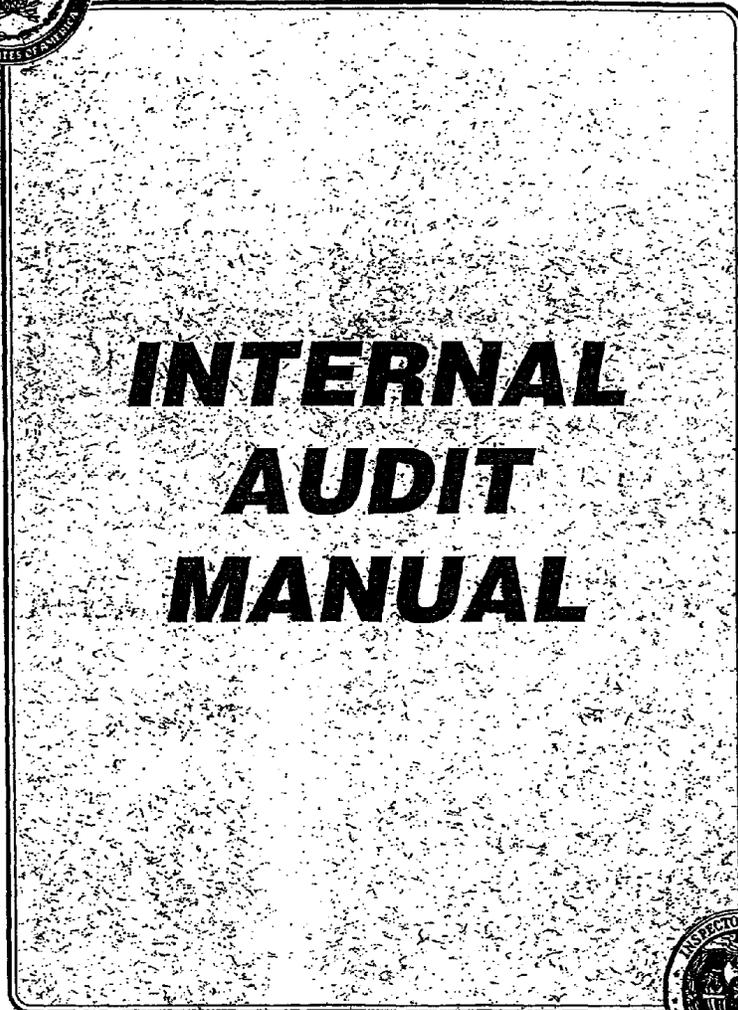


DoD 7600.7-M  
June 1990



**DEPARTMENT OF DEFENSE**



**INTERNAL  
AUDIT  
MANUAL**



**INSPECTOR GENERAL DEPARTMENT OF DEFENSE**



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

**FOREWORD**

One of the highest priorities within the Office of the Inspector General, DoD, is to promote the effective use of DoD audit resources. Cooperation and coordination among and between the various DoD oversight activities are necessary in achieving our goals to eliminate duplication of review effort and to increase sharing of techniques and results. The uniformity of audit policy and certain operating procedures ensures common understanding of our audit missions and provides the framework to ensure effective accomplishment of internal audits in the Department of Defense.

The purpose of the Manual is to establish uniform policies and procedures to be followed in conducting internal audits of DoD operations, systems, programs, and functions. It is designed to assist DoD auditors and internal audit, internal review, and nonappropriated fund audit organizations in complying with the auditing standards, policies, and procedures promulgated by the Congress, Comptroller General of the United States, Office of Management and Budget, President's Council on Integrity and Efficiency, and the Department of Defense.

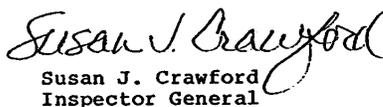
This Manual is reissued under the authority of DoD Directive 7600.7, "DoD Internal Audit Standards, Policies, and Procedures," October 31, 1983. It replaces the June 1986 version of the DoD Internal Audit Manual, as changed. The earlier edition of the Manual has been a significant tool in improving the way we conduct audits and manage an audit staff. The Manual will continue to be the criteria against which to measure audit performance and compliance with applicable auditing standards.

The Manual sections are effective when published unless otherwise noted. The provisions herein are applicable to the internal audit organizations within the Office of the Secretary of Defense (OSD); the Military Departments; the Chairman, Joint Chiefs of Staff (Joint Staff); the Unified and Specified Commands; and the Defense Agencies (hereafter referred to collectively as "DoD Components").

Guidance contained in interim audit policy memoranda issued by this office will be incorporated in the Manual in succeeding revisions. Please forward recommended changes to the Manual to:

Office of the Assistant Inspector General  
for Audit Policy and Oversight, OIG, DoD  
400 Army Navy Drive, Room 1076  
Arlington, VA 22202-2884

The DoD Components may obtain copies of this Manual through their own publication channels. Other Federal Agencies and the public may obtain copies from the U.S. Department of Commerce, National Technical Information Service, 5285 Port Royal Road, Springfield, Virginia 22161.

  
Susan J. Crawford  
Inspector General

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## REFERENCES

- (a) Appendix 3 of title 5, United States Code (Public Law 95-452, "Inspector General Act of 1978," as amended, October 12, 1978)
- (b) Office of Management and Budget Circular No. A-73, "Audit of Federal Operations and Programs," June 20, 1983
- (c) Comptroller General of the United States Pamphlet, "Government Auditing Standards," July 1988
- (d) DoD Directive 7600.7, "DoD Internal Audit Standards, Policies, and Procedures," October 31, 1983
- (e) Institute of Internal Auditors Pamphlet, "Standards for the Professional Practice of Internal Auditing," 1978
- (f) President's Council on Integrity and Efficiency Pamphlet, "Quality Standards for Federal Offices of Inspector General," January 25, 1984
- (g) Sections 7501-7507 of title 31, United States Code (Public Law 98-502, "Single Audit Act of 1984," October 19, 1984)
- (h) Office of Management and Budget Circular No. A-128, "Audits of State and Local Governments," April 12, 1985
- (i) Office of Management and Budget Circular No. A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions," March 8, 1990
- (j) DoD Directive 7750.5, "Management and Control of Information Requirements," August 7, 1986
- (k) [DoD Directive 7600.2](#), "Audit Policies," January 26, 1990
- (l) President's Council on Integrity and Efficiency Guide, "Training Program Guide for Government Audit Activities," March 1986
- (m) [DoD 1400.25-M](#), "DoD Civilian Personnel Manual," July 1978
- (n) Inspector General, Department of Defense, Contract Audit Policy Memorandum No. 1, "Relationships Between Contract and Internal Audit Organizations," December 1, 1983
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- (u) Office of Management and Budget Circular No. A-130, "Management of Federal Information Resources," December 12, 1986
- (v) Office of Management and Budget Circular No. A-123, "Internal Control Systems," revised August 4, 1986
- (w) General Accounting Office Audit Guide, "Assessing Reliability of Computer Output," June 1981
- (x) Public Law 89-306, "Automatic Data Processing Equipment," October 30, 1985
- (y) DoD Directive 7920.1, "Life-Cycle Management of Automated Information Systems," June 20, 1988
- (z) DoD Instruction 7920.2, "Automated Information Systems (AIS) Life-Cycle Management Review and Approval Procedures," March 7, 1990
- (aa) Comptroller General of the United States Audit Guide, "Assessing Reliability of Computer Output," June 1981
- (bb) Public Law 97-255, "Federal Managers' Financial Integrity Act of 1982," September 8, 1982
- (cc) [DoD Directive 5010.38](#), "Internal Management Control Program," April 14, 1987
- (dd) Office of Management and Budget Pamphlet, "Guidelines for the Evaluation and Improvement of and Reporting on Internal Control Systems in the Federal Government," December 1982
- (ee) Office of Management and Budget Circular No. A-76 (Revised), "Performance of Commercial Activities," August 4, 1983
- (ff) Office of Management and Budget Circular No. A-127, "Financial Management Systems," December 19, 1984
- (gg) Comptroller General of the United States Pamphlet, "Standards for Internal Controls in the Federal Government," June 1, 1983
- (hh) Office of Management and Budget Circular No. A-11, "Preparation and Submission of Budget Estimates," June 1989
- (ii) DoD Directive 7045.16, "Financial Management Systems," March 28, 1985
- (jj) DoD 7220.9-M, "Department of Defense Accounting Manual," October 1983
- (kk) Office of Management and Budget, "Guidelines for Evaluating Financial Management/Accounting Systems," May 1985
- (ll) General Accounting Office Manual, "Policy and Procedures Manual for Guidance of Federal Agencies," November 14, 1984
- (mm) Office of Management and Budget Pamphlet, "Financial Management and Accounting Objectives," March 1985
- (nn) [DoD Directive 4205.2](#), "DoD Contracted Advisory and Assistance Services (CAAS)," January 27, 1986

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- (rr) Contract Audit, Internal Audit, and Criminal Investigations Joint Policy Memorandum No. 2, "Coordination by Audit and Investigative Organizations in Cases Involving Allegations of Fraud," April 24, 1987
- (ss) [DoD Instruction 5505.2](#), "Criminal Investigations of Fraud Offenses," November 6, 1987
- (tt) [DoD Directive 7050.1](#), "Defense Hotline Program," March 20, 1987
- (uu) General Accounting Office Pamphlet, "Assessing Compliance with Applicable Laws and Regulations," December 1989
- (vv) DoD Inspector General Handbook, IGDH 7600.2, "Role of the Contract Auditor in Criminal Investigations," January 1989
- (ww) [DoD Directive 5106.1](#), "Inspector General of the Department of Defense," March 14, 1983
- (xx) [DoD Instruction 7600.6](#), "Audit of Nonappropriated Fund Instrumentalities and Related Activities," April 16, 1987
- (yy) Federal Acquisition Regulation, April 1, 1984, as amended
- (zz) DoD Supplement to the Federal Acquisition Regulation, 1988 Edition
- (aaa) Defense Contract Audit Agency Manual (DCAAM 7640.1), "Contract Audit Manual," January 1990
- (bbb) [DoD Directive 5400.11](#), "Department of Defense Privacy Program," June 9, 1982
- (ccc) Memorandum of Understanding Between the Organization of the Joint Chiefs of Staff and the Inspector General, DoD, "To Establish Procedures for Processing Requests for JCS Papers/Planning Information," March 10, 1986

## C1. CHAPTER 1

### GENERAL

#### C1.1. PURPOSE

This Manual provides general guidance on the standards and policies to be followed by DoD internal auditors in the performance of their audit mission, and prescribes procedures, where applicable, to ensure uniformity of implementation.

#### C1.2. APPLICABILITY

C1.2.1. This Manual applies to all DoD internal audit and internal organizations, including nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations").

C1.2.2. Provisions of certain chapters of this Manual do not apply to internal review and nonappropriated fund audit organizations. Each chapter will indicate the applicability of the provisions of that chapter to the specific audit organizations.

#### C1.3. BACKGROUND

C1.3.1. The Inspector General Act of 1978, as amended (reference (a)), and the Office of Management and Budget (OMB) Circular A-73 (reference (b)) require the Inspector General, Department of Defense (IG, DoD), to provide policy direction for audits of the programs and operations of the Department of Defense. In carrying out these policy formulation responsibilities, the IG, DoD, also is required to ensure that DoD audits comply with standards established by the Comptroller General of the United States (reference (c)).

C1.3.2. DoD Directive 7600.7 (reference (d)) authorizes the IG, DoD, to (a) develop uniform standards, policies, and procedures to improve the efficiency and effectiveness of DoD internal audit activities, and (b) provide a consistent basis for measuring the quality and effectiveness of internal audit operations. As part of these functions, the IG, DoD, is responsible for developing, publishing, and maintaining a DoD Internal Audit Manual setting forth the uniform standards, policies, and procedures. In addition, the Directive requires the DoD internal audit organizations to develop detailed procedures to implement the Internal Audit Manual.

#### C1.4. EFFECTIVE DATE

C1.4.1. Unless a specific implementation date is prescribed, objectives are to be met fully and mandatory provisions implemented fully within 1 year of final publication. Additions to this Manual may, at times, require major changes in the existing policies and procedures of the DoD internal audit organizations. In such cases, the individual organizations will be allowed sufficient time to make appropriate revisions in their implementing guidance.

C1.4.2. All deviations from the standards in the Manual must be approved by the Assistant Inspector General for Audit Policy and Oversight, Office of the Inspector General, Department of Defense (AIG-APO, OIG, DoD).

#### C1.5. OBJECTIVE

The objective of the DoD Internal Audit manual is to provide guidance that will help ensure that quality audit service is provided systematically to all DoD organizations, programs, activities, and functions. Normally, the audit policies associated with each chapter are stated near the beginning, followed by suggested procedures. When specific procedures are not prescribed, the DoD internal audit organizations are allowed to use alternative procedures so long as the basic audit policy objectives are met. However, when a high degree of uniformity is needed, mandatory procedures will be prescribed specifically; and alternate procedures may not be used without advance approval by the AIG-APO, OIG, DoD.

#### C1.6. REPORTING PROVISIONS

Attention is directed to the requirement in Chapter 16, paragraph C16.3.3., of this Manual for internal audit organizations to submit annually to the IG, DoD, a report of their expenditure and distribution of audit time for the preceding fiscal year. The report must be forwarded by November 15th each year.

## C2. CHAPTER 2

### DoD INTERNAL AUDITING STANDARDS

#### C2.1. PURPOSE

The purpose of this chapter is to prescribe the auditing standards that shall be followed by DoD internal audit organizations and auditors in the management and performance of auditing activities. Other chapters of the Manual expand upon the standards herein and prescribe applicable policies and guidance for carrying out audit responsibilities by these standards.

#### C2.2. APPLICABILITY

The provisions of this chapter are mandatory for all DoD internal audit and internal review organizations, including nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations").

#### C2.3. BACKGROUND

C2.3.1. The level of acceptance and confidence in audit work by management and external bodies is largely dependent upon the quality and reliability of such work. Properly developed standards provide criteria by which the quality and efficiency of an audit organization may be evaluated and measured. The existence and use of standards by audit organizations distinguish these organizations from other DoD review and oversight activities. The Inspector General Act of 1978, as amended (reference (a)), requires all DoD internal audit organizations to adhere to auditing standards issued by the Comptroller General of the United States (reference (c)). These standards relate to the scope and quality of audit efforts and to the characteristics of professional and meaningful audit reports. The statements on auditing standards and other pronouncements issued by the American Institute of Certified Public Accountants (AICPA) are incorporated into reference (a) unless specifically excluded by a formal announcement from the General Accounting office (GAO).

C2.3.2. The Institute of Internal Auditors (IIA) and the President's Council on Integrity and Efficiency (PCIE) also have promulgated standards (references (e) and (f)) applicable to audit activities. The IIA and PCIE standards are compatible with those issued by the Comptroller General of the United States (reference (c)). While reference (c) deals primarily with the performance of individual audit projects,

references (e) and (f) provide guidelines for the management of both audit projects and audit organizations.

C2.3.3. Office of Management and Budget (OMB) Circular A-73 (reference (b)) also provides guidance applicable to DoD internal audit organizations. Reference (b) concentrates on the areas of organization and staffing of audit activities, determination of audit priorities, formulation of audit plans, and coordination of audit work.

C2.3.4. The Single Audit Act of 1984 (31 U.S.C. 7501-7507) (reference (g)); OMB Circulars A-128 (reference (h)), and A-133 (reference (i)); and the AICPA have set forth standards for audits of State and local governments, institutions of higher education, hospitals, and other nonprofit organizations receiving Federal funds. These standards should be considered by the cognizant DoD internal audit element when monitoring or reviewing the audits conducted under provisions of this Act.

#### C2.4. DoD AUDITING STANDARDS

The auditing standards to be followed by DoD internal audit organizations and auditors are a compilation of auditing standards issued by the OMB, Comptroller General, IIA and PCIE (references (b), (c), (e), and (f)). The DoD auditing standards are comprised of 7 general standards (Nos. 100, 200, etc.) and 36 specific standards, as follow: (An overview of the auditing standards is contained in the enclosure to this chapter.)

C2.4.1. 100 INDEPENDENCE - The internal audit organization and the individual auditors must be free from personal, external, or organizational impairments and consistently shall maintain an independent attitude and appearance.

C2.4.1.1. 110 Personal Impairments - In some circumstances, auditors cannot be impartial because of their views or personal situation. While these impairments apply to individual auditors, they also may apply to the internal audit organization. These circumstances include, but are not limited to, the following:

C2.4.1.1.1. Official, professional, personal, or financial relationships, or conflicts of interest that may cause the auditor to limit the extent of the inquiry, to limit disclosure, or to weaken audit findings in any way.

C2.4.1.1.2. Preconceived ideas about individuals, groups, organizations, or objectives of a particular program that could bias the audit.

C2.4.1.1.3. Previous involvement in a decision-making or management capacity that would affect current operations of the entity or program being audited.

C2.4.1.1.4. Biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of Government.

C2.4.1.1.5. Subsequent performance of an audit by the same individual who, for example, previously had approved invoices, payroll, claim, and other proposed payments.

C2.4.1.1.6. Subsequent performance of an audit by the same individual who maintained the official accounting records.

C2.4.1.1.7. Direct or substantial indirect financial interests in the audited entity or program.

C2.4.1.2. 120 External Impairments - Factors external to the internal audit organization can restrict the audit or interfere with the auditor's ability to form independent and objective opinions and conclusions. When external factors, such as those listed below, are or appear to be evident, an audit may be affected adversely and the auditor may not have complete freedom to make an independent and objective judgment:

C2.4.1.2.1. Undue interference in the recruitment, assignment, and promotion of audit personnel.

C2.4.1.2.2. Undue restrictions on funds or other resources dedicated to the internal audit organization that could prevent the auditors from performing essential work.

C2.4.1.2.3. Authority to overrule or to unduly influence the auditors judgment as to selection of what is to be audited, determination of the scope and timing of work or approach to be used, content of any resulting report, or resolution of audit findings.

C2.4.1.2.4. Influences that jeopardize the auditor's continued employment for reasons other than competency or the need for audit services.

C2.4.1.2.5. Perceptions about the auditor or the auditor's situation that might lead others to question the auditor's independence.

C2.4.1.2.6. Interference with access to all records, reports, audits, reviews, documents, papers, recommendations, or other material to carry out the audit or denial of opportunity to obtain explanations from officials and employees.

C2.4.1.2.7. Political pressures that affect the selection of areas for audit, the performance of those audits, and the reporting of conclusions objectively without fear of censure.

C2.4.1.3. 130 Scope Impairments - When factors external to the internal audit organization and the auditor restrict the audit or interfere with the auditor's ability to form objective opinions and conclusions, the auditor shall attempt to remove the limitation, or failing that, appropriately qualify the resulting audit report.

C2.4.1.4. 140 Organizational Placement - The DoD central internal audit organizations shall report to the Heads of their Components. Other audit organizations shall report to the head or deputy head of a or activity and shall be organizationally located outside the staff or line management function of the activities or functions under audit. However placement of installation-level internal review staffs under the Chief of Staff is acceptable provided that independence is not compromised and the auditors have access, if needed, to the head/deputy head of the activity.

C2.4.1.5. 150 Objectivity - Auditors shall be objective in performing audits.

C2.4.1.5.1. Objectivity is an independent mental attitude, which auditors shall maintain in performing audits. Auditors are not to subordinate their judgment on audit matters to that of others.

C2.4.1.5.2. The auditor's objectivity is not adversely affected when the auditor recommends standards of control for systems or reviews procedures before they are implemented. However, designing, installing, and operating systems are not audit functions. Nor is the drafting of procedures for systems an audit function. Performing such activities is presumed to impair audit objectivity.

C2.4.2. 200 PROFESSIONAL PROFICIENCY - Professional proficiency is the responsibility of the internal audit organization and each auditor. The internal audit organization shall assign to each audit those persons who collectively possess the necessary knowledge, skills, and disciplines to conduct the audit properly.

C2.4.2.1. 210 Due Professional Care - Due professional care is to be used in conducting the audit and in preparing the related reports.

C2.4.2.1.1. The internal audit organization and the auditor are responsible for employing professional standards in auditing Government organizations, programs, activities, and functions.

C2.4.2.1.2. Due professional care calls for the application of the care and skill expected of a reasonably prudent and competent auditor in the same or similar circumstances. Professional care should, therefore, be appropriate to the complexities of the audit being performed. In exercising due professional care, auditors shall be alert to the possibility of intentional wrongdoing, errors and emissions, inefficiency, waste, ineffectiveness, and conflicts of interest. They also shall be alert to those conditions and activities where irregularities are most likely to occur. In addition, they shall identify inadequate controls and recommend improvements to promote compliance with acceptable procedures and practices.

C2.4.2.1.3. Due care implies reasonable care and competence, not infallibility or extraordinary performance. Due care requires the auditor to conduct examinations and verification to a reasonable extent, but does not require detailed audits of all transactions. Accordingly, the auditor cannot give absolute assurance that noncompliance or irregularities do not exist. Nevertheless, the possibility of material irregularities or noncompliance shall be considered whenever the auditor undertakes an auditing assignment.

C2.4.2.1.4. When an auditor suspects fraud or other illegal acts, the appropriate DoD criminal investigative organization shall be informed.

C2.4.2.1.5. Exercising due professional care means using good judgment in choosing tests and procedures and in preparing reports. To this end, the auditor shall consider the following:

C2.4.2.1.5.1. Extent of audit work needed to achieve audit objectives.

C2.4.2.1.5.2. Relative materiality or significance of matters to which audit procedures are applied.

C2.4.2.1.5.3. Adequacy and effectiveness of internal controls.

C2.4.2.1.5.4. Cost of auditing in relation to potential benefits.

C2.4.2.1.5.5. Adjustment of scope as deemed necessary to comply with reporting timeframes that must be met.

C2.4.2.2. 220 Auditor Qualifications - Auditors shall possess the knowledge, skills, and disciplines essential to the performance of audits. Each auditor shall possess certain knowledge and skills as follows:

C2.4.2.2.1. Proficiency in applying internal auditing standards, procedures, and techniques is required in performing audits. Proficiency means the ability to apply knowledge to situations likely to be encountered and to deal with them without extensive recourse to technical research and assistance.

C2.4.2.2.2. Proficiency in accounting principles and techniques is required for auditors who work extensively with financial records and reports.

C2.4.2.2.3. An understanding of management principles is required to recognize and evaluate the materiality and significance of deviations from good business practices. An understanding means the ability to apply broad knowledge to situations likely to be encountered, to recognize significant deviations, and to be able to carry out the research necessary to arrive at reasonable solutions.

C2.4.2.2.4. An appreciation is required of the fundamentals of such subjects as accounting, economics, quantitative methods, and computerized information systems.

C2.4.2.2.5. A knowledge of directives and other issuances from GAO, OMB, DoD, the Congress, or other authoritative bodies.

C2.4.2.2.6. A working familiarity with the organizations, programs, activities, and functions of each major DoD Component subject to audit, in sufficient depth to knowledgeably assess that Component's mission accomplishment and to identify problems to the degree required for a particular task or set of duties.

C2.4.2.2.7. A knowledge of Government policies, requirements, and guidelines related to a particular task.

C2.4.2.2.8. Managerial skills for supervisors and team leaders.

C2.4.2.3. 230 Human Relations and Communications - Auditors shall be skilled in dealing with people and in communicating effectively.

C2.4.2.3.1. Auditors shall understand human relations and maintain satisfactory relationships with auditees.

C2.4.2.3.2. Auditors shall be skilled in oral and written communications so that they can convey clearly and effectively such matters as audit objectives, evaluations, conclusions, and recommendations.

C2.4.2.4. 240 Continuing Education - Auditors shall maintain their technical competence through continuing education. Auditors are responsible for continuing their education to maintain their proficiency. They should keep informed about improvements and current developments in auditing standards, procedures, and techniques. Continuing education may be obtained through membership and participation in professional societies; attendance at seminars, college courses, and Federal and in-house training programs; and participation in research projects. (See Chapter 4, "Achieving and Maintaining Professional Proficiency," for detailed guidance.)

C2.4.2.5. 250 Compliance with Standards of Conduct - Auditors shall comply with professional standards of conduct. Auditors shall maintain high standards of honesty, objectivity, diligence, and integrity in the performance of their work.

C2.4.3. 300 SCOPE OF AUDIT WORK - The scope of each financial audit shall include an evaluation of the adequacy and effectiveness of the organization's internal control system (i.e., policies and procedures), and of the quality of performance in carrying out assigned responsibilities. For performance audits, an assessment should be made of applicable internal controls when necessary to satisfy the audit objectives.

C2.4.3.1. 310 Reliability and Integrity of Information - Auditors shall review the reliability and integrity of financial operating information and the means used to identify, measure, classify, and report such information. Information systems provide data for decision-making, control, and compliance with external requirements. Therefore, auditors shall examine information systems and, as appropriate, ascertain whether:

C2.4.3.1.1. Financial and operating records and reports contain accurate, reliable, timely, complete, and useful information.

C2.4.3.1.2. Controls over record keeping and reporting are adequate and effective.

C2.4.3.2. 320 Compliance with Policies, Plans, Procedures, Laws, and Regulations - Auditors shall review the systems established to ensure compliance with those policies, plans, procedures, laws, and regulations that could have a significant impact on operations and reports, and should determine whether the organization is in compliance.

C2.4.3.2.1. Management is responsible for establishing the systems designed to ensure compliance with such requirements as policies, plans, procedures, and applicable law and regulations. Auditors are responsible for determining whether the systems are adequate and effective and whether the activities audited are complying with the appropriate requirements.

C2.4.3.2.2. When conducting financial audits, the auditor shall determine whether the financial statements of an audit entity fairly present the financial position and the results of financial operations in accordance with accounting principles and standards prescribed by the Comptroller General.

C2.4.3.3. 330 Safeguarding of Assets - Auditors shall review the means of safeguarding assets and, as appropriate, verify the existence of such assets.

C2.4.3.3.1. Auditors shall review the means used to safeguard assets from various types of losses, such as those resulting from theft, fire, improper or illegal activities, and exposure to the elements.

C2.4.3.3.2. Auditors, when verifying the existence of assets, shall use appropriate audit procedures.

C2.4.3.4. 340 Economical and Efficient Use of Resources - Auditors shall appraise the economy and efficiency with which resources are managed.

C2.4.3.4.1. Management is responsible for setting operating standards to measure an entity's economical and efficient use of resources. Auditors are responsible for determining the following:

C2.4.3.4.1.1. Whether operating standards have been established for measuring economy and efficiency.

C2.4.3.4.1.2. Whether established operating standards are understood and are being met.

C2.4.3.4.1.3. Whether deviations from operating standards are identified, analyzed, and communicated to those responsible for corrective action.

C2.4.3.4.1.4. Whether corrective action has been taken.

C2.4.3.4.2. Audits related to the economical and efficient use of resources shall identify the following:

C2.4.3.4.2.1. Underutilized facilities.

C2.4.3.4.2.2. Nonproductive work.

C2.4.3.4.2.3. Procedures that are not cost-effective.

C2.4.3.4.2.4. Overstaffing and understaffing.

C2.4.3.4.2.5. Unneeded or costly procurements.

C2.4.3.4.2.6. Causes of inefficiencies or uneconomical practices.

C2.4.3.5. 350 Accomplishment of Established Objectives and Goals for Operations and Programs -Auditors shall review operations and programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned. Management is responsible for establishing operating or program objectives and goals, developing and implementing control procedures, and accomplishing desired operating or program results. The auditor shall determine whether the desired results or benefits are being achieved effectively and whether the entity has considered alternatives that might yield desired results at a lower cost.

C2.4.4. 400 PERFORMANCE OF AUDIT WORK - The auditor is responsible for planning and conducting the audit assignment, subject to supervisory review and approval.

C2.4.4.1. 410 Planning the Audit - Auditors shall plan each audit. Planning shall be documented and include the following:

C2.4.4.1.1. Establishment of audit objectives and scope of work.

C2.4.4.1.2. Consideration of audit requirements at all levels of Government, to the extent they are known.

C2.4.4.1.3. Background information about the activities to be audited.

C2.4.4.1.4. On site surveys to become familiar with the activities and controls to be audited, to identify areas for audit emphasis and to invite auditee comments and suggestions.

C2.4.4.1.5. Communication with all who need to know about the audit.

C2.4.4.1.6. Resources necessary to perform the audit.

C2.4.4.1.7. Consideration of materiality or significance and audit risk relative to audit objectives and scope of work.

C2.4.4.1.8. Determination of how, when, and to whom audit results will be communicated.

C2.4.4.1.9. Approval of the audit work plan.

C2.4.4.1.10. Coordination with other Government auditors, when appropriate, including work already done and other work that may be intended in the future.

C2.4.4.1.11. Reliance to the extent possible on the work of other audit, inspection, or oversight teams.

C2.4.4.2. 420 Audit Program - A written audit program is essential to conducting audits efficiently and effectively and shall be prepared for each audit. The audit program shall, when appropriate, be designed to evaluate compliance with laws and regulations, and shall be designed to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. The audit program generally shall include the following information:

C2.4.4.2.1. Introduction and background.

C2.4.4.2.2. Purpose and scope of audit.

C2.4.4.2.3. Objectives of the audit.

C2.4.4.2.4. Definition of terms.

C2.4.4.2.5. Special instructions.

C2.4.4.2.6. Audit procedures and methods to be used to gather and analyze data.

C2.4.4.2.7. Information on the general format (if not included in the audit organization policies and procedures) to be followed in the audit report and the type of information to be included.

C2.4.4.2.8. Appropriate cross-references to the supporting audit working papers.

C2.4.4.3. 430 Supervision - The internal audit organization shall ensure that audits are supervised properly. Supervision shall be exercised at each level of the internal audit organization to provide quality control over audit assignments.

C2.4.4.3.1. Supervision is a continuing process, beginning with planning and ending with the preparation of the final audit report.

C2.4.4.3.2. Supervision includes the following:

C2.4.4.3.2.1. Providing suitable instructions to subordinates at the beginning of the audit and approving the audit program.

C2.4.4.3.2.2. Seeing that the approved audit program is carried out, unless deviations are both justified and authorized.

C2.4.4.3.2.3. Ensuring that the audit is performed in conformance with professional auditing standards.

C2.4.4.3.2.4. Determining that audit working papers are prepared and retained in accordance with prescribed procedures and adequately support the audit analyses, findings, conclusions, and reports.

C2.4.4.3.2.5. Ensuring that audit reports are accurate, objective, clear, concise, constructive, and timely.

C2.4.4.3.2.6. Providing that the work assignments are commensurate with the abilities of the assigned staff.

C2.4.4.3.2.7. Determining that audit objectives are being met.

C2.4.4.3.3. Supervision includes sufficient interim checks of audit work, to determine whether audit projects are on schedule and are being executed in accordance with plans, so that necessary adjustments can be made.

C2.4.4.3.4. Appropriate evidence of supervision shall be documented and retained.

C2.4.4.3.5. The extent of supervision required will depend on the proficiency of the auditors and the difficulty of the audit assignment.

C2.4.4.3.6. All auditing assignments, whether performed by or for the audit organization, remain the responsibility of the head of the internal audit organization.

C2.4.4.4. 440 Examining and Evaluating Information - Auditors shall collect, analyze, interpret, and document information to support the audit results.

C2.4.4.4.1. Information, including its materiality or significance and audit risk, shall be collected on all matters related to the audit objectives and scope of work.

C2.4.4.4.2. Information shall be sufficient, competent, and relevant, to provide a basis for audit findings and recommendations. "Sufficient" information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. "Competent" information is reliable and the best attainable through the use of appropriate audit techniques. "Relevant" information supports audit findings and recommendations and is consistent with the objectives for the audit.

C2.4.4.4.3. Audit procedures, including the testing and sampling techniques employed, shall be selected in advance, when practicable, and expanded or altered if circumstances warrant.

C2.4.4.4.4. The process of collecting, analyzing, interpreting, and documenting information shall be supervised, to provide reasonable assurance that the auditor's objectivity is maintained and that audit goals are met.

C2.4.4.4.5. Working papers that document the audit shall be prepared by the auditor and reviewed by audit supervisory personnel. These working papers shall record the information obtained and the analyses made and shall support the basis for the results, findings, and recommendations to be reported. The working papers shall be complete, accurate, clear, understandable, legible, and neat. They shall contain relevant information and the indexing and cross-referencing to schedules and summaries.

C2.4.4.4.6. The working papers should serve to support audit planning, execution, and reporting. The working papers shall, at a minimum, document the following:

C2.4.4.4.6.1. Planning.

C2.4.4.4.6.2. The examination and evaluation of the adequacy of internal controls.

C2.4.4.4.6.3. Auditing procedures performed, the information obtained, and the conclusions reached.

C2.4.4.4.6.4. Supervision review of the working papers and disposition of review comments.

C2.4.4.4.6.5. Reporting of all audit results, including the modification or deletion of all proposed findings and recommendations.

C2.4.4.4.6.6. Follow-up.

C2.4.4.4.7. Auditors may rely on the work of others to the extent feasible once they satisfy themselves of the quality of the others work by appropriate tests or by other acceptable methods (reference (c)).

C2.4.4.4.5. 450 Internal Controls - When necessary to satisfy the audit objectives, a study and evaluation including a vulnerability or risk assessment shall be made of the internal control system (i.e., policies and procedures) applicable to the organization, program, activity, or function under audit.

#### C2.4.4.6. 460 Reliability of Computer-Processed Data

C2.4.4.6.1. For performance audits, when computer-processed data are an important or integral part of the audit and the data's reliability is crucial to accomplishing the audit objectives, auditors need to satisfy themselves that the data are relevant and reliable. To determine reliability of the data, the auditor may either:

C2.4.4.6.1.1. Conduct a review of the general and application controls in the computer-based system, including additional tests as warranted.

C2.4.4.6.1.2. Conduct other tests and procedures such as confirming computer-processed data with independent sources, comparing the data with source documents, and reviewing agency test procedures and results.

C2.4.4.6.2. The degree of testing needed to determine data reliability generally increases to the extent that the general or application controls were determined to be unreliable or were not reviewed. When the reliability of a computer-based system is the primary objective of the audit, the auditors should conduct a review of the system's general and applications controls. When computer-processed data are used by the auditor, or included in the report, for background or informational purposes and are not significant to the audit results, citing

the source of the data in the report will usually satisfy reporting standards. Refer to Chapter 9 of this Manual for additional explanation of this standard.

C2.4.4.7. 470 Fraud, Abuse and Illegal Acts - Audit steps and procedures should be designed to provide reasonable assurance of detecting material errors, irregularities, and illegal acts and to identify the effect on the entity's financial statements, operations, or programs. Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts; and if such evidence exists, auditors shall coordinate their examinations with applicable investigative agencies when suspicions of fraud or illegal acts exist.

C2.4.4.8. 480 Audit Follow-up - Auditors shall follow up on a selective basis to ascertain that appropriate corrective action was take on agreed-upon recommendations in DoD and GAO audit reports.

C2.4.5. 500 REPORTING - Auditors shall report the results of their audit work in writing.

C2.4.5.1. 510 Form - Written reports are necessary to:

C2.4.5.1.1. Communicate the results of audits to officials at all levels of Government;

C2.4.5.1.2. Make the findings and recommendations less susceptible to misunderstanding;

C2.4.5.1.3. Make the findings available for public inspection; and

C2.4.5.1.4. Facilitate follow-up to determine whether appropriate corrective measures have been taken.

C2.4.5.2. 520 Distribution - Written audit reports are to be submitted to the appropriate officials of the organization audited and to the appropriate officials of the organizations requiring or arranging for the audits, unless legal restrictions or ethical considerations prevent it. Copies of the reports also shall be sent to other officials who may be responsible for taking action on audit findings and recommendations and to others authorized to receive such reports. Unless restricted by law or regulation, copies shall be made available for public inspection.

C2.4.5.3. 530 Timeliness - Reports shall be issued promptly to make the information available for timely use by management and legislative officials and to permit prompt initiation of follow-up action. If applicable, reports are to be issued on or before the date specified by regulation or other special arrangement.

C2.4.5.4. 540 Report Contents - The audit report shall include the following:

C2.4.5.4.1. A description of the scope and objectives of the audit and background information. The scope should reflect the extent of reliance and magnitude of any work of others used as a basis for conclusions relative to audit results and objectives. Any impairments to audit scope, as well as the effect impairments may have had on the audit conclusions, shall be clearly identified in the report.

C2.4.5.4.2. A description of when the audit was performed and the period covered by the audit.

C2.4.5.4.3. A statement that the audit was made in accordance with generally accepted Government auditing standards.

C2.4.5.4.4. For financial audits, a statement on the internal controls structure, assessment of control risk, and a description of material weaknesses found in evaluating the internal control system. For performance audits, a statement on the significant internal controls that were assessed, the scope of the auditor's assessment, and the significant weaknesses found.

C2.4.5.4.5. A specific conclusion on each of the stated audit objectives, including the materiality or significance and audit risk associated with each area if necessary for a proper understanding of the auditor's conclusions.

C2.4.5.4.6. A copy of those financial statements reviewed on which an opinion is being expressed, the auditor's opinion on the financial statements, and, when appropriate, a statement on any informative disclosures included in the financial statements (applies to financial statements and financial related audits as defined by the Comptroller General of the United States).

C2.4.5.4.7. Photos, charts, graphs, attachments, and exhibits when they contribute to the clarity of the audit report.

C2.4.5.4.8. Statements on tests of compliance relative to applicable laws and regulations when required by the audit objectives. However, the report shall include a statement that identifies significant instances of noncompliance and instances or

indications of fraud, abuse, or illegal acts found during, or in connection with, the audit. Moreover, fraud or illegal acts shall be covered in a separate written report if this would facilitate the timely issuance of an overall report on other aspects of the audit.

C2.4.5.4.9. Audit findings that contain each of the following elements:

C2.4.5.4.9.1. Criteria - The standards, measures, or expectations used in making the evaluation or verification (what should be).

C2.4.5.4.9.2. Condition - The factual evidence that the auditor found in the course of the examination (what is).

C2.4.5.4.9.3. Cause - The reason for the difference between the expected and actual conditions (why it happened). If the cause(s) cannot be determined, this fact should be so stated in the report and an explanation given. If the stated audit objectives do not require an identification of cause(s), that fact should be made clear.

C2.4.5.4.9.4. Effect - The risk or exposure of management because the condition is not the same as the criteria (the impact of the difference). In determining materiality and significance of audit risk, the auditor may consider factors set forth in the U.S. Comptroller General's pamphlet (reference (c)).

C2.4.5.4.10. Specific and realistic recommendations for actions to improve problem areas noted in the audit and to improve operations.

C2.4.5.4.11. Information on the potential monetary benefits associated with the audit recommendations.

C2.4.5.4.12. Pertinent views of responsible management officials concerning the auditors' findings, conclusions, and recommendations. Their views shall be obtained in writing. Management's written comments may be included as an appendix to the report or presented in the body of the report.

C2.4.5.4.13. If the auditors disagree with management's views on the audit recommendations, the audit report shall state both positions and the reasons for disagreement.

C2.4.5.4.14. A description of noteworthy accomplishments, particularly when management improvements in one area may be applicable elsewhere.

C2.4.5.4.15. An evaluation of any corrective actions taken by management in response to recommendations in prior audits when audit objectives are similar to objectives of the prior audit.

C2.4.5.4.16. A listing of any issues and questions needing further study and consideration.

C2.4.5.4.17. A statement as to whether any pertinent information has been omitted because it is deemed privileged or confidential. The nature of such information shall be described, and the law or other basis under which it is withheld shall be stated. If a separate report was issued containing this information, it shall be indicated in the report.

C2.4.5.4.18. A listing of the reports distribution.

C2.4.5.5. 550 Report Presentation - The audit report shall conform to the following guidelines:

C2.4.5.5.1. Present complete and factual data accurately and fairly. Include only information, findings, and conclusions that are supported adequately by sufficient evidence in the auditors' working papers.

C2.4.5.5.2. Present findings and conclusions in a convincing manner, distinguishing clearly between facts and conclusions.

C2.4.5.5.3. Be objective, unbiased, and free from distortion.

C2.4.5.5.4. Be written in language as clear and simple as the subject matter permits.

C2.4.5.5.5. Be concise but, at the same time, clear enough to be understood by users.

C2.4.5.5.6. Place primary emphasis on improvement rather than on criticism of the past. Critical comments shall be presented in a balanced perspective, considering any unusual difficulties or circumstances faced by the operating officials concerned.

C2.4.6. 600 MANAGEMENT OF INTERNAL AUDIT ORGANIZATION - The head of the internal audit organization is responsible for properly managing the organization so that audit work fulfills the general purposes and responsibilities set forth in law or

approved by the Head or Deputy Head of the Agency; resources of the internal audit organization are employed efficiently and effectively; and the audit work conforms to DoD auditing standards, policies, and procedures.

C2.4.6.1. 610 Organization - The head of the internal audit organization is responsible for properly organizing the office to help ensure that the resources of the internal audit organization are deployed efficiently and effectively to fulfill the organization's general purposes and responsibilities.

C2.4.6.1.1. The organizational structure shall foster coordinated, balanced, and integrated accomplishment of the organization's mission, goals, and objectives.

C2.4.6.1.2. Recruiting, Staffing, and training shall support the mission and organizational structure; the organization should not be structured around available skills. Full advantage shall be taken of those skills that are available.

C2.4.6.1.3. The internal audit organization shall reflect the unique audit need of its own Agency. Whether this is done by function, by parallel structure, or by some combination of both, the way in of audit personnel to review agency program and operations.

C2.4.6.2. 620 Policies and Procedures - The head of the internal audit organization shall provide written policies and procedures to guide the audit staff.

C2.4.6.2.1. The form and content of written policies and procedures shall be appropriate to the size and structure of the internal audit organization and the complexity of its work. Formal administrative and technical audit manuals may not be needed by all internal audit organizations. A small internal audit organization may be managed informally. In a large internal audit organization, more formal and comprehensive policies and procedures are essential to guide the audit staff in the consistent compliance with the organization's standards of performance.

C2.4.6.2.2. A system shall be established and maintained for receiving, controlling, screening, and assuring appropriate disposition of allegations involving waste, mismanagement, fraud, and abuse, whether from internal or external sources.

C2.4.6.2.3. Procedures shall be established for safeguarding the identity of confidential sources, and for protecting privileged and confidential information.

C2.4.6.2.4. Policies shall be established for documentation of audit performance, including instructions for the types of audit working paper files to be maintained, and procedures for indexing.

C2.4.6.3. 630 Scope of Responsibility - Each internal audit organization shall maintain records of its audit universe that identify the organizations, programs, activities, functions, and systems subject to audit.

C2.4.6.4. 640 Determination of Audit Priorities - Each internal audit organization shall review periodically its audit universe and determine the coverage, frequency, and priority of audit required for each. The review shall include consideration of the following factors:

C2.4.6.4.1. Statutory and regulatory requirements.

C2.4.6.4.2. Adequacy of internal control systems as indicated by vulnerability assessments and internal control reviews.

C2.4.6.4.3. Newness, changed conditions, or sensitivity of the organization, program activity, or function.

C2.4.6.4.4. Current and potential dollar magnitude.

C2.4.6.4.5. Susceptibility of programs to fraud, waste, abuse, or potential for improperly diverting assets for personal gain.

C2.4.6.4.6. Extent of Federal participation, in terms of resources or regulatory authority.

C2.4.6.4.7. Management needs to be met, including key management decision dates, as developed in consultation with the responsible program officials and senior management.

C2.4.6.4.8. Prior audit experience.

C2.4.6.4.9. Timeliness, reliability, and scope of audits performed by others.

C2.4.6.4.10. Results of other evaluations, such as inspections, program reviews, etc.

C2.4.6.4.11. Availability of audit resources.

C2.4.6.5. 650 Planning - Each internal audit organization shall establish plans to carry out its responsibilities.

C2.4.6.5.1. The planning process shall include the following:

C2.4.6.5.1.1. Establishment of goals and objectives.

C2.4.6.5.1.2. Formulation of audit plans, including maintenance of an audit universe file and establishment of audit cycles for each area within the audit universe.

C2.4.6.5.1.3. Assessment of accomplishments.

C2.4.6.5.2. Long- and short-term goals and objectives should be established for the internal audit organization. The goals and objectives should be achievable, included in written operating plans and budgets, and accompanied by measurement criteria and target dates for accomplishment.

C2.4.6.5.3. The internal audit organization shall prepare annual audit plan. The plan shall be flexible and adjusted, as necessary, to provide for audit coverage of unforeseen priorities. The Head or Deputy Head of the Agency shall review the plan upon completion. At a minimum, such plans shall identify the programs and operations selected for audit and define the following for each:

C2.4.6.5.3.1. Specific reasons for the selection.

C2.4.6.5.3.2. Overall audit objective.

C2.4.6.5.3.3. Locations to be audited.

C2.4.6.5.3.4. Organization that will perform the audit.

C2.4.6.5.3.5. Staff days and other resources needed to perform the audit.

C2.4.6.5.3.6. Anticipated benefits to be obtained from the audit.

C2.4.6.5.4. In developing annual audit plans, suggestions shall be obtained from external management and from members of the audit organization, and feedback shall be provided regarding the disposition of audit results.

C2.4.6.5.5. The internal audit organization shall assess its results and accomplishments. To conduct such evaluations, the internal audit organization shall develop and maintain a data base that includes, at a minimum, the following: a history of past efforts and results to show prior performance, a planning process to show expected performance, and a management information system to show actual performance and results. The data base shall be developed in accordance with the policies of DoD Directive 7750.5, "Management and Control of Information Requirements" (reference (j)). The audit organizations should assess realistically the information in the data base to identify shortfalls in performance, improve operations in the future, determine whether goals and objectives are reasonable, and affix accountability for results.

C2.4.6.6. 660 Coordination - The internal audit organization shall coordinate its activities internally, and with other components of Government and independent outside auditors it may encounter, to ensure effective use of available resources.

C2.4.6.6.1. In planning work to be performed, the internal audit organization shall coordinate with agency management to ensure management needs are considered appropriately.

C2.4.6.6.2. The internal audit organization shall minimize unnecessary duplication of audit work by coordinating the nature and scope of their audits and reviews with other DoD audit, investigation, and inspection groups, the GAO, and independent outside auditors.

C2.4.6.6.3. Audit plans shall be exchanged among DoD internal audit organizations. The internal audit organization shall also meet with the appropriate GAO officials to exchange and discuss tentative audit plans for the next fiscal year. Central DoD audit activities are encouraged to communicate regularly and frequently with the GAO to discuss planned audits so as to minimize duplication and overlap. If overlapping or duplicative coverage is indicated, every effort shall be made to resolve it.

C2.4.6.6.4. Upon beginning an audit, the audit staff shall seek information concerning other audits and reviews that have been performed of that activity or program.

C2.4.6.6.5. The audit staff shall be alert to situations where problems are identified that may affect other DoD Components, Federal Agencies, and independent outside auditors. When such situations arise, the internal audit organization shall coordinate with others involved so that, where appropriate, one audit may be performed to fulfill the requirements of all.

C2.4.6.7. 670 Internal Audit Organization Qualifications - The internal audit organization shall possess or obtain the knowledge, skills, and disciplines needed to carry out its audit responsibilities.

C2.4.6.7.1. The internal audit organization shall assess the skills of staff on board, determine the extent to which these skills match requirements, and develop a plan to address the skills that are deficient.

C2.4.6.7.2. The audit staff collectively must possess the knowledge, skill, discipline, and experience essential to the practice of the auditing profession. These attributes include proficiency in applying auditing standards, procedures, and techniques.

C2.4.6.7.3. The internal audit organization shall have employees or use outside experts who are qualified in the disciplines needed to meet audit responsibilities. The disciplines include accounting, budgeting, statistics, computer systems, engineering, medicine, law, etc. Each member of the internal audit organization, however, need not be qualified in all of these disciplines.

C2.4.6.8. 680 Personnel Management and Development - The internal audit organization shall establish a program for selecting and developing its human resources. The program shall provide for the following:

C2.4.6.8.1. Selection of qualified and competent individuals.

C2.4.6.8.2. Training and continuing educational opportunities for each staff member.

C2.4.6.8.3. Appraisal of each auditor's performance at least annually.

C2.4.6.8.4. Retention and promotion of highly skilled personnel to senior management positions.

C2.4.6.8.5. Counseling of auditors on their performance and professional development.

C2.4.7. 700 QUALITY ASSURANCE - Each internal audit organization shall establish and maintain a quality assurance program to ensure that work performed adheres to applicable auditing standards, policies, and procedures; conforms to internal regulations; and is carried out economically, efficiently, and effectively.

C2.4.7.1. A quality assurance program shall include the following elements:

C2.4.7.1.1. Supervision.

C2.4.7.1.2. Internal quality control reviews.

C2.4.7.1.3. External quality control reviews.

C2.4.7.2. Supervision of the work of auditors shall be carried out continually to ensure conformance with auditing standards, organization policies and procedures, and audit programs.

C2.4.7.3. Internal quality control reviews shall be performed periodically by members of the audit staff to appraise the quality of the audit work performed. These reviews shall be performed in the same manner as any other internal audit.

C2.4.7.4. External quality control reviews shall be performed to appraise the quality of the internal audit organization's operations. These reviews shall be performed using guidelines published by the OIG, DoD. Such reviews shall be conducted at least once every 3 years. Unless otherwise directed, the Office of the Assistant Inspector General for Audit Policy and Oversight (OAIG-APO) shall conduct the reviews of the DoD central internal audit, agencies and the audit agencies, in turn, shall conduct reviews of their Components' internal review or nonappropriated fund audit organizations. On completion of the review, a formal written report shall be issued. The report shall express an opinion as to the organization's compliance with applicable auditing standards and, as appropriate, shall include recommendations for improvement.

C2.E1. ENCLOSURE 1 OF CHAPTER 2  
DoD INTERNAL AUDITING STANDARDS

<u>OVERVIEW</u>							
<u>100</u>	<u>Independence</u>	<u>200</u>	<u>Professional Proficiency</u>	<u>300</u>	<u>Scope of Audit Work</u>	<u>400</u>	<u>Performance of Audit Work</u>
110	Personal Impairments	210	Due Professional Care	310	Reliability and Integrity of Information	410	Planning the Audit
120	External Impairments	220	Auditor Qualifications	320	Compliance with Policies, Plans, Procedures, Laws, and Regulations	420	Audit Program
130	Scope Impairments	230	Human Relations and Communications	330	Safeguarding of Assets	430	Supervision
140	Organizational Placement	240	Continuing Education	340	Economical and Efficient Use of Resources	440	Examining and Evaluating Information
150	Objectivity	250	Compliance with Standards of Conduct	350	Accomplishment of Established Objectives and Goals for Operations and Programs	450	Internal Controls
						460	Reliability of Computer-Processed Data
						470	Fraud, Abuse, and Illegal Acts
						480	Audit Follow Up

OVERVIEW, Continued

<u>500</u>	<u>Reporting</u>	<u>600</u>	<u>Management of Internal Audit Organization</u>	<u>700</u>	<u>Quality Assurance</u>
510	Form	610	Organization		(General Standard Only)
520	Distribution	620	Policies and Procedures		
530	Timeliness	630	Scope of Responsibility		
540	Report Contents	640	Determination of Audit Priorities		
550	Report Presentation	650	Planning		
		660	Coordination		
		670	Internal Audit Organization Qualifications		
		680	Personnel Management and Development		

### C3. CHAPTER 3

#### AUDIT CONCEPTS

##### C3.1. PURPOSE

This chapter outlines basic concepts DoD auditors shall use in planning and performing audits of DoD organizations, activities, programs, systems, and functions.

##### C3.2. APPLICABILITY

The provisions of this chapter are mandatory requirements for all DoD internal audit activities and shall be used as guides by all internal review and military exchange audit activities.

##### C3.3. GENERAL

C3.3.1. The primary mission of the Department of Defense is to provide a defense capability and deterrent adequate to successfully repel or discourage any entity that would attempt to harm or seize any portion of the United States of America, its citizens, its possessions, or any entity entitled to similar protection by treaty or agreement. Priorities for use of audit resources shall be established consistent with this primary mission and giving recognition to the need for audit coverage of entities that have important support missions. Once an entity is selected for audit, emphasis normally shall be placed on determining whether adequate mission capability or performance is being achieved and whether it is likely to continue. Although evaluating mission performance or capability normally has a higher priority, economy of operations and vulnerability to fraud or other illegal acts shall also be considered. Inefficient operations, fraud, waste, and abuse are most significant when they impact on mission capability or performance.

C3.3.2. Current DoD policy, as contained in DoD Directive 7600.2 (reference (k)), requires adequate audit coverage to be an integral part of the management system of all DoD organizations, programs, activities, and functions. The overall objective of internal audit is to help DoD managers attain their goals by furnishing information, analyses, appraisals, and recommendations pertinent to the managers' duties and objectives. To achieve this objective, auditors independently and objectively evaluate procedures and controls used by organizations and activities in carrying out assigned programs and functions. Auditors shall conduct their reviews and present conditions,

conclusions, and recommendations constructively in their audit reports so as to stimulate corrective action.

C3.3.3. Audit types are categorized into financial and performance audits by the Comptroller General of the United States in the July 1988 revision of the Government Auditing Standards (reference (c)). Financial audits include financial statement audits and financial-related audits. Performance audits include economy and efficiency audits and program audits. The audit objectives and the required auditing standards vary for the types of audits. Audits may have a combination of objectives or may have objectives limited to some aspect of one of the audit types. As required by Chapter 2 of this Manual, the scope of each audit shall normally include an evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities.

#### C3.4. POLICY

C3.4.1. All audits within the Department of Defense shall be conducted in accordance with the Government Auditing Standards (reference (c)), as further implemented by the IG, DoD, in Chapter 2.

C3.4.2. Audits within the Department of Defense shall be performed with a view toward causing significant improvement in the major missions or programs of the auditee that need to be continued, and ensuring that internal controls are adequate to foster good performance, minimize unnecessary costs, and reduce the potential for fraud or illegal acts.

C3.4.3. Normally, audits shall address mission-related programs of the auditee using an audit-by-objectives approach. Except for mandatory or requested audits with restricted scope, performance audits normally shall evaluate the need for an activity or program.

C3.4.4. The DoD internal audit activities shall plan and conduct audits using a functional area expert concept. Under this concept, the internal audit activity shall designate an audit manager as a functional area expert for each of the functional areas identified in Chapter 16 of this Manual. A functional area expert may be assigned more than one functional area. The designee shall be the primary individual the audit organization looks to for advice, information, technical assistance on audit plans, audit approaches, trends, and the latest developments in that functional area.

C3.4.5. Auditors shall maintain their independence when doing audits, but shall establish a professional working relationship with management to facilitate agreement

on pertinent observations, facts, and conclusions; encourage prompt corrective action on major deficiencies; and, in general, foster positive solutions to problems and better ways to manage.

C3.4.6. Auditors shall report situations that require immediate management action to prevent, correct, or reduce a serious condition. If normal reporting methods cannot provide timely information to management, auditors shall issue a quick reaction report explaining the problem and the urgency for corrective action.

### C3.5. MISSION-ORIENTED AUDITS

C3.5.1. The DoD audit activity shall plan audits that assess an activity's ability to perform its mission effectively and at a reasonable cost. Auditors shall carefully consider the effect of recommendations for cost reductions or improvements, making sure they do not result in lowering performance or capability below an acceptable level.

C3.5.2. Normally, the audit resources of the DoD internal audit activity shall be devoted to mission-related programs or to those support activities or functions that impact on major missions or programs. Further, audits in support areas should concentrate on issues that impact on mission-related programs, or be performed as part of multi-location audits that evaluate specific support activities across-the-board within an Agency or Military Department, or throughout the Department of Defense.

C3.5.3. As a general rule, auditors should evaluate the economy and effectiveness of operations and the related internal controls in each area selected for audit, provide a basis for determining whether improvements are needed, identify the causes of substandard performance or excessive costs, and make realistic recommendations to solve current problems and improve future operations.

C3.5.4. Evaluations of management decisions shall be made using the information existing at the time of the decision and shall include an evaluation of whether adequate management actions were taken as conditions changed.

C3.5.5. Auditors shall determine and report the effect of adverse conditions. Normally, work should be limited to the extent needed to show the significance of the adverse condition and the nature of the risk of continuing the defective policy, procedure, or control. In those instances when audit findings have a significant monetary impact, sufficient work shall be performed to make reasonable estimates of the potential monetary benefits. All estimates of potential monetary benefits shall be coordinated with the auditee. Unless the auditee can provide a more accurate or precise estimate, the auditor's estimate shall be used. Additional guidance computing potential monetary benefits is contained in Chapter 8.

### C3.6. AUDIT-BY-OBJECTIVES APPROACH

Audit-by-objectives is an audit management technique that requires auditors to focus on audit objectives throughout the entire audit cycle from development of the initial audit idea through writing the final audit report. This approach shall be used on all audits, whether multi-location or single location. However, the process should be more formalized for larger audits, such as complex multi-location audits, than for smaller audits. Basic elements of the approach include:

C3.6.1. Establishing specific audit objectives and, if appropriate, a general audit objective for every audit.

C3.6.2. Refining the audit objectives during the planning and survey phases of the audit based on information gathered during each phase.

C3.6.3. Making a formal decision to either continue or curtail the audit at the end of the planning phase and the survey phase before beginning field verification.

C3.6.4. Developing an audit plan to achieve the established audit objectives and produce potential findings and recommendations.

C3.6.5. Structuring the audit approach to determine whether a major problem exists, the extent of the problem, the basic cause of the problem, and to formulate workable solutions.

C3.6.6. Reevaluating the audit approach during the early stages of verification.

C3.6.7. Effectively controlling the audit with a series of go or no-go decision points before beginning each audit phase. High-level audit management shall be involved at the decision points at the start of the audit, at the end of the survey phase, and at the end of the field verification.

C3.6.8. Summarizing audit results in the form of conclusions about the general objective, if there is one, and about each specific objective.

### C3.7. FUNCTIONAL AREA EXPERTS

Most audits in the Department of Defense concern complex issues that require the auditor to possess an in-depth knowledge of the audit area or to have the capability to quickly gain access to that expertise. To ensure that such in-depth knowledge exists within the audit organization, the DoD internal audit organizations shall use the functional area expert concept. Functional area experts, normally, shall be responsible for:

C3.7.1. Maintaining close liaison with key managers responsible for the functional areas in the Military Departments, Defense Agencies, or the OSD, and being aware of significant developments in the assigned areas.

C3.7.2. Disseminating appropriate information about the functional area to others in the audit organization who are involved in planning and conducting audits of the area.

C3.7.3. Preparing long-range and annual plans for the functional area that ensure the area receives adequate audit coverage.

C3.7.4. Quickly responding to requests for information about the functional area from auditors at an audit site.

C3.7.5. Directing major audits and ensuring uniformity of approach for all audits of the functional area.

C3.7.6. Discussing findings and recommendations with top-level managers responsible for the functional area and arranging for responses to findings, draft reports, and final audit reports.

C3.7.7. Developing and submitting, to management, trend or advisory reports that summarize audit results and provide advice on needed management improvements.

## C4. CHAPTER 4

### ACHIEVING AND MAINTAINING PROFESSIONAL PROFICIENCY

#### C4.1. PURPOSE

This chapter prescribes the minimum requirements for DoD internal audit organizations and auditors to achieve and maintain auditor proficiency.

#### C4.2. APPLICABILITY

C4.2.1. The policy and standards outlined in this chapter are mandatory for all DoD internal audit and internal review organizations, including the audit organizations of the military exchange systems (hereafter referred to collectively as "DoD internal audit organizations").

C4.2.2. The provisions of Sections C4.5., C4.6., C4.7., and C4.8. are mandatory for the DoD central internal audit organizations (Army Audit Agency, Naval Audit Service, Air Force Audit Agency, and the Office of the Assistant Inspector General for Auditing), but are optional for internal review and military exchange audit activities. Nevertheless, those activities are strongly encouraged to adopt the essential elements of a Training Management Control System (Section C4.6.), and ensure that professional staffs are qualified (Section C4.7.) and organized (Section C4.8.) effectively to carry out their mission.

#### C4.3. POLICY

C4.3.1. Professional proficiency of employees is the responsibility of the internal audit organization, supervisors, and each auditor.

C4.3.2. Formal training and career development programs shall be established to attract, select, develop, and maintain a competent and effective professional audit staff; and appropriate historical records shall indicate the type and length of training and experience each auditor has received.

C4.3.3. Audit organizations shall budget for training (including self-development courses) in accordance with the guidelines established in this chapter.

C4.3.4. Auditor performance shall be documented through regular performance appraisals (at least annually), and such appraisals shall be used to develop training requirements.

C4.3.5. Except for individuals filling positions designated as requiring specialized technical skills, all auditor personnel of the DoD audit organizations shall meet the qualification criteria for the GS-511 series (auditor).

#### C4.4. STANDARDS

Chapter 2 of this Manual contains the DoD internal auditing standards. The following standards apply to training and staff development:

C4.4.1. 220 - Auditor Qualifications

C4.4.2. 230 - Human Relations and Communications

C4.4.3. 240 - Continuing Education

C4.4.4. 610 - Organization

C4.4.5. 670 - Internal Audit Organization Qualifications

C4.4.6. 680 - Personnel Management and Development

#### C4.5. RESPONSIBILITIES

C4.5.1. The Assistant Inspector General for Audit Policy and Oversight AIG(APO) will review, as part of its oversight function, the implementation of this chapter by the DoD internal audit organizations. In addition, the AIG(APO), as necessary, shall sponsor meetings of the DoD audit training personnel to exchange and share training programs, practices, techniques, etc.

C4.5.2. The Heads of the DoD Central Internal Audit Organizations shall:

C4.5.2.1. Establish formal training and career development programs, which include the following:

C4.5.2.1.1. Publication of training policies and procedures;

C4.5.2.1.2. Determination of auditor skill requirements;

C4.5.2.1.3. Development of on-the-job training programs and formal training courses;

C4.5.2.1.4. Maintenance of training history records;

C4.5.2.1.5. Use of performance appraisals in the determination and planning of training; and

C4.5.2.1.6. Development of annual training plans.

C4.5.2.2. Provide training support, as they deem appropriate, to internal review and applicable nonappropriated fund audit organizations. This support shall include providing information on available training, conducting special training courses as appropriate, and allotting space for in-house training courses.

#### C4.6. TRAINING MANAGEMENT CONTROL SYSTEM

A successful training program requires management's constant assessment of changing needs, present and future; encouragement of, and support for, individual development to meet those needs; and a commitment of sufficient resources to make it possible. (See enclosure 1 to this chapter.) The elements of a management control process for training are outlined in the following paragraphs of this chapter:

C4.6.1. Policies and Procedures. The policies and procedures covering the management and execution of the training program shall:

C4.6.1.1. Define the training responsibilities of each organizational element responsible for training (e.g., training management branch, first-level supervisor, individual, etc.);

C4.6.1.2. Contain the documents and forms used in the training process;

C4.6.1.3. Establish minimum training requirements for each position;

C4.6.1.4. Contain instructions for the preparation of annual training Plans;

C4.6.1.5. Includes examples of self-development programs; and

C4.6.1.6. Prescribe criteria covering reimbursement to employees for job-related training.

C4.6.2. Auditor Profile. The profile presented by the President's Council on Integrity and Efficiency (PCIE) Training Committee in March 1986 in their "Training Program Guide for Government Audit Activities" (reference (1)) shall be used as a guide for developing an auditor profile. The PCIE profile is a multi-purpose guide that may not be entirely suitable for all DoD internal audit organizations in terms of the suggested hours and subjects prescribed. Audit organizations shall carefully consider the PCIE suggestions and tailor their own profiles to the needs of the organization and its auditors. Excerpts from the PCIE profile are shown in enclosures 2 through 6 to this chapter.

C4.6.3. Performance Appraisals. Supervisors shall submit a performance appraisal for each staff auditor at least once a year that will, as a minimum and as appropriate, identify those areas of an individual's performance that are deficient and could be improved or enhanced by additional learning, practice, or developmental experiences. Training needs shall be incorporated into the plans discussed in paragraph C4.6.4. following.

C4.6.4. Individual Development Plan (IDP). All auditors shall prepare an IDP that should be reviewed annually and updated as required. The IDP is the basic instrument of communication with management concerning professional goals and needs for further training.

C4.6.4.1. The IDP represents an understanding between each auditor, the supervisor, and management with respect to how training may advance and maintain professional proficiency, as well as mission accomplishment. Once evaluated and approved by management and returned to the auditor through the supervisor, it serves as a benchmark for making developmental decisions concerning professional growth. The IDP should not be construed as an idealistic "wish list," but rather it should be realistic and primarily address the "most important" job-related auditor training and development needs.

C4.6.4.2. The IDP, as a minimum, shall contain:

C4.6.4.2.1. Professional goals to include desired work-related courses, degrees, and professional certificates, as applicable.

C4.6.4.2.2. A description of training objectives to aid in accomplishing those professional goals.

C4.6.4.2.3. An action plan of the types of work assignments to aid in accomplishing those professional goals.

C4.6.5. Training History Record. An up-to-date, complete, and accurate record of each staff member's training is a required ingredient in the overall training management process. The most efficient method to do this is to automate the function. Excerpts from the PCIE's "Training Program Guide for Government Audit Activities," (reference (1)) (enclosures 3 and 4 to this chapter) illustrate how an automated history file can be used. As a minimum, training records will be developed for each staff member and those records will be retained for 5 years and used to evaluate training needs. Typical information may include:

C4.6.5.1. Degree(s) earned, major area(s) of study, and the year earned;

C4.6.5.2. Professional certification(s);

C4.6.5.3. Publications (magazine, book, title, year published, etc.);

C4.6.5.4. Membership in professional organization(s) (designate member or office held, if applicable);

C4.6.5.5. Awards received (purpose, date, and awarder);

C4.6.5.6. A synopsis of prior audit experience; and

C4.6.5.7. Any other data considered pertinent.

C4.6.6. Training Plans. An annual and long range training plan shall be developed each year. The data from the auditor profile, the IDPs, individual training history records and performance appraisals, known or anticipated mission requirements, and other significant data shall be used to make up the training plans. The annual plan shall detail the:

C4.6.6.1. Type of on-the-job training;

C4.6.6.2. Type of courses, together with sources and costs;

C4.6.6.3. Identities and numbers of auditors from each region, area, or office who will receive the training; and

C4.6.6.4. Extent of self-development provided for them through graduate studies, special courses from various universities, and study toward professional certification, identifying all course titles when known.

The long-range plan shall anticipate any future training needs. This plan shall provide for a projection of training needs (resources, hours, funds) for a period of at least 2 but not more than 4 years beyond the current year.

C4.6.7. Minimum Auditor Training. The DoD internal audit organizations shall set aside resources annually for the training of auditors.

C4.6.7.1. Internal audit organizations shall ensure that trainees and new hires receive training in the following matters during their first 2 years of employment:

- C4.6.7.1.1. New employee orientation
- C4.6.7.1.2. Government Auditing Standards
- C4.6.7.1.3. DoD internal auditing standards, concepts, and procedures
- C4.6.7.1.4. DoD internal audit policy
- C4.6.7.1.5. Written communications
- C4.6.7.1.6. Non-written communications
- C4.6.7.1.7. Introduction to the audit mission
- C4.6.7.1.8. Investigation orientation
- C4.6.7.1.9. Interviewing techniques
- C4.6.7.1.10. Computer training
- C4.6.7.1.11. Internal controls

This formal training may be received in-house or through outside sources, whichever is deemed more appropriate.

C4.6.7.2. To ensure that all DoD auditors achieve and maintain their professional proficiency, the following shall be established as desired training objectives:

<u>Auditors</u>	ANNUAL TRAINING HOURS ( <u>Excluding on-the-job Training</u> )
1 <sup>st</sup> and 2 <sup>nd</sup> Year	40 - 120
3d Year and Thereafter	40 - 80

The amount of training received by each individual can vary depending on environment and circumstances, but audit organizations shall ensure that a minimum of 80 hours of continuing education and training are received every 2 years. In addition,, at least 20 hours should be completed in any 1 year of the 2-year period; and at least 24 hours should be directly related to the Government environment and to Government auditing, as required by the Government Auditing Standards (reference (c)).

C4.6.8. In-House Training. The DoD central internal audit organizations and those other audit organizations able to do so shall organize an in-house cadre of qualified instructors to develop and teach courses or subjects unique to DoD operations and activities.

C4.6.9. On-the-Job Training. The DoD central internal audit organizations shall develop a formal on-the-job training program that requires written documentation when training has been accomplished. It shall be designed to train newly hired auditors through self-study and supervised instruction to perform their jobs while actually working on various types of audit assignments. Training areas may be varied according to the experience of each individual. The program shall also outline the responsibilities of trainees, auditors, supervisors, training officers, etc., involved.

C4.6.10. Self-Development. The DoD internal audit organizations shall reimburse employees engaging in approved self-development training - graduate courses, special courses, certification study, etc. - that meets legal regulations and requirements so long as training funds are available and distributed equitably among the staff.

C4.6.10.1. The DoD internal audit organizations are encouraged to budget and reimburse staff members the legal maximum amount for tuition costs and books for successfully completed courses that are considered sufficiently related to present or anticipated job duties to be of benefit to the audit organization or the Department of Defense.

C4.6.10.2. To ensure the continued high professional expertise of DoD auditors, DoD internal audit organizations shall encourage their auditors to seek professional certifications. Job-related review courses, such as Certified Public Accountant (CPA), Certified Internal Auditor (CIA), Certified Information Systems Auditor (CISA), and other related certification courses, shall be reimbursed the legal

maximum amount for tuition costs when possible. In addition, DoD internal audit organizations are encouraged to grant employees an excused absence on the day(s) of the examination(s). Applicable DoD personnel regulations permit this type of excused absence on the basis that such an absence will further an Agency function.

C4.6.10.3. The DoD internal audit organizations shall also encourage their staffs to belong to and actively participate as members on committees and as officers of professional organizations such as:

C4.6.10.3.1. American Institute of Certified Public Accountants (AICPA)

C4.6.10.3.2. American Society of Military Comptrollers (ASMC)

C4.6.10.3.3. Association of Government Accountants (AGA)

C4.6.10.3.4. Institute of Internal Auditors (IIA)

C4.6.10.3.5. State Societies of CPAs

C4.6.10.3.6. Other Audit and/or Management Related Organizations and/or Associations

Active participation by staff members in these types of professional organizations ensures that the DoD internal audit community remains up to date on new concepts and techniques and that the profession as a whole obtains the benefits of any innovative internal audit approaches developed within the Department of Defense. Further, the DoD internal audit organizations are encouraged to take advantage of all training programs provided by these professional organizations.

C4.6.11. Rotation Assignments. Training key personnel through planned formal rotational assignments can greatly benefit an audit organization. Such assignments shall ensure equal opportunity and be used for cross training and development of key personnel at the middle, senior, and executive levels; and participants should be individuals with demonstrated high potential. All formal rotational assignment plans of this type must be in compliance with DoD 1400.25-M (reference (m)).

C4.6.12. Executive Development Plan. Senior-level employees are eligible for the Executive Development Plan of their DoD Component that identifies and selects middle managers with high potential under DoD 1400.25-M (reference (m)). Each of the DoD Components has developed such a plan. Each audit organization is encouraged to participate fully in such a plan.

#### C4.7. QUALIFICATIONS

Except as noted, all personnel, military or civilian, assigned to internal auditor or internal audit management positions shall meet the Office of Personnel Management standards for the GS-511 series. The Auditors General of the Army, Navy, and Air Force and the Assistant Inspector General for Auditing, OIG, DoD, shall be qualified civilians. Exceptions to these general qualification requirements are as follows:

C4.7.1. Personnel skilled in such disciplines as mathematical sciences, automatic data processing, or engineering, if positions requiring such qualifications have been established and properly classified under OPM regulations.

C4.7.2. Junior military officers or enlisted personnel assigned to non-supervisory duty in the audit organization for the purpose of gaining broadened experience. Such assignees must possess a background or education sufficient to perform satisfactorily on audit assignments and to absorb additional training.

C4.7.3. Personnel currently serving in internal or nonappropriated fund audit positions without GS-511 auditor qualifications shall be encouraged to acquire the background or experience necessary to become fully qualified and, with the exceptions noted in paragraphs C4.7.1. and C4.7.2., above, vacancies in these positions shall generally be filled by personnel qualified as GS-511 auditors.

#### C4.8. AUDIT STAFF STRUCTURE

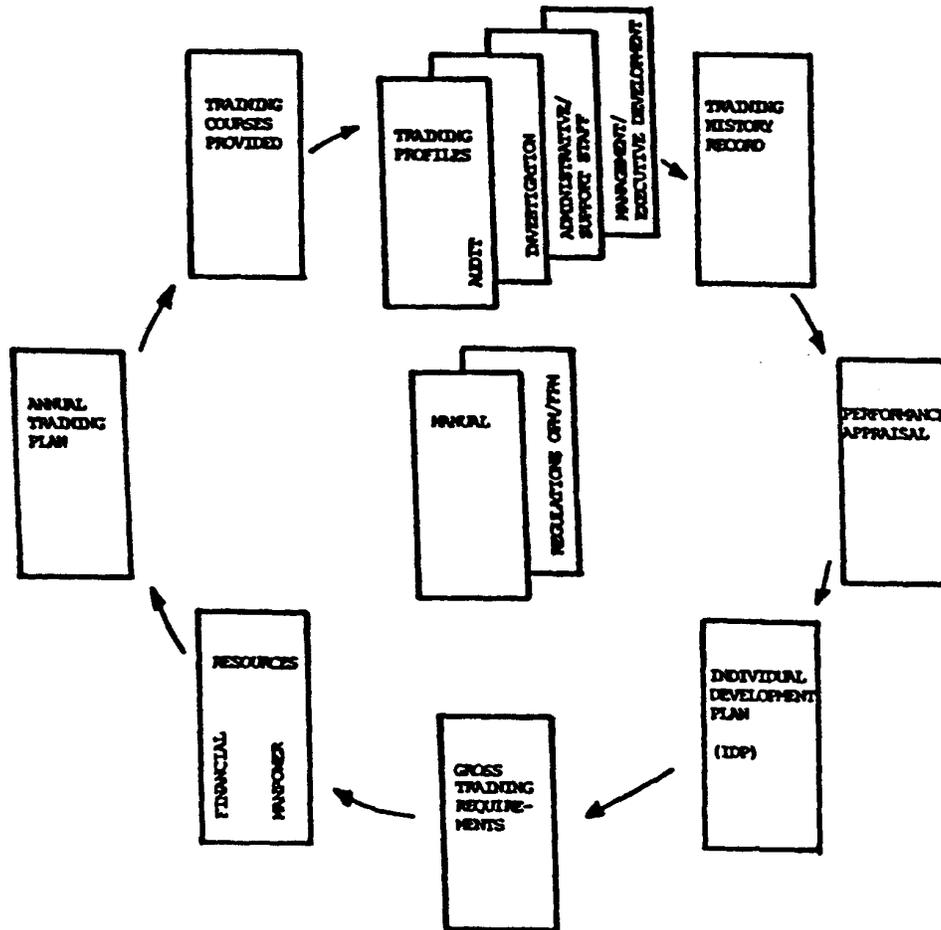
The audit staff structure shall conform to the following OPM generic position designations that also apply to military auditors and to civilian auditors employed by nonappropriated fund activities on the basis of rank equivalents:

<u>Auditor Level</u>	<u>Position</u>	<u>Description of Duties</u>
Entry Level	Staff Assistant GS-5 to GS-9	Trainees and auditors with limited experience performing detailed tasks under relatively close supervision.
Intermediate Level	Semi-Senior GS-11	On less complex audits, works with limited supervision.
Senior Level	Senior GS-12	Performs in all respects at the journeyman level. Serves as lead auditor on large complex audits, serves as auditor-in-charge on less complex audits.
Senior Level	Supervisory Senior GS/GM-13	Serves as area audit office chief, audit manager, auditor-in-charge, or as lead auditor on extremely complex audits.
Executive Level	GM-14, GM-15, SES	Audit management positions shall be at GM-14 or higher levels, depending on the complexity of the responsibilities assigned.

C4.E1. ENCLOSURE 1 OF CHAPTER 4

OFFICE OF INSPECTOR GENERAL TRAINING MANAGEMENT CONTROL SYSTEM

Figure C4.F1. TRAINING MANAGEMENT CONTROL SYSTEM



C4.E2. ENCLOSURE 2 OF CHAPTER 4  
TRAINING PROFILES

C4.E2.1.1. The first Government auditor training profile was developed in 1979 by the Federal Auditor Executive Council to provide an overall expression of the types of training for developing and maintaining the skills of a Government auditor. The profile was intentionally designed to be broad and flexible to allow each Governmental audit organization to use it as a guideline in developing a profile to meet its specific needs.

C4.E2.1.2. The passage of the Inspector General Act and the tremendous technological changes in recent years have placed increased demands on the skills required of Government auditors. The original profile no longer covers some of these skill needs; therefore, the PCIE Training Committee adopted a project under its Audit Subcommittee to expand and update the Government auditor profile.

C4.E2.1.3. The new profile (enclosure 3 to this chapter) is in the same format as the original one; however, the auditing disciplines have been revised and expanded to include the additional skills required of today's Government auditors.

C4.E2.1.4. The new profile also retains the flexibility of the old one and anticipates that Government audit organizations will use it as a guide to develop their own profiles.

C4.E2.1.5. Standard training profiles do not exist for senior executives. However, the Office of Personnel Management has published an excellent guide titled "Developing Executive and Management Talent," dated August 1980, that can be used for SES career development planning. This publication establishes an outline for the senior manager to follow in addressing both the technical and executive competencies required for his/her position and the courses, Federal fellowships, and developmental assignments available to meet the required training needs.

C4.E3. ENCLOSURE 3 OF CHAPTER 4GOVERNMENT AUDITOR TRAINING PROFILE

<u>Listing of Disciplines</u>	LEVELS OF TRAINING <sup>1</sup>			
	<u>BASIC</u>	<u>INTERMEDIATE</u>	<u>ADVANCED</u>	<u>EXECUTIVE</u>
<u>1.0 NEW EMPLOYEE ORIENTATION</u>				
Department Administrative Matters	A1.1	--	--	--
Responsibilities of the Federal Employee/Standards of Conduct	A1.2.	--	--	--
Overview of Government Regulations/Inspector General Act/Office of Management and Budget Circulars	A1.3.	--	--	--
Departmental Organization, Mission, Programs, and Responsibilities	A1.4.	--	--	--
Office of Inspector General Organization, Policies and Procedures	A1.5.	--	--	--
<u>2.0 AUDIT PRINCIPLES AND PROCEDURES</u>				
Generally Accepted Government Auditing Standards	A2.1.	B2.1.	--	--
Types and Phases of Governmental Audits	A2.2.	B2.2.	--	--
Evidential Matters	A2.3.	B2.3.	--	--
Workpaper Design and Preparation	A2.4.	B2.4.	--	--
Elements of Audit Findings	A2.5.	B2.5.	--	--
Conducting Audit Surveys	A2.6.	B2.6.	--	--
Developing Audit Programs	A2.7.	B2.7.	--	--
Audit Reporting Requirements	A2.8.	B2.8.	--	--
Audit Follow-up Requirements	A2.9.	B2.9.	--	--
<u>3.0 AUDIT APPLICATIONS AND EVALUATION</u>				
Flowcharting	A3.1.	--	--	--
Quantitative Methods	A3.2.	B3.2.	C3.2.	--
Internal Control Assessments	--	B3.3.	C3.3.	--
Financial Analysis	--	B3.4.	C3.4.	--
Manpower Analysis	--	B3.5.	C3.5.	--
Plant and Equipment Analysis	A3.6.	B3.6.	--	--
Inventory Analysis	A3.7.	B3.7.	--	--
Forecasting	--	B3.8.	C3.8.	--
Accounting Systems Reviews	--	B3.9.	C3.9.	--

<u>Listing of Disciplines</u>	LEVELS OF TRAINING <sup>1</sup>			
	<u>BASIC</u>	<u>INTERMEDIATE</u>	<u>ADVANCED</u>	<u>EXECUTIVE</u>
<u>4.0 WRITTEN COMMUNICATIONS</u>				
Writing Audit Findings	A4.1.	B4.1.	--	--
Writing Audit Reports	--	B4.2.	C4.2.	--
Editing and Reviewing Audit Reports	--	B4.3.	C4.3.	--
<u>5.0 NON-WRITTEN COMMUNICATIONS</u>				
Interviewing/Entrance and Exit Conferences	A5.1.	B5.1.	--	--
Listening/Reading Improvement	A5.2.	B5.2.	--	--
Interpersonal Communication	--	B5.3.	C5.3.	--
Oral Presentations	--	--	C5.4.	D5.4.
Conducting Meetings	--	--	C5.5.	D5.5.
<u>6.0 AUDIT MANAGEMENT AND PROFESSIONAL DEVELOPMENT</u>				
Audit Supervision	--	B6.1.	C6.1.	--
Workload Planning	--	B6.2.	C6.2.	D6.2.
Resources Management	--	--	C6.3.	D6.3.
Organizational Development	--	--	C6.4.	D6.4.
Executive Skills and Concepts	--	--	C6.5.	D6.5.
Audit Productivity	--	--	C6.6.	D6.6.
Quality Control	--	B6.7.	C6.7.	D6.7.
<u>7.0 INVESTIGATION ORIENTATION</u>				
Fraud Awareness and Reporting	A7.1.	B7.1.	--	--
Basic Investigative Techniques	A7.2.	B7.2.	--	--
Elements of Fraud	A7.3.	B7.3.	C7.3.	--
Procurement Fraud	A7.4.	B7.4.	C7.4.	--
Computer Fraud	A7.5.	B7.5.	C7.5.	--
<u>8.0 AUTOMATED DATA PROCESSING</u>				
Skill Level I	A8.1.	--	--	--
Skill Level II	--	B8.2.	C8.2.	--
Skill Level III	--	--	C8.3.	D8.3.
Auditing Microcomputer Networks	--	B8.4.	C8.4.	--

<u>Listing of Disciplines</u>	<u>LEVELS OF TRAINING</u> <sup>1</sup>			
	<u>BASIC</u>	<u>INTERMEDIATE</u>	<u>ADVANCED</u>	<u>EXECUTIVE</u>
<u>9.0 MICROCOMPUTERS</u>				
Basic Skills	A9.1.	B9.1.	C9.1.	D9.1.
Advanced Skills	A9.2.	B9.2.	--	--
Software Applications	A9.3.	B9.3.	--	--
<u>10.0 CONTRACT AUDITING</u>				
Introduction to Federal Contract Auditing	A10.1.	--	--	--
Federal Procurement Process Regulations	A10.2.	B10.2.	--	--
Cost Accounting Standards	A10.3.	B10.3.	--	--
Contract Cost Principles	A10.4.	B10.4.	--	--
Contract Pricing Requirements	A10.5.	B10.5.	--	--
Modifications and Amendments	--	B10.6.	--	--
<u>11.0 GRANT AUDITING</u>				
Introduction to Federal Grant Processes/Regulations	A11.1.	--	--	--
Cost Principles for Grants	A11.2.	--	--	--
Single Audit and Block Grant Concepts	--	B11.3.	C11.3.	--
<u>FEDERAL FUNCTIONAL/PROGRAM TRAINING</u>				
12.0 Financial Management/Federal Budget Process	A12.	--	--	--
13.0 Federal Procurement and Contract Management	A13.	--	--	--
14.0 Property and Supply Management	A14.	--	--	--
15.0 Maintenance and Repair Management	A15.	--	--	--
16.0 Personnel/Manpower Management	A16.	--	--	--
17.0 Transportation Management	A17.	--	--	--
18.0 Communications Management	A18.	--	--	--
19.0 Major Systems/Programs Management	A19.	--	--	--

<sup>1</sup> Descriptions of the various training levels (basic, intermediate, etc.) are shown in enclosure 4 to this chapter.

C4.E4. ENCLOSURE 4 OF CHAPTER 4  
DESCRIPTION OF TRAINING LEVELS

C4.E4.1. BASIC

All beginning auditors should receive basic-level training. This level of training consists of several categories and individual disciplines to assist in the development and adaptation of audit organizations with differing missions. The individual training disciplines would depend on the mission and responsibilities of the audit organization. Disciplines can be provided as individual courses or as training modules in an entry-level course. Substantial progress should be made in providing formal training in essential skills during the first year of employment. New employee orientation, auditing principles and procedures, written communications, non-written communications, and introductory training unique to the audit mission should be accomplished. These should be followed by basic training in audit applications and evaluation, investigation orientation, automated data processing and, where necessary, tract and/or grant auditing. Basic-level training should be essentially complete within 2 years of employment. Total investment in basic-level training may include from 6 to 8 weeks of formal classroom and self-study time.

C4.E4.2. INTERMEDIATE

Intermediate-level assumes substantial completion of basic-level training. Courses at this level represent increases in the complexity of disciplines provided at the basic level and introduce new or remedial training for developing auditor effectiveness and/or specialization. Depending upon the audit mission and the need for specialization, an additional 8 to 10 weeks of intermediate-level training may be required. The majority of intermediate and all planned basic-level training should be accomplished within four years of initial employment.

C4.E4.3. ADVANCED

Advanced-level training is designed for senior auditors and supervisory-level personnel. It assumes auditors have achieved mid-level responsibilities and have fulfilled basic and intermediate requirements. Training at this level is expected to develop in-depth knowledge and skills needed to manage an audit from inception to issuance of an audit report and to provide for technical specialists in support of unique mission requirements. Heavy emphasis on audit management and professional

development should coincide with advanced written and non-written communication skills. Selected emphasis in automated data processing and other specialized technical areas are needed to maintain and improve organization capabilities and proficiencies. Investment in advanced training should include approximately 3 weeks a year over an estimated 3 to 5 years to achieve minimum proficiency for executive-level consideration. In addition, individual development may include a graduate education program and success on professional certification exams.

#### C4.E4.4. EXECUTIVE

Executive-level training enhances upper-level management knowledge and skills that are related to Government audit organization operations. It is not intended to replace executive development programs established for senior executives by the OPM but to complement those programs that advance internal audit operations and professionalism in the auditing community.

C4.E5. ENCLOSURE 5 OF CHAPTER 4  
DESCRIPTION OF TRAINING CATEGORIES

C4.E5.1.1. New Employee Orientation. This category, intended for all new audit employees, provides the auditor with the basic knowledge needed as a federal OIG/audit agency employee. A course encompassing this category gives the new employee an overview of laws, regulations, directives, policies, procedures, mission, programs and responsibilities. This course should be given as soon as possible after the auditor begins work and should not last more than 2 days.

C4.E5.1.2. Auditing Principles and Procedures. The auditor needs to learn the basic auditing principles and procedures to accomplish the audit function. At the basic level, the disciplines covered may be incorporated into a single, comprehensive 2 week course that enables the auditor to function effectively as a junior member of an audit team. This course should be completed as soon as possible, and certainly within the first year of employment.

C4.E5.1.2.1. The intermediate-level disciplines may also be incorporated into a 2-week course.

C4.E5.1.2.2. At this level, new disciplines are added and complexity is increased.

C4.E5.1.2.3. Reinforcement is also a major goal for some disciplines.

C4.E5.1.2.4. At the end of the intermediate level, the auditor should have sufficient knowledge and skills to begin to assume responsibilities as an audit senior, lead auditor or auditor-in-charge.

C4.E5.1.3. Audit Applications and Evaluation. This category is designed to teach auditors how to use important techniques and tools. At the basic level, the disciplines are combined into an overview course. Auditors will not develop operating expertise but will be able to recognize needs and where to go to get the need filled. The basic-level course can be given at any time during the first 30 months of employment.

C4.E5.1.3.1. The intermediate level strives to develop sufficient skills so the auditor can use the technique or tool in job situations. Statistical sampling and cost-benefit analysis are types of courses that might be covered at this level in the quantitative methods discipline.

C4.E5.1.3.2. At the advanced level, skills would be developed to a high degree -- such as the organizational expert.

C4.E5.1.3.3. All auditors need to take the basic-level courses. However, at the intermediate and advanced levels, auditors should be assigned on the basis of individual aptitude and organizational needs.

C4.E5.1.4. Written Communications. The courses at all levels should take about 1 week. The ability to write clearly and concisely and to use the proper style and format are of utmost importance to auditors. At the basic level, the course introduces the new employee to Government style. The subjects would include formats, the use of audit terms, and how to write working paper summaries and findings.

C4.E5.1.4.1. At the intermediate level, new disciplines are added, the complexity is increased, and the techniques learned during the basic-level course are reinforced. At this level, more emphasis is placed on report writing and on the importance of presenting material in an unbiased manner.

C4.E5.1.4.2. Courses at the advanced level will concentrate on writing whole reports and on editing and reviewing the work of others.

C4.E5.1.5. Non-written Communications. The disciplines in this category are designed to help the auditor deal with auditees and others by telephone, interview, meetings, briefings, and so forth. Only two disciplines in this category should be required of all auditors -- interviewing/entrance and exit conferences at the basic-level, which should be given within the first year of training, and oral presentations at the intermediate level. Other disciplines will be given if needed.

C4.E5.1.6. Audit Management and Professional Development. This subject teaches the tools and concepts audit supervisors need in order to use the resources entrusted to them and to carry out their audit responsibilities in a professional manner. The intermediate-level courses are designed to prepare the lead auditor/auditor-in-charge for these responsibilities. No basic-level courses are given. This training is required for all employees advancing to the middle-management level. The courses provide an understanding of the role of the supervisor, the styles of leadership, motivation, and workload planning.

C4.E5.1.6.1. New courses are added at both the advanced and executive levels to broaden perspectives and to deal with organizational complexity.

C4.E5.1.6.2. Included in the upper level are courses in resource management, organizational development, and productivity.

C4.E5.1.7. Investigation Orientation. This category is not designed to form auditors into investigators, only to make them aware of investigative activities and the types of activities investigated and to foster cooperation and teamwork.

C4.E5.1.7.1. At the basic level, the disciplines can be incorporated into a brief overview of investigative activities and techniques.

C4.E5.1.7.2. At the intermediate level, a more in-depth 1-week course should be given that emphasizes the elements of fraud, investigative techniques, and the responsibilities of the auditor in reporting suspicious activities to investigators and in collecting and preserving evidence.

C4.E5.1.7.3. At the advanced level, the discipline calls for review, to sharpen the auditor's sense of awareness and cooperation.

C4.E5.1.8. Automated Data Processing (ADP). The first level of computer audit skills is required for each auditor. The skills make auditors aware of computer system areas. At the second level of skill, an auditor should be able to recognize evidence of common computer-fraud schemes and to evaluate internal controls, identify weaknesses in the controls, and use and adapt generalized audit software packages to test identified weaknesses.

C4.E5.1.8.1. Computer auditors at the third skill level should have wide experience in ADP systems and should be capable of designing and implementing audit software routines. Level III computer auditors should also have some understanding of operating systems, software security, database management systems and data communications.

C4.E5.1.8.2. The knowledge and technical capabilities required at the respective skill levels are summarized in enclosure 6 to this chapter.

C4.E5.1.9. Microcomputers. This category provides auditors with the knowledge and skills necessary to use microcomputers in the performance of audits. The basic-level course introduces the auditor to microcomputer technology and provides minimum skills for the operation of microcomputers. All auditors should receive basic-level training.

C4.E5.1.9.1. The advanced course develops the auditors proficiency in using the advanced technical capabilities of microcomputers and of mainframe computers as an audit tool.

C4.E5.1.9.2. The auditors should also be trained in the use of microcomputer software packages selected for audit use by the audit organization.

C4.E5.1.10. Contract Auditing. The introductory course at the basic level is designed to give auditors an overview of contract auditing. The other disciplines in this category are optional, unless the auditor is expected to have contract audit responsibilities. The disciplines include the Federal procurement process, regulations, standards, principles, and requirements. At the intermediate level, auditors are expected to develop contract audit expertise. (No courses are given above this level.)

C4.E5.1.11. Grant Auditing. The basic-level disciplines indoctrinate the auditor on the purposes of Federal grants, grant agreement regulations, audit responsibilities, and the use of principles and methodologies to evaluate grant activities. At the intermediate level, which is optional unless the auditor has grant auditing responsibilities, single audit and block-grant concepts are taught.

C4.E5.1.12. Federal Functional/Program Training. There are other categories of unique audit applications that are not common to all audit organizations and do not require mandatory training for all auditors. While the profile only shows training at the basic level, training can be offered to intermediate, advanced and executive-level personnel if it is required by individual or Agency needs. Examples of unique audit applications include: Federal Procurement and Contract Management (GSA); Major Weapon Systems/Programs Management (DoD); Transportation Management (DoT); Property Management (HUD).

C4.E6. ENCLOSURE 6 OF CHAPTER 4AUTOMATIC DATA PROCESSING

<u>CATEGORY</u>	<u>Skill Levels</u>		
	<u>LEVEL I</u>	<u>LEVEL II</u>	<u>LEVEL III</u>
Types	All trainee and journeyman-level auditors grades 7 to 12.	Selected auditor-in-charge or supervisory field auditors grades 12 to 13.	Selected headquarters-level auditors, supervisors, grades 12 to 15.
Responsibilities	Participate in audits of internal controls in computer-based systems under the supervision of skill-level II.	Plan and supervise audits of computer-based systems using ADP audit techniques.	Plan and supervise audits of computer-based systems and advise and assist skill-level II auditors in using high technology ADP audit techniques.
Numbers	All auditors.	Two to 3 per location.	Two to 20 per agency.

AUTOMATIC DATA PROCESSING

<u>KNOWLEDGE</u>	<u>LEVEL I</u>	<u>LEVEL II</u>	<u>LEVEL III</u>
Computer Systems	Familiarity	Basic Understanding	In-depth knowledge
File Processing Systems	Familiarity	Basic Understanding	In-depth knowledge
Systems Documentation	Familiarity	Basic Understanding	In-depth knowledge
Computer Security	Familiarity	Basic Understanding	In-depth knowledge
ADP General Controls	Familiarity	Basic Understanding	In-depth knowledge
ADP Application Controls	Familiarity	Basic Understanding	In-depth knowledge
Operating System Software	(Not required)	Familiarity	Basic Understanding
Database Management Systems	(Not required)	Familiarity	Basic Understanding

<u>SKILLS *</u>	<u>LEVEL I</u>	<u>LEVEL II</u>	<u>LEVEL III</u>
Communications	(Not required)	Familiarity	Basic Understanding
Networking	(Not required)	Familiarity	Basic Understanding
Systems Design	(Not required)	Familiarity	Basic Understanding
Generalized Audit Software	Ability to use	Ability to use and modify	Ability to design
Customized Audit	Ability to use with assistance	Ability to use and modify	Ability to design
Utility Programs	Ability to use with assistance	Ability to use with ease	Ability to use with ease
Time-Sharing Services	Ability to use with assistance	Ability to use with ease	Ability to use with ease
Flowcharting and Identifying Internal Controls	Perform with assistance	Perform with ease	Perform with ease
High-Order Programming Languages	Ability to use	Ability to modify	Ability to write
Job Control Language	(Not required)	Ability to write with assistance	Ability to write with ease
Logging	(Not required)	Use with ease	Use with ease
Program Logic Reviews	(Not required)	Perform with ease	Perform with ease
Accounting Data Analysis	(Not required)	Perform with ease	Perform with ease
Test Data	(Not required)	Use with minimal assistance	Perform with ease
Test Data Generators	(Not required)	Use with minimal assistance	Use with ease

<u>SKILLS *</u>	<u>LEVEL I</u>	<u>LEVEL II</u>	<u>LEVEL III</u>
Database Query Facilities	(Not required)	Use with minimal assistance	Use with ease
Simulation	(Not required)	(Not required)	Ability to use
Audit Modules	(Not required)	(Not required)	Ability to use
Integrated Test Facilities	(Not required)	(Not required)	Ability to use
Tagging Selected Records	(Not required)	(Not required)	Ability to use
Tracing Software	(Not required)	(Not required)	Ability to use
Extended Records	(Not required)	(Not required)	Ability to use
Program Comparison Software	(Not required)	(Not required)	Ability to use

\* Some of these skills can or may be acquired from prior experience or on-the-job training.

C4.E7. ENCLOSURE 7 OF CHAPTER 4LIST OF TRAINING COURSES TAKEN  
(John Smith Jones, SSN: 222-22-2222)

<u>COURSE</u>	<u>CODE</u>	<u>DATE</u>	<u>NO. DAYS</u>	<u>DUTY HOURS</u>	<u>NON-DUTY HOURS</u>	<u>COURSE \$</u>	<u>TRAVEL \$</u>
New Employees Orientation	A1.1-5	Jul 78	2	16	--	50	--
Introduction to Government Auditing Inter-Agency Auditor Training Program	A2.1-9 A4.1 A5.1-2	Sep 78	10	80	--	125	450
Statistical Sampling American Institute of Certified Public Accountants	A3.2	Jan 79	5	--	40	50	--
Basic Written Communications	A4.1-2	Mar 79	5	40	--	225	--
Basic ADP Concepts	A8.1	Aug 79	5	40	--	250	450
Flowcharting Inter-Agency Auditor Training Program	A3.1	Nov 79	2	16	--	200	--
Contract Auditing	A9.1	Jan 80	5	40	--	325	--
Prevention and Detection of Fraud, Waste, and Abuse	A7.1-3	Apr 80	2	16	--	150	--
Cost-Benefit Analysis	A3.6	Oct 80	3	24	--	--	--
Writing Audit Reports	B4.2-4	Jan 81	5	40	--	250	--
Project Management	B3.4-8	Jul 81	10	64	16	350	--

C4.E8. ENCLOSURE 8 OF CHAPTER 4  
TRAINING PROFILE  
(JOHN SMITH JONES, SSN: 222-22-2222)

	<u>TRAINING TAKEN</u>	<u>SUFFICIENT TRAINING TAKEN</u>
1.0 NEW EMPLOYEE ORIENTATION		
Departmental Administrative Matters	X	X
Responsibilities of the Federal Employee/Standards of Conduct	X	X
Overview of Government Regulations/Inspector General Act/Office of Management and Budget Directives	X	X
Departmental Organization, Mission, Programs and Responsibilities	X	X
Office of Inspector General Organization, Policies and Procedures	X	X
2.0 AUDITING PRINCIPLES AND PROCEDURES		
Generally Accepted Government Auditing Standards	X	X
Types of Government Audits	X	X
Phases of Government Audits	X	X
Evidential Matters	X	X
Working Paper Design and Preparation	X	X
Elements of Audit Findings	X	X
Conducting Audit Surveys	X	X
Developing Audit Programs	X	X
Audit Reporting Requirements	X	X
Audit Follow-up Requirements	X	X
3.0 AUDITING APPLICATIONS AND EVALUATION		
Flowcharting	X	X
Quantitative Methods	X	
Internal Control Assessments	X	
Financial Analysis	X	
Manpower Analysis	X	
Plant and Equipment Analysis	X	X
Inventory Analysis	X	
Forecasting	X	
Accounting Systems Reviews	X	

	<u>TRAINING TAKEN</u>	<u>SUFFICIENT TRAINING TAKEN</u>
4.0 WRITTEN COMMUNICATIONS		
Writing Audit Findings	X	X
Writing Audit Reports	X	
Editing and Reviewing Audit Reports	X	
5.0 NON-WRITTEN COMMUNICATIONS		
Interviewing/Entrance and Exit Conferences	X	
Listening/Reading Improvement	X	
Interpersonal Communication	X	
Oral Presentation		
Conducting Meetings		
6.0 AUDIT MANAGEMENT AND PROFESSIONAL DEVELOPMENT		
Audit Supervision	X	
Workload Planning	X	
Resources Management		
Organizational Development		
Executive Skills and Concepts		
Audit Productivity		
Quality Control		
7.0 INVESTIGATION ORIENTATION		
Fraud Awareness and Reporting	X	X
Basic Investigative Techniques	X	X
Elements of Fraud	X	X
Procurement Fraud	X	X
Computer Fraud	X	X

	<u>TRAINING TAKEN</u>	<u>SUFFICIENT TRAINING TAKEN</u>
8.0 AUTOMATED DATA PROCESSING		
ADP Concepts and Facilities	X	
ADP Auditing	X	
Audit Software		
File Organization and Accessing Methods		
Data Communications		
System Analysis and Design		
9.0 MICROCOMPUTERS		
Basic Skills	X	X
Advanced Skills		
Software Applications		
10.0 CONTRACT AUDITING		
Introduction to Federal Contract Auditing	X	X
Federal Procurement Process/Regulations		
Cost Accounting Standards		
Contract Cost Principles		
Contract Pricing Requirements		
Modifications and Amendments		
11.0 GRANT AUDITING		
Introduction to Federal Grant Processing/Regulations		
Cost Principles for Grants		
Single Audit and Block Grant Concepts		
<u>DEGREES - TYPE/DISCIPLINE/YEAR</u>		
BBA - Accounting - 1975		
MA - Business Administration - 1977		
<u>PROFESSIONAL CERTIFICATIONS - TYPE/STATE/NUMBER/YEAR</u>		
CPA - Virginia - #2222 - 1976		
<u>GRADE</u>		
GS-511-12		

## C5. CHAPTER 5

### PLANNING

#### C5.P1. PART I - GENERAL

C5.P1.1. Historically, the DoD audit organizations have experienced a shortfall of resources to fully cover all DoD operations and programs. Accordingly, it is essential that available audit resources be allocated and used so as to provide benefit to DoD management in terms of improving effectiveness, reducing program costs, and ensuring the adequacy of internal controls in areas vulnerable to fraud, waste, abuse, or mismanagement.

C5.P1.2. Part II of this chapter covers the establishment, maintenance, and use of an inventory of auditable entities. Part III deals with the development and staffing of an annual audit plan. The audit-planning process covered in this chapter is a multi-phased process designed to provide a systematic and rational basis for the allocation of resources. In brief, the process involves identifying and assigning priorities to auditable entities and developing an annual audit plan. Guidance on the preparation of plans for individual audit projects (as distinguished from an audit organization's annual audit workload) is covered in Chapter 8 of this Manual, "Performing Audits." The overall concepts to be used in establishing priorities and audit objectives are covered in Chapter 3, "Audit Concepts."

#### C5.P2. PART II - INVENTORY OF AUDITABLE ENTITIES

C5.P2.1. Purpose. This part covers the establishment, maintenance, and use of an inventory of auditable entities. The inventory, in turn, comprises the potential workload of an audit organization.

C5.P2.2. Applicability. All the policies, standards, and other provisions contained in Part II of this chapter shall be followed by the DoD central internal audit organizations in developing their inventory of auditable entities. Paragraphs C5.P2.4. and C5.P2.5., which outline audit policies and standards, also apply to the DoD internal review and nonappropriated fund audit organizations. The remaining paragraphs, with the exception of paragraph C5.P2.8., may be used as guidelines by those organizations in structuring their audit workload.

C5.P2.3. Background. Office of Management and Budget Circular A-73 (reference (b)) requires that each Government audit organization develop an audit

universe and maintain records of its universe that identify the organizations, programs, activities, and functions subject to audit. Each audit organization is also required to periodically review its audit universe and to determine the coverage, frequency, and priority of audit required for each identified component. Developing and maintaining a comprehensive and prioritized audit universe promotes better use of audit resources, provides a basis for selecting audit candidates, and serves as support for personnel staffing requirements.

#### C5.P2.4. Policy

C5.P2.4.1. Each DoD audit organization shall establish, maintain, and use an inventory of auditable entities for: long-term planning; developing the annual audit plan; allocating resources; evaluating audit planning, performance, and staffing levels; and answering inquiries from external sources concern past, current, and planned audit coverage.

C5.P2.4.2. The inventory shall be maintained consistent with the manner in which the audit organization intends to conduct its audit activities.

C5.P2.4.3. While the inventory of auditable entities may vary in form and content between the various audit organizations, the organization must maintain records that can be used to show for its Component:

C5.P2.4.3.1. What entities are subject to audit.

C5.P2.4.3.2. Why specific activities/functions/programs/systems have not received recent audit coverage.

C5.P2.4.3.3. Relative priorities for audit coverage.

C5.P2.5. Standards. Chapter 2 of this Manual contains the DoD internal auditing standards. The standards most closely related to the establishment, maintenance, and use of an inventory of auditable entities are as follows:

C5.P2.5.1. 610 - Organization

C5.P2.5.2. 630 - Scope of Responsibility

C5.P2.5.3. 640 - Determination of Audit Priorities

C5.P2.5.4. 650 - Planning

C5.P2.6. Audit Planning Concepts. A sound planning process is essential for the effective management of an audit organization and the proper allocation and control of audit resources. This process is as complex and important as performing audits. If audit resources are applied to areas with little return or benefit to management, the performance of excellent audit work will be of little value. Therefore, a systematic and rational basis is needed to ensure that the most important areas are selected for audit coverage. (This matter is discussed in greater detail in Chapter 3, "Audit Concepts.") The internal audit activity should be able to justify to third parties why certain areas were selected for audit, why others were not, what has been audited in the past, what is scheduled for audit, and what has neither been audited nor scheduled for audit. The audit planning process should include the following elements:

C5.P2.6.1. Identifying organizations, programs, systems, and other major areas subject to audit.

C5.P2.6.2. Recording this information well as the priority for each audit area in an inventory of auditable entities (also referred to as an audit universe file).

C5.P2.6.3. Using the data in the inventory for long-term audit planning and to develop the annual audit plan.

C5.P2.6.4. Recording information in the inventory on prior audit coverage.

C5.P2.6.5. Coordinating, as necessary, with audit follow-up officials to determine status information on prior audit findings and recommendations.

C5.P2.7. Establishing the Inventory. Each internal audit activity shall establish an inventory of auditable entities. This inventory represents the audit organization's potential audit workload. The inventory of auditable entities shall identify each organization, program, system, and function for which the audit activity has primary cognizance. This will vary for an organization such as the Office of the Assistant Inspector General for Auditing (OAIG-AUD), OIG, DoD. The OAIG-AUD has primary cognizance for audits of the Office of the Secretary of Defense, Unified Commands, and Defense Agencies, and must maintain adequate records to identify entities subject to audit coverage in those organizations. It is not required to maintain an inventory of each Organization in the Military Departments. The OAIG-AUD inventory of auditable entities should focus on activities, programs, systems, and functions that lend themselves to inter-Service audits. The OAIG-AUD is encouraged to make use of auditable entity files used by the other central internal audit agencies to the extent possible, and to coordinate its coverage with the Office of the Assistant Inspector

General for Inspections, OIG, DoD. The contents of the file are discussed in more detail in the following paragraphs:

#### C5.P2.7.1. Types of Auditable Entities

C5.P2.7.1.1. Name of Organization, Activity or Unit. Include the name of the unit and its unit identification code, as applicable. Use various sources such as unit identification code listings, the Approved Defense Program, organizational charts, telephone directories, and other similar sources to identify organizations, activities, or units to be included in the inventory. Exercise judgment when determining what constitutes an organization, activity, or unit for purposes of the inventory. For example, within the Army, a division may constitute an organization for the purpose of the inventory even though the division is comprised of many smaller units. However, exercise care to ensure that the inventory includes all smaller units that are not part of larger units already included in the inventory. Retain appropriate documentation to support the inventory of auditable entities. As a minimum, show the elements that make up each organization, activity, or unit.

C5.P2.7.1.2. Programs. Show each program for which the audit activity has responsibility. A program is a group of related policies, procedures, systems, and areas, including appropriate resources (funds, personnel, etc.), designed to accomplish predetermined and specific organizational goals or objectives. Examples of programs include: depot maintenance program, healthcare program, acquisition program for F-1 aircraft, family housing program, construction program, cash management program, industrial preparedness program, civilian personnel program, military personnel program, unit training program, traffic management program, civilian pay program, and military pay program.

C5.P2.7.1.3. Systems. A system is a series of manual or automated steps or processes by which transactions are recognized, authorized, classified, recorded, summarized, and reported. Each system for which an activity has a responsibility shall be recorded in the inventory. Some of the types of systems that should be identified are accounting systems, weapons and combat support systems, major components under project manager control, budget and programming systems, disbursing systems, payroll systems, resource management systems, automated data processing systems, communications systems, supply systems, and personnel management systems.

C5.P2.7.1.4. Other Audit Areas. Structure the inventory in the same manner in which audits are expected to be performed. If audits are performed of activities, systems, or programs, no further development of audit areas may be needed. If, however, audits are structured in some other way, recognize this in the inventory.

For example, audits might be performed on a fractional basis using the 34 fractional categories or elements of these categories specified in Chapter 16 of this Manual. If this is the case, record these audit areas in the inventory. In building the auditable entity files initially, identify and include audit areas covered during the past 2 years. Then and even more important as new audits are programmed and performed, categorize and record them in the inventory of auditable entities, showing not only the units, programs, or systems within which the audit is planned or performed, but also those units, programs, and systems that contain similar audit areas.

C5.P2.7.2. Priority of Audit. Assign a priority of audit to each audit area. In assigning priorities, an average frequency of about 3 years is desirable for all significant audit areas, but shorter or longer frequencies will be appropriate in many instances. Determine the priority by weighing the importance of various factors and assigning a numerical rating for each of the factors included in the ranking matrix. At a minimum, consider the following factors in the ranking matrix:

C5.P2.7.2.1. Risk. The adequacy of internal control systems and the ability of an area to fraud, waste, abuse, or mismanagement are the major considerations in this area. Also, the newness of, or major changes in, programs and systems could increase the risks.

C5.P2.7.2.2. Sensitivity. The sensitivity of a program or system to the mission of an organization and the importance of that mission to the overall mission of its parent organization are important considerations. Other considerations include whether an area is of high interest to the Head of the Department or organization or whether poor performance in an area could cause severe embarrassment to the Department or Agency or adversely impact its relations with Congress.

C5.P2.7.2.3. Audit Experience. Give a higher rating to an audit area that has a history of major deficiencies than to an area that has experienced only minor deficiencies in the past. Be sure to consider the results of other evaluations such as inspections, investigations, and program reviews, along with the results of the most recent reviews by the audit activity, other DoD audit organizations, the U.S. General Accounting Office (GAO), and commercial firms performing audit work on a contractual basis.

C5.P2.7.2.4. Financial Impact. Identify the current or potential dollars involved in the programs, system, or function. This can be measured in various ways such as value of assets or amount of funding.

C5.P2.7.2.5. Time Since Last Audit. Consider the date of the last audit or comprehensive inspection and assign higher ratings to those with longer elapsed times since the last review.

C5.P2.7.2.6. Management Request. Assign additional rating points when management requests audit of the area.

C5.P2.7.3. Audit Coverage. Include information in the inventory by audit area about prior audits performed by the organization itself, other DoD internal audit activities, the GAO, and commercial firms on a contractual basis that shows when each audit was performed and its magnitude. The long term goal is to maintain historical data for at least 5 years.

C5.P2.8. Coordination with Internal Activities. Periodically, coordinate the inventory maintained by the internal audit activity with the appropriate internal review activities (or other activities conducting audits at local levels). This inventory should be used by the internal review activities for long-term planning and development of their annual internal review program. Normally, the internal audit organizations would devote primary emphasis to audits of programs or systems, while internal review organizations would be concerned primarily with smaller segments of the organization to which they are assigned.

C5.P2.9. Annual Review of Inventory. Review the inventory of auditable entities each year for reasonableness and currency of the information prior to development of the annual audit plan. Adjust frequency cycles and priorities based on actual audit experience.

### C5.P3. PART III - AUDIT PLAN

C5.P3.1. Purpose. This part covers the development and staffing of annual audit plans.

C5.P3.2. Applicability. All the policies, standards, and other provisions contained Part III shall be followed by the DoD central internal audit organizations in developing and staffing their annual audit plans. Paragraphs C5.P3.3., C5.P3.4., and C5.P3.10., also apply to the DoD internal review and nonappropriated fund audit organizations. The remaining paragraphs may be used as guidelines by those organizations in developing their annual audit plans.

### C5.P3.3. Policy

C5.P3.3.1. Each DoD internal audit organization shall prepare formal guidance on the policies and procedures to be followed in developing its annual audit plan.

C5.P3.3.2. Based on the established guidance the DoD internal audit organizations shall prepare an annual audit plan containing the audits scheduled to be performed during a specific fiscal year. The plan shall be consistent with the goals of:

C5.P3.3.2.1. Meeting all statutory or regulatory requirements.

C5.P3.3.2.2. Providing audit coverage of all significant audit areas on an overall those major programs or functions audit cycle that averages 3 to 5 years. For those major programs or functions determined to have a high vulnerability, a 3-year cycle of coverage is more desirable

C5.P3.3.2.3. Achieving potential monetary benefits equal to or greater than the cost of the audit operations.

C5.P3.3.2.4. Meeting the needs of management and the organization's mission.

C5.P3.3.2.5. Responding to the concerns of the Congress for oversight of key programs.

C5.P3.3.2.6. Providing balanced and representative audit coverage of all substantive DoD operations and programs.

C5.P3.3.2.7. Maximizing the use of all available audit resources and developing the capabilities of assigned audit staff.

C5.P3.3.2.8. Providing audit coverage to those programs or activities that have a high susceptibility to fraud, waste, abuse, or mismanagement.

C5.P3.3.3. During the development of the annual audit plan, the DoD internal audit organizations shall:

C5.P3.3.3.1. Obtain suggestions for audits from both management and members of the audit organization and furnish feedback on the disposition of each suggestion.

C5.P3.3.3.2. Review the existing inventory of auditable entities for acceptability prior to developing the annual audit plan. The inventory may be particularly beneficial in supplementing multi-location, Service-wide, or DoD-wide audit coverage with subjects that have not received audit coverage in recent years.

C5.P3.3.3.3. Discuss and review the annual plan with the head or deputy head of the activity having operational control over the audit organization. Discuss pertinent portions of the plan with the head, deputy head, or designee of the organizations for which the audit activity has cognizance.

C5.P3.4. Standards. Chapter 2 of this Manual contains the DoD internal auditing standards. The standards most related to the development and staffing of an annual audit plan are as follows:

C5.P3.4.1. 610 - Organization

C5.P3.4.2. 640 - Determination of Audit Priorities

C5.P3.4.3. 650 - Planning

C5.P3.4.4. 660 - Coordination

C5.P3.5. Guidance on Annual Planning Process. In preparing the formal guidance to be followed during the development of the annual audit plan, at a minimum, the following areas should be covered:

C5.P3.5.1. Responsibilities. Identify the specific responsibilities of the various elements of the internal audit activity in the development of the annual plan. Provide for functional area audit experts to be an integral part of the planning process and to play a key role in formulating the annual audit plan. The functional area expert is the individual within an audit organization responsible for conducting audits within a specific functional area. These experts shall maintain close liaison with key management officials in their assigned fractional areas and shall provide technical guidance and support directly to the audit teams on matters within their functional area of responsibility.

C5.P3.5.2. Milestone Dates. Establish milestone dates for the completion of critical elements in the development of each annual audit plan. Generally, agencies should accomplish planning actions by the following dates, if not earlier, to permit effective coordination of annual plans with the other DoD internal audit activities and the General Accounting Office:

C5.P3.5.2.1. December 15 - Issue annual audit planning call.

C5.P3.5.2.2. February 15 - Obtain suggestions from management.

C5.P3.5.2.3. June 30 - Develop tentative audit plan.

C5.P3.5.2.4. September 1 - Review plan with Head or Deputy Head of the Department or Agency to which the audit organization is assigned.

C5.P3.5.2.5. September 15 - Issue final audit plan.

For internal review activities that develop audit plans on a calendar year basis to take into account the plans of other audit organizations, a compression of the timeframes may be necessary in order to issue the final plan by the start of each calendar year.

C5.P3.5.3. Planning Factors. Describe the process to be followed in the development of the annual audit plan and include the factors to be considered in the specific areas for audit. Some of the major factors to consider in the selection process shall include:

C5.P3.5.3.1. Ranking or priority of areas contained in auditable entity file.

C5.P3.5.3.2. Current high-level interest in a particular program or function.

C5.P3.5.3.3. Management and follow-up officials' requests for audit coverage in specific areas.

C5.P3.5.3.4. Amount of time since last audit coverage of the subject.

C5.P3.5.3.5. Target allocations of auditor days for the various functional areas making up DoD operations. (See Chapter 16 for functional area groupings.)

C5.P3.5.3.6. Achieving an acceptable mix of multi-location vs. single-location audit coverage that will best use audit staff resources.

C5.P3.5.3.7. Adequacy and status of management actions on prior audit recommendations.

C5.P3.5.3.8. Audits scheduled or planned by other audit organizations.

C5.P3.5.3.9. Results of evaluations conducted by management or other oversight organizations.

C5.P3.5.4. Contents of Annual Audit Plan. In developing the annual plan, certain basic information shall be provided for the audits proposed. The following minimal information is required for each audit project or assignment, either as part of the published plan or as backup documentation:

C5.P3.5.4.1. Specific reason for selecting the area for audit, as well as anticipated benefits, both monetary and non-monetary, from the audit.

C5.P3.5.4.2. The audit objective(s) to be accomplished.

C5.P3.5.4.3. The activities and locations to be included or considered for inclusion in the audit.

C5.P3.5.4.4. The estimated auditor-days required to perform the audit.

C5.P3.5.4.5. The planned dates for starting and finishing the audit.

C5.P3.5.4.6. An estimate of the costs to perform the audit, including travel costs.

(While some of the information required by the above paragraphs is for internal use by the audit activity, the copies of each Agency's annual audit plan that are distributed to management should, at a minimum, inform interested officials of the audits scheduled and when they will take place.)

C5.P3.6. Annual Call for Audit Plan. Before beginning work on each year's audit plan, the head of the audit activity shall provide guidance on the special factors to be considered in the development of the audit plan. This guidance should cover (but not necessarily be limited to) factors such as: auditor days available during the fiscal year; areas to be emphasized or de-emphasized; availability of travel funds; and allocation of available time to the prescribed functional areas and major categories of audit, e.g., mandatory, multi-location, single location, etc. Such guidance may need to be revised once or twice during the planning cycle as conditions change and it becomes clearer where audit resources should be focused.

C5.P3.7. Obtaining Suggestions for Audits. Internal audit activities shall ask both managers and auditors to submit suggestions for audits. This aspect of program development should be emphasized, since the quality of the annual plan is, to a great extent, affected by the quality of the audit suggestions.

C5.P3.7.1. Suggestions from Management. Establish procedures for requesting audit suggestions from all levels of management. As a minimum:

C5.P3.7.1.1. Send a letter (preferably from the head of the audit activity) to top officials of the organizations for which they have audit cognizance. Request suggestions from all levels of management and allow adequate time, such as 60 days, for managers to prepare their response.

C5.P3.7.1.2. Develop and use a standard format for audit suggestions to ensure that all the information needed to evaluate them is collected.

C5.P3.7.1.3. Notify management, in writing, about the disposition of its audit suggestion. This can be preceded by oral discussions.

C5.P3.7.1.4. Develop methods to publicize the audit suggestion process. Here are some successful methods:

C5.P3.7.1.4.1. Emphasize the audit suggestion process in day-to-day contact with management personnel and in correspondence with counterparts.

C5.P3.7.1.4.2. Ask top managers in the Military Departments or OSD to brief audit executives/functional area experts on their respective programs. These briefings often identify areas managers think are critical, highlight the results of internal control reviews, and inform audit personnel of significant program changes and corrective action in progress or planned.

C5.P3.7.1.5. Direct particular attention toward soliciting audit suggestions from the headquarters of the military Inspectors General and criminal investigation activities. These activities, by nature of their own reviews, should be in an excellent position to recommend subjects conducive to audit.

C5.P3.7.2. Suggestions from Within the Audit Activity. Establish procedures for obtaining audit suggestions from key staff members throughout the entire audit organization. For the most effective results, the audit organization should have a procedure to encourage continuous input from its own auditors throughout the year, as well as setting aside a specific period for audit suggestion development and submission

early in the annual planning cycle. Procedures should allow adequate time, perhaps 60 days, for preparation of audit suggestions. Develop and use a standard format for audit suggestions to ensure that all the information needed to evaluate them is collected.

C5.P3.7.3. Suggestions from Follow-up Officials. Establish procedures for obtaining suggestions from follow-up officials both on vulnerabilities that merit additional audit effort and areas of prior audit coverage where assistance is needed from audit organizations to assess the effectiveness of management actions.

C5.P3.8. Developing a Tentative Annual Plan. Each DoD internal audit organization shall complete a tentative annual plan showing the workload of the audit activity, including participation in DoD-wide audits, by June 30th of each year. The following techniques or reasonable variations have been successfully used by DoD audit organizations to formulate good tentative audit plans:

C5.P3.8.1. Establish a single control point in the audit activity headquarters to record, control, and distribute audit suggestions to the appropriate fractional area expert.

C5.P3.8.2. Conduct appropriate audit research of suggestions to evaluate their merit and determine the most appropriate time for scheduling the audit.

C5.P3.8.3. Hold formal meetings with management to update functional area knowledge and to discuss related audit suggestions.

C5.P3.8.4. Maintain close coordination between the appropriate audit operations directorate and field elements while developing the tentative plan, so that current developments are fully considered.

C5.P3.8.5. Convene a high-level conference of audit managers and functional area experts to discuss the audit suggestions, suggest changes, and refine the tentative audit plan. Concentrate on the more important multi-location audit proposals.

C5.P3.8.6. Closely coordinate the proposed annual audit plan with the GAO and other applicable DoD audit organizations. As specified in Chapter 6 of this Manual, coordination of audit plans is a continuous process.

C5.P3.8.7. Reserve a reasonable amount of time in the annual plan for mandatory audits and for audits that cannot be specifically identified far enough in advance to be included in the annual audit plan.

C5.P3.9. Issuing the Final Approved Plan. Complete and distribute the annual audit plan by September 15, or about 2 weeks prior to the start of the year covered by

the plan if other than a fiscal year planning cycle is used. Retain complete supporting documentation in the planning files. In addition to normal distribution, send at least one copy of the annual audit plan to the other DoD internal audit activities and to the GAO. Also, send two copies of the annual plan and any subsequent changes to the office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD.

C5.P3.10. Discussing the Plan Review the completed annual plan with the head or the deputy head of the DoD activity that has operational control over the DoD audit organization. Discuss pertinent portions with the head, deputy head, or designee of the agencies/organizations for which the internal audit organization has cognizance. The Secretary of Defense or the Deputy Secretary of Defense will be briefed at least annually on audit plans for the Department of Defense as a whole.

C5.P3.11. Updating the Plan The annual plan should be used as a planning and scheduling tool and as a notice to management of the audits planned in their areas of responsibility. The plan should be revised and updated during the year to keep it current and to apprise management officials of audit scheduling changes affecting their organizations.

## C6. CHAPTER 6

### COORDINATING AUDIT ACTIVITIES

#### C6.1. PURPOSE

This chapter prescribes policy and suggests procedures for coordinating audit activities and exchanging audit results.

#### C6.2. APPLICABILITY

C6.2.1. The standards and policies prescribed in sections C6.3. and C6.4., which follow are mandatory for all DoD internal audit, internal review, and nonappropriated fund audit activities (hereafter referred to collectively as "DoD internal audit organizations.") The provisions of sections C6.5. through C6.13. are not mandatory steps, but are suggested guidelines for accomplishing coordination policies. Certain procedures described in this chapter may not be applicable to every audit organization, but efforts still should be made to comply with the intent of the principles and objectives contained in this chapter.

C6.2.2. Procedures for coordinating audit efforts with investigative agencies when fraud or illegal acts are suspected are contained in Chapter 15 of this Manual.

#### C6.3. DoD INTERNAL AUDITING STANDARDS

The DoD internal auditing standard (Chapter 2) concerning coordination is:

660 Coordination - The internal audit organization shall coordinate its activities internally and with other components of the Government and independent outside auditors it may encounter to ensure effective use of available resources.

#### C6.4. POLICY

C6.4.1. The Inspector General Act of 1978, as amended (reference (a)), directs the IG, DoD, to give particular regard to the activities of the internal audits, inspection, and investigative units of the Military Departments with a view toward avoiding duplication and ensuring effective coordination and cooperation.

C6.4.2. Office of Management and Budget Circular No. A-73 (reference (b)) states that "...audit effectiveness is enhanced by audit coordination." Under the provisions of reference (b), Federal audit organizations are required to coordinate and cooperate with each other in developing and carrying out their respective audit plans. Effective coordination requires continuous liaison; the exchange, when appropriate, of audit techniques, objectives, plans, work papers, and audit results; and the development of audit schedules to minimize the amount of audit effort required.

C6.4.3. The provisions of reference (b) have been implemented in DoD Directive 7600.2 (reference (k)). The DoD internal audit organizations shall coordinate and cooperate with each other and with other DoD audit, investigative, inspection, and management review groups to ensure effective use of audit resources, preclude unnecessary duplication or overlap of review efforts, and permit efficient oversight of DoD programs and operations. The DoD internal audit organizations also shall coordinate and cooperate with the GOA and other Federal and non-Federal audit organizations where there is a common interest in the programs subject to audit.

C6.4.4. Coordination shall be a continuing proactive effort and not merely reaction to a potential scheduling problem. The degree of formal coordination depends, in part, on the relative size of the audit organization and its placement within a DoD Component. Although coordination is most important for large scale, multi-location audits because of the significant amount of planning, resources, and time they require, coordination of all review efforts shall be the general rule rather than the exception.

C6.4.5. Coordination shall begin as early in the audit planning process as practical because coordination, especially during the audit planning phase, can save valuable time and effort. Coordination includes sharing technical information about audit approaches and techniques, exchanging audit results, and cooperating in joint training efforts.

C6.4.6. When overlapping or duplicative coverage is indicated, the DoD internal audit organizations shall make every effort to resolve conflicts.

## C6.5. RESPONSIBILITIES

C6.5.1. Every organizational level within the DoD internal audit organizations should coordinate review efforts and exchange information. Specifically, coordination and cooperation should be exercised between the following:

C6.5.1.1. The DoD Internal Audit Activities and the GAO. The GAO frequently uses published audit reports during surveys to either direct their efforts to

areas not previously covered by DoD audit organizations, or to rely on published findings instead of performing review work of their own.

C6.5.1.2. The Military Department Audit Agencies and the Office of the Assistant Inspector General for Auditing (OAIG-AUD), OIG, DoD. Coordination in the early planning stages of each audit is especially important since both activities conduct audits within the same DoD Component.

C6.5.1.3. The Military Department Audit Agencies Concerned and Other Military Department Audit Agencies. Coordination is important because audits in one Military Service may disclose conditions that be affecting operations adversely in other Components.

C6.5.1.4. The Military Department Audit Agencies and the Internal Review Elements within Their Respective DoD Component. Internal review activities often provide an audit liaison service for their organizations, in addition to their principal mission of serving commanding officers in ensuring that sound management practices and procedures are observed within their organization. Consequently, this level of coordination is essential to effective audit work by the various internal and external audit staffs.

C6.5.1.5. The Military Department Audit Agencies and the Military Department Inspector General Organizations. With the increasing use of systemic inspection techniques, headquarters levels of Military Department inspector general organizations are undertaking broader, more in-depth reviews similar to the multi-location audits of the internal audit activities.

C6.5.1.6. The Military Department Agencies and the Military Department Criminal Investigative Agencies. Starting or continuing an audit in an area where there may be an ongoing investigation could jeopardize the investigation and requires coordination and consultation between the respective organizations before proceeding.

C6.5.1.7. The OAIG-AUD, OIG, DoD, and the Offices of the Assistant Inspectors General for Inspections, Investigations, and Audit Follow-up. Care is needed in coordinating the respective reviews of these offices so that the OIG, DoD, acts in a uniform manner and gives the appearance of functioning as one entity.

C6.5.1.8. Resident Auditors, Inspectors, Internal Reviewers, and Investigators at Major Command Levels, as well as those at Installation Level. Although procedures for coordinating in areas of mutual interest may be less formal than coordination procedures used at the central headquarters of the major review activities, cooperation and effective working relationships are equally important at local levels.

C6.5.1.9. The DoD Internal Audit Organizations and the Defense Contract Audit Agency (DCAA). When performing reviews of the procurement function, internal audit organizations may require the assistance of DCAA to evaluate contracting and contract administration activities.

C6.5.1.10. The DoD Internal Audit Organizations and DoD Follow-up Officials. Starting an audit in area where there is ongoing follow-up on corrective action pertaining to agreed-upon recommendations in prior audit reports could lead to duplication of effort.

C6.5.2. Coordination extends beyond merely exchanging audit schedules with other review groups and providing audit reports upon request. Coordination also involves establishing close liaison and good working relationships with other DoD review groups, external review groups, and DoD managers. To promote the most efficient use of resources among the members of the IG community and to ensure that the efforts of each review group complement rather than duplicate each other's work, each DoD internal audit organization should establish programs to accomplish the following:

C6.5.2.1. Meet with counterparts on a regularly scheduled basis.

C6.5.2.2. Exchange audit plans and schedules.

C6.5.2.3. Exchange information on technical matters, including audit programs.

C6.5.2.4. Obtain input on suggested areas for audit.

C6.5.2.5. Ensure management's needs are considered in establishing audit priorities.

C6.5.2.6. Suggest areas for inspection or investigation.

C6.5.2.7. Provide access to internal audit and, with command approval, internal review reports.

C6.5.2.8. Distribute copies of audit announcements, when applicable.

C6.5.2.9. Exchange information on prior audit coverage and review results.

C6.5.2.10. Request audit assistance from other review groups, as necessary.

C6.5.2.11. Be alert to problems that may affect other Agencies and, when such situations arise, coordinate with others involved to see if a single review can satisfy all requirements.

## C6.6. RESOLUTION OF POTENTIAL CONFLICTS

C6.6.1. The DoD internal audit organizations should establish formal procedures to accomplish the following:

C6.6.1.1. Identify the review efforts of other DoD and Federal review groups.

C6.6.1.2. Ascertain whether the possibility of a scheduling conflict or duplication of effort exists.

C6.6.1.3. Resolve any issues raised during the coordination process.

C6.6.1.4. Respond, in a positive manner, to the coordination efforts of other review groups. As an example, when a DoD internal audit organization receives a schedule or specific announcement of a review from another review group (for example, GAO, OAIG-AUD, Inspection, etc.), they should send the document to the appropriate offices within their organization. The offices should be required to review the information and report back to a central point (possibly the planning office) that either:

C6.6.1.4.1. No potential duplication exists; or

C6.6.1.4.2. If a problem was noted, action was taken to resolve the problem.

C6.6.2. The DoD internal audit organizations should resolve problems promptly when coordination indicates the following:

C6.6.2.1. Potential conflict exists with respect to a scheduled or ongoing audit review.

C6.6.2.2. The scheduling of an audit may be inappropriate or untimely.

C6.6.2.3. The results of a previous review could be used to satisfy the audit requirement or reduce the scope of an audit. Resolution may include:

C6.6.2.3.1. Agreeing to meet and coordinate the review efforts, etc;

C6.6.2.3.2. Rescheduling the review of either organization by mutual consent;

C6.6.2.3.3. Providing audit information to the other party that could reduce or modify the scope of audit coverage;

C6.6.2.3.4. Documenting the need for overlapping audit effort; or

C6.6.2.3.5. Elevating the problem to a higher level when agreement cannot be reached.

C6.6.3. The degree of coordination exercised by internal review and nonappropriated fund audit organizations to identify and resolve conflicts may vary with the size of the organization and with the degree of centralization or decentralization of operations. However, smaller audit organizations are still responsible for avoiding duplication and for notifying other groups when their reviews may duplicate or overlap other reviews. Internal review activities that provide liaison with auditors or other reviewers are in a unique position to identify conflicting efforts and to help promote coordination.

## C6.7. COORDINATION PROCEDURES AND PRACTICES

C6.7.1. During the coordination process, the following information on audit subjects normally should be provided in sufficient detail to clearly identify the area to be audited:

C6.7.1.1. Title of the audit review and the project number.

C6.7.1.2. Purpose and objectives.

C6.7.1.3. Scope of the review.

C6.7.1.4. Timing of the review.

C6.7.1.5. Locations, organizations, and programs to be reviewed.

C6.7.1.6. Contact point for further information.

C6.7.2. On small audits it may not be feasible to coordinate routinely descriptive information, but the DoD audit organizations should make this information available upon request. In some instances, it may not be possible or practical to identify the specific audit locations and timing during the initial coordination process; however, this information should be identified and coordinated before beginning the audit application (verification) phase. When an audit is canceled or an audit survey indicates further audit work would be unproductive, the DoD audit organizations should notify management in a timely manner. Other participants in the original coordination process may be notified through publication of a revised audit schedule periodically.

C6.7.3. When overlapping audit and inspection efforts are identified during the initial coordination process, they should be clearly defined and an effort be made to eliminate duplications. In those cases where it is necessary for organizations involved to continue their review efforts, the DoD audit organizations should arrange to exchange information on the results of the review with the other review organizations before releasing the report. This will ensure that differences in scope and objectives are clearly reported.

C6.7.4. The DoD audit organization should establish procedures for referring problems more effectively handled by Military Department inspector general activities to the appropriate inspection organization. Certain problems, by their nature, are handled more appropriately by inspectors, while others are addressed more appropriately by auditors. Therefore, the exchange of information and recommendations about audits and inspections is mutually beneficial for both types of organizations and their respective Components.

C6.7.5. The Military Department audit organizations should establish procedures for referring audit suggestions to the OAIG-AUD, OIG, DoD, if the audit subject applies to more than one DoD Component and can be addressed more appropriately by a DoD-wide audit. Conversely, the OAIG-AUD should have procedures for referring audit suggestions to the appropriate Military Department audit organization when an audit problem has limited DoD-wide applicability.

## C6.8. RELATIONSHIPS WITH MANAGEMENT

C6.8.1. Before beginning an audit, the DoD audit organizations should furnish the audit scope and objectives to appropriate managers in the activity under audit. Auditors should provide sufficient advance notice of the audit and observe the established chain of during the coordination process.

C6.8.2. Managers at local installations and intermediate levels frequently conduct studies and analyses of internal operations. During the initial coordination process, auditors should determine whether any studies or analyses are planned by management in the proposed audit area, and review these plans and any studies that may have been completed recently. If unable to review management studies before beginning the audit, the auditor should contact management or the audit liaison office to obtain the studies upon arrival at the audit site. To the extent possible, the DoD audit organizations should reduce the scope of audit efforts based on the objectives, extent, and quality of the management review.

C6.8.3. Internal auditors should make every effort to follow procedures prescribed by the activity under audit to coordinate the audit, to ensure the auditors' needs for information are communicated to responsible officials, and to ensure management's views are obtained as the audit progresses. When auditors need to contact operating personnel directly to expedite a review, auditors should notify appropriate management officials and explain the purpose and importance of the contact.

## C6.9. INTERNAL AUDIT RELATIONSHIPS WITH DCAA

C6.9.1. DoD Directive 7600.2 (reference (k)) stipulates that the DoD Internal audit organizations should coordinate all reviews involving contractor records with DCAA and with the appropriate contract administration office to avoid duplication of work. In addition, DoD audit organizations should request services of DCAA whenever data must be obtained directly from contractors or from working papers maintained by DCAA.

C6.9.2. Audit assignments requiring DCAA assistance should be coordinated with DCAA during the initial planning process. At least 60 days in advance of the start of a scheduled audit for which significant DCAA audit assistance is required, the DCAA should be contacted to finalize the extent of the audit assistance to be provided. A request should be submitted in writing to the cognizant DCAA field office with a copy to the Policy Liaison Division, Headquarters, DCAA, after audit scope and timing have been established. A request shall be prepared in sufficient detail to avoid misunderstandings as to the objectives being pursued. Final agreements will include

Field Activity Offices affected, and the general timing and objectives of the required assistance. The DCAA will normally confirm a request for assistance in writing within 7 days after the request is received. When DCAA is unable to provide the requested assistance, audit managers shall coordinate with DCAA when making arrangements to conduct the audit work themselves and to gain access to requested records. More specific guidance on this subject is contained in Contract Audit Policy Memorandum No.1 (reference (n)).

C6.9.3. To maintain consistency throughout the Department of Defense when auditing contractor records, internal audit organizations should, as a general rule, follow the guidance set forth in the DCAA Contract Audit Manual (reference (aaa)) when performing audit work within the scope of DCAA authority. Unless otherwise arranged with the DCAA, defective pricing reviews performed by DoD audit activities should include all elements of cost in the contract so as to render an opinion of the overall contract and preclude the necessity of additional audit work by the DCAA. When potential defective pricing cases are identified by audit organizations, they should normally be referred to the DCAA for appropriate action.

#### C6.10. COORDINATING AUDIT INFORMATION WITH THE GENERAL ACCOUNTING OFFICE (GAO)

C6.10.1. DoD Internal Auditing Standard No. 660 requires that representatives from internal audit organizations meet with their GAO counterparts to exchange audit information. The DoD audit organizations are encouraged to maintain continuous communications with the GAO because of the changing nature of GAO audit plans (Congressional requests, etc.) and the potential for duplication of effort. Regular periodic meetings, particularly between the central audit agencies and the GAO, can facilitate audit planning and avoid wasted effort in scheduling audits that may conflict with each other. During preparation of the annual audit plan, and before announcing major audit initiatives, internal audit organizations should:

C6.10.1.1. Review the GAO work plan.

C6.10.1.2. Contact their GAO counterparts to confirm whether their work might duplicate or overlap with a planned or ongoing GAO evaluation effort.

C6.10.2. Whenever instances of potential overlap or duplication are identified, audit personnel should attempt to reach an agreement with the GAO directors to eliminate the potential for overlap. If mutually acceptable agreements can not be reached, then the Audit Director should raise the issue for appropriate action with the organization's planning staff as well as the DoD IG liaison office (OAIG/AFU-GAORA).

## C6.11. LIAISON WITH OTHER REVIEW GROUPS

C6.11.1. The DoD internal audit organizations should recognize the complementary nature of the various types of review efforts and establish procedures for identifying review efforts completed, in process, or planned by other audit, investigative, and inspection review groups. Each auditor should determine the extent of work done by other review groups when planning audits. If the analysis of other work in the area indicates duplication or overlap, internal auditors should reduce the scope of the planned audit, cancel or postpone the audit, or build on the work already done in the area, as appropriate.

C6.11.2. To determine the scope of work covered by another review effort, internal auditors may need to review audit working papers from another Agency. The DoD internal audit organizations should provide access to other DoD internal audit organizations in the interest of avoiding duplication.

C6.11.3. Whenever possible, auditors should meet with IG Personnel to discuss their inspections of the area, obtain suggestions for the audit, and review inspection reports. If the audit is in an area that may be particularly conducive to fraud or serious abuse, or where a prior investigation may have been conducted, auditors should contact the local criminal investigative element to coordinate their work and exchange information about the subject of the audit.

## C6.12. SHARING TECHNIQUES AND PROGRAMS

To optimize the use of resources, the DoD internal audit organizations should take advantage of audit techniques developed by others. Sharing audit techniques includes making maximum use of existing audit programs and guides to reduce the time and effort required to develop new programs for individual audit projects. To help audit organizations share audit programs, the OIG, DoD, periodically publishes a Directory of Internal Audit Programs (reference (o)). The directory provides information on audit programs by organization and functional area, and provides directions for obtaining the programs. When researching and planning an audit, DoD auditors should obtain copies of audit programs and guides covering the audit area and consider using them to develop the detailed audit plan. The DoD internal audit organizations also are strongly encouraged to interchange ideas related to the use of computers or other advanced techniques for audit.

### C6.13. TRAINING COOPERATION

Audit training also should be coordinated. The DoD internal audit organizations should determine the availability of training from other audit organizations and, if possible, make arrangements to have their staff attend training courses sponsored by other audit agencies. Sharing training promotes consistency in audits, fosters closer working relationships among audit organizations, and keeps auditors informed of developments in other audit organizations. Policies and guidelines relating to auditor training are covered in Chapter 4 of this Manual.

## C7. CHAPTER 7 TYPES OF AUDITS

### C7.1. PURPOSE

This chapter defines and describes the various types of audits performed by the DoD audit organizations and relates these audits to other portions of this Manual that provide greater detail on planning and performing audits and reporting audit results.

### C7.2. APPLICABILITY

The guidance in this chapter applies to the audits performed by all DoD internal audit, internal review, and military exchange audit organizations (hereafter referred to collectively as "DoD internal audit organizations"). Certain terminology, however, may not apply to every audit organization.

### C7.3. STANDARDS AND POLICIES

Each DoD internal audit organization shall recognize the broad range of audits that may be performed and use this information in developing a comprehensive audit plan. All audits shall be performed consistent with the "Government Auditing Standards" issued by the Comptroller General of the United States (reference (c)); DoD Internal Audit Standard Number 300 in Chapter 2 of this Manual, "DoD Internal Auditing Standards;" and Chapter 3 of this Manual, "Audit Concepts."

### C7.4. CLASSIFICATION OF AUDITS

Audits performed by DoD internal audit organizations can be classified according to:

C7.4.1. Types of audits set forth in the Government Auditing Standards (reference (c)).

C7.4.2. How many DoD Components are included.

C7.4.3. Where the basic requirement for the audit originated.

C7.4.4. How many locations are covered.

C7.4.5. What type entity is covered.

C7.4.6. Where the audit resources are obtained.

C7.4.7. How the audited operations are funded.

C7.4.8. Whether the audit was specifically programmed for a follow-up review.

## C7.5. TYPES ESTABLISHED IN THE Government AUDITING STANDARDS

Chapter 2 of the Government Auditing Standards (reference (c)) classifies audits as being financial audits or performance audits and defines each type as follows:

C7.5.1. Financial Audits. These audits include financial statement and financial related audits.

C7.5.1.1. Financial Statement Audits. Financial statement audits determine whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows or changes in financial position in accordance with generally accepted accounting principles, and whether the entity has complied with laws and regulations for those transactions and events that may have a material effect on the financial statements.

C7.5.1.2. Financial-Related Audits. Financial-related audits include determining whether financial reports and related items such as elements, accounts, or funds are fairly presented; whether financial information is presented in accordance with established or stated criteria; and whether the entity has adhered to specific financial compliance requirements. Financial-related audits may include audits of: segments of financial statements; financial information; reports and schedules on financial matters; contracts; grants; internal control systems and structure over accounting, financial reporting, and transaction processing; computer-based systems; financial systems; and fraudulent activities related to any of those areas.

C7.5.2. Performance Audits. Performance audits include economy and efficiency and program audits.

C7.5.2.1. Economy and Efficiency Audits. Economy and efficiency audits include determining whether the entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently; the causes of inefficiencies or economical practices; and whether the entity has complied with laws

and regulations concerning matters of economy and efficiency. Economy and efficiency audits may, for example, consider whether the entity is following sound procurement practices; is acquiring the appropriate type, quality, and amount of resources when needed at the lowest cost; is properly protecting and maintaining its resources; is avoiding duplication of effort by employees and work that serves little or no purpose; is avoiding idleness and overstaffing; is using efficient operating procedures; is using the minimum amount of resources in producing or delivering the appropriate quantity and quality of goods or services in a timely manner; is complying with requirements of laws and regulations that could significantly affect the acquisition, protection, and use of the entity's resources; and has an adequate system of measuring and reporting performance on economy and efficiency.

C7.5.2.2. Program Audits. Program audits include determining the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved; the effectiveness of organizations, programs, activities, or functions; and whether the entity has complied with laws and regulations applicable to the program. Program audits may, for example, assess whether the objectives of a proposed, new, or ongoing program are proper, suitable, or relevant; determine the extent to which a program achieves a desired level of program results; assess the effectiveness of the program and/or of individual program components; identify factors inhibiting satisfactory performance; determine whether management has considered alternatives for carrying out the program that might yield desired results more effectively or at a lower cost; determine whether the program complements, duplicates, overlaps, or conflicts with other related programs; identify ways of making programs work better; assess compliance with laws and regulations applicable to the program; and assess the adequacy of management's system for measuring and reporting effectiveness.

## C7.6. NUMBER OF DoD COMPONENTS INCLUDED IN THE AUDIT

Audits are classified as to whether coverage is restricted to one DoD Component or whether several DoD Components are involved.

C7.6.1. Single-Service Audit. This type of audit is confined to a single Military Service (for purposes of this chapter defined as the Departments of Defense, the Army, the Navy, and the Air Force).

C7.6.2. Inter-Service Audit. An inter-Service audit is an audit of DoD policies, procedures, and operations that can best be accomplished by a single audit team. These audits are generally not limited to the evaluation of a Military Service's compliance with an established DoD policy, but evaluate whether such policy has been properly developed

and is appropriate to current circumstances. Inter-Service audits may also compare the implementation of DoD policy in the various Military Services to determine if one does it better than another. The audit objectives shall be directed toward a DoD-wide evaluation and not be limited to an audit of a single Military Service. Inter-Service audits also address areas that cut across Military Service lines that can best be evaluated by a single audit team.

C7.6.3. DoD-Wide Audit. DoD-wide audits are defined as audits of major DoD programs, systems, and functions performed jointly by the DoD central internal audit organizations. The principal difference between an inter-Service audit and a DoD-wide audit is that the latter is conducted by multiple teams under the overall guidance of a designated audit agency. A DoD-wide audit would normally have as its objective the evaluation of whether a stated DoD policy is being effectively and efficiently followed. The DoD-wide audits are characterized by a limited set of audit objectives. Coordination and timing are the critical factors. The essential ingredients of a DoD-wide audit are preparation of a general set of audit objectives equally applicable to all Military Services, scheduling the audit for execution by the cognizant DoD central internal audit organizations around the same time, and summarization of results for DoD and Military Services' management. Policy guidance, procedures, and responsibility for planning and performing DoD-wide audits are set forth in Chapter 19 of this Manual, "DoD-Wide Audit Process."

## C7.7. BASIC REQUIREMENT FOR THE AUDIT

An audit can be classified by identifying where the basic requirement for the audit originated.

C7.7.1. Mandatory. Statutory and regulatory requirements prescribe that certain audits be performed. These requirements may emanate from such sources as Congress, Office of Management and Budget (OMB), U.S. General Accounting Office (GAO), Secretary of Defense, or the Secretaries of the Military Departments.

C7.7.2. Identified by the Audit Organization (Self-Initiated). Most proposals for audit are developed by the audit organizations giving consideration to factors such as adequacy of internal controls; susceptibility to fraud, waste, or abuse; newness, changed conditions, or sensitivity; dollar magnitude; audits by others; results of other evaluations; availability of audit resources; and operational results. In developing proposals for this type of audit, suggestions should be solicited from all levels of management and personnel inside and outside the organization. Detailed policies and procedures for determining what audits are to be performed are contained in Chapter 5 of this Manual, "Planning."

C7.7.3. Management or Congressional Requests. Audit work generated from requests by management officials at all levels shall be accommodated to the greatest extent possible after audit priorities and availability of audit resources are fully considered. Criteria to be met are set forth in Chapter 8 of this Manual, "Performing Audits." Audits may also be generated to respond to congressional requests for information.

C7.7.4. Hotline Referrals. Audits may be initiated specifically to examine allegations made through the GAO, DoD, or Military Department hotlines.

## C7.8. NUMBER OF LOCATIONS

Audits can be classified as to how many locations are included.

C7.8.1. Multi-Location Audit. An audit of an organization, program, system, or other entity performed at two or more locations under the centralized direction of an audit control point.

C7.8.2. Single-Location Audit. An audit of an organization, program, system, or other entity performed at a single location.

## C7.9. TYPE OF ENTITY

The entity selected for audit may be an organization, program, system, or other type of entity.

C7.9.1. Organizations. This type of audit covers an entire organization.

C7.9.2. Programs. This type of audit covers a group of related policies, procedures, systems, and areas designed to accomplish predetermined and specific organizational goals. A program may be synonymous with one of the functions listed in Chapter 16 of this Manual, "Reporting Audit Time." Examples are construction programs, depot maintenance programs, civilian pay programs, etc.

C7.9.3. Systems. This type of audit covers a series of manual or automated steps or processes by which transactions are recognized, authorized, classified, recorded, summarized, and reported. There are various types of systems, such as accounting systems, disbursing systems, supply systems, etc.

C7.9.4. Other Entities. In many cases, it is not appropriate to audit a complete organization, program, or system. In these cases, the audit generally covers a portion of an organization, program, or system.

Additional information relative to planning for these types of audits is contained in Chapter 5 of this Manual, "Planning."

## C7.10. SOURCE OF AUDIT RESOURCES

An audit may be performed using audit resources that are either permanently or temporarily assigned to an audit site during the audit.

C7.10.1. Residency Audit. This audit is staffed with audit personnel permanently assigned to the audit site.

C7.10.2. Mobile Audit. This audit is staffed with audit personnel permanently assigned to another location but temporarily assigned to the audit site (or audit sites for multi-location audits) during the audit.

## C7.11. TYPE OF FUNDS

This classification differentiates between audits of entities financed with appropriated funds and those financed from other sources.

C7.11.1. Appropriated Funds. Funds authorized by the Congress for specified purposes against which obligations may be incurred and subsequent expenditures made. These include operating funds, investment funds, and research funds.

C7.11.2. Nonappropriated Funds. Cash and other assets received by nonappropriated fund instrumentalities from sources other than congressional appropriations, primarily from the sale of goods and services to DoD military, military family members, and authorized civilians.

C7.11.3. Revolving Funds. Stock funds, industrial funds, etc., originally authorized by the Congress for specific purposes with expenditures replenished from appropriated funds, nonappropriated funds, other revolving funds, foreign receivables, etc.

## C7.12. LEVEL OF EFFORT DEDICATED TO FOLLOW UP

An audit can be classified based on whether required follow up on recommendations in prior reports is performed as a routine part of an audit or whether an audit's sole objective is to follow up on prior recommendations. In both cases, auditors shall coordinate with Component follow-up officials to determine the status of agreed-upon recommendations on prior audit reports as documented in follow-up files.

C7.12.1. Regular Audit. Insofar as it is consistent with the objectives of the present audit, follow up is to be performed to determine if appropriate corrective action was taken on recommendations in prior reports issued by DoD audit or inspection organizations and the GAO, and whether any of the conditions cited in the prior reports still exist. This requirement is stated in Chapter 8 of this Manual, "Performing Audits."

C7.12.2. Follow-up Audit. This type of audit is solely focused on determining whether appropriate corrective action has been taken on recommendations in a specific prior audit report and whether the previously reported condition has been corrected.

## C8. CHAPTER 8

### PERFORMING AUDITS

#### C8.1. PURPOSE

This chapter provides policy and guidance on the various stages of performing an audit (planning, survey, verification, and reporting). It also prescribes policies with respect to other activities associated with an audit, including: audit-by-objectives; supervision; access to records; relations with management; internal controls; and measurement of potential benefits from audits.

#### C8.2. APPLICABILITY

Unless otherwise specified, the provisions of this chapter are mandatory for all DoD internal audit and internal review organizations, including the audit organizations of the military exchange systems (hereafter referred to collectively as "DoD internal audit organizations").

#### C8.3. STANDARDS AND POLICIES

Audits are made primarily to help management arrive at solutions to problems and devise better ways to do business. If this objective is to be achieved, audits must be planned and conducted in a logical and methodical way and must conform to auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, Department of Defense (IG, DoD).

C8.3.1. Auditing Standards. DoD auditing standards 410, 420, 430, 440, 450, 460, 470, and 480 apply. These standards may be found in Chapter 2 of this Manual, and some are amplified in this chapter.

C8.3.2. Stages of Audit. Audits performed by the DoD internal audit organizations generally progress through four separate stages -- planning, survey, verification/field work, and reporting. The amount of time spent on any one phase will vary substantially based on the size and nature of the audit. However, a formal, conscious decision must be made before going from the planning phase to the survey phase, and from the survey phase to the verification/field work phase.

C8.3.3. Access to Records. In accordance with DoD Directive 7600.2 (reference (k)), auditors, if properly cleared, are entitled to all records needed to accomplish an announced audit objective, and shall insist on quickly obtaining requested records unless a formal denial is processed by the Head of a DoD Component. For OIG, DoD, auditors, that denial must come from the Secretary of Defense.

C8.3.4. Audit-by-Objectives. The audit-by-objectives approach shall be followed in planning and performing each audit.

C8.3.5. Planning and Supervision. Each audit shall be planned and supervised effectively.

C8.3.6. Audit Program. A written audit program shall be prepared based on the results of survey work and shall be used for each audit.

C8.3.7. Audit Results. Auditors shall collect, analyze, interpret, and document information to accomplish the audit objectives and to support the audit results.

C8.3.8. Internal Controls. A study and evaluation shall be made of the internal control system applicable to the organization, program, activity, or function to plan the audit and to determine the nature, timing, and extent of tests to be performed.

C8.3.9. Computer-Based Systems. For performance audits, auditors shall conduct a review of the systems' general and application controls when the reliability of a computer-based system is the primary objective of the audit.

C8.3.10. Legal and Regulatory Requirements. An assessment shall be made of compliance with applicable requirements of and implementing regulations when necessary to satisfy the audit objectives.

C8.3.11. Fraud and Abuse. Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, or illegal acts and expenditures and, if such evidence exists, extend audit procedures to identify the effect on an entity's financial statements, operations, or programs. More specific guidance on preventing, detecting, and reporting fraud and illegal acts is obtained in Chapter 15 of this Manual.

C8.3.12. Follow-up. Due professional care includes follow-up on known findings and recommendations from previous audits completed within the past 5 years that could have an effect on the current audit objectives to determine whether prompt and appropriate corrective actions have been taken. Management of the audited entity is primarily responsible for directing and completing action on recommendations. Also,

specific follow-up programs and follow-up officials are designated for internal DoD and GAO audit reports. After coordination with the cognizant follow-up officials and use of the results of additional audit tests, the audit report should disclose the complete status of prior findings and recommendations. The report should emphasize known but uncorrected significant or material findings and recommendations from prior audits that affect the current audit objective.

C8.3.13. Potential Benefits. Auditors shall estimate potential benefits, both monetary and non-monetary, associated with the conditions disclosed by audit and the recommended corrective actions; report monetary and non-monetary benefits in the audit report; and accumulate and report statistical data on monetary benefits in accordance with appropriate Instructions and Directives.

#### C8.4. PLANNING PHASE

The planning phase of an individual audit involves the selection of appropriate subjects for examination and preliminary research/review. During this phase, audit objectives (i.e., what the audit is to accomplish, the specific audit subject, and performance aspects) are determined. Preceding the planning of individual audits is the development of an overall audit plan.

C8.4.1. Annual Audit Plan. Guidance on developing the annual audit plan is presented in Chapter 5, Part III (C5.P3.), of this Manual.

C8.4.2. Special Management Requests. Occasionally, management may request auditing service from a DoD internal audit organization that is not normally available to them during regularly scheduled audits, and may also request only limited distribution of the audit report and deviation from the normal follow-up procedures. Such requests would generally be of an urgent or unusual nature and could not be anticipated in the annual audit plan where other management requests may be scheduled. Special requests may recognize that audit organizations can perform services other than audits as authorized by Government Auditing Standards (reference (c)). The following subparagraphs describe the procedures to be followed in responding to special requests. The restrictions on the special requests, however, do not apply to suggestions from management used in developing the annual audit plan and for which the audit reports are subject to normal distribution and follow up.

C8.4.2.1. Acceptance of Requests. The nature of requests for special audits may preclude their inclusion in the annual audit plan. Therefore, such requests may be accepted from management by the DoD internal audit organization if the following criteria are met:

C8.4.2.1.1. Request is in writing, clearly defines the problem to be addressed, and explains why the problem cannot be resolved by the manager's staff.

C8.4.2.1.2. Request is for an audit that requires professional capability and resources not available from the manager's staff or from other assistance or investigative groups responsible for providing special services to the manager.

C8.4.2.1.3. Requested audit does not duplicate an audit or a portion of an audit already in process or scheduled during the current fiscal year or in the near future.

C8.4.2.1.4. Request is not for audit work where fraud, criminal conduct, or violation of law is known or suspected.

C8.4.2.1.5. Time spent on requests from management for special audits does not exceed 10 percent of the direct auditor days available to a DoD internal audit organization in a fiscal year. This ceiling is considered appropriate for coverage of unusual or urgent management requests. Normally, most management concerns would be included in the annual audit plan and completed on a scheduled basis, or otherwise satisfied using regular reporting procedures.

C8.4.2.1.6. Request audit is to obtain an independent opinion that otherwise would not be available to the requesting activity.

C8.4.2.2. Performance of Special Management Requests. Normal procedures shall be used in performing the audit, except that the audit report usually will be issued only to the requesting official. However, the head of the audit organization shall reserve the right to issue an audit report requiring normal follow up and distribution if considered appropriate. Normal follow up and distribution should always be required if the head of the audit organization determines that recommendations are to be made to officials other than the requesting official. Work papers generated under the manager's request program will be retained by the audit organization. If fraud or illegal activity is identified, procedures identified in Chapter 15 of this Manual apply.

C8.4.2.3. Follow-up. Reports generated under the manager's request program will not generally be subject to follow up under the normal DoD audit follow-up process and, for this reason, will not be reported in accordance with DoD Directive

7650.3 (reference (p)). Because reports generated from special requests should generally be held to a minimum, within 1 year after issuance of a report containing significant findings, the audit organization shall evaluate whether the audit results have been utilized effectively by management. If the head of the audit organization determines that it is more appropriate to issue an audit report requiring normal follow up and distribution, then the provisions of reference (p) apply.

## C8.5. SURVEY PHASE

C8.5.1. Approach. The information needed for the survey varies with the audit objectives and the entity to be audited. Emphasis shall be given to identifying the primary audit objectives and designing an audit approach that will maximize audit effectiveness. An effective survey normally includes:

C8.5.1.1. Establishing or redefining audit objectives and scope of work, including audit site selection, and determining methodology.

C8.5.1.2. Identifying criteria for assessing performance (where applicable).

C8.5.1.3. Gathering background information about the activities to be audited.

C8.5.1.4. Determining resources necessary to perform the audit.

C8.5.1.5. Considering skill and knowledge of the personnel staff assigned and the need for consultants, experts, and specialists.

C8.5.1.6. Communicating with all who need to know about the audit.

C8.5.1.7. Addressing compliance with laws and regulations and potential abuse and illegal acts.

C8.5.1.8. Visiting the audit site(s) to:

C8.5.1.8.1. Become familiar with the activity's control procedures and operations;

C8.5.1.8.2. Identify areas for audit emphasis; and

C8.5.1.8.3. Invite and suggestions from management.

C8.5.1.9. Assessing internal controls.

C8.5.1.10. Evaluating materiality and/or significance and audit risk of potential audit findings.

C8.5.1.11. Determining how, when, and to whom audit results will be communicated.

C8.5.1.12. Coordinating with other audit, inspection, and oversight groups, when appropriate, regarding work that has been performed in the past or is anticipated for the future.

C8.5.1.13. Coordinating with appropriate follow-up officials regarding the status of management's corrective actions on prior audit findings and recommendations.

C8.5.1.15. Identifying potentially significant findings to be developed further during the audit verification phase.

C8.5.2. Audit Approval. Information gathered during the survey shall be summarized and presented to audit managers so as to permit a decision on whether to proceed into the verification phase. The responsibility for this approval shall be assigned to a senior management official within the audit organization and may vary based on the size and type of audit. Large multi-location audits should require higher-level approval than small single-location audits. Sufficient information must be presented to permit the approving official to make an intelligent and informed decision.

C8.5.3. Audit Program. When a decision is made to proceed with the audit, an audit program shall be developed. The program shall generally include appropriate information on background, purpose, methodology, and scope of audit; objectives of the audit; definition of terms; special instructions; suggested audit steps; audit procedures; and format and general content of the report to be issued. Development of an effective audit program provides a systematic basis for assigning work to supervisors and staff, allows the audit work to be segmented for accomplishment by auditors at more than one site, and ensures a common approach is maintained that, in turn, will permit effective consolidation of results.

## C8.6. VERIFICATION/FIELD WORK PHASE

C8.6.1. Examining and Evaluating Information. Auditors shall collect, analyze, interpret, and document such information as necessary to accomplish the audit objectives and to support the audit results.

C8.6.1.1. Information shall be sufficient, competent, and relevant to provide a sound basis for audit findings and recommendations. "Sufficient" information refers to the quantity of factual and convincing information needed for a prudent, informed person to reach the same conclusions as the auditor. "Competent" information is reliable and the best attainable through the use of appropriate audit techniques. "Relevant" information is information that supports audit findings and recommendations and is consistent with the objectives for the audit.

C8.6.1.2. Audit procedures, including the testing and sampling techniques to be employed, shall be selected in advance, when practicable, and expanded or altered if circumstances warrant. Part II, Chapter 11 (C11.P2.) of this Manual, "Statistical Sampling":

C8.6.1.2.1. Generally requires the use of statistical sampling whenever there are voluminous numbers of transactions to be examined; and

C8.6.1.2.2. Provides policy and guidance for using statistical sampling during DoD internal audits.

C8.6.1.3. Assist audit requests shall be used to obtain from other audit locations the additional information needed to accomplish audit objectives. Cooperation shall be pursued so that auditors may use other's work and avoid duplicate audit efforts.

C8.6.1.4. The process of collecting, analyzing, interpreting, and documenting information shall be supervised to provide reasonable assurance that audit objectivity is maintained and audit goals are met.

C8.6.1.5. A record of the auditors' work shall be retained in the form of working papers. Working papers document the audit and shall be prepared by the auditor and reviewed by audit supervisory personnel. Chapter 18 of this Manual provides guidance on the preparation, review, retention, and safeguarding of working papers.

C8.6.2. Auditing Computer-Based Systems. The auditor shall do the following:

C8.6.2.1. Review general controls in data processing systems, to determine whether:

C8.6.2.1.1. The controls have been designed according to management direction and known legal requirements; and

C8.6.2.1.2. The controls are operating effectively to provide reliability of, and security, over, the data being processed.

C8.6.2.2. Review controls of installed data processing applications that the auditor is relying on to assess their reliability in processing data in a timely, accurate, and complete manner. Further guidance on auditing computer-based systems is contained in Chapter 9 of this Manual.

C8.6.3. Detecting Fraud, Abuse, and Illegal Acts. Auditors shall be alert to situations or transactions that could be indicative of fraud, abuse, and illegal expenditures and acts; and if such evidence exists, extend audit steps and procedures to identify the effect on the entity's financial statements, operations, or programs. Chapter 15 of this Manual establishes policy to be followed in auditing areas susceptible to fraud and illegal acts, and for dealing with situations or transactions that indicate such acts may have occurred.

C8.6.4. Audit Follow-up. For the area being audited, auditors shall follow up on known findings and recommendations from previous audits, usually completed within the past 5 years, that could have an effect on the current audit objectives. One purpose of the follow-up is to determine whether prompt and appropriate corrective actions have been taken on agreed-upon recommendations in prior reports issued by the auditors' audit organization, other DoD audit organizations, and the GAO. Another reason is to determine whether the corrective actions were effective in eliminating the adverse condition. Auditors shall coordinate with appropriate follow-up officials prior to completing field work in order to review documentation contained in follow-up files on managements' reported corrective action. Results of audit follow-up shall be reported as required by DoD Directive 7650.3 (reference (p)) and paragraph C12.8.19., Chapter 12, of this Manual.

C8.6.5. Development of Findings and Recommendations. Findings and recommendations shall be identified as early as possible in the audit. Each finding shall be sufficiently developed to show criteria, condition, cause, and effect, and be accompanied by appropriate recommendations. Benefits from the audit (monetary and non-monetary) are to be reported whenever the benefits are due directly to the audit findings and recommendations. Chapter 12 of this Manual discusses the development of findings and recommendations. As the audit progresses, potential findings and recommendations shall be discussed with officials in the activity being audited before being presented in writing.

C8.6.6. Actions Taken by Management. Management shall be given an opportunity to correct adverse conditions during the audit. Corrective actions taken should be recognized in the audit report and in the audit working paper documentation so that the auditors may take credit for corrective actions. Credit should also be given for the actions that will significantly improve operations including any alternative actions initiated independent of the audit recommendations.

C8.6.7. Draft Reports. A draft report shall normally be prepared for every assignment. In most cases, draft reports shall be issued before the exit conference and shall contain only information that has been previously communicated to management. The draft report shall be staffed with the officials addressed in the recommendations. The purpose of staffing a draft report is to surface any points that require clarification. Management shall be asked to comment specifically on any potential monetary savings or other benefits shown in the draft report. As a result of the staffing process, appropriate changes should be made to the report to reflect agreement on facts, clarify points that may be misinterpreted, and remove any unnecessary irritants that would preclude management's acceptance of the report.

C8.6.8. Exit Conference. An exit conference shall be held with management unless management declines. This is generally the last opportunity before issuing the final report to ensure accuracy of the reported information and to resolve any matters that are still in dispute. In those rare instances when an exit conference precedes the draft report, management shall be notified as to when the draft report will be furnished and shall be informed that an additional meeting will be held, if desired by management, upon review of the draft report.

C8.6.9. Post-Audit Critique. A post-audit critique shall be prepared in those instances where such a critique would be helpful in planning and performing future audits of the same or similar functions or activities. The critique shall include:

C8.6.9.1. Suggestions for improving survey and audit performance;

C8.6.9.2. Suggestions for improving audit approach; and

C8.6.9.3. Rations on the time and resources needed to accomplish the overall audit objective.

## C8.7. REPORTING PHASE

A written audit report shall be prepared for each audit. A statement shall be included that the audit was made in accordance with generally accepted Government auditing standards or qualified when standards were not followed. Reporting procedures and policies covering form, distribution, timeliness, contents, and presentation are contained in Chapter 12 of this Manual.

## C8.8. AUDIT-BY-OBJECTIVES

Audit-by-objectives is an audit management technique that requires auditors to focus on audit objectives throughout the entire audit cycle from development of the initial idea through the final audit report. This approach shall be followed on each audit performed by a DoD internal audit organization. Additional guidance on this concept is contained in section C3.6., of this Manual.

## C8.9. SUPERVISION

C8.9.1. Need for Supervision. The DoD internal audit organization shall ensure that audits are supervised properly. Supervision shall be exercised at each level of the internal audit organization to provide quality control over audit assignments. Supervision is a continuing process and includes sufficient interim checks at each stage of the audit to determine whether audit projects are on schedule and are being performed in accordance with plans, so that necessary adjustments can be made and the staff kept informed. Appropriate evidence of supervision shall be documented and retained. The extent of supervision required will depend on the proficiency and experience of the auditors and the difficulty of the audit assignment. For audit assignments that have been contracted for by a DoD Component under the provisions of DoD Directive 7600.9 (reference (q)), technical guidance and periodic oversight review remain the responsibility of the head of the DoD internal audit organization. Chapter 14 of this Manual provides policy and guidelines on effective supervision as an element of quality control within an audit organization.

C8.9.2. Nature of Supervision. Supervision includes the following:

C8.9.2.1. Providing suitable instructions to subordinates at the beginning of the audit and approving the audit program.

C8.9.2.2. Ensuring that the approved audit program is carried out, unless deviations are authorized.

C8.9.2.3. Providing work assignments that are consistent with the abilities and experience of the assigned staff.

C8.9.2.4. Determining that audit objectives are met.

C8.9.2.5. Ensuring that the audit is performed in conformance with professional auditing standards.

C8.9.2.6. Determining that audit working papers adequately support the audit findings, conclusions, and reports.

C8.9.2.7. Ensuring that audit reports are accurate, objective, clear, concise, constructive, and timely.

#### C8.10. ACCESS TO RECORDS

DoD Directive 7600.2 (reference (k)) provides that properly cleared auditors shall be entitled to full and unrestricted access to all personnel, facilities, records, reports, databases, documents, or other DoD information or material needed to accomplish an announced audit objective. In performing audits, auditors shall aggressively follow up on all requests for records and other documents to ensure that they are obtained on a timely basis. Only the Head of a DoD Component may deny auditors access to the area under his or her control. In the case of OIG, DoD, auditors, the denial must come from the Secretary of Defense. DoD Directive 7600.2 (reference (k)) and DoD Instruction 7050.3 (reference (r)) cite the reasons under which a denial may be made and explain the procedures to be followed in case of a denial. Procedures for obtaining information from the Joint Chiefs of Staff are set forth in "Memorandum of Understanding Between the Organization of the Joint Chiefs of Staff and the Inspector General, Department of Defense, to Establish Procedures for Processing Requests for JCS Papers/Planning Information" (reference (ccc)).

#### C8.11. RELATIONS WITH MANAGEMENT

C8.11.1. Notifying Management. Management shall be given reasonable advance notification of an audit. Such notification permits management to make necessary preparations for the audit team. The advance notification shall include the purpose and scope of the audit and the time period during which the audit is to be performed. In some instances during the course of an audit, some unanticipated site visits may be necessary. In such instances, the auditors shall provide management with as much

advance notice as possible. The requirement for advance notification does not apply to cash counts or other similar audits where surprise is essential to accomplish the audit objectives.

C8.11.2. Entrance Conference. Auditors shall offer to hold an entrance conference with management prior to beginning the audit or audit survey, as applicable. At the conference, management shall be informed of the purpose, scope, and duration of the audit, as well as the overall and specific audit objectives. If management declines to hold an entrance meeting, the auditors will exercise care to ensure the required information is conveyed in writing.

C8.11.3. Periodic Briefings. Periodic briefings shall be provided to management during the course of the audit. These briefings are especially important when the audit progresses from one phase to another, when audit work is substantially curtailed or expanded, or when numerous visits to the same site are made. Management shall be notified in advance of any changes in audit objectives or estimated time periods.

C8.11.4. Exit Conference. An exit conference shall be held with management before issuing the final report unless management declines. Other conferences may be necessary during the 60 days following issuance of the report and before the report is officially referred to the follow-up activity for action or resolution of unresolved issues.

## C8.12. INTERNAL CONTROLS

Management is responsible for establishing an effective system of internal controls. The need to assess internal controls and the focus of that assessment vary with the objectives of the audit. A study and evaluation shall be made of the internal control system applicable to the organization, program, activity, or function under audit. The focus of the auditor's review of internal controls may vary with the type of audit; i.e., financial and performance audits. However, the basic purpose for evaluating internal controls during audits is always the same; namely, to determine the extent to which the auditor can rely on existing controls when planning the nature, extent, and timing of audit tests to be applied during the examination and verification phases of the audit. The review of the system of internal controls by the auditors can aid in devising better auditing procedures for evaluating the results of operations or, when appropriate, for formulating an opinion on the fairness of financial statements. Chapter 9 of this Manual contains specific guidance for evaluating general controls in data processing systems and application controls of installed data system applications. Guidance on reviewing management implementation of the Internal Control Program is contained in Chapter 10 of this Manual.

### C8.13. MEASURING POTENTIAL BENEFITS FROM AUDIT

Information on potential monetary and non-monetary benefits is used in various ways. Including estimates of potential benefits in the audit report gives the reader a perspective in judging the importance of the condition and the recommended corrective action. The IG, DoD, includes information on potential monetary benefit estimates claimed by auditors in semiannual reports to the Congress. Information on monetary benefits is also one of the factors considered in evaluating the effectiveness of audit organizations. Auditors' estimates are based on information available at the time of audit. The IG, DoD, is also required to report to the Congress on the potential monetary benefits claimed by auditors that have been agreed to by management and those with which management has disagreed. Actual amounts of agreed-upon auditor estimates realized through management's action are also included in IG, DoD, semiannual reports to the Congress. Actually realized benefits may be affected by changing requirements, unforeseen costs, and other subsequent events, and may be greater or lesser than the initial audit estimates. Enclosure 1 to this chapter sets forth guidelines for identifying, classifying, and reporting potential benefits from audit. Enclosure 2 provides examples of recommendations that could result in reportable potential monetary benefits.

## C8.E1. ENCLOSURE 1 OF CHAPTER 8

### GUIDELINES FOR IDENTIFYING, CLASSIFYING, AND REPORTING POTENTIAL BENEFITS FROM AUDIT

#### C8.E1.1. TYPES OF BENEFITS

C8.E1.1.1. Potential Monetary Benefits. Many of the benefits arising from internal audits can be expressed in monetary terms. Examples of such benefits are shown in enclosure 2 to this chapter. Potential monetary benefits are classified as "Funds Put to Better Use" or as "Questioned Cost," but not both.

C8.E1.1.1.1 Funds Put to Better Use. The vast majority of potential monetary benefits resulting from internal audit is in this category. The term "funds put to better use" means that funds could be used more efficiently if management takes action to implement and complete the recommendations made by the audit organization, including:

C8.E1.1.1.1.1. Reductions in outlays;

C8.E1.1.1.1.2. De-obligation of funds from programs or operations;

C8.E1.1.1.1.3. Withdrawal of interest subsidy costs on loans or loan guarantees, insurance, or bonds;

C8.E1.1.1.1.4. Costs not incurred by recommended improvements related to the operations of the establishment, a contractor or grantee;

C8.E1.1.1.1.5. Avoidance of unnecessary expenditures noted in pre-award reviews of contract or grant agreements; or

C8.E1.1.1.1.6. Any other savings that are specifically identified.

C8.E1.1.1.2. Questioned Cost. An incurred cost that is questioned by auditors because of:

C8.E1.1.1.2.1. An alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds;

C8.E1.1.1.2.2. A finding that, at the time of the audit, such cost is not supported by adequate documentation; or

C8.E1.1.1.2.3. A finding that the expenditure of funds for the intended purpose is unnecessary or unreasonable. (This term would be applicable only to incurred cost audits such as those pertaining to defective pricing on defense contracts.)

C8.E1.1.1.2.4. A disallowed cost is a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the Government.

C8.E1.1.2. Monetary Benefits. Many audits/recommendations result in valuable benefits to a DoD component, to the Department of Defense, or to the Government, but cannot be expressed readily in monetary terms. Such benefits may stem from recommendations relating to operational readiness, equal employment opportunity, personnel safety, data accuracy, environmental programs, organizational structure, or rehabilitation programs. These benefits would normally be expressed using the most appropriate quantitative measurement in each instance. For example, higher operational readiness could be expressed by increased numbers of units meeting readiness standards, while improvements in equal employment opportunity could be expressed in terms of increases in the numbers or percentages of minorities or women employed. Non-monetary benefits can be as important as monetary benefits. Conducting audits not likely to result in monetary benefits should not be sacrificed in favor of audits where the potential for monetary benefits is greater. The emphasis should be on doing audits of importance, not just audits that are likely to result in monetary benefits.

## C8.E1.2. AREAS OF SPECIAL CONSIDERATION

Some areas present unique problems on appropriateness and classification of benefits. Those areas are discussed below:

C8.E1.2.1. Military Personnel. Recommendations regarding military personnel authorizations and assignments usually do not affect military end strength. Those recommendations generally are designed to remedy overstaffing at a particular location or to require use of civilians instead of military to do a particular function. Those types of benefits are normally reported as funds put to better use.

C8.E1.2.2. Civilian personnel. Recommendations sometimes result in reductions in personnel authorizations for an activity or organization. Generally, those spaces are transferred to other activities or organizations that were understaffed because of

Personnel or funding limitations. While those types of actions will not result in reduction of overall personnel strength for the Component, the benefits still should be reported as funds put to better use.

C8.E1.2.3. Material Excesses. Reports often contain recommendations to redistribute excess material to satisfy operating requirements or to fill inventory shortages. The determination of benefits will depend on what effect the redistribution action would have on current and future acquisition and holding costs.

C8.E1.2.3.1. Supplies. Audits of supply support activities often identify stocks that are in excess of prescribed retention limits. Redistribution of these stocks to other activities having a current need, instead of attrition in place, can result in monetary benefits through canceling requisitions or planned procurements and avoiding variable inventory holding costs, which include storage, obsolescence, and other costs. It may not always be necessary to identify and cancel outstanding requisitions to claim potential benefits when it is demonstrated that material excesses exist. The audits, however, must demonstrate that the material excesses are demand-supported; i.e., are active inventory items within the Military Department. The rationale for this is an assumption that demand-supported supplies have a high turnover rate and are reordered within the current year or next 4 years following the completion of the audit.

C8.E1.2.3.1.1. If the excess stocks are not authorized or qualified for stockage and the holding activity has no foreseeable future need for the items, monetary benefits would generally equate to the value of stock redistribution and the amount of inventory holding costs avoided by removing the items from storage and placing them into use.

C8.E1.2.3.1.2. In the case of authorized stockage items, the determination of monetary benefits weigh the potential reductions in holding and current acquisition costs against the cost to the holding activity of replacing these stocks in the future. Stocks that exceed computed economic retention limits are not considered economical to retain. If on-hand stocks exceed computed economic retention levels and are not being held for any other purpose, redistributing the stocks to satisfy current requirements generally result in monetary benefits equal to the value of the stocks redistributed. Although the holding activity may have to replace these items in a future year, the replacement costs would be offset by reductions in holding costs. When retention limits are not computed an economic item-by-item basis, the determination of monetary benefits from redistributing stocks that exceed prescribed retention limits should consider how long it would take, to use the stocks in place, and whether potential reductions in holding costs would offset the costs to replace the items in the future.

C8.E1.2.3.1.3. Another situation involves activities that continue to order stocks and to maintain an excess inventory. A recommendation to reduce ordering would result in funds put to better use if it can be assumed that the activity would have continued to order and maintain an excess position.

C8.E1.2.3.2. Equipment. Most major equipment items in the DoD Military Departments and Agencies are centrally funded, procured, and at the Department or Agency level. Procurement decisions are made at the Military Department level based on the worldwide asset position. Those equipment items are accounted for on property books at the user's level and area part of the centrally managed worldwide asset position. If procurement is based on the total Department or Agency asset position, a redistribution of local excess may not affect the net requirements or procurement decisions. Such distributions may improve productivity or readiness through improved use of available assets. If the excess items were also unrecorded assets (not on an accountable record), the recording of the asset could result in funds being put to better use if it would increase the total recorded asset position and, thus, affect procurement decisions. Unlike excess stocks of material, however, it is not enough just to demonstrate that equipment excesses are demand-supported. An assumption cannot be made that equipment items are high turnover items that are likely to be procured frequently; i.e., during the current year and the next 5 years from the date of the audit. It would be necessary for the audit to demonstrate the effect excess equipment will have on ongoing or planned procurement to claim the potential benefit, i.e., corresponding budget information might be included in the process.

C8.E1.2.3.3. If a recommendation is made to defer the procurement of supplies or an item of equipment, the deferment should be for at least 2 years to take credit for a monetary benefit.

C8.E1.2.4. Military Department or Agency Construction Projects. Funds for military construction projects by the Departments or Agencies are approved by the Congress on a project line item basis. When recommendations are made to reduce in scope or cancel an approved, funded military construction project, a benefit in the category of funds put to better use may be claimed. Benefits resulting from recommendations for the cancellation of unfunded construction projects would also be reported as funds put to better use so long as it can be assumed that the projects otherwise would have been funded. The amount claimed for the unfunded construction project should adhere as closely as possible to computation procedures discussed in section C8.E1.4. of this enclosure; that is, not exceed a 6-year period. (This exception applies only to construction projects. For other types of projects, there must be evidence of planned procurement and planned funding.)

C8.E1.2.5. Nonappropriated Funds. Benefits identified to nonappropriated funds, including the military exchange organizations, shall be claimed following the criteria presented in this chapter. Care must be exercised to ensure that those benefits are properly described in audit reports so as not to imply that the benefits involve appropriated funds when that is not the case.

C8.E1.2.6. Benefits Involving Other Activities. Audit work at one DoD Department or Agency may result in benefits at another Department or Agency within the Department of Defense or to the Federal Government overall. Those types of benefits may be claimed in connection with the report for the audit that produced the savings following the criteria presented in this chapter. The facts concerning such situations should be clearly described in the audit report. Reportable benefits must result in a net benefit to the Department of Defense or to the Federal Government overall. For example, a reportable benefit would result when a recommendation to a DoD Component results in a refund to the U.S. Treasury. Collections or reimbursements from other Federal organizations to a DoD Component are reportable if they result in a net benefit from a DoD perspective. Intra-Defense collections or reimbursements that result in "wash" transactions within the Department of Defense are not reportable.

C8.E1.2.7. Statistical Sampling. The use of statistical sampling to project potential monetary benefits is encouraged. When those methods are used in performing an audit, benefits are normally reported within a certain range or at a midpoint within the range. Under most circumstances, statistical reporting of monetary benefits should be based on the midpoint. On an exception basis, use of a one-sided projection is authorized to ensure the most efficient use of audit resources. A one-sided projection may be more appropriate in cases where obtaining midpoint projection within an acceptable range requires substantially more audit effort than a one-sided projection. However, under no circumstances will an amount in excess of the midpoint be reported. Projections shall be limited to the sampled universe. Sample results in one universe shall not be used to project monetary benefits to other universes.

C8.E1.2.8. Indefinite Recommendations. Recommendations to "consider," "re-evaluate," or "make a study" are weak recommendations and, except in unusual circumstances, should not be made. However, if such recommendations are made, any related monetary benefits would normally be too unpredictable to be estimated and claimed.

C8.E1.2.9. De-Obligation of Funds. So long as funds can be reprogrammed, they can be claimed; i.e., unexpired, or lapsed funds transferred to (merged into) an "M"

account. Unliquidated obligations under an appropriation are merged at the end of the second full fiscal year following expiration. The "M" account remains available for the payment of unliquidated obligations charged to various-year appropriation accounts. Reprogrammed funds are considered "funds put to a better use."

C8.E1.2.10. Independent Audit Verification. The validity of potential monetary benefits must be ascertained independently by the auditors before the benefits can formally be claimed and included in the report of audit; that is, the auditors shall not accept an estimated amount provided by management without an independent validation as part of the audit process.

### C8.E1.3. IDENTIFICATION OF BENEFITS

During audits, auditors shall determine the potential monetary benefits or non-monetary benefits that could result from audit findings and recommendations. Those determinations should be made early in the audit to allow time to reasonably measure potential benefits. Each recommendation in a draft or a final audit report should be considered in the following terms:

C8.E1.3.1. What potential benefits could result in future years if management takes the recommended action? Are the claimed benefits "lost opportunities" only?

C8.E1.3.2. Are the potential benefits monetary or non-monetary?

C8.E1.3.3. Are the potential monetary benefits reasonably measurable? Is there evidence of ongoing or planned procurements in the Approved Defense Program, the DoD Program Decision Memoranda, or the Program Objective Memoranda (POM), whichever is most current, that would be affected? Each document covers a 6-year period.

C8.E1.3.4. Does the report itself support the benefits? Did the auditors independently arrive at the conclusions reached?

C8.E1.3.5. Are there readily identifiable offset costs? If so, have they been deducted in computing the net potential monetary benefit?

C8.E1.3.6 . If there will be a monetary benefit but the amount is too unpredictable to be estimated, is the amount properly reported as "indeterminable" "immeasurable?"

C8.E1.3.7. Will the potential benefits claimed in the audit report result from taking action on specific situations and recommendations included in the same report?

#### C8.E1.4. COMPUTATION OF MONETARY BENEFITS

Benefits from internal audits shall be computed whenever the benefits are due directly to the audit recommendations; i.e., the benefits claimed can be expected to result once management completes recommended actions. Benefits shall be computed in a reasonable manner. Offset costs include all direct or indirect costs that will be incurred in implementing the action that will result in the monetary benefit.

C8.E1.4.1. Many recommendations produce only a one-time benefit. Examples would be reduction in requisitioning objectives, return of funds erroneously paid out, or reductions of materiel requirements. There are instances when a one-time management action will result in benefits affecting several identifiable fiscal years, such as canceling plans to acquire major items of equipment over a number of years or leasing rather than purchasing automatic data processing equipment. Certain recommendations result in recurring annual benefits that continue for an indefinite period of time. Examples would be reductions in payrolls and other operating expenses.

C8.E1.4.2. Amounts claimed for both one-time and annual benefits its may be based on budget projections. For both types of benefits, the amounts that may be claimed are limited to a 6-year period covered by the most current POM, DoD Program Decision Memorandum, or Approved Defense Program. Previously, annual benefits were limited to a 1-year period in semiannual IG submissions to the Congress.

#### C8.E1.5. REPORTING BENEFITS

##### C8.E1.5.1. Audit Reports

C8.E1.5.1.1. Audit reports shall indicate the amount of monetary or non-monetary benefits that will accrue if the recommendations are implemented. The report shall contain a complete description of each monetary benefit, either in the findings or as an attachment, to ensure that the reader understands the nature of the benefit and the basis upon which it was determined. The appropriation account and year of funds affected should be determined whenever possible and included in the monetary benefits description to aid management in taking corrective measures.

C8.E1.5.1.2. Auditors should reach agreement with management on the reasonableness of potential benefits cited in the report and document the agreement in writing. Management is required by DoD Directive 7650.3 (reference (p)) to specifically review and comment on the reasonableness of auditor-estimated potential

benefits as part of its review of draft reports. If management does not specifically comment when responding to the draft report, management must again be asked to comment on the potential benefits in a response to the final report and before the report goes to the audit follow-up activity. If management non-concurs with the auditors' estimate of the potential benefits, the amount may still be reported if, in the auditors' judgment, the estimate is valid and management's comments have been carefully considered. The matter must be resolved through the procedures specified in reference (p).

C8.E1.5.1.3. Auditor estimates of potential monetary benefits arrived at through statistical sampling methods are subject to the same provisions of reference (p) as are benefits based on other estimating procedures. If management does not agree to estimates of potential benefits based on statistical sampling because the samples did not allow management to identify specifically the organizational entities that would realize the benefits, the auditors shall try to management's agreement with respect to corrective actions required and the validity of the sample on which an estimate of monetary benefits was based. When this situation occurs, the auditors may report the potential monetary benefit. The inherent accuracy of a projection based on a methodologically sound statistical sample may be accepted if the auditors can attain management agreement on the underlying causes for the problems. The audit follow-up activity would verify that management has implemented the recommendations in accordance with audit resolution procedures. Auditor estimates of potential monetary benefits based on statistical sampling procedures are subject to the same provisions of DoD Directive 7650.3 (reference (p)) regarding the management comment/decision process as are estimates of monetary benefits based on other estimating procedures.

C8.E1.5.1.4. If during the audit, discussions with management result in changes and improvements in management operations resulting in potential monetary benefits before the audit report is issued, a record of those discussions should be part of working paper documentation if the auditors plan to claim that monetary benefits were realized based on their audit work. A record of the discussions that resulted in the potential benefits should also be included in the audit report; i.e., evidence to show that management took corrective action as a result of the audit.

C8.E1.5.1.5. Before the final audit report is issued, each potential monetary benefit shall be reviewed by an independent party within the audit organization who was not directly responsible for the audit. The purpose of this review is to ensure consistency of treatment in accumulating, categorizing, and reporting monetary benefits.

C8.E1.5.2. Statistical Reports. Data collection instructions issued by the IG, DoD, include guidance for reporting statistical data on potential monetary benefits for the

Semiannual Report to the Congress. The guidance is contained in DoD Directive 7650.3 (reference (p)), and DoD Instruction 7750.6 (reference (s)).

#### C8.E1.6. MAINTENANCE OF RECORDS

C8.E1.6.1. Establishment. A record of potential benefits shall be established for each audit by the time the draft audit report is issued. That record shall show for each recommendation in the audit report:

C8.E1.6.1.1. The amount of potential monetary benefits classified either as funds put to better use or as questioned cost. If monetary benefits will accrue from a recommendation, but the amount is "indeterminable"/"immeasurable," that fact should be noted on the record with an explanation of how the determination was made.

C8.E1.6.1.2. The functional category of each monetary benefit. The functional category codes described in Chapter 16 of this Manual for use in reporting auditor time are also incorporated into DoD Instruction 7750.6 (reference (s)) for purposes of categorizing potential monetary benefits claimed by auditors. Benefits should be categorized in the most appropriate function if more than one functional category is applicable.

C8.E1.6.1.3. A description of significant non-monetary potential benefits.

C8.E1.6.2. Details on Computation. The record shall be supported by an attachment that provides specific details on how each potential monetary benefit was computed and any exceptions taken by management. Any changes agreed to during staffing and discussions of the draft audit report should be made to the report and attachments.

C8.E1.6.3. Distribution to Follow-up Activity. A copy of the record of potential monetary benefits and the supporting attachment, along with management comments in response to the auditor-claimed benefits, shall be furnished to the activity responsible for mediation and/or follow-up on the audit report.

C8.E1.6.4. Cooperation with Management. Management often uses information on potential monetary benefits in the budget formulation process. Audit organizations shall cooperate fully in making such information available to budget personnel, including identifying applicable budget appropriations affected by the benefits, if known. However, potential benefits based on statistical sampling may present a special case. If the auditors and the activity audited agree that benefits will result but are unable to validate benefits by identifying organizational entities that would realize the benefits,

the auditors may still claim and report the benefits. Auditors should ensure that benefits based on statistical sampling that cannot be validated are appropriately identified to budget personnel so the activity audited is not unduly subjected to inappropriate or unfair budget reductions. Ultimately, however, a decision on whether or not a budget adjustment is made rests with the DoD Component Head.

C8.E1.6.5. Monetary Benefits Achieved. The auditors shall obtain statistical data from the audit follow-up activity on the benefits achieved for comparison with benefits estimated on a report by report basis. This information will enable the auditors to learn the final outcome of their audit efforts and to plan for future audit coverage.

C8.E2. ENCLOSURE 2 OF CHAPTER 8

EXAMPLES OF RECOMMENDATIONS THAT COULD RESULT IN REPORTABLE  
POTENTIAL MONETARY BENEFITS <sup>1</sup>

C8.E2.1. PROCUREMENT - INVENTORY CONTROL ACTIVITIES

Use competitive instead of sole-source procurement procedures when awarding contracts in the future.

C8.E2.2. PROCUREMENT - OTHER

Reduce the planned expansion of production base that exceeds the capacity of end item assembly facilities.

C8.E2.3. CONTRACT ADMINISTRATION

Recoup payments made to contractors for unsatisfactory or defective work or work not done, not needed, not completed, etc.

C8.E2.4. MAINTENANCE AND REPAIR OF EQUIPMENT

Repair economically repairable items instead of disposing of them.

C8.E2.5. REBUILD AND OVERHAUL OF EQUIPMENT

Curtail overhaul of equipment items that, when put into serviceable condition, would be excess to requirements; that is, when no additional requirements or planned acquisition of the equipment exist.

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<sup>1</sup> This is a list of examples and is not intended to be a complete list of recommendations that result in reportable monetary savings.

C8.E2.6. MANUFACTURING AND PRODUCTION

Assemble items in-house when it is more economical than fabrication by a contractor.

C8.E2.7. SUPPLY OPERATIONS - WHOLESALE

Delete the need to acquire major items of equipment to replace items expected to be removed from the supply system when experience shows replacements for washouts are not needed.

C8.E2.8. MILITARY PERSONNEL MANAGEMENT

Reduce training when graduates very seldom, if ever, use the skill attained after graduation.

C8.E2.9. REAL AND INSTALLED PROPERTY

Discontinue paying a 10 percent value-added tax on electricity costs for leased family housing complexes when the U.S. Forces are exempt from such taxes.

Close unneeded facilities through consolidation with existing facilities.

Adjust service contracts to compensate for reduction in scope of work.

Improve timeliness of making assignments of vacant family quarters to eliminate or reduce the need for off-post housing and subsistence.

Cancel scheduled maintenance and repair for buildings scheduled to be demolished.

C8.E2.10. CONSTRUCTION

Cancel approved and funded construction projects no longer needed.

C8.E2.11. TRANSPORTATION

Acquire aviation fuel at DoD facilities or through DoD into-plane refueling contracts, rather than civilian airports.

Use Government Bills of Lading for shipping household goods, rather than the more costly direct procurement method.

C8.E2.12. MILITARY PAY AND BENEFITS

Recoup monies improperly paid to National Guard personnel for unattended drills. Recoup monies improperly paid to active component personnel eligible to receive special allowances.

C8.E2.13. CIVILIAN PAY AND BENEFITS

Strengthen payroll procedures to make sure that requests for overtime and holiday work are fully justified.

C8.E2.14. OTHER COMPTROLLER FUNCTIONS

Implement procedures to ensure that vendors' invoices are scheduled for payment as close as administratively possible to the due date.

Reduce cash on hand needed for day-to-day operations to a minimum to avoid unnecessary interest costs.

Recoup non-recurring costs on sales of military equipment to foreign or other customers.

Recoup part of investment in ADP equipment used primarily to support the Foreign Military Sales Program.

C8.E2.15. SUPPORT SERVICES

Implement an effective work management system to reduce commissary labor costs.

C8.E2.16. HEALTHCARE

Terminate contracts with civilian physicians when alternate means (military physicians) of providing medical care are less costly.

C8.E2.17. FOREIGN MILITARY SALES

Recoup undercharged amounts on work orders. Correctly apply contract administration surcharges on all contracts.

## C9. CHAPTER 9

### AUDITING COMPUTER-BASED SYSTEMS

#### C9.1. PURPOSE

This chapter prescribes policy and guidance for auditing computer-based systems in operation or under development, relying on evidence from computer-based systems, and developing and maintaining a computer audit capability.

#### C9.2. APPLICABILITY

The audit policies and standards in sections C9.5. and C9.6. are mandatory for all DoD internal audit, internal review, and nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations"). The remaining sections of this chapter provide guidelines for successful implementation of the applicable policies and standard.

#### C9.3. DEFINITIONS

C9.3.1. Computer Auditing and Automated Data Processing (ADP) Auditing. These terms are used interchangeably. An ADP audit focuses on auditing the computer-based system as opposed to using the computer solely as an audit tool in selecting samples or analyzing data in computerized information bases. An ADP audit may be an evaluation of the management of a data processing installation or an ADP functional area. These audits may also include an evaluation of a new or substantially modified system that is proposed, under design, in development, undergoing testing, or ready for implementation. An ADP audit also may be structured to address the following objectives:

C9.3.1.1. Are automated resources being used effectively and efficiently?

C9.3.1.2. Is there a valid requirement for the system or application?

C9.3.1.3. Are the data being processed accurate, complete, reliable, and are the functional users satisfied with the output product?

C9.3.1.4. Are personnel (civilian and military) adequately trained for operation and use of the system?

C9.3.1.5. Are life-cycle management policies and procedures followed in acquiring and maintaining computer systems?

C9.3.1.6. Has an effective computer security program been implemented?

C9.3.2. General Controls. These controls include the plan of organization, methods, and procedures that apply to the overall computer operation in an Agency.

C9.3.3. Application Controls. These controls are designed to ensure the authority of data origination, accuracy of data input, integrity of processing, verification and distribution of output, integrity of data communication, and security of data storage. These controls apply on an individual basis and may vary among applications.

#### C9.4. BACKGROUND

C9.4.1. Automation resources supporting the management of information are interwoven throughout DoD programs, appropriations, and organizations. Automated resources represent not only significant investments and expenditures, they also control access to much of an organization's assets and information. While the computer may satisfy many information demands and increase productivity, if not properly controlled, it may be used to commit fraud or waste resources. The potential for misuse increases auditors' responsibilities to help management ensure that:

C9.4.1.1. Computer systems and their controls are designed and operating properly to safeguard assets; minimize opportunities for misuse; and provide accurate, timely, and reliable information.

C9.4.1.2. Automated resources are used efficiently, effectively, and economically.

C9.4.2. While ADP auditing covers a wide spectrum, audits may be categorized generally in five major areas:

C9.4.2.1. Data processing installation management issues.

C9.4.2.2. Computer hardware and software acquisition.

C9.4.2.3. System design and development.

C9.4.2.4. Specific computerized applications and software maintenance.

C9.4.2.5. Computer security.

C9.5. POLICY

C9.5.1. When the reliability of a computer-based system is the primary objective of the audit, the auditors shall review the system's general and application controls including tests as warranted.

C9.5.2. Auditors shall remain independent of ADP systems design and development teams. Accordingly, ADP audits shall be structured so that auditors objectively review the work of systems design and development teams, but do not become a part of such teams.

C9.5.3. Auditors shall be involved actively in evaluating the various aspects of computer security programs, policies, and practices because information system security is critical in the Department of Defense.

C9.5.4. Internal audit organizations shall develop and implement a formal methodology and strategy to identify and rank major ADP systems, programs, and issues for potential audit so as to effectively channel scarce audit resources to the most critical ADP areas.

C9.5.5. When computer-processed data are an important, integral part of the audit and the data's reliability is crucial to accomplishing the audit objectives, auditors shall satisfy themselves that the data are relevant and reliable. This is important regardless of whether the data are provided to the auditor or the auditor independently extracts the data.

C9.5.6. When review and/or test results indicate that computer-processed data are unreliable, the auditor shall limit the use of the data in the audit report and describe the limitations in the scope section of the report.

C9.5.7. When computer-processed data are used by the auditor or included in the report for background or informational purposes and are not significant to the audit results, auditors shall cite the source of the data in the report.

C9.5.8. A multi-skill level training approach shall be established for developing and maintaining an ADP audit capability (an example is illustrated in Chapter 4). All auditors need a basic level of computer knowledge, concepts, and functions. For auditors who specialize in ADP auditing, advanced or specialized training is needed to

perform complex system development and management audits. A formal career development program is needed to ensure that technical proficiency in auditing ADP is obtained and maintained.

C9.5.9. Internal audit organizations shall develop and maintain a high quality, broad-based ADP auditing capability that can respond effectively to the technical demands of the audit subject. (This provision is a guideline rather than a requirement for internal review activities since their size may be very limited.) Auditors shall request assistance from technical experts in examining and evaluating computer-related subjects if such skills are not available on the audit staff and audit objectives could not otherwise be accomplished.

#### C9.6. RELATED AUDITING STANDARDS

There are several internal auditing standards prescribed in Chapter 2 that specifically relate to: auditing computer-based systems, assessing the reliability of evidence from computer-based systems, and developing and maintaining a computer audit capability. These standards include:

C9.6.1. 200 - Professional Proficiency

C9.6.2. 310 - Reliability and Integrity of Information

C9.6.3. 460 - Reliability of Computer-Processed Data.

#### C9.7. REVIEW OF GENERAL AND APPLICATION CONTROLS IN COMPUTER-BASED SYSTEMS

In reviewing the general and application controls, the auditor should consider the effectiveness of those general controls relevant to the application system being reviewed. General controls are normally applicable to all data processing being carried out within an installation and provide a control environment affecting the applications being processed. Application controls, however, apply on an individual basis and may vary among applications. Guidelines for reviewing general and application controls in computer-based systems are provided in enclosure 1 to this chapter. Additional guidelines may be found in the General Accounting Office Audit Guide (reference (t)).

## C9.8. REVIEW OF COMPUTER-BASED SYSTEM DESIGN AND DEVELOPMENT

C9.8.1. The auditor's role in evaluating the design and development of automated systems is crucial if management is to have reasonable assurance that auditable and properly controlled systems are being developed. Recommended improvements may be accomplished more easily, at considerably less cost and effort, before the system becomes operational. Audit objectives for reviewing system design, development, and modifications are to provide reasonable assurance that automated systems and applications do the following:

C9.8.1.1. Carry out the policies that management has prescribed.

C9.8.1.2. Provide the controls and audit trails needed for management, auditor, and operational reviews.

C9.8.1.3. Include the controls necessary to protect against loss or serious error.

C9.8.1.4. Operate efficiently and economically.

C9.8.1.5. Conform with legal requirements.

C9.8.1.6. Contain documentation that provides an understanding of the system needed for system maintenance and auditing.

C9.8.2. The methods of achieving the six objectives in paragraph C9.8.1. are determined by the circumstances of each situation. Audits generally cover the adequacy of management policies, such as examining approvals, documentation, test results, cost studies, and other data to see whether management policies are followed and legal requirements are met. Audits also determine whether the system and/or applications have the necessary controls and audit trails. At the completion of the design and development process and during the final system testing phase, the auditor should verify that the implemented system conforms with the objectives.

C9.8.3. The system development cycle, from conception to implementation, may span several years, depending on the size and complexity of the ADP system. That factor, coupled with the scarcity of audit resources, necessitates an approach to ADP system design and development audits that is based on flexibility and segmentation. Additional explanation on the auditor's role, audit objectives, and approaches to auditing systems under development are provided in enclosure 2 to this chapter.

## C9.9. REVIEW OF COMPUTER SECURITY

C9.9.1. The availability of inexpensive but powerful computers and increased computer literacy of end-users have led to an explosion in the use of automation technology. The risks associated with the protection of personnel, proprietary, and other sensitive data also have increased. Adequate security over computer programs, data files, telecommunications networks, and input and output materials is essential.

C9.9.2. Risks jeopardizing computer security and information privacy are many and varied. The risks include: disaster; unauthorized access to commit acts such as theft, sabotage, or espionage; human errors; tampering with input, programs, or data files for fraudulent purposes; and use of computer resources for personal gain.

C9.9.3. OMB Circular A-130 (reference (u)) prescribes specific responsibilities for the administration and management of ADP resources. Appendix III to reference (u) establishes a minimum set of controls to be included in Federal automated information systems security programs; assigns responsibilities for the security of automated information systems; and clarifies the relationship between automated information systems security programs and internal control systems established in accordance with OMB Circular A-123 (reference (v)).

C9.9.4. As part of an Agency's computer security program, Agency management is required to conduct periodic reviews of sensitive applications and recertify the adequacy of security safeguards. Management reviews and recertifications are required at least every 3 years. They should be considered as part of Agency vulnerability assessments and internal control reviews conducted in accordance with reference (v). Audits of general and application controls in computer-based systems performed by the internal audit organizations may satisfy reference (u) review requirements.

C9.9.5. Computer security is a significant DoD management responsibility because of the sensitive nature, the criticality, and the value of the information processed and stored in its computer-based systems. Accordingly, auditors should be involved actively in evaluating the implementation of Agency computer security programs, policies, and practices. Audits of computer security programs and/or issues usually address the "prevention" aspects of what might happen, rather than actual detection of computer crime or abuse. Prevention is a far better audit strategy than detection and prosecution. Computer security audits also should include selected tests to determine if controls are sufficient to prevent unauthorized access to computer system and detect fictitious transactions.

## C9.10. COMPUTER AUDIT UNIVERSE

C9.10.1. Given the magnitude of the DoD information resource management program, the computer audit universe is substantial. Sufficient audit resources are not available to accomplish all ADP audit workload. Therefore, effective audit planning (consistent with Chapter 5 of this Manual) is essential to provide reasonable coverage to the computer audit universe and ensure that limited ADP audit resources are used effectively.

C9.10.2. The DoD central internal audit organizations shall develop and use a methodology and strategy for identifying and ranking critical, mission essential ADP systems and programs for potential audit coverage. A suggested approach is outlined below:

C9.10.2.1 Identify all data processing installations, ADP system development centers, and major ADP programs.

C9.10.2.2. Identify approved ADP system design and development projects that are valued at \$8 million or more over a 5-year period or \$1 million in any 1-year period.

C9.10.2.3. Select costly or high-risk systems and programs to be monitored on a continuing basis and establish procedures for obtaining periodic updates of life cycle management data such as major milestone dates, project schedules and tasks, and costs. Having life-cycle management data on system development efforts is essential to the ranking and scheduling of potential audits.

C9.10.2.4. Develop a basis or criterion for selecting the most important ADP areas for audit coverage. The selection process also should take into consideration the scope and sensitivity of resources that are or shall be controlled or influenced directly by ADP systems and programs to which they relate.

C9.10.3. The DoD internal review and nonappropriated fund audit organizations are encouraged, within available resources, to develop methods similar to those in paragraph C9.10.2. to identify the key ADP systems of their activity and schedule applicable audit coverage.

## C9.11. ASSESSING THE RELIABILITY OF COMPUTER-PROCESSED INFORMATION

C9.11.1. Auditors shall satisfy themselves that computer-processed data are relevant, accurate, and complete for the information's intended use. This is important regardless of whether the information is provided to the auditor or the auditor develops it independently.

C9.11.2. The scope and nature of the auditor's tests of data reliability should provide reasonable assurance that computer-processed data are relevant, accurate, and complete for the information's intended use. Data reliability shall be established either:

C9.11.2.1. Through reviews of general and application controls in the computer-based systems, including tests as are warranted; or

C9.11.2.2. If the general and application controls are not reviewed or are determined to be unreliable, through conduct of other tests or procedures.

The objective and requirements for performing data reliability assessments are provided in enclosure 3 to this chapter and apply to computer-processed data that are provided by the activity being audited and to computer-processed data that are retrieved independently by the auditors using audit software retrieval packages, microcomputers, or other means.

C9.11.3. When computer-processed data are used only for background or informational purposes and are not significant to the audit results, reference to the data and their source satisfy the reporting standards for accuracy and completeness.

C9.11.4. Auditors must exercise good judgment in deciding on the extent of data reliability tests so as to avoid unnecessary and time-consuming work. Primary consideration must be given to the objectives of the audit and the essentiality of the computer-processed information for an effective evaluation of the audit subject.

C9.11.5. Additional guidance on this subject can be found in the General Accounting Office Audit Guide (reference (w)).

## C9.12. COMPUTER AUDIT QUALIFICATIONS, TRAINING, AND CERTIFICATION

C9.12.1. The DoD central internal audit organizations must be in a position to cope with the increasing pervasiveness of computerized systems and to address complex data processing issues during the normal course of an audit. The development of auditor expertise in ADP is needed because:

C9.12.1.1. Most internal audit work involves the reviews of functional areas, and the records for most of those functions are increasingly automated.

C9.12.1.2. Conventional audit or management trails do not exist in some automated systems.

C9.12.1.3. Manual audit work may be reduced and audit coverage and reliability may be increased by working with the automated records.

C9.12.2. Many auditors require advanced or specialized ADP training to perform complex system development, management, and operational audits. The desired training shall depend on the complexity of the system, the audit objectives, the extent ADP specialists are available to assist the auditor, and the skill level of the auditor.

C9.12.3. While some aspects of ADP auditing may require highly specialized skills, all auditors need a basic awareness and understanding of the computer and its capabilities. The auditor needs to know what information a computer system may provide, the risks of accepting such data as correct, and when to request additional technical audit assistance to determine data accuracy and reliability. The need for computer training is an unending process due to the continuing changes in computer technology.

C9.12.4. To develop and maintain an effective computer audit capability, each DoD internal audit organization should establish a three-skill-level approach to computer training. That approach requires a continuous and long-term management commitment. The suggested knowledge and technical capabilities at the respective skill levels are provided in Chapter 4 of this Manual.

C9.12.4.1. Skill Level I. This level is required of every auditor. Auditors should have an overall awareness of the ADP environment and should know how to recognize areas of vulnerability. Auditors also should have the knowledge and skills necessary to use microcomputers in the performance of audits.

C9.12.4.2. Skill Level II. This level is required for selected journeymen auditors. Training objectives, in addition to Skill Level I, are to give auditors the ability to do the following:

C9.12.4.2.1 Evaluate internal controls in computer systems.

C9.12.4.2.2 Identify and explain weaknesses in those controls.

C9.12.4.2.3. Use and adapt generalized audit software programs to test the accuracy or validity of computer systems.

C9.12.4.2.4. Understand ADP life-cycle management policies and regulations for automated information systems.

C9.12.4.3. Skill Level III. This level is required for all auditors specializing in computer auditing. Those individuals should have wide experience in auditing ADP systems and should be capable of designing and using audit software routines. Skill Level III computer auditors, in addition to Skill Levels I and II training, should have an understanding of such areas as operating systems, software security, database management systems, networking, hardware and software controls, and data communications. Those individuals must be able to adapt their skills to rapidly changing technologies.

C9.12.5. A variety of certification programs are available to help auditors meet their professional responsibilities. The Certified Information Systems Auditor (CISA) examination, for example, tests proficiency in both auditing and data processing. The job dimensions of information systems auditors covered in the examination are described in enclosure 4 to this chapter.

C9.12.5.1. Auditor certification provides several advantages to the internal audit organization such as:

C9.12.5.1.1 It demonstrates an auditor's willingness to improve professionally.

C9.12.5.1.2 The preparation for the examination improves and sharpens an auditor's skills.

C9.12.5.1.3 The training and testing process identifies the strengths and weaknesses of the audit staff. This may be helpful to audit management in determining areas where intensified training should be provided.

C9.12.5.2. Internal audit organizations should encourage and support their staff in preparing for and taking the CISA examination. For individuals specializing in computer auditing, obtaining CISA certification or other ADP certifications is highly desirable.

### C9.13. ADP AUDIT ORGANIZATION

C9.13.1. Computer auditing expertise is a scarce resource due to the inherent complexities of computer systems and long-term training requirements. It may take 5 to 7 years to develop fully a qualified ADP auditor.

C9.13.2. To use available resources effectively and efficiently, the DoD central internal audit organizations should be organized to effectively meet and maintain their ADP audit responsibilities. The overall responsibility for the ADP audit function should be vested with a highly qualified senior audit manager. The incumbent should have primary responsibility for:

C9.13.2.1. Planning, coordinating, and providing staff direction for audits of ADP resources and issues.

C9.13.2.2. Developing and implementing an effective ADP audit strategy.

C9.13.2.3. Building and maintaining a high quality professional ADP audit staff. (See discussion of the functional area audit expert concept in Chapter 3 of this Manual.)

## C9.E1. ENCLOSURE 1 OF CHAPTER 9

### GUIDELINES FOR REVIEWING GENERAL AND APPLICATION CONTROLS IN COMPUTER-BASED SYSTEMS

#### C9.E1.1. REVIEW OF GENERAL CONTROLS IN COMPUTER-BASED SYSTEMS

General controls include the plan of organization and methods and procedures that apply to the overall computer operations in an Agency. In reviewing the general controls, the auditor should determine whether the controls have been designed according to management direction and known legal requirements, and whether controls are operating effectively to provide reliability of and security over the data being processed. The objectives and procedures followed in conducting this work vary depending on the type of general control involved, as discussed below.

##### C9.E1.1.1. Organizational Controls

C9.E1.1.1.1. The auditor should determine whether there is a clear assignment of responsibilities and accountability for planning, managing, and controlling the functions of the data processing organization. The auditor also should determine whether personnel are qualified and adequately trained and supervised, and whether there is proper separation of duties. Separation of duties, whenever feasible, should provide for separation among program and systems development functions, computer operations, controls over input of data, and the control groups that maintain application controls. The "total system" should be considered.

C9.E1.1.1.2. In reviewing separation of duties, the auditor should evaluate the control strengths and report on weaknesses resulting from inadequate separation. Policies of periodic rotation of employees and mandatory vacation scheduling may help management maintain adequate separation of duties. The auditor should determine whether such policies are being followed.

##### C9.E1.1.2. Security Controls

C9.E1.1.2.1. The auditor should determine whether adequate security is provided over the computer program, data files, telecommunications network, and input and output materials. These controls, such as physical restrictions and the use of passwords to limit system access, help ensure that only authorized persons are granted access to the computer system for authorized purposes.

C9.E1.1.2.2. In reviewing physical security of computer hardware, the auditor should consider the adequacy of a contingency plan for continued processing of critical applications if a disruption of normal processing occurs. The auditor should consider the extent to which the plan has been tested to determine the probability of continuing data processing support in a real emergency.

C9.E1.1.2.3. The auditor should review the physical security of data files. The review should ensure that whenever feasible, data and program file libraries are kept by personnel who do not have access to computers and computer programs; file libraries are secure; computer operators and other personnel do not have unlimited access to the libraries; and provisions have been made for backup of files (including offsite backup). When files are kept on-line, the auditor should consider whether they are protected by adequate access authorization controls and whether backup copies of files are kept regularly. Also, the auditor should verify whether data backup files are identified and labeled properly. The auditor also should check the contents to ensure that the files are complete and accurate.

#### C9.E1.1.3. Systems Software And Hardware Controls

C9.E1.1.3.1. Computer systems are controlled by systems software such as operating, database management, and program library systems. Systems software and hardware normally include built-in error-checking features to detect any errors during processing.

C9.E1.1.3.2. The auditor should be aware of the procedures used to ensure that systems software and hardware are functioning properly and that when errors are detected appropriate and authorized corrective actions are taken. The auditor needs to be aware of the controls the systems software can exercise over the system, how these controls can be bypassed or overridden, and how modifications to the software are controlled. The auditor may have to rely on a technical expert's judgment in making such an evaluation and should acquire the services of such an expert if the information needed is crucial to accomplishing the audit objectives. (See discussion on the use of technical experts for audits in Chapter 11, Part IV (C11.P4.) of this Manual.)

### C9.E1.2. REVIEW OF APPLICATION CONTROLS IN COMPUTER-BASED SYSTEMS

C9.E1.2.1. Application controls are designed to ensure the authority of data origination, accuracy of data input, integrity of processing, and verification and distribution of output.

C9.E1.2.2. The auditor should review the application controls to assess their reliability to process only authorized data and to process them promptly, accurately, and completely. This includes a review of the controls used to ensure that application software and later modifications are authorized and tested before implementation. These controls are intended to protect the integrity of the application software.

### C9.E1.3. TESTING FOR DATA RELIABILITY

C9.E1.3.1. The degree of testing needed to determine data reliability generally increases to the extent that the general or application controls were determined to be unreliable or were not reviewed. Testing procedures include the following:

C9.E1.3.1.1. Confirming computer-processed data with independent sources, such as third parties, and knowledgeable internal sources, such as regular users of the data and suppliers of data.

C9.E1.3.1.2. Comparing the data with source documents, or physical counts and inspections.

C9.E1.3.1.3. Reviewing Agency test procedures and results, and processing test transactions through the application.

C9.E1.3.2. Although auditing for fraud may not be the primary audit objective, the auditor should be alert to the possibility of fraud or other irregularities in computer-based systems. (See discussion of fraud, abuse, and illegal acts in Chapter 15 of this Manual.)

C9.E2. ENCLOSURE 2 OF CHAPTER 9  
AUDITOR'S ROLE DURING THE SYSTEM  
DESIGN AND DEVELOPMENT PROCESS

C9.E2.1. GENERAL

C9.E2.1.1. With the computer becoming more complex through the development of sophisticated multiprogramming capacity, the growing number of telecommunications links, and the wide variety of new input and output devices, another dimension has been added to the auditor's role. Auditors now must be able to perform a wide variety of tasks that at one time did not exist or were not considered part of their role.

C9.E2.1.2. Both the auditor and management have an interest in ensuring that system design, development, and overall operations achieve the objectives of adequate internal controls and effective auditability for systems already in existence. In the absence of an effective audit of the system design and development processes, the resultant system:

C9.E2.1.2.1. May not possess the built-in controls necessary to ensure proper and efficient operation.

C9.E2.1.2.2. May not provide the capability to track events through the system and thus impede, if not completely frustrate, audit review of the system in operation.

C9.E2.1.2.3. May not comply with generally accepted accounting principles or other criteria (for financial systems) and may result in qualifications of the auditor's opinion on the financial statements or segments of financial statements.

C9.E2.1.3. With the integration of application systems now being encountered, the payroll, personnel, and labor-cost-accounting applications may be interrelated subsystems of a far larger on-line system; and the outputs of one subsystem now may be the inputs for another without any human review. A control weakness in one segment of the system may have completely unanticipated effects on other segments, with a cascading of unanticipated effects that cause catastrophic results. Such mistakes, waste, and confusion may affect the entity's viability adversely.

## C9.E2.2. AUDIT OBJECTIVES

C9.E2.2.1. The objectives for the auditor's review of system design, development, and modifications are as follows:

C9.E2.2.1.1. Management Policies. The audit objective is to provide reasonable assurance that systems and/or applications carry out the policies management has prescribed.

C9.E2.2.1.1.1. Policies on what is expected of automated systems should be established by management, and the auditor should determine whether they are being adhered to in the design. The auditor should ascertain whether a proper approval process is being followed in developing new systems and in modifying existing systems. The auditor should verify that proper approval of a system's design is obtained by data processing management, user groups, and other groups whose data and reports may be affected. The auditor also should review system security required by management to protect data and programs against unauthorized access and modification.

C9.E2.2.1.1.2. If management's requirements are not being met or have not been articulated clearly, the auditor must report such shortcomings for corrective action. In the past, efforts to make new systems and/or applications operational by scheduled dates frequently resulted in some elements or controls that were desired by management being set aside by designers for later consideration. Auditors, in retaining their independence during the design and development processes, should report such actions to management for resolution.

C9.E2.2.1.2. Audit Trail. The audit objective is to provide reasonable assurance that system or applications provide the controls and audit trails needed for management, auditor, and operational review.

C9.E2.2.1.2.1 In financial applications, a transaction must be capable of being traced from its initiation, through all the intermediate processing steps, to the resulting financial statements. Similarly, information in the financial statements must be traceable to its origin. This capability is referred to by various terms such as audit trail, management trail, and transaction trail, and is essential in non-financial systems and/or applications. The reliability of the output may be assessed properly when the transaction processing flow is traced and the controls over it (both manual and automated) are evaluated.

C9.E2.2.1.2.2 During the design and development process, the auditor, through formal correspondence, should provide suggested audit trails or other controls to the design and/or development team. But in doing so, the auditor still needs to retain the independence necessary to evaluate management action at some future date.

C9.E2.2.1.3. Controls. The audit objective is to provide reasonable assurance to management that systems and/or applications include the controls necessary to protect against loss or serious error.

C9.E2.2.1.3.1. The system design and development processes include the following:

C9.E2.2.1.3.1.1 Defining the processing to be done by a computer.

C9.E2.2.1.3.1.2. Designing the processing steps.

C9.E2.2.1.3.1.3. Determining the data input and files that will be required.

C9.E2.2.1.3.1.4. Specifying each individual program's input data and output.

Each area must be controlled properly in consonance with good management practices. The auditor's review, in turn, is designed to provide reasonable assurance to management that the systems and/or applications, once placed in operation, shall be protected against loss or serious error.

C9.E2.2.1.3.2. Properly designed systems, with excellent control mechanisms built in, might have the controls bypassed or overridden by management direction. Many times the designers and developers override such controls to get the system operational, and then neglect to reactivate the controls after the system errors have been corrected.

C9.E2.2.1.3.3. Almost every system has manual aspects (such as input origination and output disposition) that, together with the electronic data processing controls, should be considered when the auditor is reviewing system controls for adequacy.

C9.E2.2.1.4. Economy and Efficiency. The audit objective is to provide reasonable assurance that systems and/or applications shall be economical and efficient in operation. Economy and efficiency audits include determining whether an

organization is managing and using its resources (such as personnel, property, space) efficiently and economically and reporting on the causes of inefficiencies or uneconomical practices (including inadequacies in management information systems, administrative procedures, or organizational structures). With the development of complex systems and/or applications, the auditor's review also should focus on whether the system was developed in such a way that operations shall produce desired results at minimum cost. For example, early in a system's development, the auditor should review the adequacy of the following:

C9.E2.2.1.4.1. Statement of mission needs and system objectives.

C9.E2.2.1.4.2. Feasibility study and evaluation of alternative designs to meet those needs and objectives.

C9.E2.2.1.4.3. Cost-benefit analysis that attributes specific benefits and costs to system alternatives.

C9.E2.2.1.5. Legal Requirements. The audit objective is to provide reasonable assurance that systems and/or applications conform with legal requirements.

C9.E2.2.1.5.1. Legal requirements applicable to systems and/or applications may originate from various sources.

C9.E2.2.1.5.2. One such requirement is compliance with Federal privacy statutes that restrict collection and use of certain types of information about individuals.

C9.E2.2.1.5.3. Safeguards obviously are necessary in such systems.

C9.E2.2.1.5.4. Conversely, organizations subject to the Freedom of Information Act should have systems and/or applications designed so that applicable and timely responses may be made to legitimate requests.

C9.E2.2.1.5.5. The applicability of the Federal Information Processing Standards (required by P. L. 89-306 (reference (x))) program to the system involved should also be considered by the auditor.

C9.E2.2.1.5.6. If such standards apply, they should be included in the auditor's review.

C9.E2.2.1.6. Documentation. The audit objective is to provide reasonable assurance that systems and/or applications are documented in a manner that shall provide the understanding of the system required for proper maintenance and auditing.

C9.E2.2.1.6.1. The auditor should determine whether the design, development, and modification procedures produce documentation sufficient to define:

C9.E2.2.1.2.6.1.1. The processing that must be done by programs in the system.

C9.E2.2.1.2.6.1.2. The data files to be processed.

C9.E2.2.1.2.6.1.3. The reports to be prepared.

C9.E2.2.1.2.6.1.4. The instructions to be used by computer operators.

C9.E2.2.1.2.6.1.5. The instructions to user groups for preparation and control of data.

The auditor also should ascertain whether management policy provides for evaluating documentation and adequate testing of the system before it is made operational. These steps are taken to ensure that the system and its controls may be relied on.

C9.E2.2.6.2. At the completion of the design and development processes and during the final system testing phases, the auditor should verify that the implemented system conforms with applicable audit objectives.

### C9.E2.3. AUDIT APPROACHES

C9.E2.3.1. DoD Directive 7920.1 and DoD Instruction 7920.2 (references (y) and (z)) provide a structured management approach, framework, and principles to be applied in developing and managing automated information systems over their life cycle. The life-cycle management (LCM) process provides and establishes a control mechanism to help ensure that automated systems are developed, evaluated, and operated in an effective and efficient manner. Emphasis is placed on improving early decisions, through periodic milestone reviews and high-level management participation, which affect the system's cost and utility.

C9.E2.3.2. The system development cycle, from conception to implementation, may span several years, depending on the size and complexity of the ADP system. The LCM regulations (references (y) and (z)) provide lines of demarcation showing generally where one phase of the development is completed and another is started. The beginning and ending points of specific tasks may differ somewhat within or between LCM phases depending on the management direction and needs of each ADP system

development effort. These factors, coupled with the scarcity of audit resources, necessitate an approach to ADP system development audits that is based on flexibility and segmentation.

C9.E2.3.3. There are several alternative approaches to the audit of ADP systems. Each alternative is dependent upon the size, relative importance, and timing of the system under consideration. For some systems, the audit may be limited to selected aspects; for other systems, a comprehensive examination of the complete system may be more applicable.

C9.E2.3.4. Since each system development effort is unique, the auditor should develop a plan early to ensure that timely and adequate coverage is provided to all significant audit areas during the development cycle. Audit approaches to ADP system development efforts should include an evaluation of the mission need and documentation; functional concept and architecture; risk and economic analyses; application of LCM management principles; program management structure and accountability; acquisition strategies; telecommunication plans; current status, milestones, and decision reviews; coordination, interface, and integration between ADP systems; and application of internal controls.

C9.E2.3.5. For audit planning purposes, the system development cycle may be broken down into three separate types of audits: System Planning Audits, System Development Audits, and System Evaluation and Testing Audits.

#### C9.E2.3.5.1. System Planning Audits

C9.E2.3.5.1.1. During the planning phase of the system's life cycle, feasibility studies are conducted; general and detail functional requirements are established; project management planning is accomplished; resource requirements are determined; and a series of economic analyses, including contractual support alternatives, are developed. This phase is completed with approval by proper authorities to enter into full-scale development work.

C9.E2.3.5.1.2. Audits of system planning are conducted to evaluate the procedure for ensuring that new systems are not developed before the need is justified, requirements of the proposed system are defined, and the cost-effectiveness of the proposed system is presented clearly for consideration to the decision makers. The automated system life cycle is controlled in a manner similar to that for major weapon systems. In the first phase, the planning or concept and/or design phase, comparatively few resources are expended, but decisions lead to allocation of significant resources in the next phase to develop the system. Weaknesses in the initial phase may have a

disproportionate cost impact on subsequent phases. Audits of justification documents for specific systems are conducted to determine whether the data and rationale are reasonable, accurate, and logical so they may be relied on to make decisions on the proposed system.

#### C9.E2.3.5.2. System Development Audits

C9.E2.3.5.2.1. Audits in this category include those parts of the systems development cycle from the general design to the testing phases. During this phase, system and equipment specifications are prepared and validated, ADP systems requirement specifications are prepared and validated, and the economic and risk analyses may be updated. Additionally, equipment and other resources are obtained, programming and required system documentation are accomplished, and configuration management discipline for both the functional and ADP systems is established. Finally, prototype field test plans are defined, user and specialists training programs are established, and system installation plans are developed.

C9.E2.3.5.2.2. The best opportunity for auditors to effect changes in the system of internal controls, audit trails, and audit requirements is during the system development phase. During the developmental phase, changes and extensions to the system of internal control may be accomplished with considerably less cost and effort than after the system becomes operational. The audit review of system development also enhances the auditors' knowledge of the complex new system and their ability to audit the system in the future.

C9.E2.3.5.2.3. System failures and cost overruns have resulted from insufficient management and user involvement in the systems development process. The auditor should ensure that procedures provide for both management and user involvement and that good sound management practices are employed. The auditor also should review the system design concepts for validity and the economic analyses for reasonableness.

#### C9.E2.3.5.3. System Evaluation and Testing Audits

C9.E2.3.5.3.1. During this phase of the systems cycle, the approved test plan is finalized and implemented. The prototype ADP systems are installed in a field environment for live testing by functional users. An evaluation report is prepared on performance, recommendations are made as to the adequacy of the system before extension, and installation are finalized.

C9.E2.3.5.3.2. Audits of the testing function evaluate the adequacy of the testing procedure to ensure that new systems or changes to existing systems are not accepted for implementation before they are capable of performing as intended.

C9.E3. ENCLOSURE 3 OF CHAPTER 9

GUIDELINES FOR ASSESSING  
RELIABILITY OF COMPUTER OUTPUT

C9.E3.1.1. Audits often involve computer-based systems that produce data used in audit reports of the activities audited. Products of any information system, whether computerized or not, may be inaccurate or incomplete. Auditors should not accept computer-processed information at face value for the following reasons:

C9.E3.1.1.1. Alterations made to data in computer files are not readily apparent when reviewing a computer product.

C9.E3.1.1.2. Computer product reliability is affected by data processing controls that are not always used in Agency systems.

C9.E3.1.1.3. The products are produced by a technology in which continuous changes in equipment and techniques hinder long-term credibility of a system.

C9.E3.1.2. The reliability of computer-based products shall be evaluated to determine the risks in using such products.

C9.E3.1.2.1. Objective. The objective of a reliability assessment is to determine the degree of risk in using computer-processed data.

C9.E3.1.2.2. Reliability Assessments

C9.E3.1.2.2.1. When computer-processed data are an important, integral part of the audit and the data's reliability is crucial to accomplishing the audit objectives, auditors should test the data for reliability to determine the degree of risk involved in using data that may be incomplete and/or inaccurate. It is not necessary to perform a reliability assessment if the accuracy or reliability of the data is not important in accomplishing the audit objective(s). The reliability assessment process includes the following steps:

C9.E3.1.2.2.1.1. Identifying computer-processed data that shall be used.

C9.E3.1.2.2.1.2. Determining the importance of the data to the audit.

C9.E3.1.2.2.1.3. Determining the source of the data and understanding the general flow through the system.

C9.E3.1.2.2.1.4. Conducting brief tests.

C9.E3.1.2.2.2. The auditor should perform only those tests considered necessary to support an opinion on the data reliability. A number of methods may be used, including the following:

C9.E3.1.2.2.2.1. Questioning a sufficient number of principal users about the reliability of computer outputs.

C9.E3.1.2.2.2.2. Obtaining views from auditors who have made detailed reviews of the computer system during the system development phase.

C9.E3.1.2.2.2.3. Comparing data with sources independent of the information system that generated the data.

C9.E3.1.2.2.2.4. Identifying problems from computer-generated edit reports.

C9.E3.1.2.2.2.5. Reviewing computer data for obvious errors and reasonableness.

C9.E3.1.2.2.3. A GAO audit guide (reference (aa)) provides additional details on audit work needed to test data reliability and satisfy data validation requirements.

### C9.E3.1.2.3. Unreliable Data

C9.E3.1.2.3.1. If the test results indicate that the data are unreliable, the auditor should limit use of the data in the audit report and describe the limitations, together with an explanation for the limitations, in the scope section of the report.

C9.E3.1.2.3.2. If the test results cast doubt on the data reliability and show significant problems with the data, the auditor should develop an audit finding as follows:

C9.E3.1.2.3.2.1. Using the results of the reliability tests to support the finding.

C9.E3.1.2.3.2.2. Showing the significance of the questionable data by explaining the problems that auditors and the activity's management might encounter by using such data.

C9.E3.1.2.3.2.3. Recommending that management restrict use of the data in the decision making process until the problem areas are resolved.

C9.E3.1.2.3.3. If there are significant problems with the data resulting in an audit finding, the auditor should recommend a separate review of the computer system. A GAO audit guide (reference (t)) provides additional details on performing such reviews.

C9.E3.1.2.4. Audit Working Papers. Working papers for documenting reliability assessments of computer output should be prepared, indexed, and reviewed the same as other working papers. The working papers should include the following:

C9.E3.1.2.4.1. Describe the work that was done.

C9.E3.1.2.4.2. Explain the results of the assessment and of any tests that were made.

C9.E3.1.2.4.3. Indicate the reliability that might be placed on the computer output if used either for background information or to support a finding in the audit report.

C9.E3.1.2.5. Additional Guidance. General Accounting Office Guide (reference (w)) provides procedures to help auditors determine the degree of risk in using information that may be inaccurate.

C9.E4. ENCLOSURE 4 OF CHAPTER 9  
CERTIFIED INFORMATION SYSTEMS AUDITOR  
EXAMINATION

C9.E4.1.1. The 10 job dimensions of information systems auditors covered in the examination are as follows:

C9.E4.1.1.1. Application Systems Control Review. Installed application system controls are reviewed to determine that the system produces information in a timely, accurate, and complete manner.

C9.E4.1.1.2. Data Integrity Review. Data are reviewed for completeness, consistency, and correctness to determine integrity.

C9.E4.1.1.3. System Development Life-Cycle Review (SDLC). An organization's SMC procedures are reviewed to determine adherence to generally accepted standards.

C9.E4.1.1.4. Application Development Review. Systems under development are reviewed to determine the adequacy and completeness of planned controls.

C9.E4.1.1.5. General Operational Procedures Controls Review. The data processing operating procedures are reviewed to determine that applications are processed in a controlled environment.

C9.E4.1.1.6. Security Review. Methods and procedures to ensure the applicable protection of programs, data, and the data processing installation are reviewed.

C9.E4.1.1.7. Software Maintenance Review. The process of making modifications to existing systems is reviewed for adequacy.

C9.E4.1.1.8. Acquisition Review. The acquisition of hardware, software, and services is reviewed to determine if organizational resources are being used economically.

C9.E4.1.1.9. Data processing Resource management Review. Data processing planning, administrative, and management practices are reviewed to determine their adequacy.

C9.E4.1.1.10. Information Systems Audit Management. How the information systems auditor organizes, sets priorities, and assumes responsibility for effectively utilizing available resources and for fulfilling the information systems audit requirements of the organization is reviewed.

## C10. CHAPTER 10

### AUDIT REQUIREMENTS GENERATED BY SOURCES EXTERNAL TO DEPARTMENT OF DEFENSE

#### C10.P1. PART I - INTRODUCTION

C10.P1.1. Many external forces impact on the roles and responsibilities of internal audit and internal review organizations within the Department of Defense. These include actions by the Congress, the OMB, the Comptroller General of the United States, and organizations within the professional audit community. This chapter provides policy and guidance on how to meet requirements imposed by external organizations. The various parts of this chapter describe specific requirements established by the IG, DoD, to comply with legislative acts, OMB circulars, and other authorities.

C10.P1.2. As specific requirements arise that need implementing audit policies, these audit polices will be added to this chapter.

#### C10.P2. PART II - INTERNAL CONTROL SYSTEMS

C10.P2.1. Purpose Part II establishes policy for evaluating management's implementation of the internal control program under the "Federal Managers' Financial Integrity Act of 1982" (FMFIA) (reference (bb)), OMB Circular No. A-123 (reference (v)), and DoD Directive 5010.38 (reference (cc)).

C10.P2.2. Applicability All DoD internal audit organizations, including internal review and appropriated fund audit organizations, shall comply with applicable policy provisions in Part II.

##### C10.P2.3. Definitions

C10.P2.3.1. Agency or Activity Component. A major program, administrative activity, organization, or functional subdivision of an Agency or activity.

C10.P2.3.2. Internal Control Documentation. Written materials or records of management of two different types:

C10.P2.3.2.1. System Documentation. Includes policies and procedures, organizational charts, manuals, memoranda, flow charts, and related written materials

necessary to: describe organizational structure, operating procedures, and administrative practices; and communicate responsibilities and authorities for accomplishing program and activities. Such documentation should be present to the extent required by management to control their operation effectively.

C10.P2.3.2.2. Review Documentation. Shows the type and scope of agency or activity management's review, the responsible official, the pertinent dates and facts, the key findings, and the recommended corrective actions. The GAO and OMB have agreed that documentation is adequate if the information is understandable to a reasonably knowledgeable reviewer.

C10.P2.3.3. Internal Control Evaluations. A detailed evaluation by activity management of a program or administrative activity to determine whether adequate controls exist and are implemented to achieve cost-effective compliance with the FMFIA (reference (bb)). Internal control evaluations are of two types:

C10.P2.3.3.1. Internal Control Review. A detailed examination of a system of internal controls meeting the intent of the methodology specified in the OMB Guidelines (reference (dd)) to determine whether adequate control techniques exist and are implemented to achieve appropriate control objectives.

C10.P2.3.3.2. Alternative Internal Control Review. An internal control review that does not follow the full event cycle control review methodology described in reference (dd), but achieves the same objectives as stated in paragraph C10.P2.3.3.1. above. Examples of alternative internal control reviews include OMB Circular No. A-130 (reference (u)) computer security reviews, management studies, audits, consultant studies, OMB Circular No. A-76 (reference (ee)) studies, and OMB Circular No. A-127 (reference(ff)) financial system reviews. Any alternative review must encompass GAO internal control standards (reference (gg)), must include testing of systems in operation, and must be documented. Alternative reviews should make use of existing review processes in reviewing high-risk elements of a component.

#### C10.P2.3.4. Internal Control Objectives

C10.P2.3.4.1. Internal control objectives are measures that provide DoD management with reasonable assurance that:

C10.P2.3.4.1.1 Obligations and costs comply with applicable law.

C10.P2.3.4.1.2 Assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

C10.P2.3.4.1.3 Revenues and expenditures that apply to Agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained.

C10.P2.3.4.1.4 Programs are efficiently and effectively carried out according to applicable laws and management policy.

C10.P2.3.4.2. The objectives of internal control apply to all program administrative activities or functions.

C10.P2.3.5. Internal Control Standards. Standards issued by the Comptroller General (reference (gg)) to help managers in all Executive Agencies establish and maintain effective systems of internal control, as required by the FMFIA (reference (bb)). Implementation of the standards should be according to OMB Circular No. A-123 (reference (v)), consistent with Agency or activity needs for sound cost-effective internal control system.

C10.P2.3.6. Internal Control System. The sum of an organization's plans, methods, measures, policies, and procedures used to achieve the objectives of internal or management control described in paragraph C10.P2.3.4., above.

C10.P2.3.7. Internal Control Techniques. Internal control techniques are the mechanisms by which control objectives outlined in C10.P2.3.4., above, are achieved. A number of internal control techniques are essential to providing reasonable assurance that the internal control objectives are achieved. These techniques are:

C10.P2.3.7.1. Transactions and other significant events must be clearly documented and recorded promptly.

C10.P2.3.7.2. Transactions and other significant events must be authorized and executed by persons acting within their authority.

C10.P2.3.7.3. Key duties must be separated among individuals.

C10.P2.3.7.4. Qualified and continuous supervision must be provided to ensure that internal control objectives are achieved.

C10.P2.3.7.5. Access to resources and records must be limited and accountability for custody must be assigned with periodic comparisons of the resources with the recorded accountability.

C10.P2.3.8. Management Control Plan (MCP). A written, 5-year management plan (updated annually) that identifies the complete component inventory; shows the risk rating of individual components (high, medium, low); and indicates management's planned risk assessments and internal control evaluations by fiscal year for each inventory component. Management should use the plan to monitor progress and ensure that planned actions are taken.

C10.P2.3.9. Material Weakness. A situation in which the designated procedures or the degree of compliance with the designated procedures do not provide reasonable assurance that the objectives of internal control enumerated in paragraph C10.P2.3.4., above, are being achieved. See enclosure to this chapter and DoD Directive 5010.38 (reference (cc)) for further information on material weaknesses.

C10.P2.3.10. OMB Guidelines. Guidelines (reference (dd)) issued by OMB in response to requirements in the FMFIA. These guidelines are discretionary rather than mandatory in nature; they are a suggested approach that may be adapted to meet the needs of the individual Agency or activity, provided that such adoption remains in compliance with OMB Circular No. A-123 (reference (v)).

C10.P2.3.11. Reasonable Assurance. A judgment by a Department, Agency, or activity head based on all available information that the systems of internal control are operating as intended by the FMFIA.

C10.P2.3.12. Risk Assessment. A documented review by management of a component's susceptibility to waste, loss, unauthorized use, or misappropriation. Risk assessments are of two types:

C10.P2.3.12.1. Vulnerability Assessments. Assessments as provided in the OMB Guidelines (reference (dd)).

C10.P2.3.12.2. Alternative Procedures. Procedures tailored to Department, Agency, or activity circumstances.

#### C10.P2.4. Policy

C10.P2.4.1. Internal Audit Organizations. The DoD central internal audit organizations shall normally evaluate internal controls in each area or function audited. On each scheduled audit, the audit activity shall, when such evaluation is possible and within the scope of the scheduled audit, evaluate and report on management's implementation of the internal control program. If requested, each central internal audit organization should advise the Military Department, Agency, or organization by

written report, with a copy to the IG, DoD, whether the annual internal control evaluation performed by management was consistent with OMB requirements. The central internal audit organizations are further encouraged to perform evaluations of internal control systems requested by Agencies or organizations within their respective components to provide, whenever practicable, technical assistance to further the overall DoD goal of strengthening internal control systems.

C10.P2.4.2. Internal Review and Nonappropriated Fund Audit Organizations. Internal review and nonappropriated fund audit organizations shall normally review and evaluate applicable internal control systems during every audit. These organizations may also provide technical assistance to managers in their efforts to evaluate and improve internal controls. However, they shall not engage in activities that could impair their ability to independently assess the adequacy of management's internal control systems evaluations.

C10.P2.4.3. Training. All DoD internal audit organizations shall provide their staffs with adequate training on the evaluation of internal control systems, regulatory requirements governing internal control systems, and related roles and responsibilities of management and auditors. This training should:

C10.P2.4.3.1. Be consistent with DoD Auditing Standard 200 on professional proficiency and continuing education.

C10.P2.4.3.2. Focus on regulatory requirements, definitions, and standards pertaining to internal control systems and on the related roles and responsibilities of managers and auditors with respect to internal controls.

C10.P2.4.3.3. As a minimum, include training on basic OMB and DoD requirements described in paragraph C10.P2.5. of this chapter, program evaluation techniques, interrelationships, and roles and responsibilities of the Government auditor.

#### C10.P2.5. Background

C10.P2.5.1. The Federal Managers' Financial Integrity Act (FMFIA) of 1982 (reference (bb)). The Act requires focus on managements' need to strengthen internal controls and directs the Secretary of Defense to do the following:

C10.P2.5.1.1. Establish a program of continuous evaluation of DoD systems of internal controls.

C10.P2.5.1.2. Follow OMB Guidance in evaluating those DoD system of internal controls.

C10.P2.5.1.3. Provide an annual report to the President and the Congress stating whether the Department of Defense has established systems of internal control in accordance with the standards prescribed by the Comptroller General (reference (gg)) and whether these systems provide reasonable assurance that they meet the objectives set forth in reference (bb). If the controls do not comply fully, the report shall identify material weaknesses in the controls and specify plans for correcting the weaknesses.

C10.P2.5.2. OMB Circular No. A-11. This circular (reference (hh)), requires that the FMFIA process be supported by budget estimates that: identify major accounts; include supporting justification; and reflect a commitment to resolve material internal control weaknesses.

C10.P2.5.3. OMB Circular No. A-123. This circular (reference (v)) prescribes policy and procedures for establishing, maintaining, evaluating, improving, and reporting on internal controls. In addition, the circular encourages the statutory inspectors general to assume certain responsibilities. These responsibilities include:

C10.P2.5.3.1. Providing technical assistance in the Agencies' and activities' efforts to evaluate and improve internal controls;

C10.P2.5.3.2. Conducting reviews, either self-initiated or requested by management, of internal control documentation and systems; and

C10.P2.5.3.3. Advising Agency and organization heads, on request, whether their processes for evaluating internal controls have been conducted consistent with OMB requirements.

The IG, DoD, has adopted those responsibilities for the DoD central internal audit organizations, internal review, and nonappropriated fund audit organizations. DoD Directive 5010.38 (reference (cc)) implements OMB Circular A-123 (reference (v)).

C10.P2.5.4. OMB Circular No. A-130. This circular (reference (u)) establishes policy and procedures for control and evaluation of Federal information resources. It provides requirements for audits or reviews and recertifications of sensitive computer applications, and requirements that the adequacy and security of system safeguards be recertified every 3 years. The results of these reviews and the conduct of risk assessments should be considered as a part of the Agency vulnerability assessment process.

## C10.P2.6. Audit Coverage and Assistance

C10.P2.6.1. Efforts on Audit Coverage and Assistance. For discussion purposes, these audit efforts have been divided into four general areas:

C10.P2.6.1.1. Regularly scheduled audits;

C10.P2.6.1.2. Requested audits;

C10.P2.6.1.3. Technical assistance; and

C10.P2.6.1.4. Reviews of adequacy of management's internal control evaluation process. Each of these areas is discussed in the subsequent paragraphs.

## C10.P2.6.2. Regularly Scheduled Audits

C10.P2.6.2.1. Internal auditors shall, except in unusual circumstances, evaluate and report on internal controls during every audit (DoD Auditing Standard 450). Chapter 8 of this Manual contains guidance on evaluating internal controls on each audit.

C10.P2.6.2.2. As part of or in addition to evaluating internal controls described in paragraph C10.P2.6.2.1., above, each DoD central internal audit organization shall evaluate how well management has implemented the internal control program requirements of OMB and the Department of Defense when such evaluation is possible within the scope of the scheduled audit. This would include reviewing the adequacy of risk assessments and internal control evaluations in those areas in which the auditors identify internal control weaknesses. These weaknesses shall be provided to the senior official responsible for the organizations' internal controls program, to be considered for inclusion in the annual Agency statement to the President and the Congress. In those cases where identified weaknesses may result in disallowed cost or the identification of areas where funds may be put to better use, the information and the affected budget category should also be reported.

C10.P2.6.2.3. Each audit report should contain evaluations on how well management has implemented the internal control program as it related to the scope of the scheduled audit. The auditor should compare the findings disclosed by the audit with the results of the most recent annual FMFIA evaluation for that Agency component. In those cases where the audit was made soon after the internal control evaluation called for under the FMFIA, the auditors shall note whether the management evaluation accurately disclosed any deficiencies reported during the audit. Auditors

should not use the results of management internal control reviews to develop findings and recommendations when the identified material weakness and corresponding corrective action appear to be complete and appropriate. In those cases where FMFIA action plans exist that require funding to implement recommendations, the auditor should ascertain whether appropriate budget requests were initiated to correct identified deficiencies. The results of these evaluations should be forwarded to the responsible FMFIA official for their use in improving the FMFIA evaluation process.

#### C10.P2.6.3. Requested Audits

C10.P2.6.3.1. Occasionally, managers may ask audit organizations to review aspects of their internal control systems. A review may be made separately or performed in conjunction with regularly scheduled audits.

C10.P2.6.3.2. When audit organizations agree to conduct any internal control evaluations, the Military Department, Agency, or activity heads may rely on the audit results in preparing their annual statements to the Secretary of Defense. However, the Military Department, Agency or activity heads still are responsible for the overall judgments made in the annual statement.

#### C10.P2.6.4. Technical Assistance

C10.P2.6.4.1. Although the DoD central internal audit organizations perform audits and reviews as discussed in paragraph C10.P2.6., they are not precluded from providing technical assistance to managers in their efforts to evaluate and improve internal controls. In fact, audit organizations are encouraged to provide technical assistance to further the overall DoD goal of strengthening internal control systems.

C10.P2.6.4.2. Since management has primary responsibility for maintaining a strong system of internal control, managers throughout the DoD Components need to be heavily involved in internal control programs. Therefore, auditors shall exercise due care to avoid compromise of professional independence or direct involvement in the development and administration of Agency internal control programs. Independence shall be maintained so that audit opinions, conclusions, judgments, and recommendations are impartial, and will be viewed as impartial by knowledgeable third parties. Technical assistance may include such activities as:

C10.P2.6.4.2.1. Serving in an advisory capacity on Agency committees dealing with internal control activities. The committee should be provided with planned audit activities so audit efforts can be effectively coordinated with Agency internal control evaluations when establishing priorities for conducting internal control reviews.

C10.P2.6.4.2.2. Providing technical advice on internal control training, e.g. the procedures to be used in testing internal control systems.

C10.P2.6.4.2.3. Reviewing and commenting on directives and written issuances dealing with internal control activities.

C10.P2.6.4.2.4. Meeting with senior management officials to discuss progress of annual FMFIA evaluations and to offer suggestions on how they may be improved.

C10.P2.6.5. Review of the Adequacy of Management's Internal Control Evaluations Process

C10.P2.6.5.1. Auditors shall determine periodically whether the activity's process for evaluating and report on internal controls are consistent with OMB requirements. As part of this assessment, the auditors should rely on the audit results obtained under the guidelines in subparagraph C10.P2.6.2., above. The auditors are cautioned that OMB Guidelines (reference (dd)) are discretionary in nature and are a suggested approach that management can adapt to the activity as long as the adaptation complies with OMB Circular No. A-123 (reference (v)).

C10.P2.6.5.2. Once audit has determined that management's process for evaluating its internal controls is adequate, only material changes in the process need be reviewed during a subsequent audit. Thus, audits of the process should then be made on a periodic basis to determine whether management's process is still adequate and functioning properly. Other internal audits/reviews should basically focus on the results of the internal control process, rather than the process itself.

C10.P2.6.5.3. However, management may request annually from audit an assessment of whether its process for evaluating its internal controls has been carried out consistent with prescribed regulations. Audit work, in addition to that described in paragraphs C10.P2.6.5.1. and C10.P2.6.5.2., above, should be programmed to the extent needed to respond to management's request.

C10.P2.6.5.4. Each internal audit organization shall report audit results obtained under paragraphs C10.P2.6.5.1., C10.P2.6.5.2., and C10.P2.6.5.3., above, to management with a copy to the OIG, DoD, in accordance with paragraph C10.P2.8., below. The format shown in figure C10.F1. should be used when reporting audit results under paragraph C10.P2.6.5.3., above.

#### C10.P2.7. Internal Review and Nonappropriated Fund Audit Organizations

C10.P2.7.1. DoD Directive 7600.2 (reference (k)) allows internal review and nonappropriated fund audit organizations to evaluate and report on how well management has implemented an internal control program. These audit organizations shall refrain from doing an activity's risk assessments or internal control evaluations because that is management's responsibility. Management must perform their own risk assessments. Such total involvement by these audit organizations would impair audit independence (DoD Auditing Standard 100) and could prevent them from providing a related objective-independent evaluation to management.

C10.P2.7.2. The audit organizations are, however, encouraged to provide technical assistance to help managers evaluate and improve internal controls, including assisting managers in training their staffs.

#### C10.P2.8. Reporting Requirements

C10.P2.8.1. Paragraphs C10.P2.6.5.1., C10.P2.6.5.2., and C10.P2.6.5.4. require that each central internal audit organization periodically review and report on the adequacy of management's process for evaluating and reporting on its system of internal controls and state if such evaluation and reporting were in accordance with OMB requirements.

C10.P2.8.2. Paragraph C10.P2.6.5.3., above, also recognizes that management may request annually that audit organizations determine if their process for evaluating their internal controls have been carried out in accordance with prescribed requirements. Even though this is a limited review, it should include:

C10.P2.8.2.1. A determination if any material changes have occurred in the program or process requiring additional audit coverage.

C10.P2.8.2.2. A review of the Management Control Plan (MCP) for component inventory, risk ratings, and 5-year evaluation schedule. The plan should include schedule dates for the evaluations, types of evaluation, and the name of the senior management official responsible for each evaluation. The MCP shall be updated

annually to include changes to components, new programs, and restructuring of existing programs.

C10.P2.8.2.3. A selected sample of risk assessments and evaluation of their methodology, and whether or not the results are reflected in the MCP.

C10.P2.8.2.4. An assessment of internal control evaluations performed. Analysis should include the type of evaluation made, assurance that testing included procedures to determine that internal controls were working, and a determination about the adequacy of documentation to support the conclusions reached.

C10.P2.8.2.5. A review of formal follow-up procedures for tracking corrective actions and verification that actions have in fact been taken to correct deficiencies noted. In those cases where a formal follow-up system does not exist, a sample of reported actions should be taken and the results verified.

C10.P2.8.2.6. A review of the proposed annual statement for ascertaining the adequacy, propriety, and reasonable assurance that evaluations were conducted in accordance with applicable laws and regulations; that material weaknesses identified during the internal control review process were reported (enclosure 1 to this chapter); that effective plans for correcting material weakness are listed; that financial systems conform with accounting principles and standards; and that assurance is provided that there is adequate security of Agency automated information systems as required by OMB Circular No. A-130 (reference (u)).

C10.P2.8.3. When such annual evaluations are made by the audit organizations, the audit results should be reported to management in writing using the format in figure C10.F1. The auditors shall report any disagreements they may have with management's annual statement. A copy of each audit report should also be forwarded to the IG, DoD (ATTN: OAIG-APO), to arrive by November 15 of each year or as soon thereafter as possible.

### C10.P3. PART III - ACCOUNTING SYSTEMS

C10.P3.1. Purpose Part III establishes policy for evaluating the management process used to meet the annual reporting requirements for DoD accounting systems under Section 4 of the Federal managers' Financial Integrity Act of 1982 (reference (bb)), OMB Circular No. A-127 (reference (ff)), DoD Directive 7045.16 (reference (ii)), and DoD 7220.9-H (reference (jj)).

C10.P3.2. Applicability The policies in this part apply only to the DoD central internal audit organizations.

### C10.P3.3. Policy

C10.P3.3.1. Process Evaluation. Each central internal audit organization shall periodically review and report on the adequacy of the respective Department, or activity process for evaluating and reporting under Section 4 of the Integrity Act on whether its accounting systems comply with the Comptroller General's principles, standards, and related requirements as implemented by the Department of Defense, and whether the process has been carried out in a reasonable and prudent manner.

C10.P3.3.2. Self-Initiated/Requested Audits. Each central internal audit organization may, depending on workload, priorities, and resource availability, make self-initiated or requested audits of accounting systems, either as separate systems reviews or in conjunction with larger audits.

C10.P3.3.3. Technical Assistance. Each central internal audit organization is further encouraged to provide, whenever practicable, technical assistance to management in their efforts to:

C10.P3.3.3.1. Evaluate and determine if their accounting systems conform to the Comptroller General requirements, as implemented in DoD 7220.9-M (reference (jj));

C10.P3.3.3.2. Improve them; and

C10.P3.3.3.3. Report on those systems under the FMFIA.

C10.P3.3.4. Training. All DoD internal audit organizations shall provide their audit staffs with adequate training on the Comptroller General requirements, as implemented in DoD 7220.9-M (reference (jj)) for accounting systems, regulatory requirements governing evaluating and reporting on operating accounting system, and related roles and responsibilities of management and auditors.

### C10.P3.4. Background

C10.P3.4.1. The Federal Managers' Financial Integrity Act of 1982. Section 4 of the Act (reference (bb)) requires the Secretary of Defense to report annually on whether the DoD accounting systems conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General. This report

accompanies the DoD report to the President and the Congress on its internal control systems, which is discussed in detail in Part II (C10.P2.) of this chapter.

C10.P3.4.2. OMB Circular No. A-127. This Circular (reference (ff)) prescribes policies and procedures for developing, operating, evaluating, and reporting on all financial management systems. Accounting systems are a subset of financial management systems. The OMB Circular requires that, at least, a limited review of financial management systems be conducted annually by the associated system manager. This Circular also states that for reporting purposes, accounting systems that conform to the provisions of this Circular shall be considered as meeting the requirements of the Integrity Act.

C10.P3.4.3. OMB Guidelines for Evaluating Financial Management/Accounting Systems. This publication (reference (kk)) provides detailed procedural guidance to agencies for:

C10.P3.4.3.1. Establishing system inventories;

C10.P3.4.3.2. Organizing and conducting detailed systems evaluations on a recommended 3-year cycle; and

C10.P3.4.3.3. Using evaluation results to establish and update 5-year agency system improvement plans required by Paragraph 7.c., OMB Circular No. A-127 (reference (ff)).

C10.P3.4.4. DoD Directive 7045.16. This Directive (reference (ii)) implements the requirements of OMB for evaluating DoD financial systems. It defines operating accounting systems and requires that the accounting principles, standards, and related requirements prescribed by the Comptroller General be implemented by DoD Components in accordance with guidance issued by the Director of the OMB. Those Comptroller General requirements are included in the GAO Policy and Procedures Manual for Guidance of Federal Agencies (reference (ll)). DoD Directive 7045.16 further requires that each DoD Component follow related detailed instructions contained in DoD 7220.9-M (reference (jj)).

C10.P3.4.5. Department of Defense Accounting Manual, DoD 7220.9-M. Chapter 12 of the Accounting Manual (reference (ll)) incorporates the requirements of OMB and the Comptroller General as they relate to operating accounting systems. Further, Chapter 12 establishes detailed procedures for:

C10.P3.4.5.1. Inventorying operating accounting system annually.

C10.P3.4.5.2. Evaluating accounting systems for compliance with prescribed accounting principles, standards, and related requirements.

C10.P3.4.5.3. Reporting the status of actions to upgrade accounting systems to meet prescribed requirements.

C10.P3.4.5.4. Preparing the annual report on accounting systems required by Section 4 of the FMFIA.

#### C10.P3.5. Accounting Systems Compliance Reporting Process

C10.P3.5.1. Section 4 of the FMFIA requires the Secretary of Defense to report by December 31 each year whether the DoD accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General. The Secretary's accounting system report is based primarily on related annual reports furnished by the Service Secretaries, Directors of the Defense Agencies, and Heads of DoD activities.

C10.P3.5.2. Each central internal audit organization shall periodically evaluate the adequacy of the respective DoD Component's process for determining whether its accounting systems are in compliance with the Comptroller General requirements and whether managements' evaluation and reporting have been carried out in reasonable and prudent manner. Once management's process has been found adequate by audit, only material changes in the process need be reviewed and evaluated by audit. Consequently, audits normally would be made on a cyclical or periodic basis to determine whether management's process is still adequate and accounting systems are functioning properly.

C10.P3.5.3. When management contemplates reporting under Section 4 of the FMFIA that a particular accounting system is for the first time in compliance, the respective audit organization should evaluate the basis for such compliance reporting. Audit organizations shall maintain close contact with management officials so as to be aware when new systems are scheduled to be reported.

C10.P3.5.4. When audits of DoD Component processes are made, the audit results should be reported to management, and a copy of the results should be sent to the IG, DoD (ATTN: OAIG-APO). See paragraph C10.P3.1. of this chapter for further information on reporting.

### C10.P3.6. Requested and Self-Initiated Audits

C10.P3.6.1. Occasionally, management may ask audit organizations to review accounting systems or aspects of selected systems. These reviews may be made separately or performed in conjunction with regularly scheduled audits. Based on the request, the audit organization should establish specific audit objectives to guide the audit effort and to address the specific concerns of management.

C10.P3.6.2. Depending on workload, priorities, and other such factors, internal audit organizations may also initiate audits of accounting systems. If management has reported that an accounting system is in compliance with the Comptroller General requirements under the FMFIA reporting, the self-initiated audit should include an evaluation of management's basis for such reporting. Whenever possible, all self-initiated audit efforts in accounting systems should be programmed and scheduled in concert with any audit efforts relating to the annual FMFIA reporting requirement.

C10.P3.6.3. Financial audits shall adhere to standards prescribed in Chapter 2 of this Manual and Chapter 5 of the Government Auditing Standards (reference (c)) when evaluating internal controls. As a minimum, each report shall include information on the controls identified, whether they were or were not evaluated, and the material weaknesses identified as a result of the study or evaluation. The evaluation may have to be limited when:

C10.P3.6.3.1. An adequate internal control structure does not exist.

C10.P3.6.3.2. The auditor concludes it is more efficient to conduct actual testing rather than place reliance on the internal control structure.

C10.P3.6.3.3. The control structure contains extensive weaknesses requiring the auditor to rely on testing.

C10.P3.6.3.4. The objective of the financial audit did not require an understanding or assessment of internal controls.

The above circumstance, if applicable, should be documented and explained in the report on internal controls.

C10.P3.6.4. When audit organizations agree to conduct audits in accounting systems, the Military Department, Agency, or activity heads may rely on the audit results in preparing their annual reports to the Secretary of Defense. However, audit personnel shall ensure that activity heads understand that they are still responsible for overall judgments made in their annual reports.

#### C10.P3.7. Technical Assistance

C10.P3.7.1. Although the DoD central internal audit organizations perform audits and reviews as discussed in sections C10.P3.5. and C10.P3.6., they are not precluded from providing technical assistance to managers in their efforts to evaluate and improve their accounting systems. In fact, audit organizations are encouraged to provide technical assistance to further the overall DoD goal of bringing all accounting systems into compliance with the Comptroller General requirements.

C10.P3.7.2. Since management has the primary responsibility for evaluating and reporting on its accounting systems, auditors shall exercise due care to avoid compromise of professional independence. Independence shall be maintained so that audit opinions, conclusions, judgments, and recommendations are impartial and will be viewed as impartial by knowledgeable third parties. Paragraph C10.P2.6.4.2., above, provides guidance on types of assistance that should be made available.

#### C10.P3.8. Training

C10.P3.8.1. The audit organizations shall provide accounting systems-related training for their auditors consistent with DoD Auditing standard 200 on professional proficiency and continuing education. Training should focus on regulatory requirements; Comptroller General principles, standards, and related requirements; and methods and procedures for determining whether accounting systems are properly documented, operated, evaluated, and reported as required. Appropriate training is essential for efficient audit or review in this area.

C10.P3.8.2. Training should, at a minimum, include the following:

C10.P3.8.2.1. Reporting requirements for accounting systems under Section 4 of the FMFIA.

C10.P3.8.2.2. Interrelationship of accounting systems, annual reviews required under OMB Circular No. A-127 (reference (ff)), and the required reporting of accounting systems under the FMFIA. Accounting systems that conform to reference (ff) are considered as meeting the requirements of the FMFIA.

C10.P3.8.2.3. The Comptroller General principles, standards, and related requirements for accounting systems included in the GAO Policy and Procedures Manual for Guidance of Federal Agencies (reference (ll)). Even though the principles and standards are developed by the Comptroller General, they must be implemented through OMB guidance (reference (mm)). Training should cover both sources and their interrelationship.

C10.P3.8.2.4. Specific evaluation and reporting requirements for accounting systems are included in DoD 7220.9-M (reference (jj)). Emphasis should be given to the minimum requirements that management must meet to satisfy the requirements of the Comptroller, DoD.

C10.P3.9. Reporting Requirements Paragraphs C10.P3.5.2. and C10.P3.5.4., above, require that each internal audit organization periodically review and report on the adequacy of the respective DoD Component's process for evaluating and reporting under Section 4 of the Integrity Act (reference (bb)) and whether the process has been carried out in a reasonable and prudent manner. This audit or review could be done annually or less frequently at the discretion of the internal audit organization. The audit results should be reported to management using the format in figure C10.F2., and a copy should be sent to the IG, DoD (ATTN: OAIG-APO). When such a review is done at the end of the year, a copy of the report should be sent to the IG, DoD, by November 15. Paragraph C10.P3.5.3. requires review and evaluation of management's basis for reporting accounting systems, newly determined during the current fiscal year, to be in compliance with the Comptroller General's principles and standards. An explanation should any significant changes in numbers of accounting systems in compliance or in noncompliance.

Figure C10.F1. Sample Format of Audit Statement to DoD Component on the Adequacy of Management's Internal Control System Evaluation

MEMORANDUM FOR (DoD Component Head)

SUBJECT: Statement on Internal Control Systems Evaluation

We have conducted a review to determine whether the (DoD Component) has evaluated its system of internal accounting and administrative control for the year ended (date) in a reasonable and prudent manner and in accordance with prescribed regulations and requirements. During this review, nothing came to our attention that would indicate that the (DoD Component) did not comply with prescribed regulations or requirements.<sup>1</sup>

(signature)

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<sup>1</sup> If this statement cannot be made, revise to highlight major deficiencies.

Figure C10.F2. Sample Format of Audit Statement to DoD Component on its Process for Evaluating and Reporting on Accounting Systems Compliance

MEMORANDUM FOR (DoD Component Head)

SUBJECT: Reporting on Accounting Systems Compliance

We have evaluated the adequacy of your process for determining whether your accounting systems comply with the Comptroller General principles, standards, and related requirements, as implemented through OMB Circular No. A-127, and whether your evaluation and reporting was carried out in a reasonable and prudent manner. We found your process to be adequate and properly functioning.<sup>1</sup>

(signature)

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<sup>1</sup> If this statement cannot be made, revise to highlight major deficiencies.

C10.E1. ENCLOSURE 1 OF CHAPTER 10

EXPANDED DEFINITION OF MATERIAL WEAKNESS IN THE INTERNAL CONTROLS OF THE DEPARTMENT OF DEFENSE

C10.E1.1.1. A material weakness in the DoD system of internal controls may be due to lack of an appropriate control or, more frequently, inadequate compliance with existing controls. These controls deal with all program and administrative functions; they are not limited to financial or accounting matters. Regardless of the levels in which weakness in internal controls occurs within the Department of Defense, the Office of the Comptroller, DoD, lists the following factors and examples for consideration in classifying or reporting a weakness as material:

C10.E1.1.1.1. Impairs fulfillment of mission.

C10.E1.1.1.2. Violates statutory or regulatory requirements.

C10.E1.1.1.3. Deprives the public of needed Government services.

C10.E1.1.1.4. Results in adverse publicity or embarrassment.

C10.E1.1.1.5. Diminishes credibility or reputation.

C10.E1.1.1.6. Endangers national security.

C10.E1.1.1.7. Leads to waste or loss of funds, property, or other resources.

C10.E1.1.1.8. Allows fraud or other criminal activity to go undetected.

C10.E1.1.1.9. Causes harm, even though minor in individual instances, that is nevertheless extensive in the aggregate.

C10.E1.1.1.10. Causes loss of control over 5 percent or more of the resources for which an organization is responsible.

C10.E1.1.2. Because of the size and diversity of the Department of Defense and its Component organizations, material weaknesses are to be considered at four levels:

C10.E1.1.2.1. DoD Level.

C10.E1.1.2.2. Component Level.

C10.E1.1.2.3. Major Command or Field Activity Level.

C10.E1.1.2.4. Installation or Activity Level.

C10.E1.1.3. Listed below are some specific examples of the above factors applied at each of the four levels:

C10.E1.1.4. DoD Level

C10.E1.1.4.1. (At the DoD level, a material weakness includes a problem that appears in several components, amounts to \$2 million or more, or may be national or international in scope. However, depending on the effect or impact of the problem, a less extensive problem could be of concern to the Secretary of Defense.)

C10.E1.1.4.1.1. Breakdowns in supply or repair policies and practices that result in too few ships, planes, vehicles, or weapons to accomplish intended missions.

C10.E1.1.4.1.2. Failure to observe controls over expenditure of funds within appropriation limits.

C10.E1.1.4.1.3. Poor medical care caused by inadequate procedures or insufficient resources.

C10.E1.1.4.1.4. Overpriced components of weapons systems (waste cans, toilet seat covers) or inappropriate overhead charges being tolerated from contractors.

C10.E1.1.4.1.5. Inadequate control over transfer of technology to foreign governments.

C10.E1.1.4.1.6. Insufficient attention to control over travel advances or over interest penalty payments; small at each location, but pervasive through the Department of Defense.

C10.E1.1.5. Component Level

C10.E1.1.5.1. (At the Component level, a recommended threshold for monetary problems in the larger components is \$250,000. For small Defense Agencies, lesser thresholds may be appropriate.)

C10.E1.1.5.1.1. Problems that amount to losses of less than \$250,000 but are pervasive, chronic, or constant.

C10.E1.1.5.1.2. Using funds from operations appropriations for procurement or construction purposes, or otherwise misusing appropriations.

C10.E1.1.5.1.3. Using systems that do not conform with GAO principles and standards.

C10.E1.1.5.1.4. Inadequate control over access to records inter databases.

C10.E1.1.5.1.5. Improper practices in acquiring and maintaining computer equipment.

C10.E1.1.5.1.6. Failure to collect on debts owed the Government before members separate from service.

C10.E1.1.5.1.7. Poor control over property on hand or over property turned in as excess.

C10.E1.1.6. Major Command/Field Activity Level

C10.E1.1.6.1. Inadequate control over maintenance versus new construction decisions.

C10.E1.1.6.2. Weaknesses in payroll practices.

C10.E1.1.6.3. Weaknesses in control over temporary duty travel.

C10.E1.1.7. Installation/Activity Level

C10.E1.1.7.1. Inadequate performance by contracting officer representatives in user offices.

C10.E1.1.7.2. Failure to comply with controls over weapons, ammunition, or property.

C10.E1.1.7.3. Poor procedures for processing personnel on or off base.

C10.E1.1.7.4. Improper use of facilities or equipment.

C10.E1.1.7.5. Breakdown in controls allowing fraudulent actions in morale, welfare, or recreation activities.

C10.E1.1.8. The OMB in its question and answer booklet dealing with the Federal Managers' Financial Integrity Act and Circular A-123 (references (bb) and (v)) provided the following guidance in reporting material weaknesses:

C10.E1.1.8.1. The material weaknesses included in the report to the President and the Congress should consist of matters of significance to the President and the Congress.

C10.E1.1.8.2. Assurance letters at other levels in an Agency or organization probably will disclose weaknesses of varying degrees of significance to the Agency as a whole. The recipient of the assurance letters at each level should collect and analyze those cross-cutting weaknesses or items common to several units and other weaknesses of significance, and consider whether they are appropriate for inclusion in the assurance letter to the next higher-level official.

C11. CHAPTER 11  
ADVANCED AUDIT TECHNIQUES

C11.P1. PART I - INTRODUCTION

The following parts of the chapter provide policy and guidance relative to the use of statistical sampling (Part II, C11.P2.), computer assisted audits (Part III, C11.P3.), and technical experts (Part IV, C11.P4). Other parts may be added at a later date as the need arises. Unless otherwise indicated, the policies prescribed in this chapter are mandatory for all DoD internal audit, internal review, and nonappropriated fund audit organizations.

C11.P2. PART II - STATISTICAL SAMPLING

C11.P2.1. Purpose This chapter provides policy and guidance for using statistical sampling during DoD internal audits. Statistical sampling is an additional tool that may be employed by the auditor in the performance of an audit. It is to supplement, but not replace, professional judgment and experience. This chapter is not intended as a technical "how to" manual. It shall be used as guidance for auditors who have a basic knowledge of statistical concepts and sampling theories. Other publications and textbooks provide more detailed instructions for auditors on the techniques involved in sampling. A selection of publications is shown in Enclosure 1 to this chapter.

C11.P2.2. Terminology

C11.P2.2.1. The term "statistical sampling," as it relates to auditing, indicates use of the following audit procedures:

C11.P2.2.1.1. Defining the universe (population) and the sampling units.

C11.P2.1.1.2. Determining the sample size by statistical mans.

C11.P2.1.1.3. Selecting sample items using some statistical methods such as: simple random, stratified random, or cluster random sampling, or a combination of several types in a multi-stage design.

C11.P2.1.1.4. Appraising sampling results using statistical formulas appropriate for the type of sampling procedures used.

C11.P2.2.2. The two most common kinds of statistical sampling procedures encountered by auditors involve sampling for attributes data (attributes sampling) and sampling for variables data (variables sampling). This chapter pertains primarily to the use of these two kinds of procedures to conduct audits.

C11.P2.2.2.1. Attributes Sampling. If the sample is used as a means of establishing the frequency of occurrence of some event or type of transaction, the process is referred to as "attributes sampling." In attributes sampling, the auditor checks for the presence of a particular predefined characteristic. The results of the sample are used to answer the question "how many" or "what percentage." An example of such use would be the auditor's test of the effectiveness of internal controls.

C11.P2.2.2.2. Variables Sampling. If the sample is used to provide an estimate of an average or total value of a continuously measured variable, the process is referred to as "variables sampling." The results of the sample are used to answer the question "how much." Examples of such use would be a test to determine the dollar value of errors in inventory records or the time it takes to pay vendors in a prompt payments review. Variables sampling often requires more time and effort on the auditor's part than attributes sampling, because more variability generally exists in that type of data. In most cases, however, a sample must be designed that will serve both purposes. This involves several sets of precalculations.

C11.P2.2.3. Definitions of other terms used in this chapter are included in Enclosure 2 to this chapter.

C11.P2.3. Applicability The policies contained in paragraph C11.P2.4., below, are mandatory for all internal audit, internal review, and nonappropriated audit organizations (hereafter referred to collectively as "internal audit organizations"). The remaining paragraphs provide general criteria for auditors to follow in considering the use of statistical sampling for auditing.

C11.P2.4. Policy

C11.P2.4.1. Statistical sampling shall normally be used whenever there are voluminous numbers of items to be examined, and the auditor intends to express an opinion concerning the entire population from which only selective item were examined. (Note: Computer technology may, in some cases, make 100 percent examination of the population of automated data more practical than sampling portions of that population when a 100 percent examination is not practical, then statistical sampling, as distinguished from judgmental or selective sampling, is the preferred method of sampling to be used for preparing audit estimates or conducting reviews.)

C11.P2.4.2. Statistical sampling plans shall be developed in all instances where statistical sampling is used. The sampling plans shall be made a part of the audit work papers and shall support the audit programs for the particular audit assignment.

C11.P2.4.3. The degree to which statistical sampling procedures are used in an audit shall be determined by the need to assess the quality or quantity of data, the adequacy of internal controls over the items examined, the necessity to make overall projections, and the audit time and costs involved.

C11.P2.4.4. The audit report findings developed though the use of statistical sampling shall include a statement that statistical sampling methods were used in selecting items (transactions or operations) to be reviewed, and shall include any other appropriate details necessary for an understanding of the situation. In expressing the results of the audit whenever statistical sampling methods were used, the population (universe, field size) from which the sample was drawn shall be shown. In addition, sample projections shall generally be made without detailed comments as to the size of the sample, confidence levels, or confidence limits, except as may be prudent to report in an appropriate appendix.

C11.P2.4.5. All audit staff members shall be trained in the use of basic statistical sampling methods. In addition, technical assistance shall be made available to the audit staff to develop sampling techniques and project audit results. Where there is a potential for use of complicated sampling plans to further save audit time or reduce travel costs, the auditor should consult an expert in statistical methodology.

C11.P2.4.6. Audit staffs shall be encouraged to use computer equipment and computer programs for sample selection wherever feasible. Programs developed for selection of samples shall be thoroughly tested and validated before they are disseminated to the field for general use by auditors. See Part III (C11.P3.) of this chapter for policy on use of software programs.

C11.P2.4.7. Statistical sampling techniques shall be used wherever feasible to estimate (project) the potential monetary benefits attributable to the audit in order to support the calculations with a high degree of confidence.

#### C11.P2.5. Auditing Standards

C11.P2.5.1. The DoD internal auditing standards (Chapter 2) most closely related to statistical sampling are numbered 210.3, 440.3, and 670.3. Excerpts follow:

C11.P2.5.2. "Due care requires the auditor to conduct examinations and verification to a reasonable extent, but does not require detailed audits of all transactions. Accordingly, the auditor cannot give absolute assurance that noncompliance or irregularities do not exist" (210.3).

C11.P2.5.3. "Audit procedures, including the testing and sampling procedures employed, shall be selected in advance, when practicable, and expanded or altered if circumstances warrant" (440.3).

C11.P2.5.4. "The internal audit organization shall have employees or use outside experts who are collectively qualified in the disciplines needed to meet audit responsibilities. The disciplines include... statistics..." (670.3).

#### C11.P2.6. Sampling Concepts

C11.P2.6.1. Every auditor has used the sampling process, although it may have been referred to as "testing" or "test checking" that is, forming an opinion about a group of items or transactions (records, vouchers, entries, etc.) on the basis of examination of a limited number. Perhaps such tests were performed based on the auditor's judgment, with no scientific basis for what was done (judgment sampling). In contrast, statistical sampling is based on the laws of probability and, through proven mathematical procedures, has demonstrated that a group of items taken at random from a universe will be almost certain to contain the characteristics of that universe. The underlying assumption is that sample statistics are representative of population parameters.

C11.P2.6.2. The primary purpose of a statistical sampling approach in auditing is to provide an objective result from a sample, together with a means of measuring the reliability of the estimate obtained through the sampling process. In short, the statistical sample is a miniature representation of the whole and, within limits, all conclusions reached based on evaluating sample statistics can be projected to the parameters of the whole universe.

C11.P2.6.3. Each auditor does not need to be a skilled statistician, but should be able to consult an expert when needed. In performing an audit, the auditor must:

C11.P2.6.3.1. Get the most out of the work at each audit location.

C11.P2.6.3.2. Minimize the time necessary to obtain meaningful data.

C11.P2.6.3.3. Produce a report containing conclusions supported by factual, accurate, and defensible data.

In certain cases, the most economical, efficient, and practical method to accomplish these tasks is through the use of statistical techniques. Statistical sampling methods are additional tools that may be employed quite often by the auditor during examination. They add to the auditor's capability and can be used in conjunction with professional judgment and experience.

C11.P2.6.4. Statistical sampling is a practical method that allows the auditor to determine the risks in making estimates and inferences, and come to conclusions about a population (universe) from a sample of that population. When a 100 percent examination is not practical, then statistical sampling, as distinguished from judgmental or selective sampling, should be used (unless justified as impractical for conducting reviews of the entire population). Inherent in the technique of sampling is the risk of statistical sampling error--the likelihood that the estimate based on the sample will be within a predicted amount of the universe parameters. With this, there is a predictable risk that specific material errors could occur that might not be detected in the auditor's examination.

C11.P2.6.5. In order to know everything about the whole population, the entire population must be examined. Sampling, however, is an excellent, cost-effective, and timesaving way of looking at a relatively small portion of a population in order to come to an informed conclusion about the entire population. While there will always be a certain amount of risk present, statistical sampling allows the auditor to control and predict the extent of that risk by controlling sample size and sampling methods. The auditor relies on the system of internal controls to reduce the possibility that errors have occurred, and on audit tests of sampled transactions, or other audit procedures, to minimize the risk that any errors will remain undetected during the audit examination.

C11.P2.6.6. The sheer volume of accounting, or other data to be examined, and the many areas to be audited clearly demonstrate the need to use statistical sampling techniques for auditing. Selective examinations using scientific

sampling procedures, together with other audit techniques, form a basis for conclusions and recommendations for significant actions at all levels in the Department of Defense. In these circumstances, great significance is attached to the propriety of the auditor's test and samples, and to the reliability of the conclusions drawn.

C11.P2.6.7. The statistical sampling procedures used for audit tests, as discussed in the remainder of this chapter, cover the five general steps that follow:

C11.P2.6.7.1. Developing a statement of sampling test objectives (sampling plan). (This includes deciding on whether to stratify, cluster, or perform a simple random sample.) Where appropriate, a randomly selected preliminary sample should first be taken and the results evaluated. This step will help the auditor to obtain knowledge of the population involved and then choose an appropriate sampling test.

C11.P2.6.7.2. Determining the universe to be sampled.

C11.P2.6.7.3. Determining the proper sample size.

C11.P2.6.7.4. Choosing and examining the sample items.

C11.P2.6.7.5. Evaluating the sampled results using methods consistent with the particular sampling plan applied. This includes universe estimation (projection) of the attribute and/or variable under study.

#### C11.P2.7. Developing a Sampling Plan

C11.P2.7.1. There are several approaches that may be used in developing a sampling plan to meet the auditor's test needs. The exact approach to be used will be determined by the objectives of the particular test at hand. In arriving at the correct sampling decision, the objective should be known in specific terms. For instance, if sampling attribute data is the procedure to be used, definitions of categories must be very specific. In the case of a check for errors, the auditor must determine in advance what constitutes an error (or, perhaps more desirable, a significant or material error). If the errors are to be analyzed by type, the categories for the different types must be carefully defined. Unless the precise types of errors, occurrences or values under review are defined in the audit program, it will be difficult to design an economical or efficient sampling plan that will provide the results required.

C11.P2.7.2. Sampling tests or pilot surveys may be conducted prior to design of the formal sampling plan to:

C11.P2.7.2.1. Appraise methods and procedures, or the effectiveness of the internal control systems.

C11.P2.7.2.2. Determine the need for further sampling, and the type to be used.

C11.P2.7.2.3. Determine the occurrence rate (how many) of certain defined errors or other characteristics (attributes sampling).

C11.P2.7.2.4. Determine the average (or total) value (how much) and the standard deviation of some characteristic, such as dollar value (variables sampling).

C11.P2.7.2.5. Determine desired precision and confidence level and estimate population size.

C11.P2.7.3. To ensure statistically valid conclusions, it is essential that a statistically valid sampling plan be designed and that some type of random selection be used. This, coupled with an analysis method tied to the sampling plan, will ensure that the auditor's conclusions are valid.

C11.P2.7.4. The objective of the auditor in developing the sampling plan should be to choose a minimum of tests and/or locations, and yet sample enough data with sufficient precision to demonstrate that the condition does or does not exist. As can be seen in tables for determining sample sizes for simple random samples, reducing the sampling error or improving the precision to an unnecessarily low value will sharply increase the sample size and also the cost. The sampling plan must provide for a method of selection in which each sample item in the universe has a determinable chance of being selected for examination. In developing the sampling plan, the auditor also must consider practical limitations such as time constraints, cost, and type of items to be examined.

#### C11.P2.8. Determining the Universe

C11.P2.8.1. The universe (population, field, etc.) is the total group of items or transactions from which the sample is selected. It is important to determine with a fair degree of accuracy the composition of the universe to ensure that all items in that universe are available for sampling. In addition to determining the number of items in the universe, it also may be useful to determine the total dollar value of the universe (if applicable). These values are necessary in deciding whether to break-down (stratify or cluster) the universe into various groupings to improve sample reliability and ensure adequate selection of the more significant items.

C11.P2.8.2. The audit purpose for stratification is to isolate for separate handling the critical groups in the universe (most often the high-dollar items), thereby reducing the risk the auditor takes in missing any significant items or actions. Further, by considering the large or sensitive items separately from the remainder of the universe, the auditor also reduces the degree of variability in the sample area, thus increasing the reliability of the subsequent audit test.

#### C11.P2.9. Determining the Sample Size

C11.P2.9.1. The auditor's decision as to the proper sample size will depend on:

C11.P2.9.1.1. What precision or sampling reliability is believed necessary to estimate the characteristic (attribute) or other value (variable).

C11.P2.9.1.2. The degree of assurance (confidence level) desired that the sample will represent the population and fall within the required distance from the true value.

C11.P2.9.2. When the desired sample reliability and confidence level have been carefully determined, the sample size can then be obtained from a table or formula. However, the process of determining sample size is not to be solely mechanical in nature; it requires careful thought and trade-offs by the auditor.

C11.P2.9.3. In order to determine the sample size, the following factors must be considered:

C11.P2.9.3.1. Sampling precision.

C11.P2.9.3.2. Confidence level.

C11.P2.9.3.3. Maximum expected error rate for attributes or standard deviation for variables.

C11.P2.9.3.4. Size of universe.

C11.P2.9.3.5. Practical limitations.

C11.P2.9.3.5.1. Sampling Precision. Sampling precision refers to the amount or degree of probable error associated with an estimate; in other words, the extent to which the sample findings may differ from the actual unknown values or conditions. The precision is generally expressed in plus and minus terms from the

sample average or proportion. The specified precision is the maximum value the auditor may allow the sample result to vary from the true universe value. The greater the precision desired (or the smaller the sampling error), the greater the number of items to be examined (sampled). Greater precision or accuracy will obviously demand more of the auditor's time and effort. Thus, a trade-off must be reached between the desire for greater precision and the need for greater expenditure of time and effort to complete the sample examination.

C11.P2.9.3.5.2. Confidence Level. The confidence level chosen represents the risk the auditor is willing to take in using the sample to estimate the universe characteristics. The degree of assurance (confidence level) must be specified in advance. This degree of assurance will be expressed in percentages; for example, 90 percent, 95 percent, 99 percent. A confidence level of 95 percent indicates that 95 times out of 100, the actual universe value will be expected to fall within the precision computed from the sample results. Correspondingly, 5 percent of the time, it may be expected to fall outside. In establishing the confidence level, the auditor should consider other sources of audit reliance. In most cases, this is accomplished subjectively by the auditor in deciding that a lower confidence level is adequate for a particular situation where there are other sources of reliance as, for example, the presence of a strong internal control system (known as a result of other observations or prior experience). The confidence level has a direct relationship to the sampling precision, since they affect each other and are integral parts of the sample selection process.

C11.P2.9.3.5.3. Maximum Expected Error Rate or Variance. The maximum expected error rate for attribute sampling or the variance for variables sampling should be known from historical data or other information; for example, results of previous reviews. If there is no prior experience to rely on, it may be necessary to take a preliminary (test) sample to determine the error rate expected.

C11.P2.9.3.5.4. Size of Universe. The universe (field, population) refers to the total number of items that could be examined or observed, and it is this universe from which the sample will be drawn. The size of the universe, while desirable to know, is not an absolute need in determining the size unless the universe is small in number. It is permissible to estimate the universe size since the sample size is not a fixed percentage of the universe. In a statistical determination of sample size, the number of items in the universe is not nearly as significant as the variability.

C11.P2.9.3.5.5. Practical Limitations. The lack of time and sufficient personnel may dictate the need for a smaller sample size than desired. In such cases, it is important to realize that the precision and confidence level will be

somewhat diminished. In such cases, the audit report may need to specify the nature of the precision and confidence.

C11.P2.10. Examining the Sample. Once the auditor has selected the sample, the actual testing can be performed. In the case of testing for compliance with prescribed procedures, the auditor should examine the available documentation or support to see if there is evidence that in each case (for each sample item) the controls in which the auditor is interested were operating and were followed. The actual conduct of the test needs to be done with care because of the reliance placed upon it. Statistical sampling helps to provide the auditor with assurances of what conditions have occurred, but not why the conditions occurred. When the sample results indicate error conditions, the auditors need to determine the significance of the errors, why the errors have occurred, and what steps can be taken to prevent their recurrence.

#### C11.P2.11. Evaluating Valuating Sampling Results

C11.P2.11.1. After the sample has been selected and examined, the results can then be evaluated through use of the appropriate mathematical formulas, depending on the sample method selected. This involves comparing the actual test results with the expected results. If the actual results fall within the precision range (expected error rate plus or minus the sampling precision), the auditor may conclude with the specified level of confidence that the actual error rate or dollar value is within acceptable limits. The auditor should recheck the sample for errors, emissions, or other circumstances that could affect its validity. It is likely that the computed (actual) error rate will differ from the expected error rate. When such a difference occurs, the actual sampling precision and confidence level will not be the same as those values originally selected. Therefore, it is necessary to reevaluate or appraise the sampling results to determine the correct precision and sampling reliability attained.

C11.P2.11.2. Sample results must be viewed with an auditor's judgment; that is, are the results meaningful, saleable, reasonable, and precise enough for the audit objective. In instances where the auditor determines it is necessary to expand the sample size to arrive at a more acceptable result, then the same random selection procedures must be followed in choosing additional items for review. Regardless of whether or not the sample is expanded, if the auditor concludes that the error rate is unacceptably high, then an attempt must be made to identify the reasons before the matter is reported to management and corrective actions are recommended.

C11.P2.11.3. An error rate may be acceptable under one set of circumstances, but not acceptable under another. For example, a 3 percent error rate in payroll operations may be unacceptable, whereas for inventory operations the same error rate may be within tolerable limits and considered acceptable.

C11.P2.11.4. When statistically designed samples are used, it is possible to evaluate the reliability of sampling results at any point during the examination, provided that the items selected for audit were taken in their random number sequence. This is important because it means that an audit test developed in this manner can be terminated earlier with corresponding savings in time and cost. When the items are selected in their original random number sequence, the auditor can compare the sampled results at any point in the examination for an appraisal of the sampling reliability. If the results provide the auditor with the desired information, the test may be terminated. This procedure is frequently referred to as "stop-and-go" sampling.

C11.P2.12. Working Paper Documentation. The audit working papers should fully document and explain the sampling procedures followed during the audit. Such documentation should include the following:

C11.P2.12.1. A description of the sample objectives.

C11.P2.12.2. The type of sample selection method used.

C11.P2.12.3. The procedures followed in selecting random numbers for the sample.

C11.P2.12.4. A statement of the appropriate formulas used for selecting and evaluating the data.

C11.P2.12.5. The random numbers selected and/or used.

C11.P2.12.6. The size and characteristics of the field.

C11.P2.12.7. Information on determination of sampling precision, confidence levels and sample size.

C11.P2.12.8. Detailed results of each sample unit examined.

C11.P2.12.9. A summary of the results and basis for any projections made.

C11.P2.12.10. Such other information or data considered appropriate by the auditor.

C11.P2.13. Projection Monetary Benefits. Auditors are encouraged to use statistical sampling to estimate the potential monetary benefits derived from an audit. This analytical tool is the preferred method for estimating monetary benefits when only selected items of a universe are evaluated and projections are made about that universe. Monetary benefits projections based on statistical sampling will be limited to the universe from the sample was actually drawn. Auditors should avoid conditionally implying that those transactions or items examined in detail in one universe are representative of other universes; there is no statistical basis for such a connection. See Chapter 8, Enclosure 1 (C8.E1.), for guidelines on measuring potential benefits resulting from audits.

C11.P2.14. Using Automated Data Processing Sampling Techniques

C11.P2.14.1. Computers can be programmed to select audit samples required under statistical sampling techniques. Many activities have sample selection routines already available their data processing programs. Commercially developed software routines are also available for retrieving data from computer files and conducting sampling examinations. The use of such routines as the Statistical Analysis System, Statistical Packages for the Social Sciences, and other proprietary software can save auditor time. The use of any software program to select an audit sample should be approached in line with policy set forth in Part III (C11.P3.) of this chapter.

C11.P2.14.2. Care, however, must be used by the auditor to ensure the integrity of the sample when relying on management to extract the required data. If possible, the auditor should exercise complete control in extracting the sample. Where this is not possible, the auditor should apply checks to ensure that the integrity of the data is not compromised. Adequate testing is required to ensure that the universe accurately represents the group of items of transactions under review and has not been altered. The number and type of tests required for such verification will depend on the reliance placed by the auditor on the internal control system. (See section C9.9.)

C11.P2.14.3. Usually, more items should be generated during the sample selection process using the computer selection procedure than the auditor plans to examine. This will facilitate expansion of the sample if warranted by the results of the initial examination.

### C11.P3. PART III - COMPUTER-ASSISTED AUDITS

C11.P3.1. Purpose. This chapter provides policy and guidance for using computer technology in audits. It supplements existing policy and procedures on maintaining quality audit work by identifying special considerations to be recognized when computerized techniques are used in the audit process.

C11.P3.2. Applicability. The policies contained in paragraph C11.P3.4., below, are mandatory for all internal audit, internal review, and military exchange audit organizations (hereafter referred to collectively as "internal audit organizations"). The remaining paragraphs provide guidelines for the successful integration of computerized techniques in the audit process.

#### C11.P3.3. Background

C11.P3.3.1. The use of computerized techniques in the audit process has evolved over many years. The computer has been used primarily as an audit tool in selecting samples or analyzing data in computerized information databases. Audit software packages also have been used for data retrieval purposes. Technical specialists trained in computer usage were needed to accomplish most of the computer-related audit tasks.

C11.P3.3.2. The emergence of microcomputers in recent years is now revolutionizing the audit profession. Microcomputers are relatively easy to operate and are affordable, thereby giving practically every auditor a powerful tool that may be used in virtually all aspects of an audit. Widespread use of microcomputer technology makes it possible to do work faster and at less cost. Effective use of microcomputers also may improve the quality of analyses and reports and provide auditors with a means of better understanding automation concepts, principles, and techniques.

C11.P3.3.3. Being a relatively new tool for auditors, the introduction of microcomputers has brought with it several issues that need to be addressed. These issues include the following:

C11.P3.3.3.1. How to apply microcomputer technology effectively and efficiently.

C11.P3.3.3.2. Data entry and verification considerations.

C11.P3.3.3.3. Data reliability and security.

C11.P3.3.3.4. Automated working papers.

While this chapter focuses on using microcomputers, the principles apply equally to maintaining quality in the audit process when using mainframe computers or audit retrieval techniques.

#### C11.P3.4. Policy

C11.P3.4.1. An effective program shall be established for improving productivity and mission performance by integrating computerized techniques into the audit process. Such a program should include the following:

C11.P3.4.1.1. Conducting projects designed to identify and test new audit applications.

C11.P3.4.1.2. Providing applicable technical assistance to the audit staff when complex analytical applications need to be developed and/or used.

C11.P3.4.1.3. Developing a means of publicizing computerized audit techniques and results.

C11.P3.4.2. Proper planning for the effective and efficient use of available computer resources shall be encouraged for increasing auditor productivity and improving quality of audit products. The need for microcomputers to aid the audit function shall be assessed and applicable requirements developed to support budget requests for computer resources.

C11.P3.4.3. Effective controls and oversight of computerized techniques shall be instituted to provide reasonable assurance that reliable and accurate audit results are obtained. Control features shall address the adequacy of the following:

C11.P3.4.3.1. Data entry and data verification processes.

C11.P3.4.3.2. Data management practices.

C11.P3.4.3.3. Audit software application development, testing, and documentation procedures.

C11.P3.4.3.4. Supervisory reviews and approval of computer-generated analyses.

C11.P3.4.4. The DoD internal audit organizations shall review existing information security policies and procedures for protecting sensitive data and shall

follow applicable procedures when classified, sensitive, and/or proprietary information is retrieved, processed, or stored during the course of a computer assisted audit.

C11.P3.4.5. Training programs shall be developed and implemented to address the auditor's need to become familiar with, or proficient in, the effective use of computers in performing audits. Audit managers and supervisors shall be familiar with the capabilities of computer software used by their staff.

C11.P3.4.6. The use of computers in auditing shall be documented and explained in the audit working papers so that a reviewer may repeat the process leading to the audit conclusions. Provisions shall be made for retaining and storing working papers and records created in an electronic form that support the audit report.

#### C11.P3.5. Standards

C11.P3.5.1. Chapter 2 of this Manual contains the DoD internal auditing standards. The standards most closely related to using computers in the audit process are as follows:

C11.P3.5.1.1. 210 - Due Professional Care.

C11.P3.5.1.2. 220 - Auditor Qualifications.

C11.P3.5.1.3. 430 - Supervision.

C11.P3.5.1.4. 440 - Examining and Evaluating Information.

C11.P3.5.1.5. 670 - Internal Audit Organization Qualifications.

C11.P3.5.1.6. 690 - Quality Assurance.

#### C11.P3.6. Front-End Planning

C11.P3.6.1. Careful planning in the audit process takes on additional significance as computers assume an increasingly larger role in audits. Getting the most value from available computer resources requires that they be managed properly. The audit team first should formulate the objectives of the audit, indicating the purpose of the effort and what is to be accomplished. These audit management issues then should be assessed considering the automated environment involved in the audit and the availability of computer resources to assist the auditor.

C11.P3.6.2. Computers can be used productively at each step of the audit process (planning, data collection, data analysis, report writing, and presentation) and in managing the audit itself. It is important to look for ways to increase productivity through the use of computer applications. Issues that should be addressed include the following:

C11.P3.6.2.1. Determining how much of the audit process should be automated.

C11.P3.6.2.2. Identifying tasks to be automated.

C11.P3.6.2.3. Determining the types and sources of data to be used.

C11.P3.6.2.4. Determining the types or mix of computer resources needed to accomplish data analysis requirements; i.e., mainframe computers versus microcomputers.

C11.P3.6.2.5. Defining the roles and responsibilities of audit and support staff.

Computer software requirements also should be determined early in the audit to ensure availability. This is especially important if special computer programming support is required.

C11.P3.6.3. The skill level of the audit staff (e.g., computer knowledge, expertise, experience) and the availability of microcomputers may have an impact on various aspects of the audit design and methodology. Required training should be provided before starting the audit, or training time should be built into the audit schedule. In many audits, microcomputers may be shared among team members at certain phases. At other points, however, it is essential that staff members have use of a microcomputer, particularly in the data analysis and draft report preparation phases. Productivity gains may diminish quickly if microcomputers are not readily available: The lack of sufficient microcomputers also may discourage auditors from using microcomputer technology.

C11.P3.6.4. A multitude of environmental factors affecting the use of microcomputers should be addressed in the planning phase. Such issues as power supply, available phone lines, level of static electricity, and temperature in the area where a microcomputer will be used should be considered. If domestic or foreign travel is expected, special consideration should be given the following:

C11.P3.6.4.1. Transportation of microcomputers and storage media through airport security.

C11.P3.6.4.2. Laws on carrying microcomputers through customs.

C11.P3.6.4.3. Communication requirements and potential restrictions.

C11.P3.6.4.4. Availability of computer supplies.

C11.P3.6.4.5. Differences in electrical power.

### C11.P3.7. Data Entry

C11.P3.7.1. Data entry options should be identified and considered in computer-assisted audits. The most frequently used methods of capturing data in a microcomputer are direct data entry by keyboard and loading from another computer. Also, there are situations where the entity being audited may have the capability to record the data needed by auditors on diskettes, which then may be transferred to a microcomputer.

C11.P3.7.2. Direct data entry is defined as keying data directly into the microcomputer and is accomplished when data to be entered are available only in manual form.

C11.P3.7.2.1. Direct data entry may be assigned to a data entry clerk or other administrative clerk. If there are decisions to be made or interpretation of the source documents required, the task should be accomplished by the responsible auditor.

C11.P3.7.2.2. Regardless of who enters the data, the data elements should be defined and the format or record design should be set before data entry begins. Otherwise, nonstandard records may be generated and may cause a problem when the audit applications are run. The specific design of the input format is determined partially by the particular software package being used. If data are analyzed using more than one type of software package, the format should be designed to ease the process of moving data from one program to another.

C11.P3.7.3. Downloading is the process for selecting and retrieving data from another computer system in a way that makes it usable on a microcomputer. This method of data entry is used frequently when selecting data from large files stored on a mainframe computer. Because the loading process may be a very technical and

time-consuming process, it is advisable to seek the assistance of technical specialists and to begin the process in time to meet the audit needs.

C11.P3.7.3.1. Downloading requires that a compatible communications link be established between the microcomputer and another computer. To establish the link, applicable communications protocol needs to be established and access rights to the automated data files obtained. The automated database may contain data elements not required by the auditor that should be eliminated from the downloading process. Standard software for downloading data may be used to select the desired data elements. Once the data have been downloaded into the microcomputer, it may be necessary to reformat the data for use with available microcomputer software.

C11.P3.7.3.2. The available storage space and/or memory capacity of the microcomputer often limit the amount of data that may be downloaded. It is essential that the auditor knows the size of each record (number of characters) and the number of records to be downloaded to ensure that the microcomputer has the capacity to accept all data transmitted and to provide an estimate of the time needed to accomplish the downloading. If the microcomputer does not have sufficient capacity, the auditor may have to redesign the intended analysis or may have to use other means for accomplishing the analysis.

#### C11.P3.8. Data Management

C11.P3.8.1. If data and computer resources are shared among audit team members, responsibility should be assigned for a range of data management issues to include the following:

C11.P3.8.1.1. Developing the needed databases.

C11.P3.8.1.2. Providing adequate documentation.

C11.P3.8.1.3. Establishing data dictionaries and directories.

When more than one audit team is involved in collecting and summarizing data, close coordination among audit teams should be emphasized to ensure uniform collecting of data.

C11.P3.8.2. Proper management of access controls and data storage is essential for data integrity. Access to data resources should be assessed, and applicable access rights provided for only those individuals who need them. It should be determined which users shall be authorized to make changes in the data files and which users shall be limited to "read only" access privileges.

C11.P3.8.3. An important area for attention is the physical security of the microcomputers and the information security of the data. DoD information security policies require minimal levels of protection for processing sensitive data or critical functions. Sensitive information includes classified information, proprietary information, and personal information subject to DoD Directive 5400.11 (reference (bbb)). Classified information may not be processed on computer equipment that has not been certified previously for such use.

C11.P3.8.4. Computer usage should be restricted to official business. In order to prevent introduction of software devices, such as a "virus," that could destroy the data in a system or provide unauthorized access to a system, unapproved and unauthorized software should not be used.

C11.P3.8.5. Procedures for system and database backup should be established and enforced. If periodic file backup is not done during the audit, the auditor runs a high risk of losing temporary or pet access to files created. A good practice is to maintain at least two copies of all critical files on diskettes, which provides the opportunity for separating storage locations. Auditors should be familiar with and adhere to the terms of the licensing agreements regarding the duplication of commercial software packages.

C11.P3.8.6. The methods for producing, reviewing, and storing working papers change significantly when computers are used in audits. Guidelines for automated working papers are provided in paragraph C11.P3.12., below.

#### C11.P3.9. Data Verification

C11.P3.9.1. Ensuring the quality of audit results requires verification of the data used. Verification consists of assessing the reliability of the source data before the data entry process and testing the data after data entry is completed.

C11.P3.9.2. Whatever the source of data used in the automated application, it is the responsibility of the auditor to perform sufficient work to ensure that the data used in the audit are relevant, accurate, and complete. For data derived from manual source documents, the data should be verified in the manner as if being transferred to manual working papers. For computer-generated information that is to be downloaded to the microcomputer or retrieved using audit software retrieval packages, procedures in Chapter 9 of this Manual should be used for assessing data reliability.

C11.P3.9.3. Data entry is the first major point where error may be introduced in the automated process. When data are entered directly from the keyboard, keying

errors may occur. Transmission errors may occur when data are downloaded from a mainframe computer or communicated from another microcomputer. To guard against introducing error in the data entry process, verification should be accomplished.

C11.P3.9.4. There are a variety of verification procedures that offer varying degrees of protection against introducing error. In selecting a type of verification, the auditor should consider the alternatives, balancing the costs and feasibility of various procedures against the risk of error that may be tolerated. It is a good practice to keep an unmodified copy of the original data to preserve the information until it is verified.

C11.P3.9.4.1. When data are entered from the keyboard, one option for verification is re-keying all data (or only some portion of it) and matching the two resulting sets. Another option is to have a second person reenter the data.

C11.P3.9.4.2. Visual scanning of the results of the data entry for reasonableness is a way of detecting any gross errors and always should be done. This is particularly important for data that have been downloaded and/or retrieved or transmitted from another computer. Transmission problems or line noise may result in transmitting unreadable data.

C11.P3.9.4.3. The auditor should know the total number of records in the original data sources. This number always should be compared to a count of the records in the newly entered data set. Knowing the exact number of data records to be transmitted is important, especially in the downloading process. The auditor should compare the sum of selected critical field(s) of the original data source to the sum in the newly entered data set. For example, certain fields in a record may be conducive to providing totals such as dollar amounts. Any discrepancies noted in record counts, batch totals, or other control fields used should be accounted for.

#### C11.P3.10. Software Controls

C11.P3.10.1. When audit software is used in the audit process, adequate controls should be established to ensure the software programs work as intended. The term audit software includes the following:

C11.P3.10.1.1. Commercial "off-the-shelf" (COTS) microcomputer software packages.

C11.P3.10.1.2. Audit software retrieval packages.

C11.P3.10.1.3. Customized software programs developed in house for a specific or recurring application.

The basis for ensuring the accuracy of software performance shall vary depending on the circumstances involved.

C11.P3.10.2. For commercial software acquired and supported, the internal audit organizations should establish proper procedures for ensuring the quality of software for Agency-wide use. These procedures should include making sure that the commercial software meets the requirements of the organization, designating a central point for resolving problems auditors may encounter, and providing feedback to commercial vendors for correcting potential software errors. For Agency-supported commercial software, the auditors should be confident that these programs shall perform as expected when properly used. Auditors should not use commercial software that has not been designated for Agency-wide use.

C11.P3.10.3. When complex analytical or audit software retrieval packages need to be developed and/or used in the audit process, it may be necessary to provide auditors with technical assistance. For example, special programs may have to be written in programming languages such as BASIC, CCBCCL, or Pascal. In these cases, additional steps should be taken to define the roles and responsibilities of the auditor and the technical specialist, communicate audit requirements effectively, and ensure the quality of technical assistance provided. Steps taken should be documented and retained in the working papers.

C11.P3.10.3.1. A clear understanding should be established between the auditor and the technical specialist as to what is required and what is actually provided. To promote such an understanding, the auditor should communicate clearly and distinctly the audit requirement in the form of a written statement of work. The technical specialist then should do the following:

C11.P3.10.3.1.1. Document the work performed.

C11.P3.10.3.1.2. Approve the results obtained.

C11.P3.10.3.1.3. Provide his and/or her professional opinion, as may be applicable, on the uses and/or limitations of automated products and/or services provided.

With these assurances, the auditor then assumes responsibility for how the automated products and/or services are used in accomplishing the audit.

C11.P3.10.3.2. Adequate testing should be accomplished for customized software programs developed in-house. The extent and type of testing should be based on the complexity of the application and the risk when relying on the results generated. It is recommended that automated applications developed in-house be validated with test data having a predetermined result.

C11.P3.10.3.3. The results of the testing process should be reviewed and approved by someone knowledgeable in the particular language used to write the program. Also, the testing process should be documented to show the following:

C11.P3.10.3.3.1. The capabilities tested.

C11.P3.10.3.3.2. Actual tests performed.

A copy of all programs and supporting documentation should be retained in a permanent file or with the audit working papers.

C11.P3.10.4. To minimize the risk of making errors, control features should be incorporated into microcomputer applications. The free format capability of spreadsheet software, in particular, provides great flexibility while lacking built-in controls to ensure accurate results. Use of the following control features should be considered for microcomputer applications where proper:

C11.P3.10.4.1 Use lock formula commands to protect formulas.

C11.P3.10.4.2 Use totals as a form of control.

C11.P3.10.4.3 Calculate key balances using two alternative methods and then compare the results to make sure they are equal.

C11.P3.10.4.4. Print a listing of formulas and relationships.

C11.P3.10.4.5. Describe each formula's purpose in the same database or spreadsheet that the formula exists.

C11.P3.10.4.6. Verify that the formula and queries used are correct.

C11.P3.10.4.7. Provide instructions and identifications with the spreadsheet (include preparer's name, date created or last modified, input expected, output produced, file name, date last tested, etc.).

C11.P3.10.5. Computer applications may be employed by a number of users and also may be modified to fit a variety of audit situations. Adequate controls should be established for these applications to prevent any unauthorized or unintentional alterations. Information on their structure and operation should be maintained in a "permanent" file to reduce the learning time required of another individual to operate them effectively, to determine exactly what the applications may and may not do, and to facilitate their retrieval at a later date. Such information should include the following:

C11.P3.10.5.1. Preparer's name and date prepared or modified.

C11.P3.10.5.2. Capabilities and limitations of the application.

C11.P3.10.5.3. Hardware and software requirements, including the version of the microcomputer operating system and software used.

C11.P3.10.5.4. Operating instructions such as initial set up, data entry, and how to make corrections and reconciliation's.

C11.P3.10.5.5. Description of record layouts and data elements.

C11.P3.10.5.6. Testing procedures to verify the integrity of the template's operation.

C11.P3.10.5.7. Any warning in the event the model's logic or structure is altered.

C11.P3.10.5.8. Retesting procedures accomplished if the model is modified.

C11.P3.10.5.9. Sample printouts illustrating the results generated.

#### C11.P3.11. Quality Assurance

C11.P3.11.1. When new tools are introduced and used without detailed understanding, the potential for misapplication always exists. Errors may be introduced and, if undetected, subsequently may be magnified or spread through an application.

C11.P3.11.2. Effective training and supervisory reviews are important factors in ensuring that microcomputers and automated audit techniques are used effectively and in maintaining quality assurance over automated tasks. The key to becoming an effective microcomputer user is learning the capabilities of the hardware and software

being applied. This may be achieved by formal training, on-the-job training, and by self-training.

C11.P3.11.3. Requirements for supervisory reviews of audit work apply equally to the review of computer-generated analyses. The reviewer should evaluate each application based on its objectives and its relative sensitivity to the audit conclusions. General points to consider when reviewing an automated audit application include the following:

C11.P3.11.3.1 Does the application perform as intended?

C11.P3.11.3.2. Was the audit task accomplished in an efficient manner?

C11.P3.11.3.3. Are underlying assumptions applicable to the specific assignment?

C11.P3.11.3.4. Were good application design techniques used?

C11.P3.11.3.5. Was the application properly tested?

C11.P3.11.3.6. Was the correct version of the template or software used?

C11.P3.11.3.7. Have accurate data been used in the application?

C11.P3.11.3.8. Have adequate computer backup files been created?

If the audit supervisor does not have sufficient computer expertise, a qualified technical specialist should review and approve the use of computerized techniques.

#### C11.P3.12. Documentation of Audit Processes and Results

C11.P3.12.1. The methods for producing and reviewing working papers change significantly when automated resources are used in the audit process. Special care should be taken to document all automated procedures and data files used during the audit. A description of how automated resources were used should be provided in enough detail to allow a reviewer to comprehend fully the application purpose, processing function, underlying logic, tests performed, and conclusions reached. The reviewer also should be provided a road map through the electronic working papers, showing clearly all steps in the audit process.

C11.P3.12.1.1. For each audit, a single master index or directory should show the storage media and location of each automated working paper. It also should

provide information on the subject of the working paper, its title, the type of file (such as spreadsheet or database) and the software used to create the file. All diskette labels should include a signature block for the preparer and reviewer. Alternatively, some portion of the audit working papers, including official signatures, should be retained in paper form.

C11.P3.12.1.2. Indexing may be facilitated by devising and using standard file names that contain coded information on the type of file, the number of the working paper, or other information relevant to locating particular documents from a whole set of related documentation.

C11.P3.12.1.3. The requirements for cross-referencing automated working papers are the same as for hard copy working papers. Cross-references may be included in the automated files. While there is no standard approach, cross-referencing alternatives have a critical feature in common. They all require that careful attention be given to planning for systematic file naming and descriptions.

C11.P3.12.1.4. The working papers should contain a concise but complete description of all procedures for data entry, data verification, and the results obtained by using these procedures. For example, if a 10 percent sample of data is re-keyed as a verification procedure, the rationale for selecting that procedure and that sample size should be documented. The error rate as determined from the sample should be reported and any subsequent steps to correct errors should be described. Specific steps for documenting statistical sampling can be found in Part II (C11.P2.) of this chapter.

C11.P3.12.1.5. When data are obtained by downloading from another computer system or using audit software retrieval packages, a description of both the process and the data files should be included in the working papers. A separate working paper should be developed specifically for these applications identifying the host computer system, the original data file, the software and procedures used for extracting data, and the communications hardware and software. All procedures to verify the data should be outlined.

Additional information regarding the preparation, review, and retention of working papers can be found in Chapter 18 of this Manual.

C11.P3.12.2. When commercial microcomputer software packages are used, documentation of the program normally is not required. The auditor should document fully the automated tasks accomplished. The specific equipment and software version (application and operating system) used should be documented adequately.

C11.P3.12.2.1. Spreadsheet Applications. Much of the information required for good documentation may be entered directly on the automated spreadsheet. Separate sections of the spreadsheet may be used to do the following:

C11.P3.12.2.1.1. List data sources.

C11.P3.12.2.1.2. Indicate what information is contained in each row and column.

C11.P3.12.2.1.3. Describe the variables and assumptions in the analysis.

C11.P3.12.2.1.4. Describe calculations embedded in the spreadsheet.

Separate sections may be devoted to information on the preparer, the date prepared, the version of the spreadsheet, and on other facets of file management. It is important that any formulas used in the spreadsheet be examined carefully by the auditor and by the supervisor and/or an independent technical specialist. This also applies to the use of a "macro" (a group of instructions treated as a unit entity) that is important to a particular analysis. It is a good practice to list separately all formulas used.

C11.P3.12.2.2. Database Applications. When database programs are used in the audit process, then it is necessary to provide documentation on the database, on its structure and content, and on the reports generated using the program. If the database is revised, modified, or updated, then the working papers should include a copy of the database used to support the audit work. Where database programs are developed by the user, these programs should be available in the working papers.

#### C11.P4. PART IV - USE OF TECHNICAL EXPERTS

C11.P4.1. Purpose. Part IV describes the process of determining the need for technical experts to assist in conducting audits and in locating, acquiring, and using these experts.

C11.P4.2. Applicability. This part applies to all DoD internal audit and internal review organizations, including nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations").

### C11.P4.3. Standards and Policies

C11.P4.3.1. Department of Defense Internal Auditing Standard 670, "Internal Audit Organization Qualifications," (see Chapter 2) requires that audit organizations possess or obtain the knowledge, skills, and disciplines needed to carry out its audit responsibilities.

C11.P4.3.2. Each internal audit organization shall determine when to use technical experts and how to identify, acquire, and use technical experts in meeting audit responsibilities.

C11.P4.3.3. Technical experts shall be effectively controlled when they are assisting the audit organization. Precautions shall be taken to ensure that the expert can provide independent and objective evaluations.

C11.P4.3.4. While the appropriateness and reasonableness of methods or assumptions used and their applications are the responsibility of the specialist, the auditor shall obtain an understanding of these matters to determine whether the audit findings are clearly supported by the technical expert's evaluation.

C11.P4.3.5. The specialist should be relied upon unless the auditor has evidence to the contrary that the technical expert's work is suspect. In these cases, attempts should be made to reconcile differences with the specialist.

C11.P4.3.6. Audit reports shall contain appropriate explanation if the required technical expertise was not available or was not used.

C11.P4.3.7. An evaluation of requirements and capabilities for providing technical support shall be made a formal part of the organization's audit planning process.

C11.P4.4. Definition of Technical Expert. A technical expert is an individual possessing a level or type of technical expertise normally not expected of a generalist auditor and whose technical expertise is used to perform or assist in performing audits. personnel who provide support services such as clerical, stenography, typing, reproduction, personnel administration, financial management, or similar duties are not considered to be technical experts. Some of the types of technical experts that may be needed by internal audit organizations are computer and information specialists, attorneys, writers/editors, contract and procurement specialists, actuaries, mathematicians, engineers, statisticians, program management specialists, administrative specialists, realty specialists, quality assurance specialists, audiovisual specialists,

cost-price analysts, technical information specialists, training specialists, energy specialists, healthcare professionals, document examiners, fuel management specialists, personnel management specialists, and operations research analysts.

C11.P4.5. Determining Need for Technical Experts. In determining what types of technical experts will be needed to accomplish assigned audit responsibilities, consideration needs to be given to the length of time technical assistance is required. Frequently used experts normally would be employed by the audit organization on a full-time basis; experts used less frequently normally would be obtained as the need arises. The objectives of each audit should be evaluated to determine what types of technical experts are needed to accomplish the audit effectively and what specific tasks are to be done by each expert. The need for experts normally would be identified during the planning or survey phases of an audit so the audit organization will have sufficient time to locate and acquire technical expertise.

C11.P4.6. Sources of Technical Experts. Technical experts may be obtained from various sources. Many factors, such as frequency of use, level of required expertise, time available to acquire the needed expertise, and the amount of funds available to reimburse technical experts should be considered when determining the best source to satisfy a specific need. Some of the potential sources are as follows:

C11.P4.6.1. Audit Organization. Some commonly used experts may be available in the audit organization. These include computer and information specialists, attorneys, writers/editors, statisticians, and engineers.

C11.P4.6.2. Element of Agency. Many experts are available from the organizations that are subject to audit. The audit organization shall ensure that the expert selected is in a position to render an independent and unbiased appraisal. Generally it is not appropriate to use an individual from the organization being audited as a technical expert. When the use of such individuals is the only available option, other precautions need to be followed for ensuring an independent and unbiased evaluation by the technical expert.

C11.P4.6.3. Other Audit or Inspector General Organizations. Technical experts may sometimes be obtained from other audit or inspector general organizations. Enclosure 3 to this chapter shows the types of technical experts used by Federal Inspector General organizations. Enclosure 4 to this chapter shows the types of technical experts used by the General Accounting Office (GAO). The data for these tables were compiled from a report issued by the President's Council on Integrity and Efficiency entitled "Use of Technical Experts by Inspector General Organizations," issued in October 1985. Defense Contract Audit Agency has also established an

Engineering Support Branch at its Technical Service Center for providing assistance in acquisition of technical specialist and interpreting technical reports. The Office of the Assistant Inspector General for Audit Policy and Oversight, Office of the Inspector General, DoD, is available to help audit organizations identify points of contact in other Federal audit or inspector general organizations.

C11.P4.6.4. Elements of Another Agency. Many types of experts are available from other Government Agencies. The Directory of Federal Laboratory and Technical Resources, prepared by the National Technical Information Service, Department of Commerce, provides a listing of over 1,000 sources of experts available to auditors through Federal resource sharing. The publication is arranged under 30 subject oriented resource headings including: Computer Technology, Engineering, Nuclear Technology, Ocean Sciences and Technology, and Transportation. Additional sources include such private publications as Gale's Government Research Directory, which contains 3,700 Institutes, Laboratories, and Test Facilities, including User Oriented Facilities and Research Programs supported by the Government. (See Enclosure 5 to this chapter for a partial list of publications that can be used for identifying technical experts.)

C11.P4.6.5. Paid Consultants. Paid consultants are a major source of technical expertise and are a source frequently used by the GAO. (See Enclosure 2 to this chapter.) Paid consultants shall be obtained in accordance with provisions of DoD Directive 4205.2 (reference (nn)). Gale Research Inc., Dunn and Bradstreet, and others have compiled extensive reference publications containing over 25,000 consulting firms with a wealth of consultant specialties and expertise. (See Enclosure 5 to this chapter for a partial list of publications that can be used for identifying paid consultants.)

C11.P4.6.6. Unpaid Consultants. Technical experts may be available, especially for short periods, on a non-reimbursable basis. Possible sources include local colleges and universities, trade associations, and professional societies. When requiring the services of unpaid consultants, care must be taken to ensure that there is no conflict with the voluntary services prohibition of the Anti-Deficiency Act (reference (oo)).

C11.P4.6.7. Trade Associations and Professional Societies. Trade associations and professional societies are useful sources of technical expertise. Publications identifying such organizations include State Directory of Business Activities, issued by the U.S. Small Business Administration, and are listed in Enclosure 5 to this chapter.

C11.P4.7. Selecting the Right Expert for the Job. After determining the experts who are available to perform special audit analysis, the correct person for the job must be chosen. Because of the wide variety of technical experts employed by the Government and available to the audit community, the need for outside technical experts will be rare. In those cases where outside technical services are required, the cross-checking of references becomes extremely important and may often provide the audit organization with the information on which to make the most accurate assessment on the consultant's capacity for contributing to the audit.

C11.P4.8. Managing the Technical Expert Program. Effective control is needed over the technical experts while they are assisting the audit organization. The expert employed may not have knowledge of the requirements associated with Government Auditing Standards. Therefore, there must be an agreement of what, specifically, the expert shall do; the type of documentation required and how the expert shall communicate the review results to the audit organization; with whom in the audit organization the expert shall deal; and to whom the expert shall report. Consideration must also be given to whether the required technical services can be performed on a one-time basis or whether additional support will be required when responding to the auditee's comments and concerns prior to issuance of the final audit report. These aspects normally should be formulated in writing before engaging the expert.

C11.P4.9. Reporting Results. Readers of audit reports must be able to assume that properly qualified people, including technical experts when appropriate, are used to accomplish audits. If a primary audit objective cannot be accomplished without relying on technical experts, and an expert is not used, then the audit report shall be qualified to explain why applicable Government and DoD internal auditing standards were not followed.

C11.E1. ENCLOSURE 1 OF CHAPTER 11  
PUBLICATIONS ON APPLICATION  
OF STATISTICAL SAMPLING TECHNIQUES

C11.E1.1.1. Applications of Statistical Sampling to Auditing, Alvin A. Arens and James K. Loebbecke, Prentice-Hall, 1981

C11.E1.1.2. Handbook of Sampling for Auditing and Accounting, Third Edition, Herbert Arkin, McGraw-Hill, 1984

C11.E1.1.3. Practical Statistical Sampling for Auditors, Arthur J. Wilburn, Marcel Decker Inc., 1984

C11.E1.1.4. Sample Design in Business Research, W.E. Deming, Wiley, 1960

C11.E1.1.5. Sampling for Modern Auditors: A Personal Study Course, Institute of Internal Auditors, Inc., 1977

C11.E1.1.6. Sampling Techniques, Third Edition, William G. Cochran, Wiley, 1977

C11.E1.1.7. Statistical Methods, Sixth Edition, G.W. Snedecor and W.G. Cochran, Iowa State University Press, 1967

C11.E1.1.8. Statistics for Business and Economics, H. Kohler, Scott Foresman and Company, 1985

C11.E1.1.9. Statistics for Business and Economics, Second Edition, D.R. Anderson, D.J. Sweeney, and T.A. Williams, West Publishing Company, 1981

C11.E1.1.10. Statistics for Management, Third Edition, B.J. Mandel, Dangary Publishing Company, 1984

C11.E1.1.11. Using Statistical Sampling, U.S. General Accounting Office, 1986

C11.E2. ENCLOSURE 2 OF CHAPTER 11

GLOSSARY OF STATISTICAL SAMPLING TERMS

C11.E2.1.1. Attributes Sampling. The sampling process used to estimate the number of times a characteristic or situation occurs in a population. It is usually expressed as a percentage of the total. Attributes can be counted, but not measured.

C11.E2.1.2. Cluster Sampling. Sampling from groups of items that may be conveniently broken down into subgroups or "clusters"; for example, trays of file cards. Each cluster is evaluated as if it were a single observation. Generally requires the assistance of a specialist in statistical sampling.

C11.E2.1.3. Confidence Level. Relates to the probability that the sample will, through certain calculations, fairly represent the true population average. Indicates the risk the auditor is willing to take in the sample selection. For example, in choosing a 95 percent confidence level, the auditor has used a method of estimating that is successful about 95 percent of the time.

C11.E2.1.4. Discovery Sampling. This type sampling is sometimes referred to as detection or exploratory sampling. The audit objective is usually to locate at least one instance of some type of critical event where it occurs, rather than the frequency of occurrence as with estimating sampling of attributes.

C11.E2.1.5. Interval Sample. The process of selecting a random sample of items from a population (universe) on a fixed interval basis; for example, every 10th item, every 15th item, etc. Also known as systematic sampling. The method is useful when the population items are not numbered and to number them solely for the purpose of sampling would be costly.

C11.E2.1.6. Judgmental Sample. A non-statistical sample that cannot be used to project population values. conclusions can be reached only for those items that were examined. Judgment samples are best used in an exploratory manner; that is, to determine if more extensive sampling is needed, and in tests where the mere presence or absence of an item being checked is significant, rather than the degree of presence or absence.

C11.E2.1.7. Mean. The term used to describe a population or sample average. It is the sum of all the values in a set of observations divided by the number of observations. It is used for variable sampling.

C11.E2.1.8. Parameters. The term applied to population or sample characteristics, such as the mean and standard deviation.

C11.E2.1.9. Population. Same as universe or field. Any group of items. In auditing, it usually represents the total number of records to be examined.

C11.E2.1.10. Probability. The chance that a specific event will occur.

C11.E2.1.11. Probability Sample. Same as a random sample. A sample selected in a manner that assures that each remaining item in the population has an equal chance of being selected.

C11.E2.1.12. Projection. The expansion of sample results to estimate the entire population value.

C11.E2.1.13. Representative. Used to indicate that the sample is a reasonable cross section of the population from which it is drawn and estimates the true universe characteristics as accurately as possible.

C11.E2.1.14. Sampling Precision. Same as sampling error. Precision is the range within which the estimate of the population characteristics will fall at the stipulated confidence level. Usually expressed in terms of a plus or minus value, such as:  $\pm 3\%$ .

C11.E2.1.15. Simple Random Sample. A statistical sample, selected randomly from a population (universe) through the use of random numbers, in which each item has an equal chance of being selected.

C11.E2.1.16. Standard Deviation. The term used to describe the degree of spread or variability in a set of individual item values about the population mean. The less variation item values, the smaller the standard deviation. Conversely, the greater the variation, the larger the standard deviation.

C11.E2.1.17. Statistical Sampling. The process by which items are selected from a population (universe) in which some type of scientifically designed sampling technique is used and may include such techniques as simple random, stratified random, cluster random, systematic selection with a random start, or multi-stage random sampling.

C11.E2.1.18. Stratified Random Sampling. A method of reducing sample variability for the purpose of improving that sample reliability. Stratified sampling consists of dividing the population into homogeneous groups and sampling each group.

As an example, large or sensitive items may be segregated from the balance of the population and examined in greater detail.

C11.E2.1.19. Universe. Same as population. The total group of items possessing a certain characteristic(s).

C11.E2.1.20. Variability. A term expressing the spread of items around a sample average, usually measured as a standard deviation.

C11.E2.1.21. Variables Sampling. The sampling process used to measure characteristics in a population in terms of their individual magnitudes or values. This method measures "how much," for example, the total dollar value of inventory or the total value of a certain type of recurring error. The variable may be dollars, length of time, weight, age, or any quantitatively measurable value.

C11.E3. ENCLOSURE 3 OF CHAPTER 11TECHNICAL EXPERTS USED BY THE U.S. GENERAL ACCOUNTING OFFICE

Type of Technical Expert	<u>DOA</u>	<u>AID</u>	<u>DOC</u>	<u>DOED</u>	<u>DOEN</u>	<u>EPA</u>	<u>GSA</u>	<u>HHS</u>	<u>VA</u>	<u>DOD</u>	<u>HUD</u>	<u>DOI</u>	<u>DOL</u>	<u>NASA</u>	<u>SBA</u>	<u>DOS</u>	<u>DOTRANS</u>	<u>DOTREAS</u>
Computer & Information Specialists	X		X	X	X	X	X	X	X	X	X	X	X	X	X		X	X
Attorneys			X	X		X		X						X	X		X	
Writers/Editors	X		X					X		X	X	X		X		X		
Contract & Procurement Specialists			X				X			X								X
Engineers						X	X			X								X
Security Administration Specialists		X						X	X						X			
Actuaries, Mathematicians, Scientists, Statisticians X								X		X		X	X					
Program Management Specialists								X		X				X				
Budget Specialists				X						X	X							
Administrative Specialists										X				X				
Realty Specialists							X			X								
Quality Assurance Specialists							X			X								
Audio Visual Specialists								X										
Cost/Price Analysts										X								

Type of Technical Expert	<u>DCA</u>	<u>AID</u>	<u>DOC</u>	<u>DOED</u>	<u>DOEN</u>	<u>EPA</u>	<u>GSA</u>	<u>HHS</u>	<u>VA</u>	<u>DOD</u>	<u>HUD</u>	<u>DOI</u>	<u>DOL</u>	<u>NASA</u>	<u>SBA</u>	<u>DOS</u>	<u>DOTRANS</u>	<u>DOTREAS</u>
Technical Information Specialists										X								
Training Specialists															X			
Architects							X											
Building Management Specialists							X											
Energy Specialists							X											
Health Professionals								X										
Electronic Surveillance Specialists								X										
Photography Specialists								X										
Document Examiners								X	X									
Subsistence Management Specialists											X							
Fuel Management Specialists											X							
Supply & Logistics Specialists											X							
Personnel Management Specialists											X							
Industrial Specialists											X							
Operations Research Analysts											X							

C11.E4. ENCLOSURE 4 OF CHAPTER 11TECHNICAL EXPERTS USED BY THE U.S. GENERAL ACCOUNTING OFFICE

<u>Type of Expert</u> <sup>1</sup>	<u>Source</u> <sup>2</sup>
Attorney	PR
Accountant	PR
Economist	ER
Computer Programmer/Computer Programmer Analyst	PR
Social Science Analyst	ER
Management Analyst	ER
Writer/Editor	PR
Operations Research Analyst	PR
Auditor	R
Adjudicator	R
Psychologist	ER
Technical Information Specialist	R
Program Analyst	ER
Statistician	R
Actuary	PR
Civil Engineer	E
Electronics Engineer	ER
Physical Scientist	ER
Logistics Management Specialist	E
Financial Administration Specialist	ER
Geologist	ER
Environmental Protection Specialist	R
Intelligence Specialist	E
Historian	E
Archeologist	E
Ecologist	E
Medical Officer	E
General Engineer	E
Architect	E
Mechanical Engineer	E
Industrial Engineer	E
Technical Writer	R
Financial Analyst	E

<u>Type of Expert</u> <sup>1</sup>	<u>Source</u> <sup>2</sup>
Physicist	E
Mathematical Statistician	R

<sup>1</sup> Excludes experts used exclusively for administrative purposes.

<sup>2</sup> Source Code:

R - Regular General Accounting Office Staff Members.

E - Experts and/or Consultants.

ER - Combination of Regular Staff Members and Experts and/or Consultants.

PR - Predominantly Regular General Accounting Office Staff Members.

C11.E5. ENCLOSURE 5 OF CHAPTER 11

PUBLICATIONS USEFUL IN IDENTIFYING TECHNICAL EXPERTS

C11.E5.1.1. Directory of Federal Laboratory and Technical Resources, Jan 1988, A Guide to Services, Facilities and Expertise, U.S. Department of Commerce, National Technical information service, center for the utilization of Federal Technology, 1988

C11.E5.1.2. State Directory of Business, Activities, U.S. Small Business Administration, Office of Advocacy, 1989

C11.E5.1.3. National Trade and Professional Associations of the United States, Columbia Books, Inc., 1986

C11.E5.1.4. Government Research Directory, Gale Research Inc., 1989

C11.E5.1.5. Consultants and Consulting Organizations Directory, Gale Research Inc., 1989

C11.E5.1.6. Dunn's Consultant Directory, Dunn and Bradstreet Inc., 1989

## C12. CHAPTER 12

### REPORTING AUDIT RESULTS

#### C12.1. PURPOSE

This chapter covers the reporting of the results of audits performed by DoD internal audit organizations. Specifically, the chapter describes the form, distribution, timeliness, contents, and presentation of DoD audit reports and suggests formats to be used.

#### C12.2. BACKGROUND

Audits are made primarily to assist management in arriving at solutions to problems and in devising better ways to do business. Many benefits to the audited activity occur during an audit through meaningful discussions of the audit results with the activity's management. These discussions often lead to on-the-spot corrections. The basic purpose of the audit report is to document the audit results and outline a corrective action program to be followed. Audit reports are used for a variety of purposes. For example, they are used by: the activity to which the recommendation is addressed to develop a corrective action program; management as part of the follow-up process; congressional committees to evaluate budget requests and other legislative acts; top Defense officials to identify problems and trends that may have Component-wide or Defense-wide repercussions; internal and external audit and inspection officials to adjust the scope of their reviews; and instructors as training aids or case studies.

#### C12.3. APPLICABILITY

The provisions of sections C12.4. through C12.9. of this chapter are mandatory for all DoD internal audit, internal review, and military exchange audit activities (hereafter referred to collectively as "DoD internal audit organizations"). In addition, DoD internal audit organizations are strongly urged to use the suggested formats in section C12.10. of this chapter, although their use is not mandatory. Certain procedures described in this chapter may not apply to every audit, but the principles and objectives remain mandatory. The term "should" is used to denote the desirability of an action.

#### C12.4. STANDARDS AND POLICIES

All internal audit organizations shall issue audit reports fully complying with standards for reporting as set forth in the "Government Auditing Standards" (reference (c)). These reporting standards deal with form, distribution, timeliness, report contents, and report presentation.

#### C12.5. FORM

Auditors shall report the results of their audit work in writing. Written reports are necessary to: communicate the results of audits to officials at all levels of Government, make the findings and recommendations less susceptible to misunderstanding, make the findings available for public inspection, and facilitate follow up to determine whether appropriate corrective measures have been taken. The requirement to use a written report is not intended to limit or prevent discussions of findings, judgments, conclusions, and recommendations with persons who have responsibilities for the area being audited. On the contrary, such discussions are required by Chapter 8 of this Manual, "Performing Audits." However, a written report shall be prepared upon completion of each audit regardless of whether such discussions are held. If one or more of the major objectives of an audit is completed, a numbered audit report (standard report format or letter report format) shall be issued. It is not appropriate to close-out efforts of this nature with unnumbered letters, memoranda, or other informal correspondence. See section C12.10. of this chapter for guidance in determining the particular report format to be used. Pertinent security regulations covering presentation and safeguarding of classified material shall be followed. When an audit is terminated prior to completion, the auditor should communicate the termination in writing to the auditee and other appropriate officials.

#### C12.6. DISTRIBUTION

Written audit reports shall be submitted to appropriate officials both of the organization audited and the organization requiring or arranging for the audits unless legal restrictions or ethical considerations prevent it. Copies of the reports shall also be sent to officials responsible for monitoring internal controls, other officials responsible for taking action on audit findings, and to others authorized to receive such reports. Unless restricted by law or regulation, copies of audit reports shall be made available for public inspection. As a general rule, audit reports should be submitted to all interested officials. Pertinent security regulations covering the release of classified material shall be followed. Procedures for review and distribution of reports from independent public accountants are included in DoD Directive 7600.9 (reference (q)).

## C12.7. TIMELINESS

Audit reports shall be issued promptly to make the information available for timely use by management and legislative officials and to permit prompt initiation of follow-up action.

C12.7.1. Each internal audit organization shall establish a time standard or a series of time standards for each major milestone in the audit report process, which shall be used for evaluating and improving the time it takes to issue a report. Generally, draft reports issued more than 60 days after completion of the field work and final audit reports issued more than 120 days after the draft report is issued shall be considered untimely.

C12.7.2. In those instances where the audit activity is unable to obtain management comments in a timely manner, the final report may be issued without them. Action should then be taken to obtain and resolve final management comments during the audit report resolution process.

C12.7.3. Auditors should consider interim reporting of significant matters to appropriate officials during the audit. This is not a substitute for a final written report, but it does alert officials to matters needing immediate attention and permits them to take corrective action before the final report is issued.

## C12.8. CONTENTS

The audit report shall include pertinent information on the following:

C12.8.1. Audit Entity. The audit entity is the organization, program, system, or other area that was audited. The audit entity must be accurately and precisely included in the audit report title and elsewhere in the report as a prerequisite to understanding the other parts of the audit report. Most audits conducted by DoD internal audit organizations, whether performed at a single location or on a coordinated multi-location basis, are limited to specific areas of operations that are identified as being particularly significant. Special care must be taken to see that the audit report does not imply greater audit coverage than was actually provided.

C12.8.2. Scope. The scope paragraph shall tell the reader what the auditors did and did not do. The scope shall clearly indicate which elements of audit examination--the accomplishment of established objectives and goals for operations and

programs; the reliability and integrity of information; the compliance with policies, plans, procedures, laws, and regulations; safeguarding of assets; and economical and efficient use of resources--were covered during the audit and the extent of such coverage. Any limitations in scope, such as restricting the audit to specific activities or locations, shall be clearly spelled out.

C12.8.3. Methodology. The statement on methodology should clearly explain the evidence gathering and analytical techniques used to accomplish the audit objectives. The explanation should identify any assumptions made in conducting the audit; describe any comparative techniques applied and measures and criteria used to assess performance; and if sampling is involved, describe the sampling methods used.

C12.8.4. Objectives. Unlike most audits in the private sector, internal audits within the Department of Defense are seldom limited to certifying to the reliability of financial statements. As required by Chapter 3 of this Manual, "Audit Concepts," most DoD internal audits are mission-oriented audits involving evaluations of various aspects of the effectiveness and economy of organizations, programs, systems, and other audit areas. The mission-oriented audit concept does not preclude an audit activity from auditing support activities but, instead, requires placing audit emphasis on the mission areas of the entity selected for audit, whether it is a program, system, or a supporting activity. Since each DoD internal audit is usually unique, audit objectives must be carefully formulated at the start of the audit and must be clearly stated and covered in the audit report. Normally, there is an overall objective and series of specific objectives, all of which are related to the overall objective. While objectives related to the effectiveness of the major missions are most important, those dealing with internal controls, compliance, and action on prior recommendations are also important and must be clearly stated. Chapter 8 of this Manual, "Performing Audits," establishes procedures for developing audit objectives.

C12.8.4.1. Internal Controls. Normally, each audit shall include an evaluation of internal controls for the area audited. This evaluation is generally not stated as a specific objective of the audit, although the report shall state that the audit "...included such tests of the internal controls as considered necessary." However, when a major objective of the audit is to evaluate internal controls, this shall be listed as one of the specific objectives of the audit. There are a number of reasons why a study and evaluation of internal control may not be made. For example: the entity may be too small to have an adequate internal control system; the audit can be performed more efficiently by expanding substantive audit tests, thus placing very little reliance on the internal control system; or the internal control system may be so weak that the auditor has no choice but to perform substantive testing. In addition, each scheduled audit shall include an evaluation of management's effectiveness in implementing the Internal Control Program as it relates to the scope of the audit.

C12.8.4.2. Compliance. Most audits require some determination of compliance with appropriate laws and regulations. Compliance is not usually stated as an objective for the audit although noncompliance with laws, regulations, procedure, etc., must be identified in the report. However, when a major objective of the audit is to determine compliance, compliance shall be listed as one of the specific objectives of the audit.

C12.8.4.3. Action on Prior Recommendations. Follow up on corrective action taken by management is an important part of every audit. When a major objective of the audit concerns follow up on prior recommendations, this shall be shown as a specific objective of the audit.

C12.8.5. Background. The audit report shall contain sufficient background, information to provide the reader with an adequate understanding of the audit entity. Information about the size, volume, and nature of operations of the audit entity, for example, provide a perspective against which the significance of audit findings and conclusions can be judged. Readers should not be expected to possess all the facts that the auditor has since many audit reports, particularly those issued by the DoD internal audit activities, are used by personnel in organizations and activities far removed from the activity audited. Even when the distribution of reports is limited to levels of management directly responsible for the operation being reported on, a brief description of the mission, available resources (amount and type funds), and size of operations or volume of transactions during the audit period provides a ready reference to such information for those managers involved and informs all readers of the significance of the audit subject.

C12.8.6. Period Audit Performed. The audit report shall show the period during which the audit was performed.

C12.8.7. Period Covered by the Audit. The audit report shall show the period covered by the audit.

C12.8.8. Conformance With Auditing Standards. The audit report shall state, "The audit was made in accordance with Government Auditing Standards." When applicable standards are not followed, the auditors should modify the statement to disclose the required standard that was not followed, the reasons therefore, and the known effect on results of the audit. In conducting Government audits, independent public accountants are required to follow generally accepted auditing standards as well as the standards set forth in Chapters 3, 4, and 5 of the "Government Auditing Standards" (reference (c)).

C12.8.9. Statement on Internal Controls

C12.8.9.1. For each performance audit, the audit report shall identify the significant internal controls that were assessed, the scope of the auditor's assessment work, and any significant weaknesses found during the audit. For performance audits, the reporting on internal controls will vary depending on the significance of any weaknesses found and the relationship of those weaknesses to the audit objectives. In audits where the sole objective is to audit the internal controls, weaknesses found of significance to warrant reporting shall be considered deficiencies and shall be identified in the audit report. The internal controls that were assessed shall be identified for full presentation of the findings. In audits having as their objective an assessment of performances, auditors, in seeking the cause of deficient performance found, may identify weaknesses in internal controls of such significance to be a key reason for the deficient performance. In reporting finding, the deficiencies in internal controls would be identified as the "cause."

C12.8.9.2. For each financial audit, the auditors shall prepare a written report on their understanding of the entity's internal control structure and the assessment of control risk. The report may be included in either the auditor's report on the financial audit or a separate report. The auditor's report shall include as minimum:

C12.8.9.2.1. The scope of the auditor's work in obtaining an understanding of the internal control structure in assessing the control risk.

C12.8.9.2.2. The entity's significant internal controls or control structure, including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and result of the financial-related audit.

C12.8.9.2.3. The reportable conditions, including the identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk.

C12.8.9.3. In addition to the above reporting requirements, each audit report shall also summarize the audit results on how well management had implemented the internal control program as it is related to the scope of the scheduled audit. More details on the auditor's responsibilities for evaluation of internal controls are contained in Chapter 10 of this Manual, "Audit Requirements Generated by Sources External to the Department of Defense."

C12.8.10. Compliance with Laws and Regulations. The report shall include all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit. Illegal acts may be covered in a separate report if including them in the overall report would compromise investigations or legal proceedings or otherwise preclude the report from being released to the public. For all financial audits, this statement should contain a statement of positive assurance on those items which were tested for compliance and negative assurance on those items not tested.

C12.8.11. Audit Conclusions. The report shall contain a specific conclusion on each of the stated audit objectives. This is perhaps the most important portion of the report. Auditors should be able to reach conclusions on the stated audit objectives if they followed suitable evaluation criteria and conducted the audit in accordance with appropriate auditing standards. Management expects and is entitled to this type of summary evaluation. Failure to provide such a summary evaluation deprives management of a significant service. Also, report balance and objectivity can be seriously impaired by not collectively putting the impact of individual deficiency findings (e.g., potential savings, funds that could be put to better use, improvements in efficiency, etc.) in proper perspective.

C12.8.12. Financial Statements. For financial audits, the audit report shall contain a copy of the financial statements reviewed and an opinion on whether the financial statements were prepared in accordance with generally accepted accounting principles. The report shall identify those circumstances in which such principles have not been

consistently observed in the current period in relation to the preceding period. Unless otherwise stated in the auditor's report, informative disclosures are to be regarded as reasonably adequate. The audit report shall contain the auditor's opinion regarding the financial statements taken as a whole, or an assertion to the effect that an opinion can not be expressed. The American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards for reporting, to the extent they are relevant, shall be followed on financial audits. These standards are set forth in the AICPA's "Codification of Statements on Auditing Standards" (reference (pp)).

C12.8.13. Photographs, Charts, and Similar Presentations. Effective use should be made of captions, photographs, charts, graphs, attachments, appendices, and exhibits to highlight areas and to organize the narrative. Lengthy explanations and supporting data should generally be covered in attachments rather than in the main body of the findings.

C12.8.14. Audit Findings. Each audit finding shall normally show criteria, condition, cause, and effect. However, the elements needed for a complete finding depend on the objectives of the audit. In all instances, sufficient, competent, and relevant information about findings shall be included to promote adequate understanding of the matters reported and to provide convincing and fair presentation in proper perspective.

C12.8.14.1. Criteria. This element sets forth the standards, measures, or expectations used in making the evaluation or verification. It shows "what should be." In the absence of definitive, externally defined, authoritative criteria, as is often the situation, auditors have to rely on their own professional knowledge and experience in selecting suitable evaluation criteria. In such cases, however the auditors must assume the responsibility of convincing officials of the audited activity and other recipients of the report that the evaluation criteria are valid and reasonable.

C12.8.14.2. Condition. This element presents the factual evidence that the auditor found in the course of the examination. Normally, a clear and accurate statement of the condition evolves from the auditor's comparison of the results of fact-finding procedures with appropriate evaluation criteria.

C12.8.14.3. Cause. This element shows the reason for the difference between the expected and the actual conditions. It answers the question, "Why did it happen?" If the condition has persisted for a long period of time or is getting worse, this aspect would normally be described. Identification of the cause of an unsatisfactory condition is a prerequisite to making meaningful recommendations for corrective actions. Failure to identify the cause in a deficiency finding may mean that the cause was not ascertained due to limitations or defects in audit work or that it was

emitted to avoid direct confrontation with responsible officials. To identify the root cause of an adverse condition, audit findings should not merely state that prescribed procedures were not followed, but should indicate the reason(s) why they were not.

C12.8.14.4. Effect. This element shows the risk or exposure management faces because the area being audited is not working the way it is supposed to. It indicates the impact of the disparity, and shows the extent of the risk inherent in continuing a deficient procedure, practice, or control. The significance of a condition is usually judged by its effect. Proper statement of effect is valuable in convincing management to correct adverse conditions disclosed by the auditors. In program audits, shortfalls in attaining program objectives or reductions in available resources are appropriate measures of effect and frequently can be expressed in quantitative terms such as dollars, number of personnel, units of production, quantities of material, number of transactions, and elapsed time. If an actual effect cannot be ascertained, a potential or intangible effect can sometimes be useful in showing the significance of a condition. Chapter 8 of this Manual, "Performing Audits," establishes requirements for identifying, computing, reporting, and accumulating information on potential benefits from audit. It is most important to point out to management and readers of the report the estimated savings that could be realized if the auditor's recommendations are followed.

C12.8.15. Recommendations. The audit report shall contain specific and realistic recommendations for actions to correct problem areas noted during the audit. Each recommendation shall identify the suggested remedial action and answer the question, "What is the solution?" The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical. Each aspect of the deficiency should carry a corresponding recommendation. If full corrective action will take 1 or 2 years to complete, the auditor should consider also making recommendations to improve conditions in the interim period. A recommendation merely to comply with regulations or laws shall not be made. Instead, if appropriate, the auditor shall recommend specific actions needed to cause compliance. Further, when appropriate, the auditor shall recommend changes to regulations and laws.

C12.8.16. Views of Management Officials. Chapter 8 of this Manual, "Performing Audits," requires that draft reports be staffed with management officials responsible for taking corrective actions. Management's views on findings, recommendations, and potential monetary benefits shall be obtained in writing; and appropriate changes shall be made to the report. Further, pertinent views of responsible management officials concerning the auditors' findings, conclusions, and recommendations shall be incorporated into the audit report. Management comments may be included verbatim, although obvious errors in spelling, grammar, and sentence structure shall be corrected,

and material no longer appropriate because the report has been revised shall be deleted. Extremely lengthy comments may be summarized. If doubts exist about the auditor's presentation of management's position, discussions should be held with the respondent prior to issuance of the final report. The final report is the product of the audit activity and not a forum for the audited activity to cast doubt upon the credibility of the auditors or to confuse issues. The audit activity shall always retain the right to include only pertinent, responsive, and rational comments.

C12.8.17. Auditor's Position. If the auditor disagrees with management's views on the audit recommendations or considers the views to be non-responsive, the auditor shall state the reason for refuting them in such a way as to convince an independent third party of the correctness of the auditor's position. Conversely, if the auditor finds management's views to be valid, the auditor shall make appropriate changes to the audit report.

C12.8.18. Noteworthy Accomplishments. To provide appropriate balance, the report shall contain a description of noteworthy accomplishments, particularly when management improvement in one area may be applicable elsewhere. The inclusion of such accomplishments may lead to improved performance by other Government organizations reading the report.

C12.8.19. Action on Prior Recommendations. Each audit report shall include a summary section that evaluates corrective actions taken by management in response to recommendations in prior audit reports as they relate to objectives of the current audit. If any of the findings in the current report cite conditions substantially the same as those previously reported, this fact shall be disclosed. This disclosure shall be made whether or not the cause of the current conditions and the recommendations to correct the current conditions are the same as those in the prior report. If the prior report was issued more than 5 years before the current audit began, a finding shall not be classified as a repeat, even if it represents substantially the same condition that was previously reported. Each audit report shall also indicate, whether in the summary section or in a separate section or appendix, which reports and recommendations were reviewed and the result of follow-up work on each recommendation. If a follow-up review was previously made and the issues were closed satisfactorily, additional follow up should be unnecessary.

C12.8.20. Issues Needing Further Study. If the scope of the audit or other factors limit the auditor's ability to inquire into certain matters which should be studied, the auditor shall include in the report a statement about such matters and the reasons why further study is required.

C12.8.21. Omission of Privileged or Confidential Information. The report shall contain a statement indicating whether or not any pertinent information has been emitted because it is to be privileged or confidential. Information of this type may be prohibited from general disclosure by regulation. If pertinent information is emitted, the nature of such information shall be described and the law or other basis under which it was withheld shall be stated. If a separate report was (will be) issued on any emitted information, it should be so indicated in the report.

## C12.9. REPORT PRESENTATION

Report presentation shall comply with the following factors:

C12.9.1. Accurate and Complete Support. The audit report shall present factual data accurately and fairly, report results impartially, and include only information, findings, and conclusions that are adequately supported by sufficient evidence in the auditor's working papers. One inaccuracy in a report can divert attention from the substance of a report. The use of statistical methods in projecting audit results is encouraged. In most cases, a single example of a deficiency is not sufficient to support a broad conclusion or a related recommendation. However, once the condition is adequately supported, additional detailed supporting data need not be included in the report. Only findings that are substantive in relation to the size and nature of the activities or programs audited should be included in the report.

C12.9.2. Convincingness. The audit report shall present findings and conclusions in a convincing manner, distinguishing clearly between facts and opinions. The information in reports shall be sufficient to persuade the readers of the importance of the findings, the reasonableness of the conclusions, and the desirability of accepting the recommendations.

C12.9.3. Objectivity. The audit report shall be objective, unbiased, and free of distortion. It shall be fair and not misleading and shall place primary emphasis on matters needing attention. The auditor shall guard against the tendency to exaggerate or overemphasize deficient performance. The information needed to provide proper report balance and perspective should include: the reason the audit was made; the size and nature of the activities or programs audited; and correct and fair descriptions of findings, including appropriate information on sampling methods, if used.

C12.9.4. Clarity and Simplicity. The report shall be written in language as clear and simple as the subject matter permits. The auditor shall not assume that readers have detailed knowledge of the subject. The use of acronyms and abbreviations shall be

kept to a minimum. If unfamiliar abbreviations, acronyms, or technical terms are used, they shall be clearly defined.

C12.9.5. Conciseness. The audit report shall be concise but contain enough information to be understood by users and third parties. Too much detail detracts from a report, may conceal the real message, and may confuse or discourage readers.

C12.9.6. Completeness. Audit reports shall be complete and shall contain sufficient information about background, findings, conclusions, and recommendations to promote adequate understanding of the matters reported and to provide convincing, but fair, presentations in proper perspective.

C12.9.7. Constructiveness of Tone. Audit reports shall place primary emphasis on improvements. Critical comments should be presented in a proper perspective balanced against any unusual difficulties or circumstances faced by management. Audit reports should not contain language that unnecessarily generates defensiveness and opposition. Management shall be given appropriate credit in the audit report when it initiates timely actions to correct deficiencies.

## C12.10. REPORT FORMAT

This section suggests report formats for the various type of reports issued by DoD internal audit organizations. These formats incorporate the most desirable features of the reports used by each of the DoD internal audit organizations. Although use of the formats is optional, all the provisions of C12.5. through C12.9. of this chapter, which specify report content, are mandatory and shall be complied with. Suggested report formats for the various types of reports are:

C12.10.1. Standard Report. The standard report format (Enclosure 1 to this chapter) should normally be used on audits of appropriated and nonappropriated funds, including overall reports on multi-location audits. Some modification will be needed to accommodate unusual conditions, such as when only a single finding was developed or when the report results from audit work performed under the Commanders Audit Program.

C12.10.2. Advisory Report. This format is used to present significant problems of wide interest that were documented during a multi-location audit or a series of single location audits. Advisory reports (see Enclosure 2 to this chapter for format) are given wide distribution, particularly to activities that have not had recent audit coverage, who are then encouraged to identify and correct similar problems that may exist within their operations. Views of management officials are not required. Since advisory reports

are written for people who are familiar with the areas discussed in the report, lengthy and detailed discussions are generally not necessary.

C12.10.3. Quick-Reaction Report. The quick-reaction report (see Enclosure 3 to this chapter for format) is a letter used for interim reporting of situations demanding immediate action to prevent, correct, or reduce a situation that cannot be handled by normal reporting methods.

C12.10.3.1. Situations that might warrant quick-reaction reporting are:

C12.10.3.1.1. Pending procurements that are not in the best interest of the Department of Defense.

C12.10.3.1.2. Waste of large sums of money or other Government resources.

C12.10.3.1.3. Endangered lives.

C12.10.3.1.4. Illegal actions.

C12.10.3.1.5. Proposed or ongoing actions that could cause significant embarrassment to the Department of Defense.

C12.10.3.2. Normally, a problem covered in a quick-reaction report will be reported in a standard report that will also include an evaluation of the area in which the problem was found. Recommendations other than those in the quick-reaction report normally will be needed to correct procedural weaknesses that led to the problem. In such cases, the problem reported in the quick-reaction report should be used as an example in a finding that discusses the need to correct the procedural weaknesses. If appropriate action is taken on a quick-reaction report, it may not be appropriate to repeat the recommendations made in the quick-reaction report. Reference, however, should be made to the quick-reaction report, the actions recommended, and the actions that were taken by as a result of the quick-reaction report.

C12.10.4. Letter Report. This report (see Enclosure 4 to this chapter for format) is used when an audit is curtailed because of lack of sufficient adverse conditions and should not be used when significant conditions and related recommendations are presented.

C12.10.5. Memorandum of Minor Findings. This letter-type report (see Enclosure 5 to this chapter for format) will be released concurrently with the formal report. It should be used to report deficiencies excluded from the formal report because these deficiencies are considered to be of minor significance.

C12.E1. ENCLOSURE 1 OF CHAPTER 12  
SUGGESTED FORMAT FOR STANDARD AUDIT REPORT

C12.E1.1.1. Cover

C12.E1.1.2. Cover Sheet

- Audit report number
- Date of issue
- Name of audit
- Location of audit

C12.E1.1.3. Letter of Transmittal

- Objectives and scope
- Multi-location relationships
- Auditors, conclusion on each objective
- Briefly summarized recommendations
- Indication of position of each level of management to which recommendations are directed
- Reference to contents of report

C12.E1.1.4. Table of Contents

- Identification of each part of the report
- Identification of each finding by alphabetical or numerical designation and title
- Identification of each appendix to the report

C12.E1.1.5. Part I - Summary

- Subject of audit
- Audit objectives and scope
- Statement of auditing standards followed
- Period during which audit was performed
- Period covered by the audit
- Audit location/multi-location relationships
- Summary evaluation
- Conclusion on each stated objective
- Other observations and conclusions, including management accomplishments
- Evaluation of internal controls and results thereof
- Evaluation of management's internal control review program for area under audit

- Constraints placed on program accomplishment
- Other observations and conclusions, including management accomplishments
- Statement of mission and resources
- Identification of repeat findings

C12.E1.1.6. Part II - Findings, Recommendations, Command Comments and Auditors Remarks

Finding

- Finding paragraph

- Criteria

- Condition

- Cause

- Effect

- Discussion

- Potential benefits achievable (e.g., monetary savings, funds put to better use, etc.), if applicable

- Recommendations

- Management comments

- Auditor's remarks

C12.E1.1.7. Part III - Auditor's opinion and financial statements \*

- Auditor's opinion statement

- Financial statements

- Balance sheet

- Income statement

- Notes to financial statements

C12.E1.1.8. Appendices

- Follow up on prior findings

- Other appendices

- Major contributors to the audit report

\* Applies only to financial audits.

C12.E2. ENCLOSURE 2 OF CHAPTER 12  
SUGGESTED FORMAT FOR ADVISORY REPORT

C12.E2.1.1. Cover

C12.E2.1.2. Cover Sheet

- Audit report number
- Date of issue
- Name of audit
- Location of audit

C12.E2.1.3. Letter of Transmittal

- Purpose of the report
- Observations and conclusions about the general problem areas
- Identification of who should receive the report and what is expected of each addressee
- Identification of who in the audit activity should be contacted for additional information

C12.E2.1.4. Table of Contents

- Identification of each part of the report
- Identification of each problem by alphabetical or numerical designation and title
- Identification of each appendix to the report

C12.E2.1.5. Part I - Summary

- Purpose and scope
- Overall conclusions
- Common problems

C12.E2.1.6. Part II - Problems and Suggested Actions

- Problem
- Summary of problem
- Discussion of problem
- Suggested actions

C12.E2.1.7. Appendices

C12.E3. ENCLOSURE 3 OF CHAPTER 12  
SUGGESTED FORMAT FOR QUICK-REACTION LETTER

C12.E3.1.1. Introduction

Statement of problem

Explanation of urgency of problem

Benefits possible from taking immediate action

C12.E3.1.2. Background \*

C12.E3.1.3. Results of Audit

Problem

Details about problem \*\*

Urgency

Magnitude

Recommendations \*\*\*

C12.E3.1.4. Request for Management Comments

\* Should be sufficient to permit reader to understand problem and its urgency.

\*\* Should show cause and effect to the extent known.

\*\*\* Deals with actions to be taken immediately.

C12.E4. ENCLOSURE 4 OF CHAPTER 12  
SUGGESTED FORMAT FOR LETTER REPORT

C12.E4.1.1. Introduction

- Objectives and scope
- Observations and conclusions
- Mission and resources

C12.E4.1.2. Results of Review

- Overall conclusion
- Conclusion on each survey or audit objective

C12.E4.1.3. Discussion of Results

- Reference to date of discussion
- Request for comments
- Reference to formal management reply process

C12.E5. ENCLOSURE 5 OF CHAPTER 12

SUGGESTED FORMAT FOR MEMORANDUM OF MINOR FINDINGS

C12.E5.1.1. Purpose of letter

C12.E5.1.2. Synopsis of minor conditions found and suggestions to correct

C12.E5.1.3. Solicitation of any comments management wishes to make

C12.E5.1.4. Reference to formal management reply process

## C13. CHAPTER 13

### MANAGING INTERNAL AUDIT OPERATIONS

#### C13.1. PURPOSE

This chapter covers the responsibilities of audit management for ensuring that audits conducted fulfill the mission and responsibilities approved for the DoD internal audit organizations by the leadership of the Department of Defense and the Military Departments, that resources are employed efficiently and effectively, and that audits conform to generally accepted Government auditing standards and DoD internal audit policies and procedures.

#### C13.2. APPLICABILITY

This chapter applies to the DoD internal audit organizations. While compliance with this chapter is not required of internal review and nonappropriated fund audit organizations, those organizations are strongly encouraged to apply the policies, as appropriate.

#### C13.3. STANDARDS POLICIES

Sections 600 and 700, DoD Internal Auditing Standards (Chapter 2 of this Manual), include nine standards applicable to the management of a DoD internal audit organization. Complete guidance for two standards and a portion of the guidance for two others are covered in this chapter. Policy guidance for the remaining standards is provided in the other chapters of the Manual. The following identifies the applicable chapter(s) for the nine standards:

<u>Standard</u>	<u>Chapter</u>
610 - Organization	13
620 - Policies and Procedures	13
630 - Scope and Responsibility	5
640 - Determination of Audit Priorities	5
650 - Planning	5 & 13
660 - Coordination	6
670 - Internal Audit Organization Qualifications	4, 11 & 13
680 - Personnel Management and Development	4
700 - Quality Assurance	14

The following sections discuss standards 610, 620, 650 and 670:

## C13.4. ORGANIZATION

### C13.4.1. General Guidance

C13.4.1.1. The head of each DoD internal audit organization shall report directly to the Secretary or Deputy and/or Under Secretary of the applicable DoD Component. No intermediary organizational element within the DoD Component shall exercise technical direction over the applicable DoD internal audit organization.

C13.4.1.2. The DoD internal audit organization shall be structured to help ensure that audit resources are deployed efficiently and effectively and to foster coordinated, balanced, and integrated accomplishment of the organization's mission, goals, and objectives.

C13.4.1.3. The methods of recruiting, staffing, and training of personnel resources shall ensure the mission and responsibilities of the DoD internal audit organization are supported. While the audit organization should not be structured around available skills, full advantage shall be taken of those skills that are available.

C13.4.1.4. The DoD internal audit organization shall reflect the unique audit needs of the Military Departments and Agencies. Whether this is done by function, by parallel structure, or by some combination of both, the way in which each office is organized should simplify, and not complicate, the ability of audit personnel to review the Military Department or Agency programs and operations.

C13.4.2. Resource Requirements. The DoD internal audit organization should determine and document personnel resources as to numbers and skills required to provide audit coverage using as a minimum a 3-year cycle for those major programs or functions determined to have a high vulnerability. Annual budget requests should reflect the audit coverage shortfall when sufficient staffing and funding are not provided to accomplish high-priority audit coverage within the 3-year cycle.

### C13.4.3. Goals and Objectives

C13.4.3.1. A formal process should be developed for the establishment of organizational goals and objectives. The goals and objectives should be designed to promote improvements in the efficiency and effectiveness of audit operations and staff qualifications, productivity, and job satisfaction. In developing individual goals and objectives, inputs should be solicited from senior audit management and staffers.

C13.4.3.2. A detailed action plan should be prepared for each goal and objective with estimated completion dates. The status of each action plan should be tracked and adjusted as necessary. Responsibility for implementation of action plans should be assigned and incorporated in applicable employee performance appraisal documents. The goals and objectives should be reviewed and updated on an annual basis, as appropriate.

## C13.5. POLICIES AND PROCEDURES

### C13.5.1. General

C13.5.1.1. The head of the DoD internal audit organization shall provide written policies and procedures to guide the audit staff. DoD auditing standards and policies, as well as DoD/Military Department regulations, shall be implemented in organizational directives or regulations.

C13.5.1.2. An auditor's handbook or manual should be prepared covering the policies, procedures, techniques, and methodologies to be followed by the staff in planning, performing, and reporting audit activities. The principal value of an auditor's handbook or manual is threefold:

C13.5.1.2.1. It serves as a ready reference for the staff to use in performing audits.

C13.5.1.2.2. It helps the audit staff make decisions regarding a broad array of judgmental factors encountered in every audit.

C13.5.1.2.3. It serves as a quality control device.

C13.5.1.3. Procedures for supervisory auditors should be developed to cover their specific responsibilities in planning and managing individual audit projects.

### C13.5.2. Assessing Accomplishments

C13.5.2.1. In order to evaluate organizational performance, each audit organization should have a database system(s) that provides, at a minimum, for comparing actual and planned performance on individual major audit projects (single installation-level audits may be excluded), measuring audit resources devoted to various functional areas, tracking direct and indirect audit time and/or cost, and accumulating monetary and other benefits resulting from audits.

C13.5.2.2. The data generated by these data systems should be analyzed periodically to identify deviations from planned performance, assess deviations from predetermined standards or goals, and identify performance trends. The information gathered from such evaluations should be used to develop plans to improve the efficiency and effectiveness of audit operations. Such improvements, for example, might result in an improved planning process, identification of more cost-effective approaches to audits, reorganization of headquarters or field operations, and justification for additional resources.

### C13.5.3. Productivity Programs

C13.5.3.1. The head of each DoD internal audit organization shall establish and implement a Productivity Improvement Program in support of Executive Order 12552 (reference (qq)). The goal of the program should be to improve the quality, timeliness, and efficiency of the audit organization.

C13.5.3.2. Each DoD internal audit organization should establish effectiveness and efficiency measures and goals commensurate with the complexity of its mission and functions, budget, and standards for quality and timeliness.

## C13.6. PLANNING

C13.6.1. An organizational planning process should be provided to ensure that the audit organization keeps pace with changes in DoD/Military Department programs, emerging technologies, and other external developments. Organizational planning involves the estimating or anticipating of the type of organizational structure, manpower, facilities, training needs, audit techniques, etc., needed to direct an effective audit function over a long period of time.

C13.6.2. Organizational planning requires that senior audit management officials obtain sufficient information from external sources to anticipate changing conditions

and develop long-term strategies. This may be done by participating in professional organizations and state-of-the-art conferences, sponsoring research or testing of new audit techniques or methodologies, and meeting with senior DoD, Military Department, or other Federal Agency officials.

#### C13.7. INTERNAL AUDIT ORGANIZATION QUALIFICATIONS

The DoD internal audit organization shall possess or obtain the knowledge, skills, and disciplines needed to carry out its audit responsibilities. Formal documentation should exist covering the analysis of skill needs and the identification of shortfalls in numbers of personnel by skill level. A plan should be developed to address any shortfalls through the recruitment of personnel, training programs, and/or use of personnel external to the audit organization.

## C14. CHAPTER 14

### QUALITY ASSURANCE PROGRAMS

#### C14.1. PURPOSE

This chapter prescribes policy for establishment of quality assurance programs in conformance with applicable Government Auditing Standards (reference (c)) and DoD Internal Auditing Standards, and describes the essential elements of such programs in DoD internal audit organizations.

#### C14.2. APPLICABILITY

This chapter applies to all DoD internal audit, internal review, and nonappropriated fund audit organizations (hereafter referred to collectively as "DoD internal audit organizations").

#### C14.3. RELATED GOVERNMENT AUDITING STANDARDS

C14.3.1. The Government Auditing Standards (reference (c)) prescribe general standards for conducting financial and performance audits. The fourth general standard relates to the presence of quality controls. The standard states that "Audit organizations conducting Government audits should have an appropriate internal quality control system in place and participate in an external quality control review program."

C14.3.2. The second field work standard for Government performance audits is, "Staff are to be properly supervised." This standard places responsibility on the auditor and audit organization for seeing that staff who are involved in accomplishing the objectives of the audit receive appropriate guidance and supervision to ensure that the audit work is properly conducted, the audit objectives are accomplished, and the staff are provided effective on-the-job training. External consultants and specialists also should be given appropriate guidance.

#### C14.4. POLICY

C14.4.1. To maintain the confidence and trust of DoD management, the Congress, and private citizens, DoD auditors shall provide objective, reliable, timely, and professional audit products. The value of the services provided by DoD auditors is

related directly to the quality of the audit work performed. In addition, the professionalism of DoD auditors is critical to acceptance and use of their work by DoD managers in improving and strengthening DoD programs and operations.

C14.4.2. Each DoD internal audit organization shall establish and maintain a viable and effective quality assurance program that provides reasonable assurance to parties inside and outside the Department of Defense that DoD auditors comply with applicable auditing standards and DoD audit policies, and that work is carried out economically, efficiently, and effectively. Each organization's quality assurance program shall incorporate the elements of supervision, internal quality control reviews, and external quality control reviews as described in the following sections of this chapter.

C14.4.3. The DoD internal audit organizations shall establish a supervisory process that ensures audits are planned and completed in accordance with applicable auditing standards, DoD auditing policies, and internal organization policies and procedures. The supervision process shall ensure that audit work is supported by clear, demonstrable, and objective evidence that is documented in audit working papers.

C14.4.4. The internal quality control system established by the audit organization should provide reasonable assurance that it has:

C14.4.4.1. Established and is following adequate audit policies and procedures.

C14.4.4.2. Adopted and is following applicable auditing standards.

C14.4.5. Organizations conducting Government audits should have an external quality control review at least once every 3 years by an organization not affiliated with the organization being reviewed. The external quality control review program should determine that:

C14.4.5.1. The organization's internal quality control system is in place and operating effectively.

C14.4.5.2. Established policies, procedures, and applicable auditing standards are being followed in its audit work.

## C14.5. SUPERVISION

Supervision is the first and most important step in a quality assurance program and it is a continuing process on all audit assignments within an audit organization. Responsibility for all audits remains with the head of the audit organization. However, the head of the

audit organization may delegate audit tasks to audit managers or supervisors, who in turn may delegate these tasks to audit teams. Delegation requires that audit managers at all levels establish methods that ensure audit assignments are planned, controlled, and directed properly. The degree of control may vary among audit organizations and audit assignments.

C14.5.1. Supervision is the most effective way to ensure audit quality. To supervise effectively, supervisors should be involved in every phase of the audit, from planning to the final report. Supervisors should make sure auditors understand, without ambiguity, the nature, scope, content, and timing of the work assigned to them and the expected end product. Supervisors should review progress periodically on audit projects to determine whether jobs are on schedule and executed in accordance with plans. Supervision should be sufficient to make any required mid-course corrections without disrupting the audit assignment.

C14.5.2. The actual amount of supervision required may vary based on availability of resources, complexity and sensitivity of audit work, and staff experience. However, supervision should be exercised at each level of the organization and for each level of task responsibility. Most audit assignments include the following phases: coordination, planning, survey, audit performance or application, and reporting. During these phases, supervisors should concentrate on the following:

C14.5.2.1. Coordination. To ensure quality audit performance and efficient use of resources, supervisors should be aware of other audit projects within the audit organization and in other Federal audit activities. Supervisors should maintain open lines of communication with the headquarters of the audit organization and with other field offices in the organization. The objective of open communication is to reduce the overlap of audit projects and enhance the quality of audits. Supervisors should share ideas on audit design, audit planning, audit survey scope and techniques, audit objectives, audit approaches, training needs and audit workload.

C14.5.2.2. Planning. Supervisors should establish the overall direction of the audit effort determine the best use of available resources; establish goals and objectives for audits that make sure programs, activities, and segments of Agency operations are covered adequately; and coordinate audit efforts with review efforts of other activities such as the military inspector general offices. Chapter 5 and Chapter 8 of this Manual prescribe additional guidance relating to planning for both individual audit assignments and the development of an annual audit program.

C14.5.2.3. Survey. Supervisors should approve the survey approach, estimate time required for the survey, and establish milestones for review of survey results.

C14.5.2.4. Program. After reviewing survey results, supervisors should modify overall objectives if necessary, identify the steps or segments requiring further audit work, and determine any program modifications needed to fulfill the audit objectives. Supervisors should also estimate the time required for the detailed audit review and establish milestones for review of the program development.

C14.5.2.5. Audit Performance

C14.5.2.5.1. Project Reviews. Supervisors should review audit projects periodically to make sure they meet applicable auditing standards and DoD internal audit policies. Supervisors should use onsite visits to assist in project management, solve specific problems during audit application, provide technical assistance, counsel and train audit team members, and review overall management of the audit.

C14.5.2.5.2. Reviews of Working Papers. Supervisory reviews of audit working papers are essential to ensure reports are supported with clear, demonstrable, and objective evidence. These reviews can be tailored to the particular situation and individual, but should provide enough information to supervise projects properly and to evaluate staff performance. Problems discovered during working paper reviews should be discussed and resolved promptly; working papers should be revised to preclude any misinterpretation or unsupported conclusions. Working papers should be reviewed periodically throughout the audit. All supervisory reviews of working papers should be documented and retained. Supervisory reviews of audit work and the report should be timely and determine whether:

C14.5.2.5.2.1. Conformance with audit standards is obtained.

C14.5.2.5.2.2. The audit programs are followed unless deviation is justified and authorized.

C14.5.2.5.2.3. The audit work has been conducted with due professional care.

C14.5.2.5.2.4. The working papers adequately support findings and conclusions and provide sufficient data to prepare a meaningful report.

C14.5.2.5.2.5. The audit objectives are met.

Chapter 18 of this Manual prescribes additional guidance on the review of audit working papers.

C14.5.2.6. Reporting. Auditors should prepare a report outline and discuss preparation of the initial draft report with their supervisor. First-level supervisors should review the draft audit report, and the second-level supervisors should review comments and the results of any discussions with management concerning the audit results. Based on these reviews, the second-level supervisor finalizes the audit report, making sure the audit report complies with the applicable auditing standards and DoD audit policies on reporting. Chapter 12 of this Manual prescribes additional guidance on reporting audit results.

## C14.6. INTERNAL QUALITY CONTROL REVIEWS

Internal quality control reviews, the second step in an effective quality assurance program, are periodic reviews of selected audits, organizational functions, or internal processes, conducted by an independent element within the audit organization. During the internal quality control review, an in-house team evaluates the adequacy and effectiveness of the audit organization's policies and procedures, and determines whether the audit work meets applicable auditing standards and DoD auditing policies. Essential elements of an effective internal quality control review program include: formal policies and operating procedures; workload identification and planning; assignment and training of permanent staff; and adherence to Government Auditing Standards (reference (c)) and DoD Internal Auditing Standards for performing reviews and reporting results.

C14.6.1. 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 its appropriate cost-benefit considerations. Thus, the systems established by individual organizations, as well as the extent of their documentation, will vary.

C14.6.2. Each DoD internal audit organization shall develop and issue formal policies establishing an internal quality control review program consistent with this chapter. Formal policies should prescribe responsibilities and procedures for planning and performing internal quality control reviews and reporting the results of reviews.

C14.6.3. Each major element of the audit organization should receive an internal quality control review at least once every 3 years. Major elements include divisions, regions, large field offices, or residencies. As an alternative, selected functional areas may be reviewed on an across-the-board or Agency-wide basis, provided there is representation given to the various elements within the organization. Internal quality

control reviews should emphasize matters relating to the accomplishment of audit projects; that is, planning, survey, and field work, including preparation of working papers and reporting.

C14.6.3.1. Annual and long-range plans should be developed to ensure the 3-year Internal quality control review requirement is met. Once experience shows that an effective quality standard has been achieved by the major elements of the audit organization, consideration can be given to reducing the 3-year review frequency. Subjects for internal quality control reviews should be solicited from all levels of the audit organization. Internal quality control review plans should be published annually, and sufficient resources should be allocated to accomplish the annual plan. The long-range plan should include audit issues/standards to be reviewed objectives, timeframes and resource requirements.

C14.6.3.2. Compliance with Government Auditing Standards (reference (c)) is the basis for how audit work is judged by external quality control review team. Accordingly, the Government Auditing Standards, DoD Internal Auditing Standards, and DoD auditing policies should form the baseline for planning internal quality control reviews. To facilitate the planning process and the setting of priorities, an inventory of internal quality control review subjects should be developed and maintained. For example, the inventory should include audit planning, audit performance, audit reporting and follow up, as well as issues raised in external quality control reviews.

C14.6.4. A permanent staff should be assigned to fulfill the internal quality control review requirement, and the organizational placement of the staff should provide for sufficient independence. Assignment of permanent staff enhances individual expertise and provides for added program continuity.

C14.6.4.1. The permanent staff, which may be augmented as needed, should be highly qualified, experienced auditors. These qualifications are essential for ensuring the credibility of the internal quality control review program and for enhancing the level of professionalism in the audit organization.

C14.6.4.2. Formal or on-the-job training may be needed for newly assigned members to the internal quality control review program. At a minimum, gaining an appreciation and exchanging information on approaches used by other audit organizations in accomplishing their internal quality control review program would be beneficial.

C14.6.5. Internal quality control reviews, like an audit, should be performed in accordance with Government Auditing Standards (reference (c)), DoD Internal Auditing Standards, and DoD auditing policies.

C14.6.5.1. Review objectives should be established, and conditions found during the review should be documented and retained in working papers.

C14.6.5.2. A formal written report should be prepared and issued on the results of each internal quality control review. The report should specifically address each review objective. The report should also recommend corrective actions, when appropriate; include comments from the organizational elements reviewed, followed by an evaluation of the cements; and establish target dates for implementation. Recommendations should be tracked until fully implemented or otherwise satisfactorily resolved. When significant deficiencies are identified, a follow-up review to determine that adequate corrective actions were taken may be, appropriate.

C14.6.5.3. All working papers and reports of internal quality control reviews should be retained for 3 years for use by external quality control review teams.

#### C14.7. EXTERNAL QUALITY CONTROL REVIEWS

Within the Department of Defense, external quality control reviews of internal audit organizations will not be conducted by the office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, with the assistance of representatives from the DoD internal audit organizations as needed. The DoD central internal audit organizations, using guidelines published by OIG, DoD, are responsible for external quality control reviews of the internal review and nonappropriated fund audit activities for which they have audit cognizance. Generally, OIG, DoD, will limit its external quality control reviews of internal review and nonappropriated fund audit activities to assessing how well the central internal audit organizations carried out their external reviews. The General Accounting Office conducts similar quality control reviews of DoD internal audit organizations.

C14.7.1. The objectives of the external quality control reviews are to ensure DoD internal audit organizations adhere to Government Auditing Standards (reference (c)), DoD Internal Auditing Standards, and DoD auditing policies and operate in an economical, efficient, and effective manner.

C14.7.2. External quality control reviews should be conducted in accordance with applicable auditing standards and quality control review guidelines. The team leader of the review should observe the requirement for holding entrance and exit conferences and for discussing periodically the progress of the review with appropriate managers in the audit organization.

C14.7.3. External quality control review team members should be selected based on the requirements of a particular review. Functional experts from inside and outside the Department of Defense may augment the quality control teams in certain specialized or technical areas. The staffers nominated for the external quality control review team should not have been associated in the past 2 years with the organization subject to review.

C14.7.4. Before starting an external quality control review, the review team should collect background information about the audit organization, including its organizational environment and governing policies and procedures. The review team is encouraged to use questionnaires to gather background data, identify related audit policies and procedures, obtain opinions of the audit staff on policies and procedures used by the audit organization, and solicit opinions of auditees regarding the relationships of the audit organization and its clients.

C14.7.5. External quality control reviews should be conducted on a recurring schedule and should normally include each audit organization at least once every 3 years. As an alternative, selected functional areas may be reviewed on an across-the-board or Agency-wide basis. As with any audit, the scope, objective, and work program of the quality control review should be tailored to meet specific situations.

C14.7.6. A formal written report should be prepared and issued on the results of each external quality control review. The report should specifically address each review objective and express an opinion, as appropriate, as to the audit organization's compliance with Government Auditing standards (reference (c)), DoD Internal Auditing Standards, and DoD auditing policies. The report should also recommend corrective actions when appropriate; include comments from the organization reviewed, followed by an evaluation of the comments; and establish target dates for implementation. Recommendations should be tracked until fully implemented or otherwise satisfactorily resolved. When significant deficiencies are identified, a follow-up review to determine that adequate corrective actions were taken may be appropriate.

C14.7.7. Working papers and reports of external quality control reviews should be retained for 3 years from the date of the final report.

C15. CHAPTER 15  
PREVENTING, DETECTING, AND REPORTING  
FRAUD AND ILLEGAL ACTS

C15.1. PURPOSE

This chapter establishes policy in auditing areas susceptible to fraud and illegal acts and in alerting auditors that such acts may have occurred. It supersedes the internal audit provisions contained in Contract Audit, Internal Audit and Criminal Investigations Joint Policy and Memorandum No. 2 (reference (rr)). The Joint Policy and Memorandum will no longer apply

C15.2. APPLICABILITY

All DoD internal audit organizations including internal review and nonappropriated fund audit activities shall comply with applicable provisions in this chapter.

C15.3. DEFINITIONS

C15.3.1. Fraud. Action that violates a fraud-related statute of the United States Code. The term includes Government theft/embezzlement, bribery, gratuities, conflicts of interest, and violations of antitrust laws, as well as fraud (e.g., false statements and false claims) in such areas as pay and allowances, procurement, contract performance, nonappropriated funds, and the Civilian Health and Medical Program of the Uniform Services. Fraud involves a misrepresentation of facts made so with knowledge and intent. Fraud is further characterized by acts of guile, deceit, concealment, or breach of confidence, which are used to gain some unfair or dishonest advantage. Fraud can also include deceit or intentional false statements in official correspondence intended to affect the decision-making process regardless of whether personal gain is involved. The purpose of the fraud may be to obtain money, property, or services; to avoid payment or loss of money, property, or services; or to secure business or personal advantage.

C15.3.2. Illegal Act. A type of noncompliance in which the source of the requirement not followed or the prohibition violated is a statute or implementing regulation. Enclosure 4 to this chapter contains information on Federal statutes and Standards of Conduct regulations that may be applicable in the auditor's examination and the fraud referral process.

C15.3.2.1. Criminal Acts. An illegal act for which incarceration, as well as other penalties, is available if the Government obtains a guilty verdict.

C15.3.2.2. Civil Acts. An illegal act for which penalties that do not include incarceration are available for a statutory violation. Penalties may include monetary payments and corrective actions.

C15.3.3. Referral. The term relates to formal (written) letters to appropriate criminal investigative organizations of suspicions of fraud and illegal acts. The purpose of such communications must be to seek consideration of the facts (as stated by the audit organization in its letter) for investigative action where warranted.

#### C15.4. POLICY

C15.4.1. The DoD internal audit organizations shall establish a fraud monitor at the headquarters level for fraud referrals and other fraud-related actions. The fraud monitor shall maintain liaison with the applicable investigative organizations regarding the status of all referrals.

C15.4.2. Internal auditors shall give special emphasis to those portions of the DoD Internal Auditing Standards (Chapter 2) relating to fraud and illegal acts.

C15.4.3. During every audit, a review and evaluation shall be made of the internal control system applicable to the organization, program, activity, or function under audit. When computer-processed data is an important and integral part of the audit and the data's reliability is crucial to accomplishing the audit objectives, the auditors need to satisfy themselves that the data is reliable.

C15.4.4. Where an auditor's work includes an assessment of compliance with laws and regulations, it shall be designed to provide reasonable assurance of detecting fraud or illegal acts that could significantly affect the audit objectives.

C15.4.5. Auditors, in exercising due professional care, shall be alert for situations or transactions that could indicate fraud or illegal acts to determine whether the acts occurred and, if so, to determine the extent to which these acts significantly affect the audit results. Where such evidence exists, the auditors shall extend audit steps and procedures to identify the effect on the entity's financial statements, operations, or programs. However, auditors should not extend audit steps to the point of jeopardizing potential investigations by law enforcement officials.

C15.4.6. When the review or the extended audit steps and procedures indicate that fraud or other criminal acts may have occurred, the auditor shall document the situation and promptly notify the appropriate DoD investigative organization as indicated by DoD Instruction 5505.2 (reference (ss)). Following notification of the investigators, the auditor shall notify the top official of the entity under audit of the situation, unless advised otherwise by investigators or it is obviously inappropriate (e.g., top official involved).

C15.4.7. The method of reporting the audit results will vary depending upon individual circumstances. Audit matters dealing with fraud or irregularities shall be covered in a separate written audit report if this would facilitate the timely issuance of an overall report on other aspects of the audit. The opinion of legal counsel should be obtained on the reporting method chosen.

C15.4.8. The DoD audit organizations shall encourage direct contact between their field personnel and personnel of the applicable criminal investigative organization concerning referrals of suspected or potential fraud disclosed during audits. The audit organization's fraud monitor must be kept apprised of referrals in order to track the status of fraud investigations resulting from audit referrals.

C15.4.9. Should the applicable criminal investigative organization decide not to investigate a fraud referral from auditors, nor refer the allegations elsewhere for investigation (in cases where the allegations are considered to be of lesser significance, for example), the audit organizations, upon notification by the criminal investigative organization, should then evaluate the matter for other disposition. Procedures for referring allegations of this type were required to be established by individual DoD Components as called for in paragraph 5.2.6. of reference (ss). Audit organizations shall make disposition of the allegation in accordance with their Component's procedures.

C15.4.10. Appropriate audit support of criminal investigations is authorized under DoD Directive 7600.2 (reference (k)), and is encouraged to the greatest extent possible within legal limitations, availability of resources, and the guidelines set forth in Enclosure 2 to this chapter. Further, DoD internal audit organizations are strongly encouraged to work with their criminal investigative counterpart organizations to exchange information situations discovered during audits where, although no fraud may be suspected, weaknesses in controls and procedures could lead to incidents of fraud.

## C15.5. FRAUD INDICATORS AND CHARACTERISTICS

C15.5.1. Fraud encompasses the entire array of illegal acts and irregularities, and is characterized by intentional deception or manipulation with adverse effects. Fraud can be perpetrated for the benefit of, or to the detriment of, the organization, Agency, or activity and can be carried out by a person or persons outside as well as inside the entity. In some instances involving civil fraud, fraud can be alleged where the negligence of an individual is so gross as to amount to implied knowledge of wrongfulness of the act.

C15.5.2. The key to prevention and detection of fraud and illegal acts is a recognition of conditions that allow these practices to go undetected. As such, the auditor has the responsibility for being aware of fraud indicators. Several sources are available for information on fraud and indicators of fraud. Some of these sources are listed in Enclosure 1 to this chapter. The following warning signals were developed by the American Institute of Certified Public Accountants to assist auditors in identifying the possible existence of fraud.

C15.5.2.1. Problems encountered in performance of an examination, such as delay situations or evasive or unreasonable responses to audit inquiries.

C15.5.2.2. Difficulty in obtaining audit evidence for unusual or unexplained entries, incomplete or missing documentation and authorizations, and alteration of documents and accounts.

C15.5.2.3. Inadequate controls over cash accounts or credit cards.

C15.5.2.4. Unexplained fluctuations in material account balances, physical inventory variances, and inventory turnover rates.

C15.5.2.5. Widely dispersed locations accompanied by highly decentralized management and inadequate reporting systems.

C15.5.2.6. Known continuing weaknesses in internal controls over access to computer equipment or electronic data entry devices.

## C15.6. PREVENTION AND DETECTION

C15.6.1. The principal mechanism for the prevention and detection of fraud and illegal acts is a strong system of accounting and administrative internal controls. Deterrence or prevention is primarily the responsibility of the management of the

organization, program, activity, or function under audit. The OMB Circular A-123 (reference (v)) states that Agency Heads are responsible for establishing and maintaining systems of internal control that conform to standards prescribed by the Comptroller General.

C15.6.2. Internal auditors are responsible for examining and evaluating the adequacy and effectiveness of management's actions in deterring or preventing fraud, including appropriate internal control systems. Auditors should assess the effectiveness of the system to safeguard resources against waste, loss, or misuse. They shall test and evaluate management's applicable fraud deterrent mechanisms and make appropriate recommendations if weaknesses exist.

C15.6.3. The internal auditor's responsibilities are further extended in the detection of fraud and illegal acts. On audit assignments, the internal auditor's responsibilities are to:

C15.6.3.1. Maintain sufficient knowledge of the characteristics of fraud, techniques used to commit fraud, and the types of fraud associated with the activities being audited. Such knowledge is necessary for the auditor to be reasonably effective in determining the adequacy of controls to limit or discourage opportunities to commit fraud or illegal acts, and in evaluating evidence that these acts might have been committed. The sources of information on fraud and fraud indicators discussed in section C15.5., above, and listed in Enclosure 1 to this chapter can reinforce the auditor's knowledge and skills. The DoD internal audit organizations should work closely with investigative organizations to develop additional information on the characteristics of fraud and fraud indicators and share it with other DoD internal audit organizations.

C15.6.3.2. Be alert for situations or transactions that could indicate fraud and illegal acts. This is especially true when performing audits of such sensitive areas as pay, procurement, cash management, property disposal, nonappropriated funds, commissaries, or inventories. In exercising due professional care, auditors should be alert to the possibilities of intentional wrongdoing, conflicts of interest, and those conditions and activities where irregularities are most likely to occur. Accordingly, internal auditors need to satisfy themselves that a system of checks and balances is in place that will disclose any irregularities and improprieties that would have a material impact on operations or financial reporting. In discussing the auditor's responsibility to detect errors and irregularities, the American Institute of Certified Public Accountants (AICPA) has stated that "... the auditor should exercise...the proper degree of professional skepticism to achieve reasonable assurance that material errors or irregularities will be detected." For additional guidance on related responsibilities, auditors should refer to AICPA Statements on Auditing Standards No. 53 ("The Auditors

Responsibility to Detect and Report Errors and Irregularities"), No. 54 ("Illegal Acts by Clients"), and No. 55 ("Consideration of the Internal Control Structure in a Financial Statement Audit").

C15.6.3.3. Where assessment of compliance with laws and regulations is required as part of the audit objectives, auditors should design audit steps and procedures to provide reasonable assurance of detecting irregularities or illegal acts that could significantly affect the audit objectives. This requires the auditor to assess, for each compliance requirement, the risk that irregularities and illegal acts could occur.

C15.6.3.4. Be alert to the opportunities for potential perpetrators to commit fraud or illegal acts. The DoD Directive 7600.2 (reference (k)) requires that each audit include an evaluation of the adequacy and effectiveness of the system of internal and administrative controls (internal controls) applicable to the organization, program, activity, or function under audit.

C15.6.3.5. Include specific audit steps designed to provide reasonable assurance of detecting fraud for those programs or functions that have a high vulnerability to fraud or a past history of fraud, or where initial audit survey has identified particular weaknesses in internal controls that could allow fraudulent acts to occur. In addition to expanding audit steps, audit managers should also consider assigning more experienced personnel and increasing the amount of audit supervision where conditions warrant.

C15.6.3.6. Where evidence exists that indicates fraud or illegal acts might have been committed, and such acts could significantly affect the audit results, internal auditors shall perform extended tests and procedures to obtain additional evidence sufficient to determine whether:

C15.6.3.6.1. The initial suspicions of fraud were true;

C15.6.3.6.2. The extent to which the acts significantly affect the audit results;

C15.6.3.6.3. Operations, programs, or functions have been adversely affected;

C15.6.3.6.4. The appropriate investigative organization should be alerted to a possible need for an investigation;

C15.6.3.6.5. Internal controls need additional strengthening; and

C15.6.3.6.6. Any further action appears necessary.

Auditors should, however, exercise due professional care and use caution so as not to extend tests to the point of jeopardizing potential investigations by legal authorities. Due care would include consulting legal counsel and the applicable investigative organizations, as appropriate, to determine the actions and procedures to follow or to avoid. If, after extending the audit steps and procedures, the internal auditors cannot confirm their suspicions of fraud, they should discuss the situation with the appropriate investigative organization to determine whether or not to pursue the situation.

C15.6.3.7. Document the situation or particular transaction when the initial review or extended audit indicates possible fraud or other criminal acts and promptly notify the appropriate DoD investigative organization in accordance with DoD Directive 7600.2 (reference (k)). Formal written notification is required for all fraud referrals and will normally have been preceded by informal discussions with investigative personnel. At the same time, the auditors shall notify the top official of the audited entity, unless that official is believed to be a party to, or implicated in, the improper acts or unless the auditors are advised to the contrary by the investigative organization.

C15.6.3.8. Complete the evaluation of the system of internal controls and the audit, if possible, so as not to interfere with or hamper any related investigation. The advice of the investigative activity should be obtained in determining how to complete the evaluation and report the results in a manner that will not compromise an investigation. The auditors should not accuse the affected parties of suspected fraud or discuss the potential fraud with the subject in any manner that would be prejudicial to an investigation. Legal counsel and the advice of investigators should also be sought on how to discuss the situation with the affected parties and obtain confirmation of the facts.

C15.6.4. Internal auditors cannot be expected to have knowledge equivalent to an investigator whose responsibility is detecting fraud and other illegal acts. Also, an audit made in conformance with the provisions outlined in this chapter will not necessarily guarantee the discovery of all fraud or illegal acts that might have been committed. However, if the audit was made in accordance with this chapter, the auditor will have fulfilled the professional responsibilities expected.

## C15.7. REPORTING

C15.7.1. The method of reporting audit results to appropriate management officials shall be guided by the situation and individual circumstances surrounding any suspected or potential fraud disclosed through audit. A separate audit report on the evaluation of the internal controls related to the matter referred to the investigative agency shall be used, if necessary, to avoid delays in issuing the overall audit report. This also permits release of the overall report to the public without compromising an investigation or legal proceeding.

C15.7.2. A separate report is not necessary when the matter can be effectively discussed in the regular report of audit, and no undue delay will result from holding the audit report open until the fraud referral has been resolved. The auditors shall not release to the public reports containing information on suspected fraudulent acts, or reports with references that such acts were emitted from reports, without first consulting with appropriate legal counsel, since this release could interfere with legal processes, subject the implicated individuals to undue publicity, or subject the auditor to potential legal action.

## C15.8. TRAINING

C15.8.1. The problem of fraud in the Department of Defense has received widespread attention in recent years, and as the budget increases, the potential and the attractiveness of committing fraud also increases. Therefore, it is incumbent upon internal auditors to maintain and even enhance their detection abilities and skills in order to more effectively address these problems.

C15.8.2. The DoD internal audit organizations shall provide training for their audit staffs consistent with DoD auditing standards on professional proficiency and continuing education. Specific fraud-related training should focus on detecting, preventing, and reporting fraud and illegal acts. The key to any successful training program is the recognition of the indicators of fraud. Chapter 4 of this Manual suggests guidelines for training audit staffs in areas of fraud awareness and working with investigators.

## C15.9. DoD HOTLINE

C15.9.1. Under DoD Directive 7050.1 (reference (tt)), all substantive allegations of fraud and mismanagement received by the DoD Hotline normally will be examined by qualified auditors, inspectors, or investigators. Accordingly, each DoD internal audit organization shall maintain procedures and controls to ensure that due professional care

and organizational independence are observed, and that impartial and objective examinations are made for all referred Hotline allegations.

C15.9.2. Each internal audit organization shall control, process, and examine promptly all allegations received and shall expedite processing those Hotline allegations that are time-sensitive. Necessary controls shall be maintained to protect, to the maximum extent, the identity of all DoD Hotline users who request anonymity.

C15.9.3. Audit working papers and files on Hotline reviews shall generally be retained for at least 3 years after an audit is completed before being disposed of under applicable DoD or Agency regulations. Reports shall be submitted in accordance with paragraph 6.3. of DoD Directive 7050.1 (reference (tt)).

#### C15.10. RELATIONS WITH DoD CRIMINAL INVESTIGATIVE ORGANIZATIONS

C15.10.1. Close cooperation between auditors and investigators is critical to successful investigation and prosecution of fraud. Once the auditor finds indications of potential fraud, the organizational fraud monitor shall be notified and contact should be made with representatives of the appropriate DoD investigative organization.

C15.10.2. As discussed in paragraph C15.6.3.6., above, after developing sufficient fraud indicators, the auditor shall formally refer the matter to the appropriate investigative organization. The DoD audit organization should subsequently follow up to keep track of the disposition of the fraud referral. Under the provisions of Joint Policy Memorandum Number 2 (reference (rr)), DoD criminal investigative organizations are required to assist the audit organizations by providing periodic status on referrals made from auditors.

C15.10.3. The DoD audit organizations should respond timely when investigative organizations request audit assistance in performing formal investigations. Related audit working papers should be provided to the investigative organization if required. Guidelines for audit support of fraud investigations are outlined in Enclosure 2 to this chapter.

C15.10.4. Most DoD investigative organizations periodically conduct "crime prevention surveys" to identify administrative, physical, or internal control weaknesses that allow the commission of fraud or illegal acts. The DoD audit organizations should request that they be placed on distribution for such survey reports, and consider the results of the reports in scheduling audits.

C15.10.5. Internal audit organizations are urged to participate with investigative organizations in joint reviews of programs and operations highly susceptible to fraudulent activities. At a minimum, auditors should contact their investigative counterparts in the survey or planning stage of an audit to discuss the susceptibility of a particular area to fraud and ascertain whether there are any ongoing or completed investigations of the area that would be of interest to the auditor.

C15.10.6. Internal audit organizations are encouraged to assist criminal investigative organizations by providing information they may come across during their audits (information referrals) that could alert investigators to weaknesses in internal controls and to procedures that could create conditions conducive to fraud, even though no fraud may actually be suspected. One technique for doing this is to highlight findings from audit reports and provide these under a cover memorandum to the investigative organization. This suggested procedure is considered to be a more effective way of actually bringing specific weaknesses to the attention of investigators than by merely relying on the routine distribution of audit reports to the investigative organizations.

#### C15.11. ADDITIONAL GUIDANCE

The General Accounting Office (GAO) has published a pamphlet, dated December 1989, entitled "Assessing Compliance with Applicable Laws and Regulations," (reference (uu)) that provides additional guidelines for implementing Government Audit standards (reference (c)) related to fraud and illegal acts. The guide was prepared to help the GAO staff implement the strengthened requirement for detecting noncompliance. The provisions of the guide are equally applicable to the work of DoD internal auditors in evaluating noncompliance and designing audit steps to detect instances of fraud, abuse, and illegal acts.

C15.E1. ENCLOSURE 1 OF CHAPTER 15  
SELECTED SOURCES OF INFORMATION  
ON FRAUD AND FRAUD INDICATORS

C15.E1.1.1. "Indicators of Fraud in Department of Defense Procurement," IG, DoD 4075.1-H, Office of the Inspector General, DoD, June 1987.

C15.E1.1.2. "Fraud Awareness Letter," Office of the Inspector General, DoD, published quarterly.

C15.E1.1.3. "Common Violations of the United States Code in Economic Crime Investigations," U.S. Criminal Investigation Command, November 15, 1983.

C15.E1.1.4. "Manual for Fraud Investigations (NIS-6)," Naval Investigative Service, October 1983.

C15.E1.1.5. "Fraud Indicators Handbook," U.S. Marine Corps, June 27, 1983.

C15.E1.1.6. "Indicators Handbook," Air Force Audit, Inspection and Investigative Council, June 4, 1986.

C15.E1.1.7. "Crime Prevention Survey Technical Guidelines Handbook," Defense Logistics Agency, October 1983.

C15.E1.1.8. "Fraud Indications in AAFES Operations," Headquarters, Army, Air Force Exchange Service, Safety and Security Division, 1981.

C15.E1.1.9. "Developing Fraud Awareness in Management," Office of the Inspector General, Services Administration, December 1980.

C15.E1.1.10. "Codification of Statements on Auditing Standards," American Institute of Certified Public Accountants, 1989.

C15.E1.1.11. "Handbook on Labor Fraud Indicators," Office of the Inspector General, DoD, August 1985.

C15.E1.1.12. "Handbook on Scenarios of Defective Pricing Fraud," Office of the Inspector General, DoD, December 1986.

C15.E1.1.13. "Handbook on Fraud Indicators: Material," Office of the Inspector General, DoD, July 1986.

C15.E1.1.14. "Unauthorized Quality Assurance Practices by Contractors," IGDH 4000.50, Office of the Inspector General, DoD, May 1988.

C15.E1.1.15. "Criminal Defective Pricing and the Truth in Negotiations Act," IGDPH 4200.50, Office of the Inspector General, DoD, March 1988.

C15.E1.1.16. "Compendium of Publications on Fraud, Waste, and Abuse Indicators," President's Council on Integrity and Efficiency, June 30, 1988.

C15.E1.1.17. "Fraud Awareness Concepts for Department of Defense Quality Assurance Personnel," Office of the Inspector General, DoD, May 1, 1985.

C15.E1.1.18. "Role of the Contract Auditor in Criminal Investigations," IGDH 7600.2, Office of the Inspector General, DoD, January 1989.

C15.E1.1.19. "Fraud-Related Audit/Investigative Publications," President's Council on Integrity and Efficiency, April 7, 1989.

C15.E1.1.20. "Directory of Internal Audit Programs," IGDD 7000.1, Office of the Inspector General, DoD, June 1989.

C15.E1.1.21. "Assessing Compliance with Applicable Laws and Regulations," General Accounting Office Pamphlet, December 1989.

C15.E2. ENCLOSURE 2 OF CHAPTER 15  
GUIDELINES FOR AUDIT SUPPORT OF FRAUD INVESTIGATIONS

C15.E2.1. INTRODUCTION

C15.E2.1.1. The DoD criminal investigative organizations frequently request support from DoD audit Organizations, Audit support to criminal investigations as authorized by paragraph 6.6.1. of DoD Directive 7600.2 (reference (k)), and encouraged by the provisions of this chapter, furthers significant DoD interests. Such support facilitates the identification of information and evidence needed for the effective accomplishment and coordination of criminal, civil, administrative, and contractual remedies. Audit support may include the provision of audit advice; the transmission of results or information obtained during separate, cooperative, or coordinated audit activity initiated by the audit organization; or on occasion, the assignment of auditors to a team investigating a suspected irregularity.

C15.E2.1.2. From time to time questions have arisen concerning various aspects of the relationship created by an auditor's cooperation/coordination with, or assignment to, an investigative team. The purpose of this enclosure is to provide general guidelines regarding the most frequently encountered issues concerning audit support of investigations and, in particular, to address the issues that arise as a result of an auditor's assignment to an investigative team. Additional guidelines are contained in IG, DoD, Handbook IGDH 7600.2 (reference (vv)), that may be useful in those instances where the internal auditor is involved with examining contractor records and fraud is suspected.

C15.E2.2. REQUESTS FOR AUDIT SUPPORT

C15.E2.2.1. The DoD audit organizations should require all requests for audit support from a criminal investigative agency to be in writing. When the request stems from a prior referral made by the audit organization, the request should be directed to the same organization initiating the fraud referral for which the investigation is being undertaken. When no fraud referral was involved in initiating the investigation, the request for audit support should be directed to the DoD audit organization that has primary audit cognizance, under DoD Directive 7600.2 (reference (k)), for the organization, activity, contract, or contractor under investigation. The DoD internal audit organizations, in consultation with the investigative organization, should formulate a list of the audit tasks needed to support the investigation.

C15.E2.2.2. The list of audit tasks should be updated and amended from time to time depending on investigative developments, or as the audit organization deems necessary to properly fulfill its mission or functions.

C15.E2.2.3. When a DoD audit organization elects to conduct an audit after a request for support by a DoD criminal investigative organization, steps to accomplish the requested tasks should be included in the audit program, and the audit should be conducted in cooperation with the requesting organization. A final decision on how the audit results will be reported rests with the audit organization, although it should defer to any request to withhold reporting if it would interfere with the investigative/judicial process.

### C15.E2.3. SELECTION AND ASSIGNMENT OF AUDIT PERSONNEL TO INVESTIGATIVE TEAMS

C15.E2.3.1. Occasions will arise when it will become necessary to assign an auditor to act as a member of an investigative team. Selection of an auditor in this situation is a matter for determination by the respective audit organization. Audit officials making the selection should take into account such factors as a specific name request by the investigative or prosecutive organization; future anticipated assignments of the potential selectee(s); special skills or work experience that may be required as a member of the investigative team; professional credentials of the possible selectee(s) (Certified Public Accountant, Certified Internal Auditor, Certified Information Systems Auditor, Certified Fraud Examiner, etc.); and the desires of potential selectees to serve on the investigative effort.

C15.E2.3.2. Any disagreements between the audit and investigative organizations regarding the need for audit support or which auditors will be assigned to an investigative team shall be referred to the head of the internal audit activity. Every effort shall be made to find a mutually acceptable solution without compromising required audit independence. If such a solution cannot be found, the matter should be elevated through the chain of command to the IG, DoD, for a decision. Where the disagreement exists between an internal review element and an investigative activity of the same Component, the matter need not be referred to the IG, DoD, but should be resolved within the Component. Generally, requests for audit support should be handled by the audit organization of the Component requesting the assistance.

#### C15.E2.4. ROLE OF THE AUDITOR ON THE INVESTIGATIVE TEAM

C15.E2.4.1. The auditor shall not perform clerical or other nonprofessional services on behalf of the investigators. The investigative organization has the responsibility for arranging for adequate clerical resources. Audit resources should be conserved whenever possible. The auditor should request clerical support when certain procedures can be organized and performed by non-auditors under the general supervision of the auditor. An example would be the examination of a large volume of documents for indications of erasures, whiteouts, or other alterations.

C15.E2.4.2. The auditor shall not undertake duties that are traditionally the role of the criminal investigator.

C15.E2.4.3. To the extent that information obtained by auditors is not a matter occurring before a grand jury, and thus covered by Rule 6(e) of the Federal Rules of Criminal Procedure on grand jury secrecy, the information may be shared for both audit and investigation purposes. (Section C15.E2.8. contains additional guidance on grand jury proceedings.)

#### C15.E2.5. HANDLING DOCUMENTARY EVIDENCE

C15.E2.5.1. The DoD audit organizations, in the performance of their official responsibilities, are likely to accumulate audit working papers that would be of use to DoD criminal investigative organizations. Such working papers should be made available for inspection and copying by the investigative organization upon request. Working papers generated as part of an investigative assist should normally be turned over to the investigative team.

C15.E2.5.2. The DoD audit organizations may occasionally obtain, in connection with their official duties, custody and control of original documents, including contractor records, that reflect indicators of fraud or other unlawful activity. When an audit organization becomes aware of potential fraud or other unlawful activity, it should immediately notify the applicable criminal investigative agency in order that appropriate measures can be taken for the Government to maintain custody and control of the documents that may be needed as evidence in subsequent criminal proceedings.

#### C15.E2.6. NOTICE TO AN AUDITEE AND RESPONSE TO INQUIRIES

C15.E2.6.1. The decision on whether to inform an auditee that an audit is being conducted in connection or coordination with a criminal investigation is the responsibility of the cognizant investigative agency in consultation with the Department of Justice prosecutor, as necessary.

C15.E2.6.2. Auditors who are assigned to a criminal investigative team will not, in any way, cover up the fact that they are working with a criminal investigative effort if they are asked specifically what they are doing.

#### C15.E2.7. OBTAINING NECESSARY RECORDS

C15.E2.7.1. Records and information needed to conduct an audit in support of an investigation can be obtained by various means including, but not limited to, the access-to-records clause of a contract, voluntary disclosure by the auditee, Inspector General subpoena (in the case of non-Federal records), search warrant, and grand jury subpoena.

C15.E2.7.2. An auditor assigned to an investigation will not use his position to gain access to information or documents unless that information would normally be available to the audit organization in performing its mission. If the investigation requires documents that are not available under that audit organization's existing authority, those documents will be obtained through other authorities.

#### C15.E2.8. GRAND JURY INVESTIGATIONS

C15.E2.8.1. Rule 6(e) of the Federal Rules of Criminal Procedure requires matters occurring before a grand jury to be kept secret. An auditor involved in an investigation of this type must obtain, and act in accordance with, guidance from the cognizant Assistant United States Attorney or his designee in addition to the minimum guidance provided herein.

C15.E2.8.2. The following criteria should be followed to prevent even the appearance that matters occurring before a grand jury may have been improperly disclosed to support DoD audit functions:

C15.E2.8.2.1. An auditor while assigned to a criminal investigation being pursued under grand jury auspices will not be involved in any other audit that in any manner relates to the matter under investigation. This precept should be kept in mind when selecting an auditor to serve on such an investigative team.

C15.E2.8.2.2. An audit supervisor should not continue to exercise normal audit responsibilities for a contractor or entity when that audit supervisor is designated as a member of a grand jury investigative team examining matters related to the same contractor or entity. The audit supervisor will not resume audit responsibility for the contractor or entity until completion of the criminal investigation and all related criminal prosecutions brought by the United States Government.

C15.E2.8.2.3. Audit organizations should, when possible, use auditors as witnesses rather than having them made agents of the grand jury. By carefully structuring the role of an auditor in this regard, it may be possible to limit adverse impact of grand jury secrecy on the auditor's normal duties and responsibilities.

### C15.E3. ENCLOSURE 3 OF CHAPTER 15

#### GUIDELINES FOR COORDINATION AND FEEDBACK ON FRAUD REFERRALS

##### C15.E3.1. INTRODUCTION

Coordination between DoD audit and criminal investigative organizations is necessary to carry out effectively their responsibilities for DoD programs. Adherence to the procedures and guidelines provided in this enclosure will enable the audit organizations to plan better for audit resources that may be needed in pursuing issues raised in referrals and in providing support for, or working in connection with, DoD criminal investigative organizations. Feedback obtained as part of the coordination process will also enable the audit organizations to more effectively evaluate and improve their future referrals. The enclosure also provides guidelines for audit organizations to follow in continuing audit activity while an investigation is pending.

##### C15.E3.2. PROCEDURES

C15.E3.2.1. The DoD audit organizations shall:

C15.E3.2.1.1. Encourage dialogue between audit and investigative field personnel regarding the need for and content of referrals for suspected or potential fraud.

C15.E3.2.1.2. Ensure that auditors performing contract audits will not make reference to or discuss with the contractor the fact that a fraud referral has been made. Further, no attempt will be made by the auditors to resolve with the contractor their suspicions that possible fraud has occurred. Discussions will be limited to the auditor's judgments and conclusions on matters other than fraud, and to the underlying facts that support those judgments and conclusions.

C15.E3.2.1.3. Ensure that internal auditors follow restrictions outlined in paragraph C15.6.3.7. of this chapter on notifying officials of the entity under audit of suspected fraud where the officials may be a party to or implicated in the fraud.

C15.E3.2.1.4. Ensure that after making a referral of suspected fraud or after notification of the initiation of an investigation, no actions are taken that would compromise the investigation. The audit scope may, after consultation with the investigative organization, be expanded to determine the impact of the suspected fraud or other unlawful activity on the audit objectives. Audit scope, however, shall not be

expanded for the sole purpose of gathering additional information (after a referral is made) to support an investigation into suspected fraud or other unlawful conduct. Audit activities outside the area of investigative interest can continue unless a request from the investigative organization recommends a deferral for investigative reasons. If the auditor believes the requested deferral will result in financial harm to the Government or will unnecessarily impede the audit mission, the matter shall be elevated for management resolution between the respective organizations.

C15.E3.2.1.5. Ensure that when an audit report is issued for any audit in which there has been a related referral to a criminal investigative organization, the audit report includes or is accompanied (under separate transmittal memorandum) by a statement of cautionary language regarding the existence of the referral or an investigation resulting from the referral. Legal counsel should be contacted for advice on reporting where there are any statements contemplated with regard to fraud, illegal acts, or pending/ongoing investigations.

C15.E3.2.1.6. Ensure coordinated action between the audit organization's fraud monitor and appropriate field personnel. The field personnel will ensure that the organizational fraud monitor is kept apprised of all referrals. Field audit personnel will also provide the designated fraud monitor with copies of status information received from applicable investigative organizations on matters previously referred to investigators.

C15.E3.2.1.7. Establish procedures for making referrals that assign a unique identifying number to each referral and enable the referral to be tracked through an automated system.

C15.E3.2.1.8. Assess the information received regarding investigations conducted based on audit referrals in order to identify lessons learned, and use that information to develop more effective audit techniques and tests that will help disclose the existence of similar situations in other audits.

C15.E4. ENCLOSURE 4 OF CHAPTER 15

DoD DIRECTIVES AND FEDERAL STATUTES  
GENERALLY APPLICABLE TO CRIMINAL REFERRALS AND  
STANDARDS OF CONDUCT REFERRALS

Presented below is a brief outline of DoD Directives and Federal statutes generally applicable to criminal referrals or Standards of Conduct referrals. Auditors should obtain legal counsel when ever questions exist on the applicability or interpretation of laws or implementing regulations.

C15.E4.1. DoD DIRECTIVES:

DoD Directive 5500.7, "Standards of Conduct," May 6, 1987, prescribes conduct required of all DoD personnel regardless of assignment. It establishes criteria and procedures for reports required of certain former and retired military officers and former DoD civilian officers and employees who are presently employed by defense contractors, and former officers and employees of defense contractors presently employed by the Department of Defense.

C15.E4.2. FEDERAL STATUTES:

C15.E4.2.1. Sherman Antitrust Act, 15 U.S.C. 1. This Act prohibits competitors from entering into any agreement to restrain trade in interstate commerce, including price fixing, bid rigging, and bid rotations schemes.

C15.E4.2.2. Bribery, Graft, and Conflicts of Interest, Generally 18 U.S.C. 201-209. These statutes prohibit a broad range of activities that can be generally described as corruption. Such activities include giving or receiving a bribe or gratuity, as well as engaging in a conflict of interest.

C15.E4.2.2.1. Bribery includes giving a Government employee something of value for the purpose of influencing the performance of that employee's duty.

C15.E4.2.2.2. Gratuities include giving a Government employee something of value because of the employee's official position. There is no requirement for the Government to prove that the gratuity was given for the purpose of influencing any official act.

C15.E4.2.2.3. Conflicts of interests include those situations where a Government employee engages in activities that create a conflict between the employee's personal interests and his or her duty to protect and serve the interests of the Government.

C15.E4.2.3. Voiding Contracts, 18 U.S.C. 218. Federal Agencies have the authority to void and rescind contracts obtained through bribery, graft, or conflicts of interest.

C15.E4.2.4. Conspiracy to Defraud the Government With Respect to Claims, 18 U.S.C. 286. Whoever enters into any agreement or conspiracy to defraud the United States by obtaining the payment of any false or fraudulent claim, shall be fined not more than \$10,000 or imprisoned not more than 10 years or both.

C15.E4.2.5. False Claims, 18 U.S.C. 287. This statute makes it illegal to present or make any false, fictitious, or fraudulent claim against any Department or Agency of the United States. The crime is complete when the claim is presented. Payment of the claim is not an element of the offense and need not be proven to obtain a conviction.

C15.E4.2.6. Conspiracy, 18 U.S.C. 371. This statute prohibits any agreement between two or more persons to defraud the United States or to violate any Federal law or regulation when at least one act is taken in furtherance of the agreement.

C15.E4.2.7. Theft, Embezzlement, or Destruction of Public Money, Property, or Records, 18 U.S.C. 641. This statute prohibits intentional and unauthorized taking, destruction, or use of Government property or records. It also prohibits receiving or concealing such property or records.

C15.E4.2.8. False Statements, 18 U.S.C. 1001. This statute makes it illegal to engage in any of the three types of activity listed below in any matter within the jurisdiction of any Department or Agency of the United States.

C15.E4.2.8.1. Falsifying, concealing, or covering up a material fact by any trick, scheme, or device;

C15.E4.2.8.2 Making false, fictitious, or fraudulent statements or representations; or

C15.E4.2.8.3. Making or using any false documents or writing. Any certification in a DoD contract that contains false, fictitious, or fraudulent information may be a violation of this statute.

C15.E4.2.9. Mail Fraud, 18 U.S.C. 1341, and Wire Fraud, 18 U.S.C. 1343. These statutes make it illegal to engage in any scheme to defraud in which the mail or wire communications are used. Use of the mail or wire communications includes sending or receiving any matter through the use of these mediums.

C15.E4.2.10. Obstruction of Federal Audit, 18 U.S.C. 1516. Whoever, with intent to deceive or defraud the United States, endeavors to influence, obstruct, or impede a Federal official in the performance of official duties relating to a person receiving an excess of \$100,000, directly or indirectly from the United States, in any 1 year period under a contract or subcontract, shall be fined under that title or imprisoned not more than 5 years, or both. A Federal auditor is defined as any person employed to perform an audit or quality assurance inspection for or on behalf of the United States. This section was intended to prohibit a wide range of obstructive conduct such as destruction or fabrication of documents as well as intimidation of witnesses and contractor employees.

C15.E4.2.11. Trade Secrets Act, 18 U.S.C. 1905. This statute prohibits unauthorized release of any information relating to trade secrets or confidential business data by a Federal employee who receives such information in the course of his employment. Such information includes advance procurement information, prices, technical proposals, proprietary information, income information, etc.

C15.E4.2.12. Racketeer-Influenced and Corrupt Organizations Act, 18 U.S.C. 1961-1968. This statute was aimed at traditional organized crime activities but is applicable in situations involving fraud in Federal Agencies. "Racketeering" is defined as any number of offenses under Federal law, including those discussed above. The statute is applicable to "enterprise," including an individual, partnership, corporation, associations or other legal entity.

C15.E4.2.13. Anti-kickback Act, 41 U.S.C. 53-55. This Act makes it a crime for any person to provide, attempt to provide or offer any fee, commission, compensation, gift or gratuity to a prime contractor or any higher tier subcontractor, or an employee of one of these, for the purpose of improperly obtaining favorable treatment under a Government contract.

C15.E4.2.14. Federal Procurement Policy Act, 41 U.S.C. 423. Effective July 16, 1989, Section 27 (entitled "Procurement Integrity") of the Act prohibits certain actions by Government officials, employees, consultants and advisors, and those of competing contractors during the conduct of any Federal Agency procurement of property or services. All "procurement officials" are required to certify that they are familiar with certain provisions of the law, that they will not violate these provisions, and that they will report immediately to the contracting officer any information concerning a violation or potential violation. Administrative, civil, and criminal penalties are prescribed for violations of the Act's provisions.

C15.E4.2.15. Forfeiture of Fraud Claims, 28 U.S.C. 2514. A claim against the United States shall be forfeited to the United States by any person who corruptly practices or attempts to practice any fraud against the United States in the proof, statement, establishment, or allowance thereof. In such cases, the United States Claims' Court shall specifically find such fraud or attempt and render judgement or forfeiture.

C15.E4.2.16. False Claims Act, 31 U.S.C. 3729. A person is liable for a civil penalty of not less than \$5,000 and not more than \$10,000, plus three times the amount of damages that the Government sustains if the person knowingly presents a false or fraudulent claim for payment, or knowingly makes a false record or statement to get a false or fraudulent claim paid or approved by the Government. The statute defines knowingly as having actual knowledge of the information, acting in deliberate ignorance of the truth or falsity of the information, or acting in reckless disregard of the truth or falsity of the information.

C15.E4.2.17. Program Fraud Civil Remedies Act, 31 U.S.C. 3801. The Act was passed by Congress in 1986 because too often low-dollar false claim cases and cases involving false statements are declined for criminal or civil prosecution by the Department of Justice (DOJ), leaving the Government without an effective alternate remedy. The Act applies to false statements are declined for criminal or civil prosecution by the Department of Justice (DOJ), leaving the Government without an effective alternate remedy. The Act applies to false statement cases and claims made on or after October 21, 1986, involving a false submission of \$150,000 or less where the DOJ has declined to prosecute. A defendant found liable by the presiding officer can be assessed a penalty of up to \$5,000 for each false claim or false statement, and an additional money penalty in claims cases up to twice the amount falsely claimed.

C16. CHAPTER 16  
REPORTING AUITIT TIME

C16.1. PURPOSE

The purpose of this chapter is to prescribe uniform requirements for accumulating and reporting time expended on audits of DoD programs and operations. The time reporting information will be used by the IG, DoD, to assess the adequacy of audit coverage given to DoD programs, activities, and functions.

C16.2. APPLICABILITY

The policies and reporting procedures outlined in this chapter are mandatory, unless otherwise specified, for all DoD internal audit, internal review, and nonappropriated fund audit activities (hereafter referred to collectively as "DoD internal audit organizations"). Internal operating procedures may be modified to satisfy each organization's unique requirements for management data so long as each system meets the reporting provisions of this chapter.

C16.3. POLICY

C16.3.1. The DoD internal audit organizations shall maintain reporting systems that provide information on applicable direct or indirect (administrative) time expended for the categories, functional areas, and audit types identified in the tables of this chapter.

C16.3.2. Time reporting systems shall be structured to provide information on a recurring basis to the OIG, DoD, that:

C16.3.2.1. Identifies functional areas and the type of audits where audit resources are expended;

C16.3.2.2. Permits an evaluation of the adequacy of audit coverage devoted to the various functions, programs, and activities within the Department of Defense; and

C16.3.2.3. Provides historical information for use in updating audit universe files and in planning future audit coverage.

C16.3.3. The DoD internal audit organizations shall report audit time expenditures annually to the IG, DoD. Reporting procedures are prescribed in section C16.5. of this chapter.

C16.3.4. Information on audit time expenditures shall be maintained with sufficient accuracy to show the actual time spent during the reporting period on each of the designated functional areas for all audits completed and in process at the end of a reporting period.

C16.3.5. The DoD central internal audit organizations are responsible for ensuring that their resources are employed efficiently and effectively. (See Chapter 13.) One measure of efficiency is the ratio of direct audit time to total time available to the organization. These organizations shall maximize direct audit time and are encouraged to attain or maintain direct time expenditures of at least 60 percent of total time available. Each of these organizations should identify and remove obstacles that prevent it from attaining the best possible ratio of direct audit time to total time available.

C16.3.6. The DoD central internal audit organizations shall maintain management information systems that provide information on the "types" of audits scheduled, in process, and completed as outlined in Table C16.T4. Reporting will be on an "as required" basis in response to specific requests from the OIG, DoD.

#### C16.4. TIME REPORTING DISTRIBUTION

Schedules shall be prepared that show the total time applied by each DoD internal audit organization during the fiscal year, as well as the distribution by categories of Indirect Time (Format for Schedule A) and by functional area of Direct Time (Format for Schedule B). The formats for reporting are shown in Tables C16.T1. and C16.T2., respectively. A description of each schedule follows:

C16.4.1. Application of Total Time Available (Format for Schedule A). This schedule shall show the total workdays for the period for each reporting organization, as well as a distribution of the indirect and administrative time. A description of each indirect/administrative category for reporting purposes is included as Table C16.T5. The total direct audit time from Schedule B (see following paragraph) shall be added to the indirect/administrative time shown to arrive at the total time available to the organization during the period.

#### C16.4.2. Direct Audit Time (Format for Schedule B)

C16.4.2.1. This schedule shall show the direct audit time expended on audits by the functional areas identified in Table C16.T3. Time shall be expressed in auditor workdays. Audit organizations shall segregate time among functional areas as realistically as possible. Direct time reporting is structured along functional lines, with minor exceptions. The exceptions are:

C16.4.2.1.1. "Nonappropriated Funds," for which all audit work will be charged;

C16.4.2.1.2. "Real and Installed Property," which will be charged for audit work that includes maintenance of facilities;

C16.4.2.1.3. "Investigative Support," which will be charged for the time spent by auditors in providing assistance to investigative agencies; and

C16.4.2.1.4. "Audit Compliance Services," which will be charged by internal review activities for the unique services involved with their liaison and follow-up functions. (See Functional Area 33, Table C16.T3.)

C16.4.2.2. An effort has been made to show many different auditable areas under each functional area (Table C16.T3). These auditable areas are listed for illustration only to indicate the scope of audit that might fall within that functional area and to ensure consistency of reporting between Agencies. The areas listed below each functional area are not all inclusive, nor are they intended for use as subcategories under which audit time is to be accumulated. Time reporting is only required for those 34 major functional areas identified.

C16.4.2.3. When doubt arises as to the exact fraction to be charged, the audit manager shall exercise good judgment and be guided by the listing of auditable areas shown under each functional area, as described in Table C16.T3.

## C16.5. REPORTING PROVISIONS

Tables C16.T1. and C16.T2. shall be completed and submitted for the fiscal year ending each September 30th. Time reporting data shall be consolidated in the usual manner for each internal audit organization, including single reports for the Army, Navy, Marine Corps, Air Force, and Defense Logistics Agency internal review and nonappropriated fund audit activities. Reports Control Symbol DD-IG(A)1740 shall be used for this requirement. The requested information shall be submitted in two copies to the OIG, DoD, and marked "ATTN: Office of Assistant Inspector General (Audit Policy and

oversight)." Reports should be forwarded by November 15th each year. Early cutoff dates should be avoided in order to provide complete and comparable information from all audit activities.

#### C16.6. AUDIT-TYPE CLASSIFICATION

The following procedures apply only to the DoD central internal audit activities:

C16.6.1. In addition to the audit time reporting system prescribed in this Chapter, data are periodically needed by the OIG, DoD, to show the different "types" of audits undertaken by the DoD central internal audit activities. This information is used to supplement time reporting data and respond to external inquiries (Congress, OMB, GAO, President's Council on Integrity and Efficiency) on how internal audit organizations are applying their resources and adjusting to shifting priorities. Table C16.T4. contains a listing of audit "type" codes, titles, and descriptions.

C16.6.2. The DoD central internal audit activities shall maintain management information systems that will capture the requested information for all audits scheduled, in process, and completed. These activities shall have the data available, as needed, to respond to inquiries from the OIG, DoD. No specific reporting frequency is prescribed because of the sporadic nature of the need for this information. However, periodic inquiries to the central internal audit activities are likely, asking such typical questions as: How much audit time has been devoted to special request audits? How much time has been spent on Hotline referrals? What percentage of audit time was devoted to multi-location audits and to DoD-wide audits?

C16.6.3. The audit "types" are not mutually exclusive, and many audits could fall into more than one type code. Therefore, appropriate identification of audits by the different prescribed types must be included in supporting management information systems and be readily available to respond to external inquiries. Since certain audits will be categorized under more than one type code, the total time captured for all audits by audit type will not necessarily be comparable to data furnished in the formats for Schedules A and B.

TABLE C16.T1. FORMAT FOR SCHEDULE A - APPLICATION OF TOTAL TIME AVAILABLE FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 19\_\_

CATEGORY	NUMBER OF WORKDAYS
Orientation and Training	
Leave and Holidays	
PCS and TDY Travel	
Management and Administrative Functions	
Technical Functions	
Other	
Total Indirect and Administrative Time	
Direct Audit Time (from Schedule B) (Table C16.T2.)	
GRAND TOTAL:	
Name of Activity:	

TABLE C16.T2. FORMAT FOR SCHEDULE B - DIRECT AUDIT TIME ANALYSIS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 19\_\_

FUNCTIONAL AREA	NUMBER OF AUDITOR WORKDAYS
Research and Development	
Test and Evaluation	
Major Systems Acquisition	
Procurement-Inventory Control Activities	
Procurement-Research and Development	
Procurement-Other	
Contract Administration	
Forces Management	
Maintenance and Repair of Equipment	
Rebuild and Overhaul of Equipment	
Manufacturing and Production	
Supply Operations-Wholesale	
Supply Operations-Retail	
Property Disposal	
Civilian Personnel Management	
Military Personnel Management	
Real and Installed Property	
Construction	
Information Technology	
Intelligence and Security	
Communications	
Transportation	
Military Pay and Benefits	
Civilian Pay and Benefits	
Program and Budget	
Other Comptroller Functions	
Support Services	
Nonappropriated Fund Activities	

TABLE C16.T2. FORMAT FOR SCHEDULE B - DIRECT AUDIT TIME ANALYSIS FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 19\_\_

FUNCTIONAL AREA	NUMBER OF AUDITOR WORKDAYS
Security Assistance Program	
Commercial Activities Program	
Investigative Support	
Healthcare	
Audit Compliance Services	
Other	
TOTAL:	
Name of Activity:	

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING

<u>Functional Area Number</u>	<u>Functional Area Title</u>	<u>Description and Examples of Auditable Areas</u>
1.	Research and Development	<p>This area encompasses reviews of the initial formulation of requirements for research and development and translation of those requirements into a specific program. It also includes audits of basic and applied research and exploratory, advanced, and engineering development. It excludes audit work in connection with the procurement of such services.</p> <p>Material and Weapons Qualitative Requirements  War Gaming  Combat Strategy Concepts  Basic and Applied Research  Exploratory Development  Advanced Development  Engineering Development</p>
2.	Test and Evaluation	<p>This area covers audits of the testing phase, including operations of DoD test facilities, and evaluation of test data.</p> <p>Testing Center Operations  Development Testing  Operational Testing</p>
3.	Major Systems	<p>This area includes audits of those items Acquisition meeting the definition of a Major Defense Acquisition Program (as defined in DoD Directive 5000.1) and designated as a Defense Acquisition Board Program or a Component Program. Audits of programs subject to the reporting requirements of DoD Instruction 7000.3, "Selected Acquisition Reports," are also included in this functional area. When applicable programs are audited, some of the areas included in this functional area are:</p> <p>Requirements  Development of Specifications  Preparation of Invitations for Bid/Requests for Proposals  Solicitation  Negotiation and Award  Evaluations of Bids/Proposals  Major System Development and Acquisition Management  Aspects of Competition  Cost and Price Analysis</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
4.	Procurement-- Inventory Control Activities	<p>This area encompasses reviews of the major procurement mission at the national inventory control points (ICPs) of the Military Departments and the Defense Logistics Agency (DLA). It includes procurement for the wholesale supply system, but excludes local procurements to satisfy internal requirements of the ICPs and DLA. Includes:</p> <ul style="list-style-type: none"> <li>Requirements</li> <li>Development of Specifications</li> <li>Preparation of Invitations for Bid/Requests for Proposals</li> <li>Negotiation and Award Solicitation</li> <li>System(s) Development and Acquisition Management</li> <li>Evaluation of Bids/Proposals</li> <li>Aspects of Competition</li> <li>Follow-on Contracts</li> </ul>
5.	Procurement-- Research and Development	<p>This area covers the procurement related to systems or items while they are in research and development for all items except those classified major systems for which audit time is charged under Functional Area 3. This includes the procurement of research and development services and the initial buy of an item or system emerging from research and development. Includes:</p> <ul style="list-style-type: none"> <li>Requirements</li> <li>R &amp; D Services</li> <li>Proposal Development</li> <li>Request for Proposals</li> <li>Evaluation of Proposals</li> <li>Solicitation</li> <li>Negotiation and Award</li> <li>Competitive Aspects</li> </ul>
6.	Procurement-- Other	<p>This area covers all procurement actions other than those related to Major Systems Acquisition, Procurement--Inventory Control Activities, and Procurement--Research and Development (Functional Areas 3, 4, and 5) from initiation of a procurement work directive or some other form of</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
		procurement requirement, up through and including award of a contract or actual purchase of the item. Includes: Local Purchases Solicitation Leases Lease vs Buy Decisions Service Contracts Procurement Specifications Small Purchases Procurement of Transportation Negotiation and Award Consultant Services Procurement Management
7.	Contract Administration	This area covers the review of all functions associated with procurement that follow the award of a contract, including the management of the administration process, acceptance of and payment for the product or service, and compliance with contractual provisions.  Quality Assurance Contract Compliance Acceptance Testing Contract Payments Government-Furnished Material Property Review of Administrative Contracting Officer Actions

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
8.	Forces Management	<p>This area encompasses audits of the operational readiness capability of combat and combat support (both Active and Reserve component) forces. It includes analyses of the use of resources to attain required combat capability or readiness levels.</p> <p>Military Unit Training  Contingency/Mobilization Planning  Readiness Reporting Systems  Active/Reserve Forces Operations  Actions to Improve Readiness  Force Structure Planning  Training Exercises  Prepositioned Equipment Programs</p>
9.	Maintenance and Repair of Equipment	<p>This area covers the management and operations of the maintenance and repair function for equipment, materials, and supplies of all commodities at organizational and field (below depot) levels. However, it excludes the maintenance and repair of real property and facilities.</p> <p>Field Maintenance  Organizational Maintenance  Maintenance Inspection  Calibration  Performance measurement  Production Control  Demilitarization (other than for disposal)  Modification Work Orders</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
10.	Rebuild and Overhaul of Equipment	<p>This area major repair (depot level), reconditioning, and associated functions such as inspection, for all commodities and classes of material. It includes reviews of the management, operations, and scheduling of the maintenance program at the depot or shipyard level in both CONUS and overseas.</p> <p>Depot Maintenance  Maintenance Inspection  Production Control  Depot-Level Modifications  Calibration  Shipyard Maintenance  Quality Assurance</p>
11.	Manufacturing and Production	<p>This encompasses the review of both in-house and contractor-operated manufacturing and production facilities. It includes reviews of the production and scheduling system, and associated quality control functions.</p> <p>Operations at Government Arsenals  Government-Owned Contractor-Operated Plants  Printing Plants and Services  Production of Maps, Charts  Production Scheduling and Control  Government-Owned Government-Operated Plants</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
12.	Supply Operations-- Wholesale	<p>This area encompasses the review of supply operations the wholesale (depot and inventory control point) level from the initial determination of material requirements through receipt, storage, issue reporting, and inventory control. It excludes the procurement of material and supplies.</p> <p>Wholesale Level--National Inventory Control Points/Depots Requirements Determination Inventory Control Material Receiving and Issuing Warehouse and Storage Stock Balance and Consumption Reporting Systems Contingency and War Reserve Stockage Configuration Management Technical Publications Preservation and Packaging Supply Management-Wholesale</p>
13.	Supply Operations-- Retail	<p>This area covers audits of all supply operations at retail (customer) level, including the accountability and control for supplies and equipment of all commodities. It excludes procurement of material and supplies.</p> <p>Retail Level--Installation/Base Supply Points Requirements Determination Material Receiving and Issuing Storage Inventory Control Requisitioning Stock Balance and Consumption Reporting</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
		<p>Operating Stocks</p> <p>Supply Management-Retail</p> <p>Property Accountability (Personal)</p> <p>Equipment Utilization and Reporting *</p> <p>Shop/Bench Stocks</p> <p>Asset Accountability</p>
		<p>* Does not apply to equipment falling under another functional area (e.g., Transportation; R &amp; D; Manufacturing; ADP).</p>
14.	Property Disposal	<p>This area audits of actions taken to dispose of property, equipment, and supplies and the management of activities engaged in disposing of property.</p> <p>Management of Disposal Operations</p> <p>Shipment for Disposal</p> <p>Demilitarization Prior to Disposal</p> <p>Screening for Reutilization</p> <p>Control Over Scrap Material</p>
15.	Civilian Personnel Management	<p>This includes reviews of all aspects of managing and training the civilian workforce, including recruitment, hiring, utilization, development of skills and abilities, provision of training, separation, and grievances. It excludes the procurement of personnel services under contract and reviews of personnel compensation, which are chargeable to other functional areas.</p> <p>Personnel Utilization</p> <p>Personnel Authorizations</p> <p>Recruitment</p> <p>Classification</p> <p>Individual Training Programs</p> <p>School Training</p> <p>Manpower Surveys</p> <p>Personnel Management</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
		Productivity Standards Productivity Procurement Equal Employment Opportunity Actions Professional Development Incentive Awards Merit Pay Systems Employee Assistance Standards of Conduct
16.	Military Personnel Management	This area covers the authorization, recruitment, training, assignment, and use of military personnel. It excludes the training of military units, which is included under Forces Management.  Personnel utilization Recruitment Basic and Advanced Individual Training Personnel Management Training Quotas Training Center Operations Military Schools Military Personnel Retention Requisitioning Management of Reserve Component Technicians Reserve Officer Training Corps

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
17.	Real and Installed Property	<p>This area covers reviews of the management and control over real and installed property from determination of the need for the property through use and disposition. It also includes reviews of the maintenance of such property.</p> <p>Requirements Determination  Utilization Reviews  Energy Conservation  Utility Systems  Family Housing Operations  Facilities Engineering Management  Pollution Control  Backlog of Maintenance and Repair  Maintenance of Facilities  Troop Housing  Environmental Issues  Hazardous Waste Disposal/Cleanup</p>
18.	Construction	<p>This area encompasses the construction, rehabilitation, modernization, expansion, and improvement of real property and facilities. Both military and civil works construction are included.</p> <p>Military Construction  Civil Works Construction  Requirements Determination  Minor Construction  Rehabilitation of Facilities</p>
19.	Information Technology	<p>This area covers the design, development, operation, use, testing, and security of electronic data processing and other types of management information systems, both automated and manual. It also includes the analysis of requirements for both equipment and software.</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
		Systems Design Data Processing Operations Utilization of Data Processing Equipment Equipment Requirements Software Requirements Word Processing Operations Computer Security Adequacy of Output Acceptance Testing
20.	Intelligence and Security	This functional area includes all aspects of the management, supervision, and operational control of intelligence, as well as aspects of security associated with controlling and safeguarding resources.  Intelligence Collection Intelligence Analysis/Interpretation Threat Development Dissemination of Intelligence Information Intelligence Operations Counterintelligence Intelligence Systems Intelligence Support Personnel Security Physical Security Industrial Security Communications Security Security of Classified Material Military Police Operations

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
21.	Communications	<p>This area encompasses activities dealing with the radio, signal, voice, and visual communication of information over tactical, non-tactical, strategic, or commercial networks.</p> <p>Strategic Communications  Tactical Communications  Commercial Communications  Requirements  Communications Operations  AUTOVON  AUTODIN  WATS/FTS  Alert/Warning Networks</p>
22.	Transportation	<p>This area includes the management and control of all aspects related to the use of land, sea, and air transportation for movement of personnel and equipment, using both military and, commercial sources.</p> <p>Requirements Determination  Port Operations  Air Terminal Operations  Motor Pool Operations  Utilization of Transportation Equipment  Traffic Management  Passenger, Freight, and Household Goods Movements</p>
23.	Military Pay and Benefits	<p>This area deals with compensation of military personnel and the administration of leave and military allowances.</p> <p>Pay Systems Review  Payroll Preparation  Leave Administration  Review of Allowances  Special/Proficiency Pay  Reenlistment Bonuses</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
24.	Civilian Pay and benefits	<p>This area covers compensation of civilian personnel, administration of leave systems, recording of time worked, and controls over and authorization for overtime and incentive pay.</p> <p>Pay Systems Review  Payroll Preparation  Leave Administration  Overtime Controls and Administration  Timekeeping</p>
25.	Program and Budget	<p>This area encompasses the management of program priorities and shifting of resources; the translation of those priorities into an approved budget; the carrying-out of that plan; and overview of the entire process. Normally these are Comptroller functions, but there may be a Program or Program Analysis office separately established.</p> <p>Program Priorities  Budget Preparation  Budget Review  Budget Execution  Year-End Spending Controls  Administrative Control Of Funds</p>
26.	Other Comptroller Functions	<p>This area encompasses the review of all remaining financial areas with the exception of those functions covered under military pay, civilian pay, and program and budget.</p> <p>Travel  Accounting Systems  Financial Reporting  Disbursements  Imprest Fund Management  Cash management  Industrial  Stock Funds</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
		Financial Management Review of Unliquidated Obligations Financial Certifications Cost Analysis Accounts Receivable Accounts Payable Overseas Banking Operations Reimbursements Use of Special Funds Voucher Examination Internal Control Review System
27.	Support Services	This area encompasses the various services financed from appropriated funds that are required to support DoD operations, activities, and organizations. Excluded are reviews of the procurement, financing, personnel utilization, etc., which are chargeable to other functional areas identified herein.  Food Service Operations Commissary Operations Libraries Laundry Facilities Officer/Enlisted/Visitor Quarters Clothing Sales Stores Guard Services Janitorial Services Dependent Schools Morale, Welfare, and Recreation Activities (MWR) (Appropriation Funded) Service Clubs Audiovisual Services Postal Operations

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
28.	Nonappropriated Fund Activities	<p>This area includes those activities, usually of a morale, welfare, or recreational nature, which are financed from nonappropriated funds. Audits of procurement, personnel, financial management or other functions in connection with nonappropriated funds are also included in this functional area. All audit work in a nonappropriated fund regardless of the activity examined, including:</p> <ul style="list-style-type: none"> <li>Officer/Enlisted Club Operations</li> <li>MWR Activities (Nonappropriated Funds)</li> <li>Civilian Welfare Funds</li> <li>Package Store Operations</li> <li>Restaurant Operations</li> <li>Rod and Gun Clubs</li> <li>Concessions</li> <li>Stars and Stripes</li> <li>Chaplains Fund</li> <li>American Red Cross</li> <li>Exchange Systems Operations</li> </ul>
29.	Security Assistance Program	<p>This area covers audits of DoD foreign military sales and grant aid activities that comprise the Security Assistance Program. Reviews in this area range from overall management of the programs to compliance and performance at the recipient country level.</p> <ul style="list-style-type: none"> <li>Foreign Military Sales Program</li> <li>Customer Order Programs</li> <li>Program Management</li> <li>Requirements Determination</li> <li>Foreign Military Sales Training</li> <li>Material Pricing (Includes Recoupment of R&amp;D costs)</li> <li>Collections</li> <li>Military Assistance Advisory Groups</li> <li>Billings</li> <li>Grant Aid Assistance</li> </ul>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
30.	Commercial Activities Program	<p>This area includes reviews of those actions taken in connection with the program established by Office of Management and Budget Circular No. A-76 (reference (ee)), including management of the program, validation of cost studies, and reviews of post-decision actions.</p> <p>Independent Cost Comparison Reviews            Cost Studies            Post-award Reviews            Program Management</p>
31.	Investigative Support	<p>This area covers that time spent on reviews performed in support of investigative agencies or the time of auditors loaned to investigative teams, regardless of the functional area being reviewed. Includes that time devoted to providing audit support to criminal investigative activities.</p>
32.	Healthcare	<p>This area encompasses reviews of the management and operations of medical, dental, psychiatric, and veterinary activities, the Civilian Health and Medical Program of the Uniformed Services (MMUS), and other healthcare-related areas.</p> <p>Medical Care            Professional Services            Medical Facilities and Equipment            Pharmacy Operations            Medical and Dental Clinics            Veterinary Services            CHAMPUS</p>

TABLE C16.T3. LIST OF FUNCTIONAL AREAS FOR DIRECT AUDIT TIME REPORTING-Continued

<u>Functional Area Number</u>	<u>Functional Area</u>	<u>Description and Examples of Auditable Areas</u>
33.	Audit Compliance Services	<p>This functional area is used by internal review activities only. Internal review personnel shall charge time to this functional area for time spent in:</p> <ul style="list-style-type: none"> <li>a. Negotiating audit results between management and audit organizations;</li> <li>b. Assisting management in the development of responsive replies to audit findings and reports;</li> <li>c. Following up on findings contained in audit reports and ensuring compliance with agreed-upon recommendations; and</li> <li>d. Performing all liaison actions necessary to ensure the proper and professional conduct of external audit activity.</li> </ul>
34.	Other	<p>This area reflects the direct audit time that cannot be specifically identified with one of the other listed functional areas. Every effort should be made to report direct time in an appropriate functional area. The reporting of direct time as "other" shall be kept to a minimum. The DoD central internal audit activities should include in this category time spent evaluating their component's audit follow-up systems and time spent conducting reviews of internal review, inspection, or investigative activities.</p>

TABLE C16.T4. AUDIT "TYPES" CODES, TITLES, AND DESCRIPTIONS

This Table describes the audit types and titles to assist the DoD central internal audit activities in classifying their scheduled, started, or completed audits by one or more of the audit types. Certain "type" titles and codes are no longer applicable. Therefore, "type code numbers" were replaced with letters to obtain consecutive lettering/numbering and avoid using the same code with the old and new definitions in the same database. Accordingly, it will not be necessary to change the codes of audits previously entered into an organization's database; but some audits may need additional classification to accommodate the new audit types.

<u>Type Code</u>	<u>Title and Description</u>
A	<u>Financial Statement.</u> These audits determine: whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows or changes in financial position in accordance with generally accepted accounting principles, and whether the entity has complied with laws and regulations for those transactions and events that may have a material effect on the financial statements.
B	<u>Financial Related.</u> These audits determine whether financial reports and related items such as elements, accounts, or funds are fairly presented; whether financial information is presented in accordance with established or stated criteria, and whether the entity has adhered to specific financial compliance requirements.
C	<u>Economy and Efficiency.</u> These audits determine: whether the entity is acquiring, protecting, and using its resources (such as personnel, property, space) economically and efficiently; the causes of inefficiencies or uneconomical practices; and whether the entity has complied with laws and regulations concerning matters of economy and efficiency.
D	<u>Program.</u> These audits determine: the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved; the effectiveness of organizations' programs, activities, or functions; and whether the entity has complied with laws and regulations applicable to the program.
E	<u>Single Location.</u> This applies when the entire job has been accomplished at one site. This coding should be used even though some peripheral discussion or review may have occurred at another location such as a command headquarters, but the vast majority of the review was conducted at a single site.

TABLE C16.T4. AUDIT "TYPES" CODES, TITLES, AND DESCRIPTIONS-Continued

<u>Type Code</u>	<u>Title and Description</u>
F	<u>Multi-Location</u> . Use this code to distinguish audits conducted at multiple sites. "Single location" and "multi-location" types are mutually exclusive.
G	<u>Commanders Audit Program</u> . This identifies those audits or reviews where an audit service is provided directly to commanders, which is not normally available to them during regularly scheduled audits or from their own staff and can be provided by the audit organization in a relatively short timeframe.
H	<u>Special Request Audits</u> . Generally refers to unprogrammed audits done on relatively short notice at the special request of a major commander or high-level official of the Military Departments or OSD. The audit must have resulted in an audit report subject to the follow-up provisions of DoD Directive 7650.3 (reference (p)).
I	<u>Reserve Components</u> . This is used to identify any audit where work was primarily done within a military Department Reserve component (i.e., Army National Guard, Army Reserve, Navy Reserve, Marine Corps Reserve, Air National Guard, Air Force Reserve, and Coast Guard Reserve) or at the departmental levels charged with management of the Reserve components.
J	<u>Hotline Referrals</u> . Those audits specifically made to examine allegations made through the GAO, Department of Defense, or Military Department hotlines.
K	<u>Inter-Service/DoD-Wide/Inter-Departmental Reviews</u> . This code shall be used to identify: <ol style="list-style-type: none"> <li data-bbox="318 1230 1382 1283">1. Reviews where audit participation was on an inter-Service basis (Assistant Inspector General for Auditing, OIG, DoD only).</li> <li data-bbox="318 1335 1406 1388">2. Part of a DoD-wide review where similar work is being done in the Army and/or the Navy, the Air Force, or the Marine Corps.</li> <li data-bbox="318 1440 1382 1535">3. Reviews that are being jointly conducted in other Federal Departments or Agencies under the sponsorship of a departmental inspector general or organization such as OMB or the President's Council on Integrity and Efficiency.</li> </ol>

C16.T5 TABLE C16.T5.SCHEDULE A - APPLICATION OF TOTAL TIMEC16.T5.1. GENERAL.

The format for Schedule A (Table C16.T1.) shows the total workdays and distribution of indirect and administrative time expended. This table explains the indirect and administrative classifications used for Schedule A reporting purpose. Direct audit time is reported using Schedule B (Table C16.T2).

C16.T5.2. EXPLANATION OF INDIRECT ADMINISTRATIVE CLASSIFICATIONS

C16.T5.2.1. Orientation and Training. Record the time spent (during duty hours only) in formal or informal orientation and training. Orientation and training are defined as special guidance or instruction dealing with administrative and technical (audit) subjects designed to improve the auditor's knowledge. This classification includes, but is not limited to, auditor and technical staff training, such as GS-5/7 trainee schools, management courses, and specialized training classes. Time of personnel preparing or conducting these types of training shall be included. (Time expended in preparing for a particular audit and on-the-job training during a specific audit shall not be charged to this classification.)

C16.T5.2.2. Leave and Holidays. Report civilian and military time charged to annual, sick, holiday, or administrative leave; leave without pay; and jury duty. Also, report the time of civilians while performing military active duty for training. Do not include time of military personnel expended for purely military applications such as flight training, physical training, and alerts.

C16.T5.2.3. Permanent Change of Station (PCS) and TDY Travel. This category shall be charged with PCS time (excluding leave) for assigned personnel and all time spent traveling to and from TDY audit locations where non-audit activities are to be performed. This travel must be accomplished during duty hours.

C16.T5.2.4. Management and Administrative Functions. This classification includes indirect time of auditors, technical staff, and administrative personnel at central and regional headquarters devoted to management and administration, including development of audit policy, overall audit planning and program management, and review and quality control of audit reports. The category will also be used to record the time of office personnel while providing clerical, stenographic, typing and reproduction

services. It also includes support services, such as military and civilian personnel administration, financial management, and statistical analysis and reporting.

C16.T5.2.5. Technical Functions. This classification reflects the time expended on technical audit matters other than duties related directly to a specific audit. It includes special studies and projects, audit research, and preparation of standardized audit programs when such programs are developed for recurring use by field auditors rather than for a specific audit.

C16.T5.2.6. Other. This category reflects unassignable time and time expended on miscellaneous duties. It also includes the time of military personnel engaged in military activities, such as flight training and proficiency flying, weapons schools, physical training, and alerts.

### C16.T5.3. DIRECT AUDIT TIME

C16.T5.3.1. On the "Direct Time" line, show the total direct workdays. The total on this line must agree with Direct Time" (workdays) reported on the format for Schedule B.

C16.T5.3.2. For this report, direct audit time shall cover the time of audit personnel chargeable to a specific audit or to "Consultant Services" assignments. All other time shall be chargeable as Indirect and Administrative time. As a general rule, the time of personnel at central and intermediate headquarters offices shall not be charged to direct audit time categories, except to the extent that the personnel are performing functions directly related to a planned or ongoing audit. The time of clerical personnel or others involved in performing clerical functions shall not be included in direct audit time. The following types of activity shall be included in direct audit time:

C16.T5.3.2.1. Audit work on a specific job.

C16.T5.3.2.2. Direct supervision of an audit.

C16.T5.3.2.3. Planning and research relating to specific audit assignments.

C16.T5.3.2.4. Report preparation (by auditors).

C16.T5.3.2.5. Entrance and exit conferences.

C16.T5.3.2.6. On-the-job training.

C16.T5.3.2.7. Audit follow up and, for Internal Review organizations, audit compliance services.

C16.T5.3.2.8. Travel during duty hours by auditors on specific audit assignments.

C16.T5.3.3. A description of the Direct Audit Time functional areas, to be reported in total on the format for Schedule A and broken out separately on the format for Schedule B, is contained in Table C16.T3.

## C17. CHAPTER 17

### DoD INTERNAL AUDIT POLICY ADVISORY GROUP

#### C17.1. PURPOSE

This chapter establishes a permanent internal audit policy advisory group to advise the IG, DoD, on internal audit policy matters within the Department of Defense.

#### C17.2. APPLICABILITY

This chapter applies to all DoD audit organizations, including internal audit, internal review, and military exchange audit activities.

#### C17.3. POLICY

C17.3.1. Under DoD Directive 5106.1 (reference (ww)), the IG, DoD, is responsible for providing policy direction for internal audits of DoD programs and operations. Current DoD policies on internal auditing are contained in DoD Directive 7600.2 (reference (k)), DoD Instruction 7600.6 (reference (xx)), and in other chapters of this Manual.

C17.3.2. The Internal Audit Policy Advisory Group shall provide advice and assistance to the IG, DoD, on internal audit policy within the Department of Defense.

#### C17.4. ADVISORY GROUP MEMBERSHIP

C17.4.1. The chairperson of the advisory group shall be the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD (AIG-MO). Members of the IG audit policy staff shall assist in presenting issues of current interest to the advisory group.

C17.4.2. In addition to the AIG-APO, each member organization shall appoint a representative to the advisory group who has direct access to the head of his/her audit organization. Each organization shall designate a primary member and an alternate and shall notify the chairperson in writing whenever the primary or alternate representatives change. The following organizations shall be represented on the advisory group:

C17.4.2.1. Office of the Assistant Inspector General for Auditing, OIG, DoD.

C17.4.2.2. Army Audit Agency.

C17.4.2.3. Naval Audit Service.

C17.4.2.4. Air Force Audit Agency.

C17.4.2.5. Army and Air Force Exchange Service.

C17.4.2.6. Navy Resale and Services Support Office.

C17.4.2.7. Marine Corps Nonappropriated Fund Audit Service.

C17.4.2.8. Army Internal Review.

C17.4.2.9. Defense Logistics Agency Internal Review.

#### C17.5. ADVISORY GROUP RESPONSIBILITIES

The policy group shall advise the IG, DoD, on all aspects of internal audit policy and make recommendations for changes in those policies. Policy issues include, but are not limited to, management of audit organizations; interpretation of auditing standards; auditor training and career development; and relationships with DoD managers, civilian professional associations, and other Federal Agencies. The chairperson shall attempt to provide the members of the advisory group with an opportunity to comment on major audit issues being considered by the OIG, DoD, during the policy formulation process. Proposed draft audit policy documents generally will be forwarded to advisory group members of the various audit organizations for their comments and suggestions before official staffing of the documents with OSD, the Military Departments, and the Defense Agencies. The chairperson of the policy advisory group shall provide appropriate feedback to group members on the disposition of their comments.

C17.6. MEETINGS

The advisory group shall convene semiannually or when determined to be necessary by the chairperson. An agenda generally shall be published in advance of meetings, and representatives shall be given an opportunity to add topics or suggest changes to the agenda. Minutes shall be kept to ensure a record of important discussions and confirm agreements on any taskings. Distribution of the minutes shall be made to advisory group members before the next meeting.

## C18. CHAPTER 18

### WORKING PAPERS

#### C18.1. PURPOSE

This chapter prescribes policies, principles, and criteria for the preparation, review, and retention of audit working papers for all internal audits conducted within the Department of Defense.

#### C18.2. APPLICABILITY

The general policies contained in section C18.4., below, are mandatory for all internal audit, internal review, and nonappropriated fund audit organizations (hereafter referred to collectively as "internal audit organizations"). The remaining sections provide guidelines which will ensure compliance with working paper policies and standards. Each organization shall review existing internal operating procedures to ensure they conform to these requirements.

#### C18.3. DEFINITION

The term "working papers" encompasses all documents containing the evidence to support the auditor's findings, opinions, conclusions, and judgments. They include the collection of evidence prepared or obtained by the auditor during the audit.

#### C18.4. POLICY

C18.4.1. Audit working papers are the connecting link between field work and the audit report. They serve as the systematic record of work performed and shall contain sufficient, competent, and relevant evidence to support the auditor's findings, opinions, conclusions, judgments, and recommendations in the audit report.

C18.4.2. The increasing interest and attention given to auditors' reports make it mandatory that audit findings be adequately supported by evidence in the auditor's working papers. This evidence is necessary to demonstrate how the conclusions were arrived at and to provide the basis for determining whether the conclusions are reasonable and correct. Good working papers are evidence of properly planned, well organized, and effectively controlled audits.

C18.4.3. The preparation and review of audit working papers shall conform to audit standards issued by the Comptroller General of the United States and DoD internal audit standards contained in Chapter 2 of this Manual.

C18.4.4. Auditors shall observe the following basic principles when preparing audit working papers:

C18.4.4.1. Working papers shall be complete and accurate to provide proper support for findings, conclusions, and judgments, and to demonstrate the nature and scope of the auditor's examination.

C18.4.4.2. Working papers shall be understandable to a knowledgeable reader. Detailed supplementary oral explanations should not be needed.

C18.4.4.3. Working papers shall be legible and neatly prepared.

C18.4.4.4. The information in working papers shall be restricted to matters that are materially important and relevant to the objectives of the assignment.

C18.4.5. Procedures shall be adopted by each audit organization to ensure the safe custody and retention of working papers for a time sufficient to satisfy the legal and administrative requirements of their components.

## C18.5. STANDARDS

Chapter 2 of this Manual contains the DoD internal auditing standards. The standards most related to the preparation, review, and retention of working papers are as follows:

C18.5.1. 230 - Human Relations and Communications

C18.5.2. 430 - Supervision

C18.5.3. 440 - Examining and Evaluating Information

C18.5.4. 700 - Quality Assurance

## C18.6. EVIDENCE

C18.6.1. Evidence may be categorized as physical, documentary, testimonial, and analytical. Descriptions of the categories are as follows:

C18.6.1.1. Physical evidence is obtained by direct inspection or observation of (1) activities of people, (2) property, or (3) events. Such evidence may be documented in the form of memoranda summarizing the matters inspected or observed, photographs, charts, maps, or actual samples.

C18.6.1.2. Documentary evidence consists of created information such as letters, contracts, accounting records, invoices, and management information on performance.

C18.6.1.3. Testimonial evidence is obtained from others through statements received in response to inquiries or through interviews. Statements important to the audit should be corroborated when possible with additional evidence. Testimonial evidence also needs to be evaluated from the standpoint of whether the individual may be biased or only have partial knowledge about the area.

C18.6.1.4. Analytical evidence includes computations, comparisons, reasoning, and separation of information components.

C18.6.2. The evidence obtained by an auditor should meet the basic tests of sufficiency, relevance, competence. To meet these tests the following guidelines are provided:

C18.6.2.1. Sufficiency is the presence of enough factual and convincing evidence to support the auditors' findings, conclusions, and any recommendations. Determining the sufficiency of evidence requires judgment. When appropriate, statistical methods may be used to establish sufficiency. (See Chapter 11, Part II (C11.P2.), for guidance on the use of statistical sampling methods.)

C18.6.2.2. Relevance refers to the relationship of evidence to its use. The information used to prove or disprove an issue is relevant if it has a logical, sensible relationship to that issue. Information that does not is irrelevant and therefore should not be included as evidence.

C18.6.2.3. Competence means that the evidence should be valid and reliable. In evaluating the competence of evidence, the auditors should carefully consider whether reasons exist to doubt its validity or completeness. If so, the auditors should obtain additional evidence or reflect the situation in the report.

## C18.7. PLANNING AND UNIFORMITY

C18.7.1. Well-planned and organized working papers are necessary to achieve a professional quality audit. Working papers are more than just a record of the work performed. Their use in controlling the audit operation and in arriving at sound conclusions is an auditing technique in itself. Adequate planning is the key to the development and preparation of good working papers. Before preparing any working papers, the auditor should have a clear concept of the primary purpose of the working paper and any subordinate purposes. Therefore, it is necessary to understand how the subject of the working paper relates to other audit areas and what will be done with the information after it is transcribed.

C18.7.2. Working papers should be designed to provide any data required for the audit areas and should not include data that is or will be available from another source. Before the auditor develops working paper analyses, exhibits, and schedules, the following should be determined:

C18.7.2.1. What the objectives are or what needs to be proven.

C18.7.2.2. What data or information is needed to complete the analysis.

C18.7.2.3. Where the needed data or information is located (filed, recorded, etc.).

C18.7.2.4. What comparisons must be made to prove the condition(s) or conclusion(s).

C18.7.3. As part of the overall plan for each audit, directions should be prepared that cover working paper file structure, indexing and cross-referencing procedures, and provisions for working paper reviews. Each assigned auditor should be familiar with the working paper plan.

C18.7.4. When working papers are uniform in design and arrangement, this facilitates the reviewer's job. However, the primary consideration is how the audit is conducted, and efforts to achieve uniformity are secondary. If the working papers on a particular audit are of a uniformly high quality and are developed, organized, indexed, and controlled in accordance with the overall audit plan, supervisors and other knowledgeable readers should experience no difficulty in reviewing them.

C18.7.5. All relevant working papers prepared during an audit should be retained and included in the files. Working papers developed using microcomputers should be printed when required for ease of review and included in the audit folders, or maintained

on computer disks for retention with the working paper files (specific guidance for automated working papers is contained in Chapter 11, Part III (C11.P3.), of this Manual).

C18.7.6. Even though auditing in a particular area may be discontinued after a few audit steps, the reasons for discontinuance should be recorded in the working papers. If a finding is dropped prior to the issuance of the final report, the reasons for the action should be documented. This is often a matter that may require discussion with and resolution by a higher level supervisor. The rationale for the decision should be documented in the audit working papers to enable reviewers to track the disposition of tentative audit findings.

## C18.8. ARRANGEMENT OF WORKING PAPERS

C18.8.1. There are two general classes of working paper files: permanent (background) and current. Internal audit organizations should establish and maintain permanent files for each activity, major program, or function included in the organization's audit universe. Current files should be set up for each audit and contain the working papers developed during that audit.

C18.8.2. Materials contained in permanent files should be of a continuing or recurring nature and useful in future audits. Background data obtained during the survey phase should be included in this file. The permanent file can also serve as a repository for copies of all prior audit and inspection reports relating to that activity. Unnecessary or outdated material should be destroyed during periodic updates of the file. The permanent file can be a convenient single source to which to go for information regarding the audit entity and its audit history.

C18.8.3. Current files should be arranged in a logical sequence in accordance with the file structure developed by the auditor-in-charge. Generally, the arrangement will be by audit segment. For large audits, the current files may consist of several distinct segments: one file for each segment examined, others for general segments pertaining to the audit as a whole, and one for audit administrative matters. Items should be arranged within working paper files to provide for ready reference during and after the audit; and the items should follow a consistent scheme for all segments of the audit files. Current files should contain the following items:

C18.8.3.1. Table of contents.

C18.8.3.2. Review sheets.

C18.8.3.3. Summary of the audit area.

C18.8.3.4. Notes detailing discussions with personnel of the audited activity.

C18.8.3.5. The audit program, or sections of the audit program, cross-referenced to supporting working papers.

C18.8.3.6. Analyses, schedules, exhibits, and other working papers and supporting documentation arranged according to the table of contents and cross-referenced back to the audit program.

## C18.9. PRINCIPLES OF DOCUMENTATION

C18.9.1. The procedures followed by the auditor, including the analysis and interpretation of the audit data, should be documented in the working papers. Working papers should be sufficiently documented so as to be understood by readers having some knowledge of the subject and to lead a reviewer to the same conclusion the auditor reached without requiring supplementary oral explanations. Working paper information should be clear and complete, yet concise. Knowledgeable individuals using the working papers should be able to readily determine their purpose, the nature and scope of the audit work, and the preparer's conclusions. Good working papers also permit another auditor to pick up the examination at a certain point (for example, at the completion of the survey phase) and carry it to its conclusion.

C18.9.2. Certain basic information applies to most working papers or series of working papers. When the information is common to a series of working papers, it need only be recorded on the first paper of the series and referred to in the succeeding working papers. The basic information includes the following:

C18.9.2.1. Subject of the working paper.

C18.9.2.2. Identification of the activity being audited and the function being examined.

C18.9.2.3. The "as of" date for the information and the records used in the analysis.

C18.9.2.4. Name of the preparer/name of reviewer.

C18.9.2.5. Date prepared/date reviewed.

C18.9.2.6. Explanation of any signs, symbols, or acronyms used.

C18.9.2.7. Working paper index number for filing and reference.

C18.9.3. Other information is also essential to understand the individual working papers supporting the audit examination. The following information should be included whenever applicable:

C18.9.3.1. Source of Information. Where did the auditor obtain the information shown in the working papers? This applies to schedules prepared by the audited activity and furnished the auditor, as well as to data compiled by the auditor.

C18.9.3.2. Purpose of the Working Paper. What is the reason for preparing this working paper? Clearly stating the purpose of each working paper facilitates review of the papers as well as use by succeeding auditors.

C18.9.3.3. Scope of the Auditor's Examination. What did the auditor's examination include? This is particularly important when determining the volume of the transactions involved; the number examined; what part of the total volume the audit test represents; why these transactions were selected; the period covered by the auditor's review; and what the examination consisted of (for example, comparison of data between different periods, matching data to standards, etc.). When the analysis was based on a sample of transactions, information should be included to describe the sampling plan contained elsewhere in the working papers. When factors external to the audit organization and the auditor restrict the audit or interfere with the auditor's ability to form objective opinions and conclusions, this should be explained in the working papers.

C18.9.3.4. Criteria. What criteria, standards, policies, etc., did the auditor use to support a judgment? Whenever applicable, a reference to this criteria should be included. This can be satisfied by citing applicable documents such as regulations, laws, standards, etc.

C18.9.3.5. Conclusions. What judgment did the auditor reach after analyzing the data? These are the conclusions drawn from analysis and interpretation of the results of the auditor's test and from any related facts. When the conclusions recorded on one working paper are based in part on information in other working papers, this fact should be noted and appropriately cross-referenced.

C18.9.3.6. Comments and Viewpoints by Others. What are the comments and viewpoints made by others regarding the auditor's facts and conclusions? This information is needed to place the auditor's conclusion in perspective. The viewpoints and comments of operating personnel or other pertinent matters bearing on the auditor's conclusions should be made a matter of record. For example, the auditor may wish to

include an explanation of the causes or extenuating circumstances for any noted deficiencies.

#### C18.10. WORKING PAPER SUMMARIES

Narrative summaries should be prepared by the auditor for all audit areas and included in the working papers. Summary sheets will be used to consolidate the results of various audit steps. They will also be used to control and administer the audit and to analyze and interpret the audit results. Summary sheets should be summarized in one of the papers of the series. Summaries should support the development of audit findings and clearly spell out deficiencies surrounding facts, effects, causes, and recommended actions. If no deficiencies are found, that information should also be summarized for the record.

#### C18.11. INDEXING

C18.11.1. To facilitate review and understandability of working papers, indexing of the files is essential. The primary purpose of indexing is to facilitate the cross-referencing of working papers one to another and to summary analyses and reports. A secondary purpose is to indicate the relationship of the working papers to the particular areas or segments of the audit. Because of the diversity of audits made by the DoD internal audit organizations, a uniform system of indexing may be impractical.

C18.11.2. An indexing system for each audit should be established as part of the overall audit plan. It should be tailored to the overall focus of the audit, the selection of areas for emphasis, and the planned sequence of the audit. By following the audit plan, the indexing system permits ready reference to any working paper at any time.

C18.11.3. The indexing system should show the logical grouping of interrelated working papers. Appropriate groupings will not only contribute to ease of reference, but will assist the auditor's analysis, interpretation, and summarization of the results of the audit by audit segments, and facilitate supervisory review.

C18.11.4. The indexing system should be simple and capable of expansion.

C18.11.5. Indexing should be current. Preferably, working papers should be indexed as soon after their preparation as possible. Having an indexing plan available will make this task easier.

## C18.12. CROSS-REFERENCING

C18.12.1. No audit should be considered complete until the working paper files are thoroughly and accurately cross-referenced. The audit report is developed through an evolutionary process, including detailed supporting working papers, analyses, summaries, findings, and draft and final reports. Cross-referencing at each step in the process is necessary to ensure that all pertinent facts and conclusions have been considered and that support exists for the auditor's position. This decreases the probability of a defective final product the audit report.

C18.12.2. Changes to or corrections made of supporting information should also be referenced to other affected sections of the working papers. To be effective, cross-referencing should be current. At a minimum, working papers should be cross-referenced to other related papers, the audit program, summaries, and the draft audit report. A copy of the final audit report, filed with the working papers, should also be cross-referenced if any new information is added as a result of the audit reply process. Sufficient time should be allowed to ensure that both cross-referencing and indexing of the audit working papers are completed before auditors are released from the assignment.

## C18.13. WORKING PAPER REVIEWS

C18.13.1. Continuous reviews of audit working papers should be made to ensure that professional audit standards are complied with. This procedure gives the reviewer the opportunity to appraise the quality of the papers, the relationship of the audit work to the objectives, and the completeness of the auditor's examination. It also permits the reviewer to assess the auditor's conclusions, determine what additional steps are necessary, and decide whether to expand or cut back the audit coverage.

C18.13.2. The depth of the working paper reviews will vary with each level of supervision. Reviews, by lead auditors or the auditor-in-charge should be accomplished frequently during the audit and should be more detailed than those made by senior audit supervisory personnel. Supervisors, at a minimum, should ensure that standards for working paper preparation are met and that there is adequate support for the auditor's conclusions and recommendations.

C18.13.3. The auditor should be informed of the results of the working paper reviews. After the auditor has considered the reviewer's notes, he or she should revise the working papers and perform additional work if needed. The auditor should then

comment, in writing, on the revisions and on any additional work accomplished. The reviewer, in turn, should indicate on the review notes acceptance of the actions taken, direct further action, or take whatever steps are needed to resolve any problems.

C18.13.4. To ensure the accuracy of the facts and figures in the draft audit report (also the final report if the draft report was significantly changed), a cross-referenced copy of the report should be reviewed by an independent reviewer (referencer) to ensure that the information in the report is correct and supported in the working papers. The referencer should be a senior auditor not involved in the assignment under review. In addition, the referencer should not be under the direct supervision of the supervisor responsible for the assignment being reviewed. In small organizations, the independence of the referencer might not always be possible, but the intent of the review is to ensure the accuracy of the report and should still be accomplished even though there may be an impairment. The review should be documented in the working papers and should contain the reviewer's comments and how the issues raised were resolved.

C18.13.5. In establishing internal quality assurance review programs, as required under Chapter 14, audit working papers shall be subjected to review on a selective basis by quality assurance review groups. The primary purpose of these reviews should be to ensure that audit findings are adequately documented and that working papers meet professional standards.

#### C18.14. RETAINING AND SAFEGUARDING WORKING PAPER FILES

C18.14.1. No specific procedures are prescribed for retaining working paper files. As a general rule, working papers should be retained for a minimum of 2 years from the closeout of an audit or until completion of the succeeding audit. There may be certain factors--controversial or current interest subjects--which would necessitate holding working papers for longer periods. There may be ongoing congressional or other investigations or unsettled issues where continued reference to the working paper files is needed. One should be careful not to destroy files that may be needed for future reference. Obsolete or superseded audit material that is no longer needed may be destroyed and should not be sent to records holding centers.

C18.14.2. Working paper files should always be adequately safeguarded, and prescribed security procedures should be followed for classified material. Access to working paper files should be restricted to authorized personnel. Special precautions should be taken with any working papers, including report drafts that may contain proprietary data, personal privacy data, plans for future Agency operations, agency

investigative and internal audit reports, congressional request material, and other reclassified sensitive information. Sensitive working paper material should be safeguarded when not in use to prevent leaks and unauthorized disclosure.

C18.14.3. Electronic working papers should be retained for the same period of time as is required for manually prepared working papers. Storage of magnetic tapes and diskettes requires special provisions. If magnetic devices are not stored properly in a cool and dry environment, significant loss of information may occur. Heat and humidity may ruin diskettes.

C18.14.3.1. When working papers are stored on diskettes, diskettes should be stored along with listings of diskette directories. Each diskette should be write-protected and labeled with the project code, key person's name, number, and contents. Applicable back-up copies of diskettes should be made and stored in a physically separate location.

C18.14.3.2. Even when most of the audit working papers are available in automated form, it may be necessary to maintain hard copy documentation for certain parts of the working papers. This is especially important when certain documents require official signatures or when proper storage conditions for automated working papers cannot be ensured.

C18.14.3.3. It may not always be practical to store copies of numerous automated data tapes used in an audit or to retain a copy of an entire database when on-line access to a database is used. In those cases, automated data tapes and records should be retained until at least the audit report has been issued and all nonconcurrences resolved. When data is extracted from a database system, the sampling plan, the criteria used to select records, the computer program designed to generate the output, and the resulting output should be sufficient evidential matter for audit retention.

## C19. CHAPTER 19

### DoD-WIDE AUDIT PROCESS

#### C19.1. PURPOSE

This chapter provides policy guidance, establishes procedures, and delineates responsibilities for planning and performing DoD-wide audits.

#### C19.2. APPLICABILITY

The policies and procedures outlined in this chapter apply to the Army Audit Agency; the Naval Audit Service; the Air Force Audit Agency; and the Office of the Assistant Inspector General for Auditing (OAIG-AUD), Office of the Inspector General, Department of Defense (OIG, DoD) (hereafter referred to collectively as "DoD central internal audit organizations").

#### C19.3. DEFINITIONS

C19.3.1. Service Audit Organizations. The Military Departments' central internal audit organizations (Army Audit Agency, Naval Audit Service, and Air Force Audit Agency).

C19.3.2. Service Auditors General. The Auditors General of the Army, the Navy, and the Air Force.

C19.3.3. Audit Chiefs' Council. The Council is composed of the Inspector General, Department of Defense (IG, DoD); the Service Auditors General; the Assistant Inspector General for Auditing (AIG-AUD); the Assistant Inspector General for Audit Policy and Oversight (AIG-APO); and the Director, Defense Contract Audit Agency (DCAA). The IG, DoD, is the chairperson of the Audit Chiefs' Council.

#### C19.4. POLICY

C19.4.1. DoD-wide audits shall be performed in accordance with Government auditing standards issued by the Comptroller General of the United States and DoD internal auditing standards contained in Chapter 2 of this Manual.

C19.4.2. Applicable criteria shall be established and followed in identifying and selecting DoD programs, systems, and functions for DoD-wide audit coverage.

C19.4.3. Common audit objectives and standard approach shall be used so that an overall evaluation of the audit subject may be made and a summary DoD-wide audit report may be prepared.

C19.4.4. DoD-wide audit procedures shall contain the necessary management controls to ensure that effective centralized direction and coordination of the audit is maintained throughout the audit process. Effective management controls include the following:

C19.4.4.1. Setting uniform audit start and completion dates to ensure that DoD-wide audits are accomplished in a responsive and timely manner.

C19.4.4.2. Performing reviews and approvals at applicable audit milestones.

C19.4.4.3. Coordinating and monitoring audit performance on a continuing basis to make sure audit objectives are being accomplished effectively and efficiently.

C19.4.5. The DoD central audit organizations shall be responsible for accomplishing the DoD-wide audit objectives within established timeframes and for processing the audit results within their respective areas of primary jurisdiction.

## C19.5. BACKGROUND

C19.5.1. Audits of major DoD programs, systems, and functions performed jointly by the DoD central internal audit organizations are known as DoD-wide audits. DoD-wide audits are authorized and supported by the IG, DoD, for the following purposes:

C19.5.1.1. DoD-wide audits allow for prompt response to high priority requests for comprehensive audit coverage.

C19.5.1.2. "The Inspector General Act of 1978" (reference (a)) requires particular attention be given to the activities of the Military Department audit organizations with a view toward avoiding duplication and ensuring effective coordination and cooperation. One way to accomplish this is through joint planning and performance of DoD-wide audits by the DoD central internal audit organizations.

C19.5.1.3. Successful accomplishment of DoD-wide audits demonstrates that the activities of the Department's internal audit organizations can be effectively coordinated and channeled toward meeting objectives in support of the DoD audit mission.

C19.5.2. DoD-wide audits inherently are more complex to perform and control than audits performed by a single audit organization. The intent of this chapter is to make the DoD-wide audit program a more formal and structured process to accomplish the intended purpose. Proper subjects that warrant DoD-wide coverage need to be identified, and DoD-wide audits need to be managed closely from start to finish. This implies that someone must be in charge and have the authority to carry out designated responsibilities.

## C19.6. SELECTION OF DoD-WIDE AUDITS

C19.6.1. Planning Concept. Being responsive to requests for audit coverage by DoD and/or Service officials is a key to the success of the DoD-wide audit process. When possible, sufficient lead time should be allowed for incorporating DoD-wide audits into the normal planning processes of the DoD central internal audit organizations. The audit planning process must be flexible to accommodate quick-reaction or time-sensitive matters. There may be cases when the annual audit plans developed by the DoD central internal audit organizations may have to be adjusted to accommodate a higher priority request for DoD-wide audit coverage.

C19.6.2. Selection Criteria. Audit subjects selected for DoD-wide audit coverage generally shall have the following attributes:

C19.6.2.1. The audit area is requested or suggested by the Secretaries of Defense or the Military Departments, the Deputy Secretary of Defense, the Under Secretaries of Defense, the Assistant Secretaries of Defense, the Heads of Defense Agencies, the IG, DoD, or the Services' Auditors General.

C19.6.2.2. The required audit coverage or time constraints are such that the resources of all DoD central internal audit organizations are required.

C19.6.2.3. The audit candidates address major DoD issues, programs, and functions that involve the Military Departments with special emphasis on programs that are directed centrally or managed at the DoD level.

C19.6.2.4. The audit proposals center on a single policy issue or functional benefit and are "high payoff and/or visibility issues making it worth while to do on a DoD-wide basis.

C19.6.2.5. The audit scope is narrow enough so that a draft summary DoD-wide audit report may be issued no later than 9 to 12 months after starting the audit execution phase.

Audit subjects that do not meet the criteria in paragraph C19.6.2.1. through C19.6.2.5., above, shall be performed by the OAIG-AUD on an inter-Service basis or accomplished individually by the Service audit organizations.

C19.6.3. Audit Suggestions. Procedures shall be established by each applicable audit organization for identifying and evaluating candidates for DoD-wide audits from suggestions received from Office of the Secretary of Defense (OSD) management officials and from other high-level sources such as the President's Council on Integrity and Efficiency (PCIE). Evaluations of audit topics shall highlight and explain the purpose and benefits a DoD-wide audit may provide.

C19.6.4. Audit Proposals and Format. The Service audit organizations may submit suggestions for DoD-wide audits. Audit proposals submitted shall be in the following fact sheet format:

C19.6.4.1. Title

C19.6.4.2. Functional Area

C19.6.4.3. Background

C19.6.4.4. Prior Audit Coverage

C19.6.4.5. Audit Objectives and Scope

C19.6.4.6. Criteria

C19.6.4.7. Reason for Project and Coverage

C19.6.4.8. Specific Issues

C19.6.4.9. Potential Benefits

Enclosure 1 (C19.E1.) to this chapter provides a description of each data element.

C19.6.5. Data Consolidation. Because the OAIG-AUD is in a unique position to evaluate the need for a DoD-wide audit and its feasibility, it shall accumulate suggestions for DoD-wide audit topics. The OAIG-AUD shall also consolidate the individual audit proposals and fact sheets, and distribute the package to members of the Audit Chiefs' Council for evaluation and comment. The OAIG-AUD shall coordinate material to be presented to the Audit Chiefs' Council with the OAIG-APO who prepares the agenda for Council meetings.

C19.6.6. Preliminary Planning and Selection. During regularly scheduled meetings, the Audit Chiefs' Council shall review and discuss DoD-wide audit proposals. Recommendations shall be developed as to the disposition of each audit proposal; e.g., either approved, rejected, further researched, or accomplished as an inter-Service audit by the OAIG-AUD. Based on recommendations from members of the Audit Chiefs' Council, the IG, DoD, shall select those audit proposals requiring further research by the DoD central internal audit organizations. The IG, DoD, also shall make the final selection and approval of all DoD-wide audits, including designation of a lead audit organization, participants, and starting dates for survey work. Problems such as a lack of funding for temporary duty travel needed to participate in the audit, shall be brought to the attention of the IG, DoD, to enable resolution of the matter or a decision on other alternatives.

## C19.7. DoD-WIDE PERFORMANCE

### C19.7.1. Responsibilities

C19.7.1.1. The lead audit organization shall have the overall responsibility and authority for directing, coordinating, and monitoring DoD-wide audits from start to finish. Additionally, the lead audit organization shall:

C19.7.1.1.1. Perform an audit survey and participate in the audit "go" or "no-go" decision making process after completion of the audit survey work by the other participating audit organizations.

C19.7.1.1.2. Accomplish audit objectives and process audit results within its area of primary jurisdiction.

C19.7.1.1.3. Prepare a comprehensive summary report on the results of each DoD-wide audit.

C19.7.1.2. The participating DoD central, internal audit organizations, within their areas of primary jurisdiction, shall:

C19.7.1.2.1. Perform an audit survey and accomplish the audit objectives.

C19.7.1.2.2. Prepare draft and final reports for management comments.

C19.7.1.2.3. Submit copies of draft and final reports to the lead audit organization.

C19.7.1.2.4. Provide any agreed to summarization or other data needed by the lead audit organization in preparation of the summary report.

#### C19.7.2. Project Initiation

C19.7.2.1. The IG, DoD, shall issue a memoranda to the applicable OSD officials, Service Secretaries, or Heads of Defense Agencies announcing the scheduled DoD-wide audit effort. The announcement memoranda shall include the survey start date, audit objectives, and scope of the audit effort.

C19.7.2.2. The participating DoD central internal audit organizations shall provide the lead audit organization with the name of the individual designated to manage the audit effort for their Agency.

C19.7.2.3. A joint planning meeting with the various representatives from each audit organization shall be scheduled by the lead audit organization representative about 2 months before the planned start of the survey by any of the DoD central audit organizations. The purpose of the meeting shall be to discuss and reach agreement on common survey objectives and scope, selection of audit sites and coverage, audit resources and techniques to be used (e.g., use of statistical sampling), and uniform start and/or completion dates. The lead audit organization representative also shall:

C19.7.2.3.1 Document and distribute to all participants the results of the planning meeting and the agreed-upon survey objectives and scope, level of effort, audit approach, and milestone dates.

C19.7.2.3.2. Prepare a memorandum from the lead audit organization to members of the Audit Chiefs' Council outlining the results of the planning meeting and highlighting any issues requiring resolution before initiating the audit survey.

C19.7.2.4. Effective preplanning is a critical and essential element to the successful accomplishment of a DoD-wide audit. Before the expenditure of audit resources, the Audit Chiefs' Council shall approve the following:

C19.7.2.4.1 Survey objectives and scope.

C19.7.2.4.2 Selection of audit survey sites and coverage.

C19.7.2.4.3. Number of auditor days planned.

C19.7.2.4.4. Audit approach.

C19.7.2.4.5. Uniform start and/or completion dates.

### C19.7.3. Survey Phase

C19.7.3.1. The lead audit organization representative shall prepare the survey program(s) for audit sites within the lead audit organization's area of primary jurisdiction. Survey programs prepared by the participating audit organizations shall be reviewed and approved by the lead audit organization representative to make sure that the survey programs are sufficiently uniform and adequately address:

C19.7.3.1.1. The audit management issues approved by the Audit Chiefs' Council as outlined in subparagraphs C19.7.2.4.1.through C19.7.2.4.5., above.

C19.7.3.1.2. The desired level of standardization needed among the DoD central internal audit organizations to ensure an overall conclusion is made on each survey objective.

C19.7.3.2. The lead audit organization representative shall coordinate and monitor the survey efforts of the DoD central internal audit organizations. Effective coordination and monitorship of the audit survey shall include the following activities:

C19.7.3.2.1. Conducting periodic meetings with representatives from each of the participating organizations. The attendees shall review audit progress and leads, identify the need for any modifications to planned audit work, and refine audit milestone dates.

C19.7.3.2.2. Making periodic field visits to audit sites managed by the DoD central internal audit organizations. The purpose of field visits shall be to review audit leads and exchange information.

C19.7.3.2.3. Resolving problems that may occur during the audit survey.

C19.7.3.2.4. Documenting and retaining with the audit working papers a description of the efforts to coordinate and monitor the DoD-wide audit survey.

C19.7.3.3. After completion of audit survey work, the lead audit organization representative shall convene a meeting to finalize the audit approach, milestone dates, and mandatory objectives for the DoD-wide audit. The other participating audit organizations may propose additional audit objectives. The rationale for adding more audit objectives and the impact on dates for completing the DoD-wide audit shall be explained and documented. The lead audit organization representative shall:

C19.7.3.3.1. Document and distribute to all participants the results of the audit survey and the agreed-upon audit execution objectives and scope, selection of audit sites and coverage, audit resources to be used (e.g., level of effort), audit approach, and milestone dates.

C19.7.3.3.2. Brief the Audit Chiefs' Council on the audit survey results and expected advantages and disadvantages of doing the DoD-wide audit. The briefing shall include a recommendation for a "go" or "no-go" decision for continuing the effort as a DoD-wide audit.

C19.7.3.4. The IG, DoD, shall approve the continuation of the DoD-wide audit into the execution phase based on recommendations from members of the Audit Chiefs' Council. Approval also shall be given to the following:

C19.7.3.4.1. Audit execution objectives and scope.

C19.7.3.4.2. Selection of audit sites and coverage.

C19.7.3.4.3. Number of auditor days planned.

C19.7.3.4.4. Audit approach.

C19.7.3.4.5. Uniform start and/or completion dates

If the audit is discontinued as a DoD-wide effort, the subject matter shall be considered for audit coverage as individual audits, as applicable.

#### C19.7.4. Audit Execution Phase

C19.7.4.1. The IG, DoD, issue a memoranda to applicable OBD officials and the Service Secretaries announcing any significant changes to the original audit objectives. Where the lead audit organization is not already the OAIG-AUD, then that organization shall prepare a draft memorandum explaining the change(s) and forward it to the OAIG-AM for the necessary action.

C19.7.4.2. The lead audit organization representative shall prepare the audit guide(s) for audit sites within the lead audit organization's area of primary jurisdiction. Audit guides prepared by the participating DoD central internal audit organizations shall be reviewed and approved by the lead audit organization representative to make sure that the audit(s) are sufficiently uniform and adequately address:

C19.7.4.2.1. The audit management issues approved by the Audit Chiefs' Council as outlined in subparagraphs C19.7.3.4.1. through C19.7.3.4.5., above.

C19.7.4.2.2. The desired scope of audit among the participating audit organizations to ensure an overall conclusion is made on each mandatory objective.

C19.7.4.3. Uneven audit coverage may lead to the misconception that problems exist in one organization and not in another. To avoid this, the lead audit organization representative shall coordinate and monitor the activities of the participating audit organizations to include the following:

C19.7.4.3.1. Conducting periodic in-process review meetings with key representatives from each of the participating audit organizations. The attendees shall review audit progress: identify probable conclusions; identify the need for any modifications to planned audit work; and refine audit milestone dates.

C19.7.4.3.2. Convening and/or attending periodic workshops.

C19.7.4.3.3. Making periodic field visits to audit sites managed by the participating audit organizations. The purpose of field visits shall be to review audit leads, draft findings and supporting working papers, and exchange information.

C19.7.4.3.4. Resolving problems that may occur during the audit process.

C19.7.4.3.5. Documenting and retaining with the audit working papers a description of the efforts made to coordinate and monitor the DoD-Wide audit.

C19.7.4.4. The lead audit organization representative shall prepare periodic status reports (i.e., monthly, quarterly) for coordinating and monitoring the DoD-wide audit. The audit control point from each of the participating organizations shall provide information and data needed by the lead audit organization for preparing the status report. The DoD-wide audit status reports shall be initiated and updated before scheduled meetings of the Audit Chiefs' Council and shall be included in read-ahead material provided to Council members. The status reports shall contain the following information:

C19.7.4.4.1. Progress on accomplishing the audit objectives.

C19.7.4.4.2. Synopsis of tentative findings and conditions being developed.

C19.7.4.4.3. Potential recommendations to OSD and/or Service management.

C19.7.4.4.4. Significant conditions that may hamper the accomplishment of the approved objectives.

C19.7.4.4.5. Needed revisions to audit milestone dates.

C19.7.4.5. The Audit Chiefs' Council meetings shall be a forum for reviewing the status of DoD-wide audits in process and for resolving significant issues.

C19.7.4.6. The tentative nature of all draft findings and recommendations shall be observed, and due care shall be taken when sharing information among the DoD central internal audit organizations on the tentative results of audit. The tentative results of audit shall not be released to any individual or organization external to the participating audit organizations unless expressed permission is provided by the originating audit organization.

### C19.7.5. Audit Reporting Phase

C19.7.5.1. On completion of the audit execution phase, the participating audit organizations shall prepare and issue draft reports through normal reporting channels. All audit reports must contain conclusions on each mandatory audit objective. Copies of all draft and subsequent final reports issued by the participating audit organizations shall be provided to the lead audit organization representative. The lead organization shall exercise care in handling and discussing audit findings of a draft nature from another Component, and shall await management replies to draft audit findings before completing the summary audit report.

C19.7.5.2. Reports issued by and other information obtained from the participating audit organizations shall be used to prepare a comprehensive summary report for the OSD-level management review and comment. The summary DoD-wide audit report shall contain the following:

C19.7.5.2.1. Statement on the purpose, objectives, and scope of the audit.

C19.7.5.2.2. Summary of audit results on each of the mandatory audit objectives and conclusions.

C19.7.5.2.3. Recommendations and supporting findings.

C19.7.5.3. To expedite and facilitate the preparation of the draft summary DoD-wide audit report, it may not be necessary to wait until command replies are received on each finding and recommendation in individual draft reports issued by the DoD central internal audit organizations.

C19.7.5.4. Before issuing the draft summary DoD-wide audit report to OSD management for review and comment, the draft report shall be furnished to the participating audit organizations. The audit organizations shall:

C19.7.5.4.1. Point out any areas of disagreement with facts, conclusions and/or recommendations.

C19.7.5.4.2. Be prepared to support the conclusions and any specific statements on their respective organizations.

C19.7.5.5. The draft and final summary DoD-wide audit report shall be signed by the IG, DoD.

C19.7.5.6. In cases where an audit report is not considered necessary (e.g., where the Service audit organization merely gathers information for submission to the lead organization), participating audit organizations shall keep their respective Components advised of the information provided and how it may be used.

#### C19.8. FOLLOW UP AND RESOLUTION

C19.8.1. The IG, DoD, will be responsible for assisting in the audit follow up and resolution process affecting the summary DoD-wide audit report in accordance with procedures specified in DoD Directive 7650.3 (reference (p)).

C19.8.2. The participating audit organizations shall assist in the audit follow up and resolution process affecting the audit reports issued within their respective jurisdictions as specified in reference (p).

C19.E1. ENCLOSURE 1 OF CHAPTER 19

DoD-WIDE AUDIT FACT SHEET

C19.E1.1. TITLE OF AUDIT

C19.E1.2. FUNCTIONAL AREA

This section should list one or more of the 34 functional area designations outlined in Chapter 16 of this Manual that best describes the area(s) to be covered.

C19.E1.3. BACKGROUND

A brief non-technical description of the subject area selected for audit should be added to the background section. The description should include purpose of the subject area, the roles and responsibilities of the DoD and the Service managers, size and scope of the subject area, and reasons for the audit proposals; i.e., high-level interest, required and/or requested. The background should be limited to two paragraphs.

C19.E1.4. PRIOR AUDIT COVERAGE

List and describe previous and ongoing audit coverage by the DoD central internal audit organizations and the GAO to include audit report references and dates. Describe the scope and results of recently completed or ongoing audits.

C19.E1.5. AUDIT OBJECTIVES AND SCOPE

C19.E1.5.1. This is the most important part of the fact sheet. The objectives to describe clearly and succinctly what the audit teams shall evaluate. The objectives must be doable within the audit survey and execution period. Two or three specific objectives are all that should be listed depending on the number of locations to be included in the scope of the audit. The objectives should be structured so that they specifically may be addressed during the audit.

C19.E1.5.2. The objectives and scope should be tailored to the type of audit being proposed. Required and requested audit proposals specifically should be designed to meet the objectives of the tasking. Self-initiated audits should be designed to provide effective coverage of subjects for which the Service audit organizations have primary

responsibility in accordance with OMB Circular No. A-73 and DoD Directive 7600.2 (references (b) and (k)).

C19.E1.5.3. The statement on the scope of audit should summarize the subject area and the primary operating activities; e.g., procurement of initial spares at four major buying commands, implementation of internal controls by the Defense Personnel Support Center, etc.

#### C19.E1.6. CRITERIA

This section shall show the criteria that the audit team shall use to evaluate the subject area; e.g., DoD policy, Directives, Instructions, Federal Acquisition Regulations, etc.

#### C19.E1.7. REASON FOR COVERAGE

This section shall display a brief recap of the prior sections; e.g., the proposed audit project was requested by a Service client (specify); the subject area is significant and of high interest to the Congress, the OMB, the Secretary of Defense, the IG, DoD; and the subject area has not been adequately and/or recently covered. In this section, state any other reasons for proposing the audit project.

#### C19.E1.8. IDENTIFICATION OF SPECIFIC ISSUES

In this section, the major issues and/or problem areas that are related to the subject area of the proposed audit project should be described; e.g., Competitive Procurement, Contracting Out, Internal Control, Test and Evaluation, Independent Research and Development, etc.

#### C19.E1.9. POTENTIAL BENEFITS

This section shall include a description of anticipated benefits such as budget savings, cost avoidances, stronger internal controls, compliance with applicable laws and regulations, manpower reductions, and improvement of program results. These descriptions shall parallel the stated audit objectives and issues.

## C20. CHAPTER 20

### OVERSIGHT OF NON-FEDERAL AUDIT SERVICES

#### C20.1. PURPOSE

This chapter provides policy and guidance for the monitoring of audit services provided by non-Federal auditors. It supplements existing policy and procedures on maintaining quality audit work by identifying special considerations to be recognized when DoD Components contract for audit services. It covers the relationships between cognizant DoD internal audit organizations and non-Federal auditors who perform audits on DoD projects or entities. The chapter does not address procedures followed when an audit is contracted for by a DoD audit organization itself since such contracting is prohibited, except in unusual circumstances, in accordance with DoD Directive 7600.9 (reference (q)).

#### C20.2. APPLICABILITY

The provisions of this chapter are mandatory for the central DoD internal audit organizations (Army Audit Agency, Naval Audit Service, Air Force Audit Agency, and the Office of the Assistant Inspector General for Auditing, OIG, DoD) and other designated audit activities having cognizance for non-Federal auditor activities. Certain provisions of sections C20.5., C20.9., and C20.10. are applicable to the office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD. In some instances, the responsibility for monitoring non-Federal audit services is shared between different audit activities within a Component. For example, the day-to-day oversight of the contracting-out process may be handled by an internal review office or a nonappropriated fund oversight organization with an audit capability, while the periodic quality assurance audits of the entire process may be carried out by the Component's central internal audit organization. The Air Force Audit Agency, for example, is responsible under the provisions of this chapter only for the periodic oversight of the Air Force contracting-out process.

### C20.3. BACKGROUND

C20.3.1. In addition to audits conducted by DoD internal audit organizations, the Department of Defense relies on the audits of non-Federal auditors performing under contracts or agreements for certain types of audit services, such as the financial audits of the military exchange systems, investment and welfare funds, and other nonappropriated funds.

C20.3.2. The non-Federal auditors performing audit services under contract for the Department of Defense are subject to Government Auditing Standards as promulgated by the Comptroller General of the United States (reference (c)). In addition, the non-Federal auditors are required to be licensed or to work for a firm that is licensed by the licensing authority in the State or other political jurisdiction where they operate their professional practice.

C20.3.3. DoD Directive 7600.9 (reference (q)) requires DoD Components to coordinate all requests for contracts involving non-Federal audit services with the cognizant DoD internal audit organization. The internal audit organization is required to conduct a technical review and approve the requests for contract before the contracting officer issues a solicitation package.

C20.3.4. The cognizant internal audit organizations are also required under reference (q) to give technical advice in accordance with the contract, periodically monitor contract performance, perform quality reviews of the contractor's work, and perform pre-acceptance reviews of completed work. In doing so, the audit organizations shall remain alert to situations that may warrant referral of the independent public accounting firm for possible debarment, suspension, or sanctions.

### C20.4. POLICY

C20.4.1. Each DoD internal audit organization, as applicable, shall designate an official to be responsible for the activities and the functions related to the work performed by non-Federal auditors for the DoD Components under its cognizance.

C20.4.2. The designated official shall be responsible for:

C20.4.2.1. Reviewing the solicitation and approving the scope of work on all requests for contract non-Federal audit services prior to the submission to the contracting officer for issuance of a solicitation.

C20.4.2.2. Providing programs and audit guides, when requested and available, to the non-Federal auditors to assist them in performance of the work under contract.

C20.4.2.3. Providing, when requested, technical guidance to the non-Federal auditors under contract.

C20.4.2.4. Monitoring, periodically, the progress of the non-Federal auditors under contract to perform audit services.

C20.4.2.5. Performing pre-acceptance reviews of completed work under awarded audit service contracts before work is accepted and final payment is made.

C20.4.2.6. Making a referral to appropriate authorities, when conditions warrant, of non-Federal auditors for debarment, suspension, or sanctions.

C20.4.2.7. Providing other appropriate technical assistance to acquisition officials responsible for procuring audit services from non-Federal auditors.

## C20.5. RESPONSIBILITIES

C20.5.1. The cognizant internal audit organizations shall:

C20.5.1.1. Develop appropriate guidelines for their staff personnel to review and approve contract work specifications and monitor contract performance of non-Federal auditors performing audit services.

C20.5.1.2. Develop appropriate guidance to be followed by their staff in monitoring contracts with non-Federal auditors to ensure:

C20.5.1.2.1 Identification, documentation, and reporting of situations that warrant debarment or suspension of contractors or subcontractors.

C20.5.1.2.2 Identification, documentation, and reporting of all cases to the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, that warrant referral of a public accounting firm to the appropriate sanctioning or licensing authority.

C20.5.1.3 Monitor all situations disclosed by their auditors that appear to warrant debarment or suspension of non-Federal auditors to ensure that all possible assistance to the contracting debarment official is rendered.

C20.5.2. The Office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, shall:

C20.5.2.1. Ensure that appropriate actions are taken by the cognizant DoD internal audit organizations in developing and implementing procedures relative to debarment and suspension of non-Federal auditors.

C20.5.2.2. Ensure that referral packages received from the central internal audit organizations comply with the guidance in the President's Council on Integrity and Efficiency (PCIE) Standards Subcommittee Position Statement No. 4, which is enclosed with this chapter.

C20.5.2.3. Transmit the formal referral package to the appropriate sanctioning or licensing authority and arrange for any required testimony or meetings resulting from the referral.

## C20.6. REVIEW OF REQUESTS FOR CONTRACT

C20.6.1. The cognizant internal audit organization shall advise the contracting officer, including evaluating the statement of work in the proposed contract, before solicitation of non-Federal audit services. The solicitation package normally includes the following elements: administrative information, work and reporting requirements, time requirements, proposal information, and contractual information. The statement of work should be scrutinized to determine whether its complete execution should result in a valid audit product in accordance with the contract.

C20.6.2. The cognizant DoD internal audit organization shall furnish technical advice to the contractor as requested. Care should be taken to make sure that the contract requirements which require the internal audit organization to provide technical assistance to the non-Federal auditor do not constitute management or supervision of the audit work. The DoD internal audit organization must maintain its independence when providing technical assistance because it also has the responsibility for monitoring and reviewing the audit work for acceptability. Additionally, the internal audit organization shall review the proposed contract to determine if it contains provisions that require the contractor to:

C20.6.2.1. Allow the head of the internal audit organization or a representative to review and make copies of working papers, including draft reports, during and after contract performance.

C20.6.2.2. Preserve working papers, records, and other evidence of audit for at least 3 years following the audit report date and make them available to DoD procurement officials, the DoD internal audit organization, and the Office of the Inspector General, DoD.

C20.6.2.3. Comply with Government Auditing Standards (reference (c)) and the office of Management and Budget Circular No. A-73 (reference (b)).

C20.6.2.4. Rely on the work of others in accordance with Government Auditing Standards.

C20.6.2.5. Explain audit procedures, working papers, and findings until all audit findings or disputes are resolved.

C20.6.2.6. Refer instances of suspected fraud to appropriate DoD officials.

C20.6.2.7. Forward a copy of the final audit report to the head of the cognizant DoD internal audit organization.

C20.6.3. The absence of any of the above provisions in the contract shall be brought to the attention of the contracting officer prior to a solicitation action.

## C20.7. MONITORING PERFORMANCE

The DoD internal audit organization shall periodically monitor contract performance on an as needed basis and as requested by the contracting officer. When warranted, the monitoring may result in a progress review of the audit plans and working papers. Any adverse conditions found during the monitoring process should be reported to the contracting officer and the users of the audit services. In selecting contracts to monitor, primary considerations shall be given to the size of activity or fund being audited; the sensitivity of the audit subject and its susceptibility to fraud, abuse, or mismanagement; and the past audit history of the activity or fund.

## C20.8. PERFORMING PRE-ACCEPTANCE REVIEWS

The cognizant DoD internal audit organization shall perform pre-acceptance reviews of completed audit work under awarded contracts before the work is accepted and final contract payment is made. This review, as a minimum, shall consist of a desk review of the audit report or other final written audit product required by the contract. A desk

review of the audit product shall determine, to the extent possible, whether the non-Federal auditors have complied with audit reporting requirements of the Government Auditing Standards and the statement of work in the contract. Tests for compliance with other auditing standards should be determined based on potential problems identified during the desk review. When the tests indicate that non-Federal auditors have not complied with the Government Auditing Standards or the statement of work, the internal audit organization shall inform the non-Federal auditors, the contracting officer, and the requesters of the audit services.

## C20.9. REFERRALS

C20.9.1. While performing assigned responsibilities, the internal audit organizations are in a position to observe conditions that may warrant debarment or suspension of non-Federal auditors performing work under Government contract or subcontract for auditing services. Reasons for debarment include violations of the terms of the Government contract or subcontract that justify debarment. Examples of such violations are willful failure to perform in accordance with the terms of one or more contracts, a history of failure to perform, or unsatisfactory performance of one or more contracts. Reasons for suspension include commission of an offense indicating a lack of business integrity or business honesty that seriously and directly affects the responsibility of a Government contractor or subcontractor (the non-Federal auditor).

C20.9.2. Procedures to be followed by DoD officials for debarment or suspension are outlined in Subpart 9.4 of the Federal Acquisition Regulation (FAR) (reference (yy)) and Subpart 209.4 of the DoD supplement to the FAR (reference (zz)). The Regulation provides guidance on such matters as: cause for debarments or suspension, procedures to be followed in investigation and referral for debarment and suspension actions, period of debarment and suspension, reporting requirements relative to debarment and suspension, and identification of debarment and suspending officials. Contracting officers play a major role in the debarment and suspension process.

C20.9.3. The cognizant DoD internal audit organizations shall be alert for instances where debarment or suspension of non-Federal auditors under contract to the Department of Defense is warranted; refer such instances to the appropriate contracting officer; assist the contracting officer in documenting the case to the authorized debarment or suspension representatives; and render full assistance to procurement and debarment and suspension officials in resolving recommendations for debarment and suspension.

C20.9.4. In addition to debarment and suspension, there may be instances of substandard work by the non-Federal auditor that warrant referral for sanctions by appropriate licensing authorities or the American Institute of Certified Public Accountants (AICPA). The cognizant DoD internal audit organizations are also in a position to detect instances where such referrals are appropriate. A referral would be appropriate when work has significant inadequacies that make the audit so pervasively deficient that users cannot rely on it. Normally, a DoD internal audit organization would reach the decision to make a referral based on a desk review of an audit report, and a working paper review of the work performed by non-Federal auditors. Criteria on what constitutes a referral condition and the procedures to be followed in making a referral are set forth in PCIE Position Statement No. 4 enclosed with this chapter.

C20.9.5. All referrals for sanctions by appropriate licensing authorities or the AICPA should be made through the Assistant Inspector General for Audit Policy and Oversight (AIG-APO), OIG, DoD. The AIG-APO shall be the only official authorized to make the referrals to the sanctioning authority. Cognizant internal audit organizations should take the steps described in the enclosure to resolve discrepancies with the non-Federal auditor prior to making a referral. The appropriate documentation and a memorandum with the reason for the proposed referral action will be forwarded to the AIG-APO if circumstances justify a formal referral.

## C20.10. QUALITY ASSURANCE

C20.10.1. Quality assurance of the contracting-out process for audit services shall be performed periodically by the cognizant DoD internal audit organization by employing one or more of the following techniques:

C20.10.1.1. Performing desk reviews of audit reports and other final written audit products.

C20.10.1.2. Performing working paper reviews during or after the contract performance period.

C20.10.1.3. Reviewing the results of professional peer reviews of the Federal auditors, which are recognized by the audit profession.

C20.10.2. The Office of the Assistant Inspector General for Audit Policy and Oversight, OIG, DoD, shall periodically review the procedures established by cognizant audit organizations to carry out the functions described in this chapter.

C20.10.3. Individual circumstances shall determine the extent of the quality assurance procedure employed. There is no requirement for performing comprehensive quality assurance reviews of the work of non-Federal auditors beyond the terms of the contract unless performance problems are evident. In accordance with the provisions of DoD Directive 7600.9 (reference (q)), all contracts shall contain a requirement for the contractor to retain audit materials for a 3-year period following the report date and to make such materials available for review by the cognizant audit organization.

C20.E1. ENCLOSURE 1 OF CHAPTER 20

PCIE STANDARDS SUBCOMMITTEE  
POSITION STATEMENT NO. 4  
DECEMBER 5, 1988

ISSUES

What uniform policies and procedures will be followed by Inspectors General when making referrals to the state boards of accountancy and the American Institute of Certified Public Accountants? What is a referable action? What essential elements are needed in a uniform Inspector General referral package to make it more useful to the state boards of accountancy and the American Institute of Certified Public Accountants?

BACKGROUND AND DISCUSSION

The Inspector General Act of 1978 requires that each Inspector General "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General." This duty is accomplished in part by the Inspector General's performance of desk reviews and audit work paper reviews of audit reports submitted by non-Federal auditors (IPAs). As a result of these reviews it may be determined that the auditor did not comply with standards established by the Comptroller General or other appropriate professional standards. The auditor's noncompliance with the standards may warrant a referral to the appropriate sanctioning or licensing authority.

The purpose of this position statement is to describe: (1) uniform Inspector General policies and procedures for making referrals, and (2) a uniform Inspector General referral package.

It was through a PCIE Standards Committee project that information was obtained from 53 of 54 state boards of accountancy as to the type of information they would need in a referral package. With the information provided from the state boards and through other discussions a uniform Inspector General referral package has been developed by the PCIE Standards Sub-Committee.

## POSITION

### Referable Action

A referable action is when the audit report or underlying audit work have significant inadequacies that make the audit so pervasively deficient that users cannot rely on it. The following are significant inadequacies.

1. The auditor is unqualified; i.e., not properly licensed as a CPA or public accountant or not independent.
2. Working papers are sufficiently inadequate to preclude an assessment of the adequacy of the auditor's work on the study of internal controls or the testing of compliance requirements; the deficiency is pervasive rather than isolated.
3. A major component of the report is missing, e.g., financial statement(s), opinion, report on compliance, required supplemental schedule, etc.
4. The auditor fails to correct substandard work on a timely basis.
5. The auditor fails to review compliance with requirements.
6. The auditor fails to perform an appropriate evaluation of internal controls.
7. The auditor commits one or more other gross departures from GAGAS that undermines the creditability of the audit. Some examples are:
  - lack of due professional care;
  - lack of sufficient evidential matter;
  - unjustified use of audit guide(s) not considered generally accepted; and
  - lack of site visits

### Procedures

The Office of Inspector General (OIG) should correspond in writing with the IPA to set forth the conclusions of the desk review and/or audit working paper review that may

result in a referral. This correspondence should contain specific details of the deficiencies noted and the applicable audit standards that have been violated. Referrals for violations of fieldwork standards would normally be based on results of a working paper review. The criteria that is being used to evaluate the deficiencies should be specifically cited.

The IPA should be given the opportunity to respond to the OIG's correspondence. If the IPA chooses not to respond to the correspondence it should be noted in the referral. If the IPA responds to the correspondence, then a reply from the OIG may be appropriate.

Referrals should be made to the state board of accountancy that licensed the individual/firm and, if different, to the board where the entity that was audited is located. Simultaneously, a referral should be made to the AICPA if the IPA is a CPA and a member of the AICPA or a state society.

The decision as to who should be named in the referral will depend on the individual circumstances. At a minimum, the partner, manager, and supervisor responsible for the audit should be named. Additionally, individual assistants may be named in the referral depending on the violations. If the state board involved requires a firm to be licensed, the OIG should consider making the firm a subject of the referral.

#### Uniform Inspector General Referral Package

The package should contain the following:

1. A cover letter addressed to the appropriate state board of accountancy/AICPA that: (1) specifically states that the referral is a complaint, (2) highlights what GAO/AICPA standards were violated, (3) gives a commitment that OIG's work papers are available for the board's use, (4) includes an offer that OIG personnel will be made available to testify at any hearings, (5) notifies the state board if similar letters are also sent to other state boards or the AICPA, and (6) requests that the OIG be advised of the decision the state board/AICPA rendered.

2. The following enclosures:

- a. A copy of the IPA's report that is the subject of the referral;
- b. A copy of the correspondence that was sent to the auditor that discusses in detail the deficiencies of the audit work;

c. A copy of the correspondence received by the OIG that contains the IPA's views or response; and

d. If appropriate, a reply from the OIG to the views submitted by the IPA. (The OIG's reply may be included in the cover letter to the state board/AICPA rather than presented as a separate document.)

A copy of the cover letter should be sent to the IPA to make him/her aware of the OIG's actions.