Oversight Report

EVALUATION OF THE DEPARTMENT OF THE ARMY
INTERNAL REVIEW ORGANIZATIONS

Report Number PO 99-6-002 March 23, 1999

Office of the Inspector General
Department of Defense

Additional Copies

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit of the Audit Followup and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, Home Page at: www.dodig.osd.mil.

Suggestions for Future Evaluations

To suggest ideas for or to request future evaluations, contact the Audit Followup and Technical Support Directorate at (703) 604-8940 (DSN 664-8940) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: AFTS Evaluation Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

AAA	U.S. Army Audit Agency
AFAA	Air Force Audit Agency
AR	Army Regulation
ASA (FM&C)	Assistant Secretary of the Army (Financial Management and Comptroller)
GAGAS	Generally Accepted Government Auditing Standards
IR	Internal Review
MACOM	Major Army Command
NAS	Naval Audit Service

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

March 23, 1999

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT AND COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Evaluation Report on the Department of the Army Internal Review Organizations (Report No. PO99-6-002)

We are providing this report for information and use. We considered management comments on a draft of this report in preparing the final report.

Management comments on the draft of this report conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Ms. Barbara E. Smolenyak at (703) 604-8760 (DSN 664-8760) (bsmolenyak@dodig.osd.mil) or Mr. Martin T. Heacock at (703) 604-8756 (DSN 664-8756) (mheacock@dodig.osd.mil). The evaluation team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. PO99-6-002 **March 23, 1999**
(Project No. 7OA-1005)

Evaluation of the Department of the Army Internal Review Organizations

Executive Summary

Introduction. The Department of the Army is the only Military Department that maintains a central internal audit agency, the U.S. Army Audit Agency, and a separate internal review organization, the Army Internal Review. The Army Internal Review organizations* provide a full range of services to the Department of the Army commands, installations, and activities, including full-scope internal audits, quick response audits, consulting services, and liaison services. The Army Internal Review organizations also perform followup on General Accounting Office; Inspector General, DoD; and U.S. Army Audit Agency audits which involve Army commands. As of March 31, 1998, the Army Internal Review program employed approximately 500 auditors located at 172 Army Internal Review offices. The Army Internal Review reported FY 1997 operating costs of $30.5 million and operating costs for the first half of FY 1998 of $14.8 million.

Objectives. The evaluation objectives were to determine whether the Army Internal Review organizations effectively use their resources and have an adequate planning process for audits and whether the Army Internal Review staffing levels are commensurate with audit organizations in other Military Departments.

Results. During FY 1997, the Army Internal Review organizations expended 38 percent of their direct time performing audits and the remaining 62 percent of their direct time on non-audit work (consulting, liaison, and followup). During this period, the Army Internal Review organizations completed 2,638 reviews and reported $341.8 million in potential monetary benefits. These results reflect a continued pattern of improvement in the Army Internal Review operations resulting from reengineering and performance measures implemented by the Office of the Assistant Secretary of the Army (Financial Management and Comptroller) beginning in FY 1994. The intent of the reengineering was to make the Army Internal Review more responsive to Army commanders. Overall, the Army Internal Review organizations reviewed are being used effectively. However, the Army Internal Review program could be further enhanced.

- Improvements could be made in the areas of compliance with generally accepted government auditing standards and regulations, followup, supervisory reviews, and quality assurance programs (finding A).

---

*Our review focused on all the Army Internal Review organizations except for the Corps of Engineers and the National Guard Bureau. The Inspector General, DoD, performed quality assurance reviews on these organizations in FY 1992 and FY 1993, respectively. Therefore, the term Army Internal Review in this report excludes reference to the Corps of Engineers and the National Guard Bureau Internal Review organizations.

- The Army Internal Review offices visited did not consistently prepare the required annual audit plans, define or support the basis for selection of the planned reviews, and reconcile or justify major deviations of the planned work to the actual work accomplished. Lack of an effective planning process, to include the preparation of dynamic and flexible annual plans, could result in the ineffective and inefficient use of Army Internal Review resources (finding B).

The combined staffing level of the Department of the Army audit organizations is closest in comparison to the staffing level of the Air Force Audit Agency. However, differences in the organizational structures, number of installations served, and workload mix affect the comparison of Army Internal Review to other military department audit organizations. In comparing the staffing levels of the Department of the Army audit organizations and the Air Force Audit Agency, there was no evidence to support that the staffing levels are not commensurate (Appendix C).

Summary of Recommendations. We recommend the Assistant Secretary of the Army (Financial Management and Comptroller) ensure that the Army Internal Review complies with continuing professional education requirements, improves supervision provided, conducts adequate internal quality assurance reviews, implements more explicit performance plans for supervisory personnel, and updates its planning guidance. We also recommend the Auditor General, Department of the Army conduct an external quality control review of the Army Internal Review program within 1 year from the date of this report, and at a minimum, every 3 years thereafter.

Management Comments. The Assistant Secretary of the Army (ASA) (Financial Management and Comptroller) (FM&C) and the Auditor General, Department of the Army, concurred with the recommendations. The ASA FM&C stated that they will emphasize the need for all Internal Review auditors to comply with continuing professional education requirements, the need for external quality assurance reviews, and identify key elements of supervisory performance plans. The ASA FM&C also will update Army Regulation 11-7 to address the appropriate level of supervision and to incorporate new review planning guidance. The Auditor General concurred that an external review of the Army Internal Review needs to be done at least every 3 years. In reference to performing a review within 1 year from the date of this report, the Auditor General concurred but noted that the 1 year time frame may not give the Army Internal Review sufficient time to implement corrective actions recommended in this report. See the report findings for a summary of management comments and the management comments section of the report for the complete text of management comments.

Table of Contents

Executive Summary i

Introduction

Background 1
Objectives 2

Findings

A. Army Internal Review Effectiveness and Compliance with Standards 3
B. Army Internal Review Planning Process 12

Appendixes

A. Evaluation Process
Scope and Methodology 14
B. Summary of Prior Coverage 15
C. Other Matters of Interest 16
D. Army Internal Review Initiatives 19

Management Comments

Department of the Army Comments 21

Background

Internal Review Organizations. The DoD Directive 7600.2, "Audit Policies," February 2, 1991, states that the DoD components may establish internal review (IR) organizations to provide local commanders with an internal audit capability to resolve known or suspected problem areas and operational deficiencies and to supplement the audit services provided by the cognizant internal audit organization. Those IR organizations are considered to be audit organizations and are expected to comply with appropriate auditing standards. According to DoD Directive 7600.2, the IR organizations may also be used to perform liaison services and audit followup. The Department of the Army maintains a central internal audit agency, the U.S. Army Audit Agency (AAA), and an IR organization, the Army IR.

The Army Regulation (AR) 36-5, "Auditing Service in the Department of the Army," December 16, 1991, further explains the role of Army IR offices. This regulation states that the Army IR offices will provide an internal audit capability and perform audits in accordance with generally accepted government auditing standards (GAGAS), issued by the Comptroller General of the United States, and audit policies prescribed by the Auditor General, Department of the Army. The Army IR mission is to support the Department of the Army by providing objective, reliable, and timely information to decision makers. The Army IR personnel perform internal audits of mission and support operations within the command; evaluate internal controls, operating performance, and compliance with legal and regulatory requirements; and implement directives from higher authority that relate to Army IR policies. The Army IR organizations are staffed with auditors and are funded at the command level as part of the commanders' operating budget. The Army IR personnel report directly to the commanders, principal deputy commanders, or chiefs of staff, and are responsive to command requests and concerns.

Oversight Responsibility. The Office of the Assistant Secretary of the Army (Financial Management and Comptroller) [ASA (FM&C)] has overall responsibility for the Army IR program. The Office of the Director, Internal Review and Management Control (Army IR headquarters), within the Office of the ASA (FM&C), is responsible for coordinating and directing all Army IR activities, to include developing Army IR policy, monitoring the execution of the Army IR program at the major Army commands (MACOMs), and overseeing the Army IR auditors' training program. The Auditor General, Department of the Army is responsible for establishing audit policy and prescribing training for all Department of the Army auditors and periodically evaluating the effectiveness of the Army IR program.

Objectives

The evaluation objectives were to determine whether the Army IR organizations effectively use their resources and have an adequate planning process for audits and whether the Army IR staffing levels are commensurate with audit organizations in other Military Departments. Refer to Appendix A for a discussion of the evaluation scope and methodology and Appendix B for the related prior coverage.

A. Army Internal Review Effectiveness and Compliance with Standards

During FY 1997, the Army IR organizations expended 38 percent of their direct time performing audits and the remaining 62 percent of their direct time on non-audit work (consulting, liaison, and followup). During this period, the organizations completed 2,638 reviews and reported $341.8 million in potential savings. Customer satisfaction surveys for FY 1997 and FY 1998 showed approval ratings of 4.19 and 4.35, respectively, out of a possible score of 5.0. These results reflect a continued pattern of improvement in the Army IR operations resulting from reengineering and performance measures implemented by the Office of the ASA (FM&C) beginning in FY 1994. Overall, the Army IR organizations reviewed are being used effectively; however, improvements could be made in the areas of compliance with GAGAS and regulations, followup, supervisory reviews, and quality assurance programs.

Reengineering Efforts and Performance Measurements

Reengineering Efforts. During FY 1994, the Office of the ASA (FM&C) conducted a utilization assessment in response to Army IR downsizing. As a result of this assessment, the ASA (FM&C) directed a number of changes to enhance the performance of the Army IR function and to cope with declining budgets, staffing reductions, and changing needs of Army IR customers. Some of the important changes included the development of an Army IR strategic plan; the use of steering committees and process improvement teams; and the performance of more quick response audits and consulting reviews and fewer time-consuming, full-scope internal audits.

Performance Measurements. As part of its continuing reengineering efforts, the Office of the ASA (FM&C) also developed the Army IR Performance Measures Guide (the Guide), effective September 8, 1997 The Guide was a result of the efforts of a process action team composed of members of the Army IR community as well as Army IR customers. The Guide was designed for use at the Army, MACOM, and individual office levels, to assess Army IR performance and to facilitate benchmarking within the Army IR community. According to the Guide, the Army IR performance measurements include return on investment; auditor productivity; customer satisfaction; and effective use of Army IR.

Based on the Army IR headquarters' data and the results of the FYs 1997 and 1998 customer satisfaction surveys, the Army IR organizations significantly improved their effectiveness since FY 1994. Specific improvements included the following.

- Return on investment is more than eight times pre-reengineering levels.
- Total number of Army IR reviews increased significantly from the FY 1993 level. In FY 1993, 760 Army IR auditors completed 1,712 reviews. In FY 1997, 484 auditors completed 2,638 reviews.
- Direct days per Army IR project decreased from the FY 1993 measurement of 51 direct days per project to 21 direct days per project for FY 1997.
- The customer satisfaction survey results for the first quarter of FY 1998 showed an increased overall customer satisfaction ratio of 4.35 out of a possible score of 5.0 (up from 4.19 in FY 1997).

In addition, as of June 1998, Army IR headquarters initiated several new reengineering efforts, including new process improvement teams for audit time reporting; consulting and advisory services; Army IR access to information; and outsourcing internal audits (Appendix D). Also, the Director, Financial Reporting and Internal Review, highlighted additional priorities for the coming year including auditor training, the need for additional reengineering initiatives, and relations with the AAA.

Compliance with GAGAS and Regulations

Professional Proficiency. According to GAGAS, the staff assigned to conduct audits should collectively possess adequate professional proficiency for the tasks required. The audit organizations should have a program to ensure that their auditors maintain professional proficiency through continuing education and training. The AR 11-7, "Internal Review and Audit Compliance Program," July 16, 1989, requires that the Army IR staff be composed of professionally qualified auditors in the Federal employee General Schedule 511 series and follow GAGAS. In addition, the Auditor General, Department of the Army is required to prescribe the technical audit training for Army IR auditors. The AR 11-7 also states that commanders should encourage active participation in the training programs sponsored by the Auditor General, Department of the Army and other sources and actively support assigned personnel by programming and budgeting training costs. The Army IR office chiefs are responsible for ensuring

that each auditor receives professional audit training each year. Proper training of Army IR personnel is essential to maintaining the skills and knowledge required in the auditing profession.

At four of the Army IR offices visited, 10 of the 67 auditors did not have the required continuing professional education training hours. For example, at one of the Army IR offices with two auditors, neither of the auditors had met the professional education training requirements for the past 2 years. At another Army IR office, only one of the six auditors met the prescribed training requirement. The Army IR personnel stated that they did not comply with the GAGAS and AR training requirements because of inadequate locally available audit-related training courses and insufficient funds included in the local Army IR office budget for travel to training courses. Because Army IR auditors have not complied with the continuing professional education requirements, there is no assurance that the quality of some of the review work performed meets GAGAS.

Performance of Audit Work. The GAGAS include the following standards for audit work.

- Audits should be adequately planned. In addition, auditors should prepare a written audit program for each audit, with suggested audit steps and procedures to answer audit objectives.
- Audit staff are to be properly supervised.
- Auditors should gather sufficient, competent, and relevant evidence to support their conclusions and document their work in working papers.
- Auditors should prepare written reports communicating the results of each audit. Auditors should report the audit objectives, scope, and methodology. Auditors should also report that the audit was made in accordance with GAGAS.

In addition, AR 11-7 states that each audit is normally preceded by a survey phase, an audit guide is normally developed to help achieve an organized approach, and Army IR office chiefs will ensure that audit reports and working papers comply with GAGAS.

For the 46 audit projects reviewed, 43 of the projects contained 133 working paper deficiencies, and 27 of the projects contained 53 reporting deficiencies when compared to the GAGAS and AR 11-7 documentation and reporting requirements. For example, the working papers for 8 audit projects contained no evidence of planning prior to the performance of the audit work, to include performing audit surveys; auditors did not prepare adequate audit programs for 15 audit projects; and working papers did not adequately support conclusions for 10 of the Army IR audit projects. In addition, 16 of the audit reports reviewed did

not cite adherence to GAGAS or qualify when GAGAS were not complied with; 11 audit reports did not adequately identify the scope and methodology for the work performed; and 6 reports did not identify the causes for the conditions identified.

Performance of Consulting Reviews. The GAGAS state that auditors may perform services other than audits and that the head of an audit organization may wish to establish policies applying standards to its employees performing non-audit work. The Army IR headquarters issued two memorandums, on December 21, 1995, and May 2, 1996, providing guidance for the performance and documentation of consulting and advisory services. The December 21, 1995, memorandum defines consulting and advisory services as services provided to the command that are not financial or performance audits. According to the Army IR guidance, as a minimum, the Army IR auditors performing a consulting service, will document the following:

- understanding with the command as related to the auditor's responsibilities, to include the review objectives, the responsibilities of the auditor and command personnel, and the review limitations;
- work methodology and data analyzed;
- communications with command personnel;
- time sheets that identify the names of the auditors and the number of hours worked;
- supervisory reviews; and
- results of the consulting service engagement, to include a qualification statement citing the extent to which the auditor complied with GAGAS during the performance of the consulting review.

Of the 26 consulting projects reviewed, 23 contained 72 deficiencies relating to working paper documentation and 19 contained 39 reporting-related deficiencies when compared to the Army IR guidance. For example, auditors did not adequately document in the working papers the understanding with the command personnel for 17 of the 26 consulting projects; 2 consulting projects did not have working papers to support the auditors' conclusions; 6 consulting projects' working papers did not include time sheets identifying the names of the auditors and the number of hours worked; and 17 final products did not include the required GAGAS qualification statement.

Followup Systems. According to DoD Directive 7650.3, "Follow-up on General Accounting Office, DoD Inspector General, and Internal Audit Reports," September 5, 1989, followup is a responsibility shared by DoD managers and

oversight personnel. Followup is the collective effort made to ensure that prompt, effective, and coordinated corrective action is taken to implement recommendations and that controls are adequate to prevent the recurrence of deficiencies. According to AR 11-7, the primary objective of the audit followup process is to determine whether agreed-on audit findings and recommendations have been translated into management actions that will correct identified problems. The AAA monitors until implemented its recommendations and associated estimates of potential monetary benefits that have been agreed to by the AAA and the Department of the Army personnel responsible for implementing the recommendations. According to AR 36-2, "Audit Reports and Follow-up," April 26, 1991, at Army field activities, this followup function is performed by the local Army IR office. Within the past 5 years, AAA performed reviews of the followup systems at certain Army IR offices (Appendix B).

Six of the 12 Army IR offices visited did not have adequate systems to track the status of or perform timely followup on external or internal audit recommendations as required by DoD Directive 7650.3 and AR 11-7. However, the Army IR headquarters, in coordination with the AAA, implemented an electronic submission of information for the semiannual followup status reports using the Army IR Internet web page. The electronic submission should provide visibility to those report recommendations requiring followup actions. This new reporting system, designed to streamline the Army IR offices' reporting, improve the accuracy of the reports submitted, reduce report preparation time, and improve the MACOM IR offices' oversight of subordinate Army IR offices required reporting, was made available to the Army IR offices during November 1998. As a result of this initiative, we are not making a recommendation related to followup systems at this time.

Supervisory Reviews and Quality Assurance Programs

The deficiencies in auditor training, working paper and reporting documentation, and followup, resulted in part from the lack of adequate supervision and an ineffective quality assurance program. The Army IR office chiefs are not ensuring that auditors are receiving the required training and are not consistently implementing the Army IR quality assurance program to ensure that the Army IR products meet GAGAS, DoD regulations, and Army regulations.

Supervisory Reviews. The GAGAS state that supervision involves directing the efforts of auditors who are involved in the audit to determine whether the objectives are being accomplished. Elements of supervision include instructing staff members, keeping informed of significant problems encountered, reviewing the work performed, and providing effective on-the-job training. However, for 34 of the 46 audit projects reviewed and 9 of the 26 consulting projects reviewed, the working papers did not contain evidence supporting supervision of the Army IR

auditors during the review or during preparation of the report. Army IR office chiefs did not complete quality control reviews to verify the accuracy for 39 of the 46 audit products and 22 of the 26 consulting projects. The management and staff at the Army IR offices stated that the reduced staffing levels (four of the Army IR offices visited were staffed with only one or two auditors) make it increasingly difficult for the Army IR personnel to adequately perform some of their functions, including documenting supervisory reviews or quality control reviews performed on supporting working papers and final Army IR products.

Quality Assurance Programs. The GAGAS require that each audit organization conducting audits should have an appropriate internal quality control system in place and should undergo an external quality control review. The Army IR headquarters issued a memorandum, dated April 8, 1997, which required that audit reports be qualified if the IR office was not in compliance with the GAGAS quality control review requirements.

Quality Assurance Guide. The Army IR headquarters issued a policy memorandum implementing a revised Quality Assurance Guide on September 3, 1997. The Quality Assurance Guide clarified the Army IR internal quality control system and instructed all Army IR offices to use the Quality Assurance Guide during the performance of internal quality assurance reviews. The policy memorandum states that with the exception of reviews scheduled by the Inspector General, DoD, or the AAA, the MACOM IR office chiefs have the final approval authority for determining who conducts the internal quality assurance reviews on subordinate offices. The memorandum also instructed the chiefs at MACOM IR offices to ensure that quality assurance reviews had been performed at all subordinate offices within the 3-year period ending December 31, 1997. The Quality Assurance Guide does not include instructions for the performance of internal quality assurance reviews on MACOM IR offices. However, according to Army IR headquarters, the MACOM IR office chiefs may arrange to have auditors from other MACOM IR offices perform the required reviews.

Timeliness of Quality Assurance Reviews. As of December 31, 1997, of the 12 Army IR offices in our sample, 2 MACOM IR offices and 5 installation IR offices had not had a quality assurance review of their office during the last 3 years. Two of these five installation IR offices, the U.S. Army Aviation and Missile Command IR office and the Fort Bragg IR office, had not obtained a quality assurance review in approximately 10 years. However, the seven IR offices did not qualify their audit products to indicate the noncompliance with the GAGAS quality control review requirements. Not obtaining a quality assurance review within the 3-year period increases the risk that the quality of the audit work produced will not be acceptable.

Performance of Quality Assurance Reviews. We also evaluated the adequacy of the performance of quality assurance reviews. At two of the IR offices, we found that the auditors, using the Quality Assurance Guide, did not

prepare working papers to support the quality assurance ratings assigned and did not identify the projects reviewed. According to the IR office chiefs at these two offices, the deficiencies were caused by the lack of auditor training in the performance of internal quality assurance reviews and the lack of instructions provided with the Quality Assurance Guide. Also at another IR office, we reviewed the quality assurance report issued by its MACOM IR office and the audit project used to assign the quality assurance rating. The results of our evaluation of the audit working papers and the MACOM IR office's reported results differed significantly. The MACOM IR office's quality assurance report identified only nonmaterial deficiencies. However, the audit working papers and audit report were materially deficient and did not comply with GAGAS. For example, there was no audit program, and the audit working papers did not include source, purpose, scope, and conclusions. In addition, there was no evidence of supervisory review of the working paper files. When we discussed the differences between the reported results and our results with the MACOM IR office chief, he stated that it was more important that the audit report was useful and important to the command. However, a quality assurance program that does not emphasize accuracy in reporting and documenting quality assurance review results would provide little benefit to the Army IR management.

External Reviews. The AAA is responsible for conducting the external quality control reviews of the Army IR organizations. The reviews are performed to ensure that GAGAS are met, audit quality is kept at a high level, and adequate management controls are applied to the audit process. The AAA had not conducted an overall external quality control review of the Army IR program since 1990. According to AAA personnel, the AAA planned to perform reviews of Army IR in FY 1994 and FY 1997. However, AAA personnel stated that AAA cancelled these reviews because of the Army IR reengineering efforts and a planned Inspector General, DoD, evaluation review of Army IR, respectively. The Inspector General, DoD, conducted external quality control reviews of the Corps of Engineers and the National Guard Bureau Army IR organizations in FYs 1992 and 1993, respectively. During its last review, the AAA identified deficiencies similar to some of the deficiencies identified in this evaluation report. The AAA Advisory Report No. EU 91-A1, "Internal Review Functions," January 21, 1991, cited the following systemic problems identified during audits of the Army IR function.

- Audit staffs did not document audit plans in their audit programs.
- Audit staffs did not receive enough guidance and supervision to make sure they did audits properly.
- Working papers that linked fieldwork to audit reports did not contain required data and often were not adequately cross-referenced.
- IR offices often did not report audit results consistent with GAGAS.

Summary

Recognizing the current DoD environment of downsizing and funding constraints, the Army IR has reengineered its operations to use its resources more effectively. The results of the reengineering efforts have been favorable as evidenced by reported increases in productivity and improved customer satisfaction ratings. In addition, the Army IR headquarters issued appropriate guidance as necessary. However, as evidenced by our evaluation results, the IR offices' compliance with applicable regulations and Army IR guidance needs improvement. Otherwise, Army IR audit products issued will have to be qualified to the point where their credibility becomes questionable. Increased compliance with applicable requirements pertaining to continuing professional education and working paper and reporting documentation could enhance the effectiveness of Army IR. Increased emphasis on supervision and the quality assurance program will help to ensure that the Army IR issues reliable products that are supported by sufficient, competent, and relevant documentation. Compliance with applicable requirements and guidance for performing audit and non-audit work should improve the quality and, therefore, the effectiveness of Army IR.

Recommendations and Management Comments

A. We recommend the Assistant Secretary of the Army (Financial Management and Comptroller) ensure that:

1. Army Internal Review auditors comply with the continuing professional education training requirements.

Management Comments. The Army concurred stating that a memorandum stressing the need for all Internal Review auditors to comply with continuing professional education requirements will be published by April 15, 1999. [1]

2. Army Internal Review office chiefs provide additional supervision and attention to the Internal Review personnel to ensure the quality of the products issued. The additional supervision and attention should include documenting of supervisory reviews of working papers for audits and consulting projects and completion of quality control reviews for final products in accordance with generally accepted government auditing standards and Army guidance.

[1] Army Management's response to the recommendations stated that the memoranda to be issued in reference to Recommendations 1, 3, and 4 would be published by March 15, 1999. However, in subsequent discussions with Army Management they requested that time be extended to April 15, 1999.

Management Comments. The Army concurred stating that a guide for determining the level of supervisory review of Internal Review engagements will be incorporated into Army Regulation 11-7 within 1 year. The new guidance will be in accordance with Government Auditing Standards.

3. Internal quality assurance reviews are conducted in accordance with Army Internal Review guidance.

Management Comments. The Army concurred stating that a memorandum stressing the need for Army Major Commands to ensure all subordinate Internal Review offices receive an external quality assurance review at least every 3 years will be issued by April 15, 1999.

4. Performance plans of Army Internal Review supervisory personnel explicitly include performance elements related to recommendations A.1., A.2., and A.3.

Management Comments. The Army concurred stating that a memorandum identifying key elements of supervisory performance plans for Internal Review personnel will be published by April 15, 1999.

A.5. We recommend that the Auditor General, Department of the Army conduct an external quality control review of the Army Internal Review program within 1 year from the date of this report, and a minimum of every 3 years thereafter.

Management Comments. The Auditor General concurred and expressed concern that the 1 year time frame would not allow sufficient time for Army Internal Review to fully implement corrective actions for all recommendations addressed to them. However, in subsequent discussions the Auditor General's staff stated that an external quality control review will be performed within 1 year of the date of this report and subsequent reviews at a minimum of every 3 years.

B. Army Internal Review Planning Process

The Army IR offices visited did not consistently prepare the required annual audit plans, define or support the basis for selection of the planned reviews, and reconcile or justify major deviations of the planned work to the actual work accomplished. The noncompliance occurred because Army IR office chiefs believed that annual plans are often invalid soon after they are developed due to limited audit resources and the emphasis on command-requested quick response audits and consulting reviews. As a result, the IR office chiefs did not place a high priority on the preparation of complete and accurate annual audit plans. Lack of an effective planning process, to include the preparation of dynamic and flexible annual plans, could result in the ineffective and inefficient use of Army IR resources.

Annual Audit Plan

Plan Requirement. The AR 11-7 requires all Army IR offices to prepare an annual plan containing the workload scheduled to be performed during a specific calendar year and to submit the plan to its next higher headquarters. The plan should ensure that auditor resources are used effectively and efficiently; coverage of high risk, high payback mission areas is maximized; and adequate coverage is provided to all functional elements with known or suspected problems. However, the current AR 11-7 was developed before electronic information exchange and Internet access to data became popular alternatives to meeting publishing requirements. Therefore, the Army needs to update its current guidance on the Army IR planning process and consider more recent dynamic, flexible, and real-time alternatives.

Plan Preparation. Seven of the 12 Army IR offices visited did not prepare annual audit plans as required. For example, one Army IR office had not developed an annual audit plan prior to 1998, and one Army IR office did not develop an annual audit plan for 1997. When the seven Army IR offices did develop plans, they prepared annual plans several months after the start of their planning year. These deficiencies occurred because Army IR management did not place a high priority on the timely preparation of annual audit plans.

Documentation. According to the AR 11-7, the annual plans should provide the specific reasons for selecting the area for audit and all available staff days should be programmed. In addition, the Army IR headquarters issued an Army IR Planning Guide, effective August 1997, recommending that annual audit plans

include information as to the type, priority, and objectives for each proposed review. At 3 of the 12 Army IR offices visited, however, the annual audit plans did not specify the basis for the selection of the proposed reviews. At two other IR offices, the annual plans did not account for all available staff days. Furthermore, at six Army IR offices, the annual audit plans did not prioritize the work to be accomplished for the year. The Army IR management stated that the review work they perform was based on the needs of the local commanders, so the commanders dictate the Army IR work priority.

Submission. The AR 11-7 states that the major Army commanders and their subordinate commanders will evaluate the effectiveness of their Army IR elements to include the annual Army IR audit plan. The regulation further states that copies of the approved annual plan will be submitted to the next higher headquarters. For example, the installation IR offices should submit annual audit plans to their MACOM IR offices and the MACOM IR offices should submit their annual audit plans to Army IR headquarters. Three of the 12 offices did not comply with this requirement. The chief at one of the MACOM IR offices stated that he did not require his subordinate installation Army IR offices to provide annual audit plans because the plans would be obsolete by the time he received them and would just be filed.

Recommendation and Management Comments

B. We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) update the Army Regulation 11-7, "Internal Review and Audit Compliance Program," July 16, 1989, to provide for a more dynamic and flexible planning process.

Management Comments. The Army concurred stating that Army Regulation 11-7 will be revised within 1 year to include a dynamic and more flexible approach to Internal Review planning.

Appendix A. Evaluation Process

Scope and Methodology

Work Performed. We performed evaluation work at Army IR headquarters; four MACOM IR offices, and eight installation-level Army IR offices. We did not include the Corps of Engineers or the National Guard Bureau Army IR organizations in our evaluation. We reviewed FYs 1996 through 1998 Semiannual Reports to the Congress, FYs 1996 through 1998 semiannual followup status reports, and documentation supporting the annual planning process. In addition, we reviewed organizational structure and operating statistics for the Military Departments' audit organizations. We also analyzed Army IR personnel training records, working papers and related reporting documentation for 29 full scope audits, 11 followup audits, 6 quick response audits, and 26 consulting reviews. Although we believe the evaluation results accurately represent Army IR operations, they are not projectable.

Interviews. We interviewed personnel from the Office of the ASA (FM&C), Army IR headquarters, Army IR offices, AAA, NAS, and AFAA.

Computer-Processed Data. We used Army IR headquarters' computer-processed data applicable to the Army IR reengineering efforts and performance statistics. We did not test the validity of the performance data.

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

Evaluation Period and Scope. We performed this evaluation from August 1997 through October 1998. The scope of the evaluation was limited in that we did not review the Army IR management control program.

Appendix B. Summary of Prior Coverage

During the last 5 years, AAA performed four reviews related to the Army IR program.

AAA Report No. AA 96-F3, "Headquarters' Internal Review Audit Follow-up System Review," May 20, 1996.

AAA Report No. AA 96-F2, "Follow-up System Review," April 30, 1996.

AAA Report No. AA 96-F1, "Headquarters' Internal Review and Audit Compliance Follow-up System Review," December 19, 1995.

AAA Report No. HQ 95-F2, "FY 94 Audit Followup System Assessment U.S. Army Forces Command," January 12, 1995.

AAA Report No. HQ 95-F1, "FY 94 Audit Followup Review Office of the Deputy Chief of Staff for Operations and Plans," December 6, 1994.

AAA Report No. HQ 95-C2, "Internal Review and Audit Compliance Program, U.S. Army Criminal Investigation Command," December 6, 1994.

AAA Report No. HQ 94-C7, "FY 94 Audit Followup Review U.S. Army Materiel Command," September 12, 1994.

Appendix C. Other Matters of Interest

Organizational Structures and Staffing Levels

According to DoD Directive 7600.2, the establishment of IR organizations is at the discretion of each Military Department Secretary. The Department of the Army maintains a central internal audit agency, the AAA, and a separate IR organization, the Army IR. The Departments of the Navy and the Air Force also have internal audit agencies, the Naval Audit Service (NAS), and the Air Force Audit Agency (AFAA), but currently do not also have separate IR organizations. See the following table that shows staffing level factors and operating statistics reviewed.

Organizational Structures and Locations. The structure of the Army IR organizations is unlike the organizational structures of the other Military Department audit organizations. Specifically, the AAA, the NAS, and the AFAA are centralized internal audit organizations directly responsible to the respective Military Department auditors general. The ASA (FM&C) has overall policy responsibility for the Army IR program, but the Army IR organizations are decentralized with over 170 IR offices. The Army IR auditors work directly for the commanders, principal deputy commanders, or chiefs of staff. In addition, commanders retain the approval authority for the IR office chiefs' performance appraisals.

Staffing Levels. The Army IR is unique in that it is the only Military Department internal review organization. Therefore, to determine whether staffing levels were comparable, we combined the staffing level figures for the Department of the Army audit organizations, Army IR, and AAA. The combined staffing levels of the AAA and the Army IR are generally comparable to the staffing levels of the AFAA, but not comparable to the NAS. According to the FY 1997 Semiannual Reports to the Congress, the Department of the Army audit organizations were staffed with 1,016 auditors (484 Army IR auditors and 532 AAA auditors); the Naval Audit Service was staffed with 491 auditors; and the AFAA was staffed with 822 auditors. The Department of the Army has more than 170 installations and activities, the Department of the Navy has approximately 106 installations and activities, and the Department of the Air Force has approximately 90 installations.

The Department of the Navy disestablished its IR program in April 1989, at which time there were about 530 IR auditors. The Secretary of the Navy Instruction 7510.9, "Command Management Economy, Efficiency and Review," April 13, 1989, cancelled the Navy IR program and replaced it with a command evaluation function staffed with non-auditors. The command evaluation program

is similar to the Army IR in that the resources are the commanders, and review results are distributed only to the responsible commander. But the command evaluation program is dissimilar to the Army IR because the command evaluators are not classified as Federal employee General Schedule series 511 auditors and are not required to comply with GAGAS. The Department of the Navy does not track that number of command evaluation personnel.

The Department of the Air Force does not maintain a separate IR organization. The AFAA performs command-level internal review services through its Commander's Audit Program and Management Advisory Services. With the Commander's Audit Program, commanders may request an AFAA audit to address a particular area of concern. The review results are usually only reported to the requesting commander. With Management Advisory Services, the AFAA auditors offer consulting services and usually present review results in an oral briefing or summary memorandum.

Workload Mix

Audit work accounted for about 38 percent of the direct staff days for the Army IR organizations. For FY 1997, audit work accounted for 88 percent, 92 percent, and 95 percent of the direct staff days for the AAA, NAS, and the AFAA, respectively.

Non-audit work (consulting services) accounted for 12 percent, 9 percent, and 5 percent of the direct staff days for the AAA, NAS, and the AFAA, respectively. On the other hand, non-audit work that includes consulting services, liaison, and followup, accounted for 62 percent of the direct staff days for the Army IR. The calculation for direct staff days for Army IR is based on a reported 21 direct staff days for FY 1997 times Army IR products issued. Although non-audit type work appears to be increasing within DoD, the NAS and the AFAA have established limits on the amount of consulting services they provide. For example, the AFAA set a limit of 15 percent of its auditors' time to be spent on providing consulting services.

Staffing Level Factors				
Factors	Army IR	AAA	NAS	AFAA
Organizational structure	Decentralized	Centralized	Centralized	Centralized
Responsible to	Local commanders	Auditor General	Auditor General	Auditor General
Mission statements	Similar	Similar	Similar	Similar
Number of installations	170	170	106	90
Number of audit offices	172	24	19	52
Total 1997 audit personnel	484	532	491	822
FY 1997 direct staff days:				
Audit	20,995 (38%)	78,847 (88%)	75,742 (92%)	117,609 (95%)
Non-audit	34,667 (62%)	11,139 (12%)	6,591 (8%)	6,170 (5%)
Total direct staff days	**55,662**	**89,986**	**82,333**	**123,779**
Services provided:				
Audits	X	X	X	X
Consulting reviews	X	X	X	X
FY 1997 operating costs (millions):				
Personnel	$28.93	$43.63	$40.98	$58.28
Travel	.98	4.74	1.89	3.74
Other	.64	2.96	3.10	2.26
Total FY 1997 operating costs (millions)	**$30.55**	**$51.33**	**$45.97**	**$64.28**

Appendix D. Army Internal Review Initiatives

Performance Measurements

The Army IR headquarters designed an Army IR Performance Measures Guide, effective September 8, 1997. The Guide, which provides the Army IR performance measurements, goals, and strategic plan for achieving Army IR goals, was designed for use at IR offices to assess IR performance. The Army IR measures its performance based on such factors as return on investment, auditor productivity, effective use of Army IR, and customer satisfaction.

Process Improvement Teams

During our evaluation, the Army IR headquarters initiated several process improvement teams to improve certain areas within the Army IR program. The following is a list of some of the on-going process improvement teams and their respective objectives.

Audit Time Reporting. The mission of the process improvement team, established on June 1, 1998, is to develop Army IR policies and guidance for calculating and reporting audit time. The process improvement team results are scheduled to be completed by June 30, 1999.

Consulting and Advisory Services. The mission of the process improvement team, established on June 11, 1998, is to produce an easy to use reference that will guide Army IR auditors in the performance of highly effective consulting and advisory services that serve the needs of their customers and meet applicable professional standards. The process improvement team was chartered to complete the following objectives by March 31, 1999:

- validate the current Army IR guidance on consulting and advisory services to ensure that it represents the most current body of knowledge and that lessons learned have been incorporated;
- develop revised guidance as necessary; and
- ensure that current and proposed guidance meets professional standards and agency policy.

Army IR Access to Information. The mission of the process improvement team, established June 15, 1998, is to develop Army IR guidance on access to

information during the performance of full-scope audits, quick response audits, consulting services, and followup reviews. The process improvement team was chartered to complete the following objectives by June 30, 1999:

- research existing policies and guidance granting access to agency or activity information;
- develop Army IR policy to cover the granting of access to records, files, documents, and databases when conducting Army IR services; and
- research computer software systems for data retrieval capabilities.

Outsourcing Internal Audit. The mission of the process improvement team, established on June 2, 1998, is to develop policies and guidelines governing the outsourcing of internal audit work within the Army. The process improvement team was chartered to complete the following objectives by September 30, 1999:

- develop and recommend Army policies for outsourcing local and command-wide audit work;
- develop guidance to assist local Army IR offices in defining work requirements and statements of work; and
- develop checklists to assist local Army IR offices in serving as contractor technical representatives in monitoring vendor compliance.

According to DoD Directive 7600.2, the Inspector General, DoD, is responsible for establishing the guidelines for determining when non-Federal auditors should be used and for taking appropriate steps to ensure that work performed by non-Federal auditors complies with GAGAS. The Army IR needs to comply with the requirement to obtain prior approval in outsourcing determinations.

Electronic Reporting

The Army IR headquarters implemented its new electronic reporting system during November 1998. The Army IR headquarters, in coordination with the AAA, developed a system to submit information for the semiannual reports to the Congress and semiannual followup status reports using the Internet. The Army IR headquarters' objectives in implementing this electronic reporting system was to streamline the Army IR reporting requirements; improve the accuracy of the submitted reports; reduce the time spent on preparing the semiannual reports, and improve the MACOM IR offices oversight of subordinate installation Army IR offices required reporting.

Department of the Army Comments

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109

REPLY TO ATTENTION OF

February 9, 1999

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDIT POLICY AND OVERSIGHT

SUBJECT: Evaluation Report on the Department of the Army Internal Review Organizations (Project No. 70A-1005)

We have reviewed your draft evaluation report of the Army Internal Review Organizations (Project 70A-1005) and offer the following comments:

FINDING A: While we concur with this finding, the statement that 62 percent of Army Internal Review's direct time was spent on non-audit work sounds somewhat misleading for it does not identify the fact that the work was a significant part of the assigned mission.

CORRECTIVE ACTIONS:

RECOMMENDATION A1: Concur A memorandum stressing the need for all Internal Review (IR) auditors to comply with continuing professional education (CPE) requirements will be published not later than March 15, 1999.

RECOMMENDATION A2: While we concur that supervisory review of IR work is necessary, the level of detail required is subjective. Government Auditing Standards understand this when they state in paragraph 3 32 "The nature and extent of an organization's internal quality control system depends on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its audit offices, the nature of its work, its organizational structure, and appropriate cost-benefit considerations. Thus, the systems established by individual organizations will vary, as will the extent of their documentation."

For full scope audits, where implications of wrongdoing or similar serious situations exist, it is imperative that a detailed supervisory/internal quality control review occur. However, for quick response audits and consulting engagements performed by an experienced auditor, a cursory review should be all that is required. It is more important for IR to use its time in direct support of command requirements. A guide for determining the level of supervisory review of IR engagements in keeping with Government Auditing Standards will be incorporated into AR 11-7 and published within one year.

Printed on Recycled Paper

RECOMMENDATION A4: Concur. A memorandum identifying key elements of supervisory performance plans for IR personnel will be published not later than March 15, 1999

RECOMMENDATION A3: Concur. A memorandum stressing the need for Army MACOMs to ensure all subordinate IR offices receive an external quality assurance review at not less than 3-year intervals will be published not later than March 15, 1999.

RECOMMENDATION A5: (From The Auditor General) Concur However, we believe the one year timeframe specified in Recommendation A5 may not allow a sufficient time interval for Army Internal Review to fully implement corrective actions for all the recommendations addressed to them.

FINDING B: This finding points out the lag time between changes in business practices and published guidance. The nature of modern internal auditing makes yearlong planning obsolete. IR offices are generally using most of their time responding to immediate need requests from the commander and staff. In fact, a sure means to identify a poorly performing IR office is to determine if they're on schedule with the annual plan If it is more than 30 days into the plan and they're still on track, they aren't being used for critical, time sensitive issues by the command.

RECOMMENDATION B: Concur The draft AR 11-7 will be revised to incorporate planning guidance developed by an IR Process Action Team in 1998. This guidance will foster a dynamic and flexible approach to IR planning Publication of a new AR 11-7 will take place within 1 year

We appreciate the opportunity to comment on your report. Should you have any questions, please contact Mrs. Karen K. Wolff, Director, Financial Reporting and Internal Review at (703) 695-2909

Ernest J. Gregory
Deputy Assistant Secretary of the Army
(Financial Operations)

CF:
The Auditor General

Evaluation Team Members

The Financial, Performance, and Single Audit Division, Office of the Deputy Assistant Inspector General for Audit Policy and Oversight, DoD, produced this report.

Donald E. Davis
Barbara E. Smolenyak
Martin T. Heacock
Shirley W. Willard