not been prepared. The audit files for this report also did not include documentation to indicate why an audit plan had not been prepared. For another audit in our review, a survey program had been prepared, but we could not determine the date that the survey program had been prepared. The steps for the survey were included as part of the audit program. While there were no dates to indicate when the auditors prepared the survey program, there was documentation in the files to show that survey steps were completed, and the auditors presented their results of the survey phase in a ninety day survey debrief to NAS management.

Recommendation: We recommend that the Auditor General of the Navy issue a memorandum to remind all SAP audit personnel of the importance of complying with established guidance for preparing survey and audit programs early in the audit.

Management Comments. The Auditor General concurred with the recommendation and stated that an e-mail will be sent to the audit staff to remind them of the importance of complying with the established guidance for preparing survey and audit programs early in the audit.

Reviewer Response. Management comments are responsive.

Evidence and Documentation. GAS 7.66 (2003 Revision) states that auditors should prepare and maintain audit documentation. GAS 7.66 also states that audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

NAS Audit Handbook (July 2006, Section 501) reiterates the GAS by stating that auditors should prepare and maintain audit documentation, and the audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report.

We judgmentally selected ten facts and/or figures from the working papers for one of the audit reports in our review. We found that all of the ten facts and/or figures were supported and included working paper elements such as purpose, source, scope, and conclusion as required in the NAS Audit Handbook. For the other audit report in our review, we judgmentally selected fifteen facts and/or figures in the audit report. We reviewed the supporting working papers for evidence and documentation and supervisory reviews. We found that one of the figures had not been properly updated in the working paper after the independent reference review. While the auditor did not properly update the working paper to reflect the change, the updated figure was corrected in the audit report. Though the information was not properly documented, it did not have a significant impact on the results or the conclusions presented in the report.

In addition, we were unable to locate a working paper in the audit files that supported at least two facts/figures in the audit report. The facts relating to the working paper did not have a significant impact because they did not affect the results and conclusions addressed in the report.

Recommendation: We recommend that the Auditor General of the Navy issue a memorandum to remind all SAP audit personnel of the importance of complying with established guidelines for documenting evidence to include maintaining information in the audit files and updating audit work included in the audit reports.

Management Comments. The Auditor General concurred with the recommendation and stated that an email will be sent to the audit staff to remind them of the importance of complying with established guidelines for documenting evidence to include maintaining information in the audit files and updating audit work included in the audit reports.

Reviewer Response. Management comments are responsive.

Quality Control. GAS 3.49 (2003 Revision) requires that each audit organization performing audits and/or attestation engagements in accordance with GAS should have an appropriate internal quality control system in place. Also, GAS 3.51 states that each audit organization should prepare appropriate documentation for its system of quality control to demonstrate compliance with its policies and procedures.

NAS Audit Handbook (July 2006, Section 857) states that editors perform a mandatory check to ensure that draft reports conform to the reporting standards for content and style. The editor provides copies of a completed guide sheet to the applicable Program Manager, Associate Director, and Assistant Auditor General who are responsible for making the appropriate corrections. The Program Manager and/or Associate Director should ensure the completed guide sheets are included in the audit files.

The NAS used quality control procedures such as supervisory initials and dates on working papers, and independent reference reviews for draft and final audit reports. One of the audits in our review was an audit assist which used a letter report format. The audit files did not contain a checklist identifying the editor's review. The NAS had not developed an editor's guide sheet for letter reports. The AAA recommended in their FY 2008 peer review of the NAS non-SAP audits for the NAS to develop an editor's guide sheet for letter reports. The NAS management commented that they would develop an editor's guide sheet for letter reports, attestation reports, and opinion reports. In response to the AAA recommendation, the NAS editor's have developed a draft of the editor's guide sheet for letter reports. They are currently in the process of refining the draft guide sheet for use by editors for letter reports, attestation reports, and opinion reports.

Appendix B. Scope and Methodology

We limited our review to the adequacy of NAS SAP audits' compliance with quality policies, procedures, and standards. We originally judgmentally selected three SAP audits from a universe of formal reports issued by NAS SAP auditors during FY 2006 and FY 2007, but limited our review to two audits because of additional security requirements for access to the third report. We tested each audit for compliance with the NAS system of quality control. The AAA conducted a review of the NAS internal quality control system for non-SAP audits and/or attestation engagements and has issued a separate report. The Acting Assistant Inspector General for Audit Policy and Oversight will issue an overall opinion report on the NAS internal quality control system that will include the combined results of the SAP and non-SAP audit reviews.

In performing our review, we considered the requirements of quality control standards and other auditing standards contained in the 2003 Revision of the GAS issued by the Comptroller General of the United States. GAS 3.52 states:

> The external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards. Audit organizations should take remedial, corrective actions based on the results of the peer review.

We conducted this review in accordance with standards and guidelines established in the April 2005 President's Council on Integrity and Efficiency (PCIE) "*Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General*." We used a modified guide to ensure consistency with the AAA review of non-SAP audits, and to reflect the unique nature of auditing within a SAP environment. We reviewed audit documentation, interviewed NAS auditors, and reviewed NAS internal audit policies. We reviewed the DoD OIG Report No. D-2005-6-010, "Quality Control Review of the Naval Audit Service's Special Access Program Audits" dated September 2, 2005, and the AAA's Letter of Comments on the Fiscal Year 2008 External Quality Control Peer Review of the Naval Audit Service, Report: A-2008-0115- PMZ dated June 12, 2008. We performed this review from July to September 2008 at one NAS field office.

We used the following criteria to select the audits under review:

- Worked backward starting with the FY 2007 audits in order to review the most current quality assurance procedures in place.

- Avoided audits with multiple SAPs associated with the audits for ease of access.

- Avoided audits that have the same or similar titles, to ensure review of multiple types of projects.

The following table identifies the specific reports reviewed.

Report Number	Date	Title
N-2006-0046	September 21, 2006	National Security Agency Military Interdepartmental Purchase Request
N-2007-0049	January 30, 2007	Intelligence Related Contracts (IRC)

Limitations of Review. Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance with it because we based our review on selective tests. There are inherent limitations in considering the potential effectiveness of any quality control system. In performing most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other human factors. Projecting any evaluation of a quality control system into the future is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

Appendix C. Naval Audit Service Comments

DEPARTMENT OF THE NAVY
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MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL
(ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY
AND OVERSIGHT)

Subj: **RESPONSE TO DEPARTMENT OF DEFENSE INSPECTOR GENERAL DRAFT QUALITY CONTROL REVIEW REPORT OF NAVAL AUDIT SERVICE'S SPECIAL ACCESS PROGRAM AUDITS**

Ref: (a) Memorandum for Auditor General, Department of the Navy – Quality Control Review of Naval Audit Service's Special Access Program Audits (Project No. D2008-DIP0AI-0090.000)

Encl: (1) Department of Defense Inspector General (Assistant Inspector General for Audit Policy and Oversight) Recommendations and Naval Audit Service Responses

1. We have reviewed your report on our Special Access Program audits (reference (a)), and are pleased that Department of Defense Inspector General has provided us with an unmodified opinion on our system of quality control for the year ended 30 September 2007. Enclosure (1) contains our response to the recommendations made in the report.

2. If you have any questions, or would like additional information, please contact Ms. Vicki McAdams, Director Policy and Oversight, at Vicki.McAdams@navy.mil or (202) 433-5854.

Samuel E. Chason

SAMUEL CHASON
Assistant Auditor General
Plans, Policy and Resource Management

Department of Defense Inspector General (Assistant Inspector General for Audit Policy and Oversight) Recommendations and Naval Audit Service Responses

Overall Comment

We are pleased to receive an unmodified opinion on our quality control system for Special Access Program (SAP) audits. We have evaluated the report and concur with the recommendations.

Department of Defense Inspector General Recommendations and Naval Audit Service Responses

Recommendation 1. We recommend that the Auditor General issue a memorandum to remind all SAP audit personnel of the importance of complying with established guidance for preparing survey and audit programs early in the audit.

Naval Audit Service Response. Concur. An All-Hands e-mail will be sent to the staff reminding them of the importance of complying with established guidance for preparing survey and audit programs early in the audit. Action will be complete by 10 October 2008.

Recommendation 2. We recommend that the Auditor General issue a memorandum to remind all SAP audit personnel of the importance of complying with established guidelines for documenting evidence to include maintaining information in the audit files and updating audit work included in the audit reports.

Naval Audit Service Response. Concur. An All-Hands e-mail will be sent to the staff reminding them of the importance of complying with established guidelines for documenting evidence, to include maintaining information in the audit files and updating audit work included in the audit reports. Action will be complete by 10 October 2008.

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Department of Defense

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