

January 30, 2007

Inspector General

United States
Department of Defense



External Peer Review

Department of Homeland Security
Inspector General
Audit Function

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Acronyms

GAGAS
IT

Generally Accepted Government Auditing Standards
Information Technology



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



JAN 25 2007

The Honorable Richard L. Skinner
Inspector General
U.S. Department of Homeland Security
1120 Vermont Avenue N.W.
Washington, D.C. 20528

Dear Mr. Skinner:

We have attached the report on the external peer review of the Department of Homeland Security Office of the Inspector General audit function. We conducted the external peer review in accordance with the President's Council on Integrity and Efficiency guidelines.

The Assistant Inspector General for Audits and the Assistant Inspector General for Information Technology of your organization provided comments to the draft report and described actions taken or planned that satisfy the intent of the report recommendations. We considered their comments when preparing the final report and no further comments are required. See the Management Comments section for the full text of the comments.

If you have any questions, please contact me or Mr. Keith West, Principal Assistant Inspector General for Auditing, at (703) 604-8905.

Thomas F. Gimble
Acting

Enclosure

Unmodified Opinion Report

Department of Homeland Security

Inspector General, Audit Function

We have reviewed the system of quality control for the audit function of the Office of the Inspector General of the Department of Homeland Security (Office of the Inspector General) in effect for the year ending September 30, 2005. A system of quality control encompasses the Office of the Inspector General's organizational structure as well as the policies adopted and procedures established to provide it with reasonable assurance of conforming to Generally Accepted Government Auditing Standards (GAGAS). The GAGAS, issued by the Comptroller General of the United States, describe the elements of quality control. The design of the system and compliance with it in all material respects are the responsibility of the Office of the Inspector General. Our objective was to determine whether the system of quality control was designed and complied with to provide reasonable assurance of material compliance with applicable auditing standards, policies, and procedures.

Although we identified design and compliance deficiencies, these deficiencies did not impair the reliability of the audit reports reviewed. Therefore, in our opinion, the system of quality control over the audits of the Office of the Inspector General of the Department of Homeland Security in effect for the year ended September 30, 2005, functioned as prescribed to preclude material deficiencies from arising in the conduct of audits. The Office of the Inspector General of the Department of Homeland Security designed and complied with its system of quality control so as to provide reasonable assurance of material compliance with applicable auditing standards, policies, and procedures.

We conducted our review in accordance with the guidelines established by the President's Council on Integrity and Efficiency and the Executive Council on Integrity and Efficiency. In performing our review, we obtained an understanding of the system of quality control for the Office of the Inspector General. In addition, we tested compliance with the Office of the Inspector General's quality control policies and procedures to the extent we considered appropriate. These tests included applying the Office of the Inspector General's policies and procedures on selected audits. Because our review was based on selective tests, it would not necessarily disclose all weaknesses in the system of quality control or all instances of lack of compliance with it. Nevertheless, we believe that the procedures we performed provide a reasonable basis for our opinion. Our scope and methodology appears in the Appendix.

Because there are inherent limitations in the effectiveness of any system of quality control, departures from the system may occur and not be detected. In addition, projecting any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate.

Background

The Office of the Inspector General of the Department of Homeland Security is relatively new and was in the process of developing and refining its policies and procedures for conducting audits and attestation engagements, as well as its audit quality control processes. The “Homeland Security Act of 2002” established the Office of the Inspector General, and on March 1, 2003, the Office of Inspector General became operational. Auditors from the Department of Transportation, the Department of the Treasury, and the Federal Emergency Management Agency formed the Office of the Inspector General. The Office of the Inspector General divided its audit function between two separate and distinct audit entities--the Office of the Assistant Inspector General for Audits (Office of Audits) and the Office of the Assistant Inspector General for Information Technology Audit (Office of Information Technology Audit), each of which reported directly to the Deputy Inspector General. In October 2005, the Office of Audits had 206 employees and the Office of Information Technology Audit had 38 employees.

Findings and Recommendations

Based on our review, we have the following findings and recommendations that should improve the Office of the Inspector General compliance with government auditing standards and its internal audit policies and procedures. These findings are not of sufficient significance to affect our overall unmodified opinion. However, the Office of the Inspector General of the Department of Homeland Security needs to continue its diligence to maintain an effective quality control system. Implementing the recommendations would improve the quality control system and help to maintain an unmodified opinion. We identified issue areas that coincide with the four characteristics of an internal quality control system outlined in the President’s Council of Integrity and Efficiency April 2005 “Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General” (the Guide). The Guide states that a system of internal quality control typically reflects four characteristics:

- policies and procedures that establish internal guidance and requirements,
- supervisory review processes,
- a quality control process for each project, for example, independent referencing, and
- a quality assurance program (or internal evaluation program).

The Office of the Inspector General needs to:

- establish and effectively communicate throughout the Office of the Inspector General its detailed audit policies and procedures,
- develop and execute a written plan for an ongoing internal quality assurance monitoring program, and
- follow up on issues raised in the internal quality control reviews conducted and this external peer review.

The written internal quality assurance program should include improved quality controls such as improved cross-referencing and independent referencing reviews of reports. Publication of clear, detailed, and effectively communicated guidance to Office of the Inspector General auditors

would minimize many of the issues discussed in this report. We discussed all issues and the results of each individual audit with the Director, team members, and the audit liaisons. We discussed the overall results of our review with the Assistant Inspector General for Audits and the Assistant Inspector General for Information Technology Audit. The Office of the Inspector General began taking action on identified issues before we completed the review.

Policies and Procedures That Establish Internal Guidance and Requirements

The Office of Audits had written policies and procedures in its Audit Manual, January 2004, for conducting audits. However, the Office of Audits did not effectively communicate the publication of the Audit Manual to the audit staff. In addition, the Audit Manual did not include implementing procedures detailing Office of the Inspector General methods of accomplishing or carrying out all of the standards in GAGAS. The ineffective communication of policies, and the omission of some implementing procedures, resulted in inconsistent application of GAGAS requirements. Also, for the period under review, the Office of Information Technology Audit had no written policies and procedures.

Requirement for Policies and Procedures

Government auditing quality control and assurance standards require that an appropriate internal quality control system be in place and include adopted policies and established procedures for providing reasonable assurance of compliance with applicable standards. Reasonable assurance of GAGAS compliance is more difficult if the Office of the Inspector General has not effectively communicated its commitment to standards and its expectations to the auditors that they follow the policies and procedures. To be most effective, policies and procedures should describe specific steps and procedures that the organization will use to implement GAGAS. The policies and procedures will tell the auditors what the standards look like when in practice at their organization.

Adequacy and Compliance

Communicating the Required Use of the Audit Manual to the Audit Staff. During our reviews of individual projects, we held discussions with two of the three Directors that were responsible for the projects we reviewed. The Directors, three Audit Managers, and two auditors, indicated that they were either not aware of the Audit Manual or did not realize that the Office of Audits had finalized the manual and mandated its use.

The Director, Policy, Plans, and Quality Assurance, Office of Audits, stated that the Office issued the Audit Manual in January 2004 and that the use of the Audit Manual is mandatory. However, the Office of Audits provided no written documentation that mandated its use. We requested, but did not receive, documentation that demonstrated that the audit staff was required to use the Audit Manual. The only evidence that the Office of Audits provided on communicating the Audit Manual to the audit staff was a May 5, 2004, e-mail from the Director, Audit Support Division, to Office of Audits personnel at Headquarters and the field offices, subject: QCR Checklists. That e-mail discussed the need for internal peer reviews and provided a “link to the Audit Manual for your convenience.” Providing a link for convenience does not convey clear communication that use of the Audit Manual is required.

Adequacy of Audit Manual. The Office of Audits’ Audit Manual contained a condensed version of GAGAS for the independence and supervision standards. However, the Audit Manual did not provide implementing procedures for the auditors to follow to meet GAGAS for independence and supervision.* In addition, a list of policies and procedures not incorporated into the Audit Manual and references for them from GAGAS follows:

- Policies and procedures that will enable the identification of personal impairments to independence (paragraph 3.08a),
- A disciplinary mechanism to promote compliance with the audit organization’s policies and procedures (paragraph 3.08d),
- Policies and procedures stressing the importance of independence and the expectation that auditors will always act in the public interest (paragraph 3.08e),
- Policies placing responsibilities on the audit organization for providing audit services (paragraph 3.16 (4)),
- Policies and procedures to ensure that the effect on the ongoing, planned, and future audits is considered when deciding whether to provide nonaudit services (paragraph 3.17), and
- Policies and procedures for reporting and resolving external impairments (paragraph 3.20).

* For a discussion of policies and procedures related to supervision, see the section on “Supervisory Review Process and Integrity of Audit Documentation.”

Audit Manual Compliance. Although the Audit Manual provides sufficient detail to address GAGAS requirements concerning competence (training documentation) and audit planning (the need for evaluating internal controls), the Office of Audits did not fully follow those procedures.

Training Documentation. The Office of Audits performed internal quality control reviews of continuing education requirements for the calendar year 2003-2004 training cycle. Those reviews reported an inability to find training documentation for 15 auditors (14 field office auditors and 1 auditor at headquarters), incorrect categorization of training at 6 of the 8 field offices, and the non-use of individual development plans as required by the Audit Manual at 1 field office.

We attempted to determine whether the Office of the Inspector General had assurance that the auditors would meet their continuing education requirements for the calendar year 2005-2006 training cycle. However, we were unable to obtain that assurance because of inconsistent compliance with the Audit Manual requirements for a 2-year individual development plan.

To identify auditor training needs during the current year and to prioritize the employee's anticipated training requirements for the entire 2-year cycle, the Audit Manual states that an individual development plan will be prepared and updated annually. However, not all employees in the four divisions contacted had individual development plans. Employees in two of the audit divisions (26 employees) did not use the individual development plans the Audit Manual requires. One project manager referred us to an office administrative professional who provided us with an April 2005 e-mail from an Office of Audits Administrative Officer stating that individual development plans were no longer required. The auditors in the remaining two divisions (44 employees) had prepared individual development plans. Those plans, however, did not meet the requirements of the Audit Manual because they did not cover the entire 2-year cycle.

The internal quality control reviews noted that the Office of Audits had implemented, in September 2005, a system for tracking continuing professional education courses taken. However, the Office of Audits was unable to provide us with reliable, complete information from the tracking system. Because the internal quality assurance teams found training deficiencies at virtually all Office of Audits' locations, the Office of the Inspector General should emphasize the prompt implementation of a reliable system to track continuing education compliance as recommended by the internal quality control reviews.

The internal quality control review of continuing education requirements performed by the Office of Information Technology Audit reported that training documentation was available to show that the auditors in the Office of Information Technology Audit had satisfied their training requirements for the calendar year 2003-2004 training cycle. The auditors in the Office of Information Technology Audit had also satisfied their training requirements for calendar year 2005.

Internal Controls. GAGAS, paragraphs 4.03.b, 6.14, 7.07.c, and 7.11, and the Audit Manual specifically state that auditors should obtain a sufficient understanding of internal controls as it relates to the specific objectives and scope. In addition, GAGAS paragraphs 8.16 and 8.17 state that auditors should include in the audit report the scope of their work on internal control and any significant deficiencies found during the audit. When we discussed Audit Report DD-05-05 with the audit team, the audit team disagreed that GAGAS required a review of internal controls. The audit team stated that it did not look at internal controls because it was

not an objective of the audit. However, the audit report did not list a scope limitation. Concerning Audit Report DS-11-05, the related audit guide listed a review of internal controls as a required procedure and the audit team did review internal controls. However, the audit report did not address the scope of the review or scope limitations on internal controls.

Office of Information Technology Audit. For the period under review, the Office of Information Technology Audit, which includes 16 percent of the overall Office of the Inspector General audit staff, did not have documented policies and procedures. Instead, the Assistant Inspector General for Information Technology Audit stated that his office relied on the written guidance in the generally accepted government auditing standards to plan and conduct audits. However, the Office of Information Technology Audit's internal quality control review team recognized the need for policies and procedures.

The Office of Information Technology Audit's internal quality control review team concluded in its quality control reviews conducted that:

Because the IT [Information Technology] Audits has not documented IT audit standards, much of the quality assurance teams' reviews were based on auditor experience, professional judgment, and the team members' interpretation of GAGAS. Therefore, there was not always a consensus regarding the materiality and nature of the inconsistencies observed when the members of the quality assurance teams discussed their conclusions of their reviews with the applicable divisions' management and staff. Consequently, to ensure consistency in the interpretation and application of the GAGAS, we are recommending that OITA [Office of Information Technology Audit] document its IT policies and procedures and establish an internal quality control process to ensure IT audit divisions fully comply with the required audit standards.

In its internal quality control report, September 21, 2005, the Office of Information Technology Audit's internal quality control review team recommended that the Assistant Inspector General for Information Technology Audit coordinate with the Assistant Inspector General for Audits to finalize an Audit Manual to address all relevant policies and procedures and to ensure the consistent application of same throughout the Office of the Inspector General.

Action Taken by the Office of the Inspector General during the External Peer Review. The Office of the Inspector General began taking action before the completion of this external peer review. Specifically, on September 1, 2006, the Deputy Inspector General signed the Audit Manual that all auditors in the Office of the Inspector General will use. The Audit Manual documented the DHS practices for standards that the Audit Manual previously had not addressed.

Supervisory Review Process and Integrity of Audit Documentation

The Office of the Inspector General did not have procedures that defined what the Office of the Inspector General considers "proper supervision." GAGAS requires the proper supervision of staff and documentation of evidence of supervisory review but is limited as to what specific actions constitute proper supervision. Given the broad and flexible nature of GAGAS, the audit organization is responsible for providing the specifics in its policies and procedures and thus provide reasonable assurance of GAGAS compliance.

Supervisory Review of the Audit Guide for the Project. The Audit Manual states that:

An audit guide is finalized for the verifying phase if the Division director agrees that further audit work is warranted and approves moving the audit into the verifying phase. The Division director must also approve the audit guide. To the extent possible, the audit guide developed for the verifying phase should be an expanded version of the audit guide used to perform the limited testing during the planning phase.

The Office of Information Technology Audit had not documented its policies and procedures concerning audit guides. However, at the start of our external peer review, officials of the Office of Information Technology Audit described the processes and procedures that their auditors follow in conducting audits and quality control reviews. The officials stated that an “audit guide is required for each audit and that the audit guide is usually formally approved (that is, signed off on) by the Team Leader, Program Manager, and Division Director.”

As shown in Table 1, for 7 of the 13 projects reviewed, there was no evidence that a supervisor approved the audit guide during the planning phase.

Table 1. Supervisory Review of the Audit Guide.

Report Number	Audit Work Began	Report Publication	Audit Guide Approved
OIG-05-20	January 2005	May 2005	No evidence of approval
OIG-05-34	May 2005	August 29, 2005	August 2, 2005
DS-11-05	August 2004	March 4, 2005	February 18, 2005, by Team Leader, no approval by Program Manager or Director
OIG-05-22	December 2003	February 2005	September 27, 2004, and February 2005
DD-05-05	September 2003	April 8, 2005	June 2004
OIG-05-05 (contractor monitoring)	April 2004	December 2004	Two Guides prepared for monitoring contractor’s work. First guide was not approved. Second guide approved over 2 months after the report was issued.
OIG-05-03	March 2004	November 2004	May 2004

Supervisory Review of Audit Documentation. GAGAS, paragraph 7.68.d, requires “evidence of supervisory review, before the audit report is issued, of the work performed that supports findings, conclusions, and recommendations contained in the audit report.” However, 4 of the 13 projects reviewed contained working papers relevant to the report, which supervisors did not review before the report was issued, as shown in Table 2.

Table 2. Supervisory Review of Audit Documentation.

Report Number	Number of Working Papers Peer Review Team Reviewed	Number of Working Papers Reviewed After Report Issued	Working Papers with No Evidence of Supervisory Review	Number Referenced to Report
OIG-05-05 (contractor monitoring)	46	35 (76%)	9 (20%)	Report was not referenced.
OIG-05-47	188	108 (57%) (42 initial review)	0	57 (53%)
DS-11-05	75	22 (29%)	1	10 (45%)
DD-03-05	100%	No supervisory review of Independent Public Accountant monitoring working papers	No supervisory review of Independent Public Accountant monitoring working papers	Report was not referenced.

For Audit Report OIG-05-05, we selected a sample of monitoring working papers to review that indicated that supervisory review of the monitoring working papers either did not occur until after the report was issued or not at all. None of the monitoring documents in one of the three binders reviewed showed evidence of supervisory review. For Audit Report OIG-05-47, review or re-review of the 108 working papers occurred after the final report was issued. The initial review of 42 of the 108 working papers did not occur until after the final report was issued. Also, the electronic working paper package documented edits made to four working papers after the report was published and three of the four edited working papers were referenced to the published report. The external peer review team could not determine what changes, if any, occurred in the working papers after report publication. Changes to working papers after the report is published can cause persons to question the integrity of the data and whether the report was supported.

Integrity of Audit Documentation. Although GAGAS is silent on the issue of modifying audit documentation after final report issuance, the fieldwork standard related to audit documentation specifically states in paragraph 7.66 that audit documentation should contain support for

findings, conclusions, and recommendations before auditors issue their report. If guidance that addresses data integrity is absent, the potential increases for auditors to inappropriately alter documentation that supports a significant finding, conclusion, or recommendation.

From a quality control system review perspective, the reviewer or other oversight official may be unable to verify that the audit documentation supported the report before the report was issued. The Office of the Inspector General would benefit from guidance on post-report changes to audit documentation to ensure the integrity of audit documentation. The guidance could include policies and procedures such as:

- An explicit understanding that supporting documentation and quality procedures should be completed before the final report is issued.
- The circumstances under which it is appropriate and acceptable to modify audit documentation after a report is issued.
- Procedures for documenting changes made including when the changes were made, who made the changes, and effects, if any, of the changes on the auditor's prior conclusions.
- The acceptable period, if any, for making changes to audit documentation after the report is issued.
- An explicit statement emphasizing the imprudence of changing working papers that the auditor used to support significant facts and conclusions in the audit report.
- An explicit statement that under no circumstances should changes be made to audit documentation when notified of pending external or internal review.

Actions Taken by the Office of the Inspector General during the External Peer Review.

The Audit Manual that the Deputy Inspector General signed on September 1, 2006, defines proper supervision and provides procedures and measurements for adequately meeting the supervision standard.

Quality Control Process for Each Project

The Office of the Inspector General did not have a consistently applied system of internal quality controls. We found issues with quality in relation to accuracy, referencing, and independent reference reviews on 9 of the 13 audits reviewed, as shown in Table 3.

Table 3. Summary of Referencing Issues.

Report Number	Reports with Error(s)	Independent Reference Review Not Performed	Reference Review After Report Issuance	Inadequate Referencing
DD-05-05	X			X
OIG-05-47	X			
OIG-05-03	X			X
DA-02-05	X			
OIG-05-20	X			X
OIG-05-34			X	X
OIG-05-27		X		
OIG-05-13		X		
DD-03-05		X		

GAGAS, paragraph 8.45, states that:

One way to help ensure that the audit report meets these reporting standards is to use a quality control process such as referencing. Referencing is a process in which an experienced auditor who is independent of the audit verifies that statements of facts, figures, and dates are correctly reported, that the findings are adequately supported by the audit documentation, and that the conclusions and recommendations flow logically from the support.

The Audit Manual provides written direction, and the Assistant Inspector General for Information Technology Audit provided oral direction, to require that auditors reference all draft and final reports. Further, the Audit Manual stated that an independent reference reviewer should review a cross-referenced copy of the audit report in order to ensure the accuracy of the data, before publication, that support the audit report.

Report Accuracy. The supervisory and the independent referencing review process did not identify factual inaccuracies in four (DD-05-05, OIG-05-03, DA-02-05, and OIG-05-20) of the five reports shown in Table 3 as containing factual errors. In Audit Report OIG-05-47, the independent referencing reviewer identified the factual inaccuracy, but the audit team did not

correct the inaccuracy in the report. However, none of the reports reviewed contained factual errors that were material and the factual inaccuracies in the reports issued did not change the substance of the reports.

Audit Report DD-05-05. Audit Report DD-05-05 contained factual inaccuracies and misstatements that were not identified by the supervisor or independent referencing reviewer. Table 4 identifies the factual inaccuracies and misstatements in Audit Report DD-05-05 that we questioned.

Table 4. Factual Inaccuracies and Misstatements in Audit Report DD-05-05

Report Statement	Support	Effect
Audit sample for contractual services, valued at \$39.5 million.	Summary working paper supported \$39.5 million, but supporting documents to the summary working paper did not support the \$39.5 million.	The Audit Manager agreed that the report overstated the sample size by \$5 million, thus changing the percentage of expense sampled.
The auditors could not reconcile contractual payments to invoices because the auditors could not determine to which contractors the payments applied.	Working papers show that the auditors could reconcile the payments to invoices if they had additional information. Further the working papers show that the auditors had requested the information needed to reconcile the payments.	The audit team agreed that the statement should have stated that it was only through extensive searches and requests for additional assistance that they were able to track many of these expenses and determine eligibility.
The Forest Service deducted disciplinary demobilization costs from employee’s salaries and billed the same amount to Federal Emergency Management Agency. The auditors questioned those amounts as duplicate credit card purchases.	The supporting documentation shows that the Forest Service did not always deduct the cost of the disciplinary demobilization from the employee’s salary.	As a result, the audit team incorrectly categorized the questioned costs and those costs were overstated. The audit team agreed that it should have categorized the costs as unsupported costs instead of duplicate costs.

We could not quantify the number and amount of incorrectly categorized costs because the supporting documentation did not always contain criteria and methodology as to why the auditors categorized the costs as “questioned costs.” The audit team based some of its conclusions on inaccurate and inconsistent analysis, duplicate transactions, assumed criteria, unsupported information, and data determined to be unreliable. In some instances, the auditors questioned transactions that either appeared twice in the same category or twice in different categories, and some instances they did not question those anomalies. To analyze the transactions, the audit team used various auditor prepared questions (for example, Is the transaction supported by invoices?) in determining whether the transactions were questionable.

In one instance, a transaction included in two different categories resulted in different answers to the same auditor-prepared question. As a result, the auditors questioned the cost of the transaction in one category but not in the other.

The senior auditor on the audit stated that the duplicate transactions occurred because several team members independently gathered the audit data. The audit team combined the audit data into one working paper. Sometimes team members gathered the same audit data. As a result, the audit data appeared more than once in the combined working paper. The senior auditor recognized that the audit staff did not consistently remove all of the audit data that were included more than once in the combined working paper.

Audit Report OIG-05-47. Audit Report OIG-05-47 stated that a wrecking company purchased 32 vehicles; however, the working papers showed that the wrecking company had purchased 23 vehicles. The quality control process did not correct this inaccuracy. The independent referencing reviewer identified the inaccuracy in the review of the draft report. However, the audit team did not correct the inaccuracy. The final report lacked referencing and received no independent reference review. Both the draft and final reports contained the inaccurate factual data when issued.

Audit Report OIG-05-03. Audit Report OIG-05-03 contained four facts that were inaccurate and did not agree with the supporting documentation in the working papers. The independent referencing reviewer did not identify the inaccuracies. For example, the report stated that there were 13 high-risk and 12 medium-risk vulnerabilities. However, the working papers show that there were 13 high-risk and 17 medium-risk vulnerabilities. The Director, Information Security Audit Division, agreed that the four facts were factual inaccuracies.

Audit Report DA-02-05. Audit Report DA-02-05 contained three facts that were inaccurate and did not agree with the supporting documentation in the working papers. Both the program director and the project manager for the audit had retired. A team leader, representing the Atlanta field office but with minimal involvement in the audit, reviewed the references in question and agreed that the three facts in the report were inaccurate. Although the inaccurate amounts did not change the substance of the report, the independent referencing reviewer did not identify the discrepancies.

Audit Report OIG-05-20. Audit Report OIG-05-20 contained three facts that were inaccurate and did not agree with the supporting documentation in the working papers. A team leader from the Atlanta field office reviewed the references in question and agreed that the three facts in the report were inaccurate. Although the inaccurate amounts did not change the substance of the report, the independent referencing reviewer did not identify the discrepancies.

Inadequate Referencing. In 4 of the 13 (31 percent) audit reports we reviewed, the references provided to support statements were difficult to follow and the working papers referenced either did not support or only partially supported the statements in the reports. We could not verify the support for statements in the report using the references provided. We had to discuss the audit documentation in detail with the audit team to complete the review of the project. We provided lists of the questioned references to the Directors responsible for the reports and met with them or their representatives to discuss the discrepancies.

Audit Report DD-05-05. Of the 114 references reviewed, we questioned 70 references (61 percent) as not providing adequate support for the statement in the report. A senior auditor reviewed the references in question and:

- agreed or partially agreed with our comments on 33 of the references,
- agreed to disagree on 33 references, and
- we agreed with the senior auditor's comments on 4 references after further discussion.

During the review, the peer review team discovered that the independent referencing reviewer for DD-05-05 did not record all of the questionable references she discovered. The independent referencing reviewer stated that she had problems finding support for statements in the report using the references provided. If the team leader could explain the unclear or questionable reference to the independent referencing reviewer, the reviewer was satisfied; however, she did not record a comment concerning the discrepancy and the team did not take action to correct the reference.

Audit Report OIG-05-34. Of 252 references reviewed, we questioned 135 references (54 percent) as not providing adequate support for statements in the report. The Director acknowledged that the issues noted by the external peer review team showed that improvements were possible in the referencing process.

Audit Report OIG-05-20. Of 100 references reviewed, we questioned 43 references (43 percent) as not providing adequate support for statements in the report. The independent referencing reviewer did not question the references. A team leader was able to provide additional references that did provide support for the statements in 42 of the 43 questioned items.

Audit Report OIG-05-03. Of 409 references reviewed, we questioned 24 references (6 percent) as not providing adequate support for statements in the report. The Director acknowledged that the issues noted by the external peer review team showed that improvements were possible in the referencing process. During our review, we had determined that the referencing issues did not have material impact on the validity of the report.

Action Taken by the Office of the Inspector General During the External Peer Review. The Office of Audits developed statements of work to contract for reference and report training and working paper techniques training. The objectives in providing those courses are to train participants to reference statements in audit reports back to the supporting audit documentation and improve the accuracy, focus, clarity, and usefulness of the audit reports and audit documentation.

Quality Assurance Program

For the period under review, the Office of the Inspector General did not provide evidence of an ongoing quality control and assurance system. Monitoring procedures (quality control reviews) were not performed annually.

GAGAS paragraph 3.50, states that an audit organization's internal quality control system should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied.

The Office of Audits did take prompt action once the Office of the Inspector General became operational, on March 1, 2003, to develop written policies and procedures for conducting audits.

However, Office of Audits senior management did not effectively communicate to the Office of Audits staff that the use of the January 2004 Audit Manual was required. Four months after issuing the Audit Manual, the Office of Audits issued its Quality Control Review Guide in May 2004 for performing its internal quality control reviews. The unsigned Quality Control Review Guide was effective for Office of Audits' audits and attestation engagements as of January 1, 2004. The Quality Control Review Guide states that, on an annual basis, the Assistant Inspector General for Audits would assign a team of senior staff members to perform an internal quality control review of the Office of Audits. The Quality Control Review Guide also states that the Office of Audits could be required to have quality control reviews more frequently than annually, when appropriate. The Office of Information Technology Audit had neither policies nor procedures for conducting quality control reviews.

Internal Quality Control Reviews Performed. The Office of the Inspector General performed commendable internal quality control reviews in 2005. The Office of Audits performed an internal quality control review in which they evaluated 54 audits that were in process or completed by 9 field offices and 10 audits that were in process or completed by audit staff at headquarters, Office of Audits. The Office of Audits quality control review team concluded that 4 of the 9 field offices did not fully comply with GAGAS. The Office of Audits quality control review team concluded that audits performed by staff at the Office of Audits headquarters generally did comply with GAGAS.

The Office of Information Technology Audit also executed a quality control review of three completed audits. The Office of Information Technology Audit quality control review team concluded that the audit teams did not conduct audit fieldwork and reporting in accordance with GAGAS for one of the three reports.

We concluded that both the Office of Audits and Office of Information Technology Audit quality control review teams adequately completed the President's Council on Integrity and Efficiency checklist for Review of Individual Performance Audits to evaluate compliance with GAGAS, as well as other criteria. This occurred despite the fact that the teams used different versions of the checklist. In addition to the checklist, the Office of Audits quality control review teams provided a survey to the audit staff that they could voluntarily answer.

Schedule of Quality Control Reviews. To determine whether the Office of the Inspector General had an ongoing system of internal quality control, we looked at reviews executed as well as the planning for future reviews, as of September 2005. The Office of the Inspector General did not conduct quality control reviews until calendar year 2005 although it had developed policies and procedures for conducting audits in January 2004 and policies and procedures for performing quality control reviews in May 2004. For the period under review, the Office of the Inspector General could not provide any documentation to demonstrate that it had executed or planned additional reviews after calendar year 2005.

Action Taken by the Office of the Inspector General during the External Peer Review. In June 2006, the Office of Audits selected an audit manager to manage its quality assurance program. The Office of Audits was also in the process of recruiting staff to work on the quality assurance program.

Recommendations and Management Comments

We recommend that the Assistant Inspectors General for the Offices of Audits and Information Technology Audit:

1. Distribute and effectively communicate to the audit staff that use of the revised Audit Manual is required. The revised Audit Manual should provide clear policies and procedures for implementing generally accepted government auditing standards including policies and procedures that address the external peer review results and other recommendations in this report.

Department of Homeland Security Comments. The Department of Homeland Security concurred. The Assistant Inspectors General for Audit and Information Technology stated that they issued their first Office of Inspector General Audit Manual in September 2006. The new manual provides internal policies and implementing procedures for all audit offices and incorporates implementing procedures for Generally Accepted Government Auditing Standards. The Assistant Inspectors General distributed the manual to all staff on October 3, 2006, and notified them in writing that compliance with the manual is mandatory. They also developed a mandatory training course for staff to ensure that they understand the requirements of the new manual, and they plan to complete staff training in March 2007.

2. Direct compliance with generally accepted government auditing standard training requirements by implementing a comprehensive system of tracking and planning training for all auditors.

Department of Homeland Security Comments. The Department of Homeland Security concurred. The Office of Audits centralized its process for tracking staff training. The new process and database allow managers to review, more frequently, their staff's progress toward meeting training requirements outlined in Generally Accepted Government Auditing Standards.

3. Provide appropriate auditor training to enhance the adequacy of the referencing and independent reference review process.

Department of Homeland Security Comments. The Department of Homeland Security concurred. In October 2006, the Assistant Inspectors General enhanced training requirements by requiring the audit staff to take two separate customized training courses in Proper Audit Documentation and Referencing. As of December 20, 2006, nearly half of the audit staff had attended both training courses. The audit staff is scheduled to complete the training by February 2007.

- 4. Establish a system of ongoing quality control and assurance system by:**
- a. signing, communicating, and distributing a quality control review guide;**
 - b. establishing a schedule of current and future reviews; and**
 - c. focusing future quality assurance reviews to emphasize those areas discussed in this report.**

Department of Homeland Security Comments. The Department of Homeland Security concurred. On November 3, 2006, the Assistant Inspectors General created a separate Planning

and Compliance Division that is external to the audit offices. The new division is responsible for managing the issuance of policies and procedures and for creating a robust quality assurance program that includes internal quality control reviews.

APPENDIX

PEER REVIEW SCOPE AND METHODOLOGY

We tested compliance with the Office of the Inspector General's system of quality control to the extent we considered appropriate. These tests included a review of 12 audit reports and 1 attestation report issued during the March 31, 2005, and September 30, 2005, semiannual reporting periods. In addition, we reviewed the financial statement audit and monitoring activities covering the FY 2004 financial statements for the Department of Homeland Security performed under contract. We also reviewed the internal quality control reviews performed by the Office of the Inspector General of the Department of Homeland Security.

OFFICE OF THE INSPECTOR GENERAL OFFICES REVIEWED

We performed our review between November 2005 and September 2006 at the Headquarters, Office of the Inspector General, Washington, D.C. The scope of our review included one classified report. Offices of the Inspector General reports reviewed were from Atlanta, Georgia; Denton, Texas; San Francisco, California; and Washington, D.C.

AUDIT REPORTS REVIEWED

We selected the following audit and attestation reports for review.

OFFICE OF AUDITS

<u>Report Number</u>	<u>Report Date</u>	<u>Report Title</u>
OIG-05-05	December 2004	Independent Auditors' Report on DHS' FY 2004 Financial Statements
OIG-05-13	March 21, 2005	Independent Review of the U.S. Coast Guard (CG) Reporting of FY 2004 Drug Control Funds Report
OIG-05-20	May 2005	Audit of FEMA's Individuals and Households Program in Miami-Dade County, Florida for Hurricane Frances
OIG-05-47	September 2005	Vehicle Disposal and Sales Program Within U.S. Border Patrol's San Diego Sector
DA-02-05	October 12, 2004	Hudson County, New Jersey
DA-25-05	August 9, 2005	Audit of the State of Florida, Administration of Disaster Assistance Funds
DD-03-05	February 25, 2005	Grant Management: Louisiana's Compliance with Disaster Assistance Program's Requirements
DD-05-05	April 8, 2005	Columbia Space Shuttle Mission Assignment, National Forests and Grasslands in Texas, Lufkin, Texas
DS-11-05	March 4, 2005	Audit of the City of Los Angeles-Department of Building and Safety, Los Angeles, California

OFFICE OF INFORMATION TECHNOLOGY AUDIT

<u>Report Number</u>	<u>Report Date</u>	<u>Report Title</u>
OIG-05-03	November 2004	DHS Needs to Strengthen Controls for Remote Access to its Systems and Data
OIG-05-22	May 2005	Disaster Recovery Planning for DHS Information Systems Needs Improvement
OIG-05-27	July 2005	Information Technology Management Letter for the FY 2004 DHS Financial Statement Audit
OIG-05-34	August 29, 2005	Evaluation of DHS' Security Program for Its Intelligence Systems (U)

U.S. Department of Homeland Security Comments

Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528



**Homeland
Security**

December 20, 2006

Mary L. Ugone
Deputy Inspector General for Auditing
Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202-4704

Dear Ms. Ugone:

Thank you for the opportunity to review and comment on the draft report on your external peer review of our audit offices. The findings and recommendations in your draft report fairly characterize the overall condition of our offices' systems of quality controls for the year ending September 2005. We agree with your overall conclusion that our system of quality controls provided reasonable assurance that we complied with applicable auditing standards and internal policies and procedures. We are pleased that the draft report specifically mentioned the reliability of our audit reports.

We concur with all four recommendations. Your suggested improvements and recommendations will serve to strengthen our existing system of controls. We took immediate action to implement suggested improvements and the recommendations.

We reiterate our commitment to maintaining an effective system of quality controls and to working to continuously improve those controls. Following are the specific corrective actions taken to address weaknesses and recommendations in the draft report.

Recommendation 1 - Policies and Procedures

We issued our first OIG Audit Manual in September 2006. This manual replaced the Office of Audits' Audit Manual and provides internal policies and implementing procedures for all audit offices. The new manual incorporates implementing procedures for all Generally Accepted Government Auditing Standards. For example, we added policies that require audit staff to plan for and document their assessment of auditee's internal controls, computer generated data, and fraud risk. We distributed the manual to all staff on October 3, 2006 and notified them in writing that compliance with the manual is mandatory. We also developed a mandatory training course for staff to ensure that they understand the requirements of the new manual and plan to complete staff training in March 2007.

The Office of Audits centralized its process for tracking staff training. Staff and managers now receive transcripts that state scheduled and completed training. The new process and database allow managers to review more frequently their staff's progress toward meeting training requirements outlined in Generally Accepted Government Auditing Standards.

Recommendation 2 - Supervisor Review Process

The OIG Audit Manual clearly defines an audit supervisor's responsibilities and establishes a standard for determining the timeliness of supervisory reviews. Supervisors are to complete their review as each audit phase is completed or prior to the final report's issuance. The manual requires supervisors to complete a standard Supervisory Review Checklist, which will assist them in determining if auditing standards and internal policies were followed. Supervisors are required to sign and date the checklist to certify that all required standards and internal policies were met. We also hired a Quality Assurance Manager who will be involved in monitoring compliance with supervisor review requirements. The Quality Assurance Manager and her staff will use our electronic audit documentation system to monitor the timeliness of supervisory reviews on a concurrent basis and during internal quality control reviews.

The integrity of our audit work is of utmost importance to our offices and we believe supervisory review requirements, audit documentation storage requirements, and an enhanced quality control review process will ensure that our audit documentation is not altered after the issuance of a final report. The Audit Manual establishes timeframes for finalizing and storing audit documents after the final report's issuance. For example, electronic files of audit documentation are to be finalized (locked) within 20 working days of the report's issuance and two copies of the files maintained to ensure an unaltered copy is preserved.

Recommendation 3 – Training

We enhanced staff training requirements. Beginning in October 2006, we required audit staff to take two separate customized training courses in Proper Audit Documentation and Referencing. Referencing training focuses on how to verify that audit documentation is accurately summarized and reported in the audit report, and how to ensure that noted inaccuracies in the report are corrected prior to the report's issuance. Audit policy requires that independent referencing take place prior to a draft report's issuance, unless an Assistant Inspector General waives the requirement in writing. A new Referencer's Checklist and procedures are included in the OIG Audit Manual. Nearly half of the audit staff has attended both training courses. Audit staff is scheduled to complete training by February 2007.

Recommendation 4 – Quality Control Process and Internal Quality Control Reviews

On November 3, 2006, we created a separate Planning and Compliance Division that is external to our three audit offices. The new division is responsible for managing the issuance of audit policies and procedures and for creating a robust quality assurance program that includes internal quality control reviews. These reviews will evaluate the audit offices' compliance with auditing standards and internal policies and cover completed and on-going audit work. In addition to hiring a Quality Assurance Manager to lead these reviews, we formed an OIG-wide Quality Assurance Committee. Each audit office assigns a member to work on the committee. The committee will advise the Quality Assurance Manager and make recommendations to improve the audit offices' quality control systems.

The Office of Audits completed one internal quality control review of a fiscal year 2006 audit. As a result of the review, we strengthened audit documentation and improved the report prior to its issuance. We also issued a Request for Proposals in September 2006 to solicit bids from an independent public accounting (IPA) firm to conduct additional quality control and assurance reviews of our fiscal year 2006 and 2007 audits. We plan for the IPA to complete reviews of a representative sample of audits completed in fiscal year 2006 and on-going in fiscal year 2007. The reviews of on-going work will allow us to assess compliance with our new OIG Audit Manual. The IPA is also to follow up on weaknesses noted in previous internal quality control reviews and your external peer review, and to evaluate audit offices' corrective action plans related to those previous reviews. The IPA reviews will be completed by September 2007.

We will revise the Office of Audits' Quality Assurance Guide to reflect the role of our new Planning and Compliance Division and the Quality Assurance Committee. The revised guide will govern all audit offices and reflect required audit standards, and communicate internal guidance and implementing procedures. The guide will enable us to better ensure that processes are in place to detect and properly resolve instances of non-compliance with auditing standards and internal policies. We will revise the guide by May 2007.


We appreciate the thorough manner in which your staff conducted the review and the generosity they displayed when sharing your best practices with our staff. We adopted many of their suggestions.

Should you have any questions, please call us, or your staff may contact Edward Stulginsky, Deputy Assistant Inspector General for Audits, at (202) 254-4100, or Ann Brooks, Audit Manager, Office of Information Technology Audits.

Sincerely,



David M. Zavada
Assistant Inspector General for Audits



Frank Deffer
Assistant Inspector General for Information Technology

Team Members

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Inspector General Department of Defense

