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United States General Accounting Office
Washington, DC 20548

December 20, 2001

The Honorable Carl Levin
Chairman
Committee on Armed Services
United States Senate

Subject: Inspectors General: Department of Defense IG Peer Reviews

Dear Mr. Chairman:

This letter and its enclosure respond to your request for information about the peer reviews of the Department of Defense Inspector General (DOD IG). A peer review, known as an external quality control review, is required by *Government Auditing Standards*¹ to be performed at least once every 3 years by an organization not affiliated with the organization being reviewed. The objective of a peer review is to determine whether the organization's internal quality control system is in place and operating effectively to provide reasonable assurance that established policies and procedures and applicable auditing standards are being followed.

As agreed with your staff, we are providing information about the results of the peer reviews of the DOD IG completed in 1997, 2000, and 2001 and our monitoring of the performance of the 2001 peer review as it was performed. In order to meet these objectives, we reviewed the peer review work papers and interviewed the IG peer review staff from the Environmental Protection Agency (EPA), the Department of the Treasury IG for Tax Administration (TIGTA), and the Department of Health and Human Services (HHS). We also reviewed the work papers from the DOD IG's own internal investigation regarding allegations that work papers for the 2000 peer review had been altered, and we interviewed DOD IG officials regarding the results of that investigation and the results of the peer reviews. To monitor the 2001 peer review, we met with the HHS IG peer review staff and discussed the additional peer review steps taken; attended key meetings between HHS IG and DOD IG officials; interviewed the HHS IG peer review staff on the results of their review; and reviewed the HHS IG peer review work papers. On November 16, 2001, we provided your staff with a briefing covering the above information. This letter transmits the materials used for that briefing.

¹ *Government Auditing Standards*, 1994 revision, as amended, was issued by the Comptroller General of the United States. IGs are required to follow these standards in their audit work.

The 1997 peer review of the DOD IG was performed by the EPA IG and resulted in a qualified opinion issued on December 10, 1997. The peer review report stated that the DOD IG's quality assurance system was inadequate and that the reviewed audits did not fully comply with *Government Auditing Standards*. For example, the EPA IG found that the DOD IG had not completed sufficient internal quality reviews; some audits lacked sufficiently documented supervision; audit programs were not always prepared; independent referencing of the facts in DOD IG reports was not always done; and summary information was not always cross-referenced to the work papers.

The 2000 peer review was performed by TIGTA and resulted in an unqualified opinion on August 9, 2000. While TIGTA noted a number of isolated problems, the peer review report stated that the DOD IG's quality assurance system provided reasonable assurance of compliance with auditing standards. However, after the 2000 peer review had been completed, the DOD IG, TIGTA, the Office of Management and Budget, the then Chairman of the Senate Armed Services Committee, and others, including representatives of the media, received serious allegations in a letter dated December 14, 2000, that questioned the integrity of the documentation that the DOD IG had provided to the TIGTA peer review staff. Subsequently, the DOD IG performed an internal investigation which was completed on February 14, 2001. The IG's internal investigation confirmed that work papers for one of the audits selected for peer review had been inappropriately altered and destroyed. The report concluded that these inappropriate actions violated *Government Auditing Standards*, internal DOD IG audit policies, and the expectations of the external peer review staff. Based on this information, TIGTA first withdrew the 2000 peer review opinion on March 15, 2001, and then issued a disclaimer of opinion on May 25, 2001, citing an inability to determine whether the substantiated allegations would materially affect the DOD IG's system of quality control.

As a consequence of these actions, the DOD IG did not meet the *Government Auditing Standards* requirement for obtaining a peer review at least once every 3 years. Beginning in early June 2001, the DOD IG began qualifying audit reports it issued to explain the lack of compliance with the peer review requirements set forth in *Government Auditing Standards*.

The DOD IG obtained the 2001 peer review from the HHS IG and received a qualified opinion on November 19, 2001. At the request of your staff, we monitored the performance of the 2001 peer review and the additional steps taken by the HHS IG staff in consideration of the DOD IG's past peer review results and the previous altering of work papers provided to the TIGTA peer review staff. These additional steps included obtaining the DOD IG work papers for the selected audits without providing any advance notification to the DOD IG staff about which audits had been selected; obtaining attestations from the DOD IG audit managers that the work papers under review had not been altered; issuing a questionnaire to DOD IG audit staff for information about audit quality; increasing the number of sampled audits for review; and increasing the emphasis on financial audits, which were the type of audit for which work papers had been altered for the TIGTA peer review. These additional steps by the HHS IG were sound and appropriate given the results of the previous peer review and the seriousness of the confirmed allegations.

Similar to the results in 1997, the 2001 peer review report stated that the DOD IG quality assurance system needs improvement and that audits were not always in compliance with *Government Auditing Standards*. For example, the DOD IG had not completed sufficient internal quality reviews; supervision was not always documented; audit plans were not always documented; work papers were not always completed; and the DOD IG auditors did not have sufficient independence on one audit. Consequently, the DOD IG received a qualified opinion.

The 2001 peer review recommended that the DOD IG implement a comprehensive corrective action plan, implement new policies and procedures, and schedule the next external quality control review in 2 years. The DOD IG's response to the peer review includes an action plan intended to address the weaknesses identified. Specifically, in accordance with the action plan, the DOD IG requires work paper documentation of audit planning; has established the Quality Management Council consisting of senior executive service-level audit personnel to monitor audit quality; requires evidence of supervision before referencing of the facts in a report can begin; and requires certification that the work papers are complete before the final report is issued. In addition, the DOD IG will study and adopt a best practice used by other audit organizations to ensure auditor independence. Under the peer review guidance used by the IGs the implemented results of this plan are to be reviewed during the next peer review, which the DOD IG has agreed will be completed within the next 2 years.

We obtained comments on a draft of this letter and the attached briefing slides from IG officials at DOD, EPA, TIGTA, and HHS, who all agreed with our presentation of the information. Our review was performed from June through November 2001, in accordance with generally accepted government auditing standards.

If you have any questions, please contact me at (202) 512-2600 or by e-mail at steinhoffj@gao.gov or Jeanette M. Franzel, Acting Director, at (202) 512-9471, or by e-mail at franzelj@gao.gov. Key contributors to this letter and the enclosure were Jackson Hufnagle, James Pittrizzi, and Clarence Whitt.

Sincerely yours,



Jeffrey C. Steinhoff
Managing Director
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Enclosure



Financial Management and Assurance Team

Inspectors General: Department of Defense IG Peer Review

Briefing for
The Honorable Carl Levin
Chairman
Committee on Armed Services
U.S. Senate



Introduction/Objectives

You requested us to provide information about the peer reviews of the DOD IG. As agreed with your staff, our objectives were to provide information about the following:

- peer review requirements and purpose
- 1997, 2000, and 2001 peer reviews of the DOD IG



Scope and Methodology

In order to meet our objectives we

- reviewed peer review work papers,
 - interviewed IG staff performing the peer reviews,
 - interviewed DOD IG staff regarding the peer review results,
 - reviewed work papers from DOD IG's internal investigation,
 - interviewed DOD IG staff regarding their internal investigation, and
 - monitored the performance of the 2001 peer review as it was performed.
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Scope and Methodology

We conducted our work from June through November 2001, in accordance with generally accepted government auditing standards.

We obtained comments on a draft set of these briefing slides from IG officials at DOD, EPA, TIGTA, and HHS, who agreed with our presentation of the information.



Peer Review Requirements and Purpose

- required by *Government Auditing Standards* at least once every 3 years
- performed by another federal audit organization
- purpose is to determine if the quality control system provides reasonable assurance that policies, procedures, and auditing standards are being followed



Peer Review Requirements and Purpose

Types of opinions possible for peer review:

- unqualified opinion
 - qualified opinion
 - adverse opinion
 - disclaimer of opinion
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1997 Peer Review of the DOD IG

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- Environmental Protection Agency (EPA) IG staff performed the peer review.
 - Qualified opinion was issued on December 10, 1997.



1997 Peer Review of the DOD IG

Peer review report stated that the DOD IG's quality assurance was inadequately designed and implemented. Weaknesses were found in the following areas:

- audit quality control
- supervision
- audit programs
- independent referencing
- cross-referencing of summaries



2000 Peer Review of the DOD IG

- Treasury Inspector General for Tax Administration (TIGTA) staff performed the peer review.
- Unqualified opinion was issued on August 9, 2000, however, TIGTA's management letter identified isolated problems.
- Allegation letter dated December 14, 2000, stated that work papers for an audit selected for peer review had been altered by DOD IG staff.



2000 Peer Review of the DOD IG

- DOD IG's internal investigation confirmed allegations on February 14, 2001, and found that DOD IG staff inappropriately altered and destroyed work papers for an audit selected for peer review.

- DOD IG staff inserted newly created work papers for an audit selected for peer review without the knowledge of the peer reviewers.



2000 Peer Review of the DOD IG

- TIGTA withdrew its unqualified opinion on March 15, 2001.
 - TIGTA issued a disclaimer of opinion on May 25, 2001.
 - DOD IG did not meet requirements for a peer review every 3 years as set forth in *Government Auditing Standards*.
 - DOD IG qualifies its own audit reports indicating the lack of compliance with peer review requirements.
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2001 Peer Review of the DOD IG

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- Performed by Department of Health and Human Services (HHS) IG staff.
 - Qualified opinion was issued on November 19, 2001.



2001 Peer Review of the DOD IG

Peer review report stated that the DOD IG's quality control policies and procedures were not always followed in the following areas:

- audit planning
- audit quality control
- supervision
- work papers

Also, auditor independence procedures were not appropriately designed.



2001 Peer Review of the DOD IG

HHS IG staff took the following additional steps in the 2001 peer review in consideration of the DOD IG's past peer review results:

- Work papers for selected audits were obtained without prior notice to the DOD IG staff.
- DOD IG managers attested that work papers under review had not been altered.
- DOD IG auditors completed an audit quality questionnaire.
- Additional audits were selected for review with an increased emphasis on financial audits.



2001 Peer Review of the DOD IG

DOD IG action plan intended to address peer review findings includes actions already taken and planned:

- improved work paper documentation for audit planning
 - Quality Management Council to monitor quality
 - evidence of supervisory review before referencing
 - certification that work papers are complete before the report is issued, and certification will be tested by management
 - study and adoption of best practices used by other audit organizations to ensure independence
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Future Actions

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- DOD IG will obtain another peer review in 2 years.
 - The next peer review is required to review implementation of DOD IG's corrective actions.