United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

FEB 19 2002

The Honorable Jeffrey A. Rush, Jr.
Inspector General
Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Rush:

The U.S. Department of the Interior Office of Inspector General (OIG) has completed an external quality control review of your audit operation. Our review was conducted in conformity with standards and guidelines established by the President's Council on Integrity and Efficiency (PCIE). This review is required by Section 3.31 of the General Accounting Office's Government Auditing Standards.

In performing our review, we gave consideration to the April 1997 policy statement on quality control and external reviews issued by the PCIE. That statement indicates that an OIG's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance that the objective of quality control will be met. It recognizes that the nature, extent and formality of an OIG's system of quality control depends on various factors such as the size of the OIG, the location of its offices, the nature of the work and its organizational structure.

The objective of our review was to determine if the Department of Treasury Office of Inspector General (Treasury OIG) internal control system was operating effectively to provide reasonable assurance that established policies, procedures, and applicable auditing standards were being followed in the conduct of its audit work. The review covered work that the Office of Audits conducted which resulted in audit reports being issued during the period April 1, 1999, through September 30, 2000. Our fieldwork was conducted from November 2000 through March 2001 at the Treasury OIG offices located in Washington, D.C. and nine field locations--Boston, Massachusetts; Marleton, New Jersey; Chicago, Illinois; Indianapolis, Indiana; San Francisco and Los Angeles, California; Houston, Texas; New Orleans, Louisiana; and Miami, Florida.

For the purposes of this review, we identified, reviewed, and assessed the following significant elements of the Treasury OIG's internal quality control system:

- written policies and procedures;
- staff qualifications;
- supervision; and
- internal quality assurance review program

In addition, to gain an understanding of the quality control system used by the Treasury OIG, we interviewed appropriate officials within their Office of Audits, reviewed four internal quality assurance reviews covering the Western, Central, Northeast, and Southern Regions; and reviewed policies and procedures for conducting internal quality control reviews.

Also, we reviewed and followed up on the prior peer review conducted by the Department of Education of the Treasury OIG's audit operations and found that two recommendations, involving independence and quality assurance reviews, had been fully addressed and resolved. The third recommendation, involving tracking and monitoring employees' continuing education, has not been fully implemented.

We conducted tests of personnel matters, including staffing qualifications and independence and concluded that the audit staff possessed the appropriate skills, education and experience to perform the OIG mission, and that the staff was well versed in the importance of maintaining its independence. We verified that all staff had access to and possessed an understanding of existing quality control policies and procedures relating to professional auditing standards. We also conducted a detailed quality control review of a judgmental sample of 25 audits (23 performance and 2 financial) performed by the Washington, D.C., and 9 field offices visited. The review found that these audits were conducted substantially in compliance with existing policies, procedures and professional standards.

Results of Review

In our opinion, the system of quality control employed by the Treasury OIG's audit function for the fiscal year ended September 30, 2000, was designed in accordance with the quality standards established by the PCIE and was complied with during this period. The system provided us with reasonable assurance that the Treasury OIG was in conformance with professional standards in the conduct of its audits. In general, audit plans and/or programs were properly prepared; work papers were properly indexed, referenced, and reviewed by supervisors; and quality procedures were properly implemented.

We did find five areas with minor problems where enhanced management attention could improve the overall performance of the Office of Audits. These five areas are:

Audit Objectives - The objectives in two audit reports did not fully address the objectives stated in the audit work program and the difference was not explained in the reports or the work papers.

Reliance on work performed by others - For two reports, auditors relied on work performed by other organizations but did not validate the accuracy of the information or disclose in the report that they had not verified such information.

Insufficient evidentiary support - Two reports had findings that were based on what we believe to be insufficient testing or documentation.

Work paper preparation and review - Fifteen work paper files had one or more deficiencies in the areas of supervision, numeric verification, quality control, support for statements, universe and sample size disclosures, and cross indexing.

Training - Additional actions are needed to ensure that employees meet their Continuing Professional Education (CPE) requirements. Our review of 116 training records disclosed 9 employees who did not meet the minimum 80-hour CPE requirement for a 2-year period and 8 employees who did not meet the minimum 20-hour CPE for 1 year. The causes for not meeting training requirements appeared to be improper interpretation of policy at the regional level and training records being maintained at the regional level with little or no headquarters oversight.

Specifics as to which audit reports and work papers contained the above-cited problems were identified and discussed with your staff during the peer review fieldwork stage and during the exit conference. The preponderance of the problems identified occurred in the Southern office that had no on-site supervision.

Recommendations

In our enclosed report, we discussed that the Treasury OIG establish controls to ensure that: (1) information used from outside sources is verified or that the report discloses that such information has not been verified, (2) sufficient work is performed to support findings, (3) work paper files fully conform with internal policies and procedures and the Government Auditing Standards, (4) projections are based on statistical samples, (5) audit program completion is documented, and (6) all employees complete the required training.

A draft of this report was provided to your office for review and comments. On October 22, 2001 a written response was received, which was used in completing this final report and which generally concurred with our recommendations.

We appreciate the cooperation of your staff in the performance of our review and your commitment, as expressed in our closing conference of October 29, 2001, to exceed the "adequate" standard of quality in conducting audits.

Sincerely,

Earl E. Devaney
Inspector General

Enclosure

COMMENTS ON THE INTERNAL QUALITY CONTROL SYSTEM AND OPPORTUNITIES FOR IMPROVEMENT

Our review found that the Department of the Treasury, Office of Inspector General (Treasury OIG), Audits, internal quality control system provided reasonable assurance that audit work was conducted in accordance with generally accepted government auditing standards (GAGAS) and that established policies and procedures of the OIG audit operations were generally being followed. The review also identified opportunities for improving quality controls, particularly those related to disclosure and documentation and work paper preparation and review. Our recommendations to address these matters are detailed below.

BACKGROUND

The GAGAS require government audit organizations to have an appropriate internal quality control system in place and to undergo an external quality control review at least once every 3 years. The President's Council on Integrity and Efficiency (PCIE) Policy Statement on Internal Quality Control and External Quality Control Reviews (Policy Statement) requires that an OIG's internal quality control system be appropriately comprehensive and suitably designed to provide reasonable assurance that the audit organization (1) has adopted and is following applicable auditing standards and (2) has established and is following adequate audit policies and procedures. The Policy Statement requires that the organization's internal quality control policies and procedures, at a minimum, encompass staff qualifications, independence, audit performance, and internal review.

OBJECTIVE, SCOPE, AND METHOD

The objective of our review was to determine whether Treasury OIG's internal control system for audit functions was adequate and operating effectively to provide reasonable assurance that applicable audit standards and established policies and procedures were being followed. In accomplishing our objective, we also determined whether the audit objective was met and the findings supported with sufficient and reliable documentation.

To accomplish our objective, we reviewed and evaluated 25 audit reports that were selected from the 115 Treasury OIG internal audits listed in the Semiannual Reports to the Congress for the period April 1, 1999, through September 30, 2000 (see Appendix 1 for a list of reports reviewed).

The 25 audit reports selected for review included 23 performance and 2 financial reports. In determining the number of reports to examine, we selected a variety of complex and narrow-scope audits and reports prepared by various directors and audit managers at the four regional and one headquarters offices. We also reviewed the Department of Education (Education) OIG's work papers, which were prepared during the last peer review of Treasury OIG's audit operations. In a February 1998 peer review report, Education made three recommendations concerning development of written policies and procedures for tracking and monitoring the continuing professional education of auditors; performance of a management review of Treasury OIG's independent referencing policy; and establishment of procedures for work paper documentation.

We also reviewed Treasury OIG's staff qualifications (including the policies and procedures for recording and documenting training hours), independence, and its quality assurance review (QAR) program as follows:

- Staff qualifications. We evaluated 116 training records, covering the period October 1, 1998 through February 28, 2001, to test compliance with continuing professional education (CPE) requirements. We also verified that training certificates were maintained for 14 (randomly selected) audit staff members. Our comments on training are included in the "Training" section of this report.

- Independence. We determined whether indications of impairment to independence were evident in each of the audits selected for review. We also reviewed the policies and procedures for identifying and resolving financial conflicts of interest and other personal impairments to independence. We identified no impairments to auditor independence.

- QAR reports. We reviewed the QAR reports issued in 2000 for three regions (Western, Central, and Northeast) and in 1998 for one region (Southern). We also reviewed OIG's policies and procedures for conducting QARs, evaluated the design of this system to determine if it complied with GAGAS and the Policy Statement, and examined the work papers for five QAR reports to test compliance with OIG policies. We identified no issues with the timeliness or quality of Treasury's QAR process.

Our review was conducted at Treasury OIG offices in Washington, D.C.; Boston, Massachusetts; Marleton, New Jersey; Chicago, Illinois; Indianapolis, Indiana; San Francisco and Los Angeles, California; Houston, Texas; New Orleans, Louisiana; and Miami, Florida. We interviewed Treasury OIG headquarters officials and audit officials at each site, and we discussed our observations with Treasury OIG staff during the review. Our fieldwork was conducted from November 2000 through March 2001. Our review was conducted in accordance with the PCIE "Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of Inspector General," dated April 1997.

RESULTS OF REVIEW

Treasury's OIG overall had an adequate internal control system for its audit function. In general, audit plans and/or programs were prepared; work papers were indexed, referenced, and reviewed by supervisors; and quality assurance procedures were implemented. However, we identified areas where improvement is needed. Specifically, we found that Treasury OIG management should focus on improving the internal quality control system with respect to disclosure and documentation, taking actions to more fully report on audit work performed and to provide additional information to support statements of fact and audit conclusions, particularly in the Southern Region. We also found that Treasury OIG's actions, taken in response to recommendations in Education's 1998 peer review report, did not fully correct cited deficiencies in work paper preparation and review. Treasury OIG also should establish controls to ensure that training requirements are met.

Documentation and Full Disclosure

Government Auditing Standards (GAS) require auditors to adequately document the work performed to support the significant conclusions and judgments reached and to disclose situations in which they are not able to follow applicable standards (GAS 6.64 and 3.29, respectively). Also, GAS 6.15 requires auditors, who rely on the work of others, to perform procedures to determine the reliability of the information. Under GAS 7.10-7.16, auditors are required to disclose any limitations on the accomplishment of an audit's objectives. In 6 of the 23 performance reports reviewed, 4 of which were prepared by staff in the Southern Region, auditors performed insufficient work to address the audit objective and/or did not disclose a scope limitation in reporting results, relied on the work of others as support for their findings without verifying the reliability of the information, or did not perform sufficient field work or testing to support their findings. Specifically:

Audit Objectives. Two audit reports did not meet or fully meet the objectives of the reviews and the auditors did not explain why the review objectives in the reports differed from those described in the audit programs. For example:

- Although the objective of one audit was to evaluate collections and imprest fund transactions at a law enforcement training facility, the audit fieldwork did not entail any testing of transactions and the report did not disclose why collections and imprest fund transactions were not tested.

- The objective of another audit was to determine whether adequate guidelines and procedures had been established for the management inquiry process. In the audit report, auditors said that "detailed testing of new procedures and controls was not performed" because the guidance had only recently been implemented. Auditors did not document a revised objective, given that audit work was insufficient to address the initial objective.

Reliance on the work of other reviewers. In two audit reports, auditors relied on work performed by other organizations. However, auditors did not validate the information or disclose in their report that they had not verified the information. For example:

- The objective of one audit was to evaluate the Comptroller of the Currency's procurement operations. However, no testing of procurements was performed because another organization recently had completed a procurement review and auditors did not validate the results of the procurement review.

- The objective of another audit was to determine the adequacy of issues pertaining to supervision of bank insurance activities. Auditors relied on the unverified work of others to accomplish the objective and did not disclose this limitation in the scope section of the audit report.

Findings with insufficient evidentiary support. Two audit reports had findings that were based on insufficient testing or documentation. For example:

- One finding stated that an automated system that was used to track cargo was "adversely affected" by the frequent rotation of personnel. The basis for this finding was an interview with one official and a comment in a General Accounting Office report on potential problems with the system.

- Another report's finding on export licensing procedures stated that employees needed additional training. However, the work papers did not document how much training was needed.

The deficiencies cited above are attributable to only a small number of offices. Specifically, four of the six audit reports were prepared by audit staffs at Southern Region offices, including two reports that were prepared by audit staff at a field office that had no official manager.

We recommend that the Treasury OIG establish controls to ensure that (1) the objective of the audit is addressed in the report and, if it is not fully addressed, define the revised objective and include in the text of the report a discussion of the reasons for the change in scope; (2) information from outside sources, which is used to support findings, is verified or that the report discloses that such information has not been verified; and (3) sufficient work is performed to support findings.

Work Paper Preparation and Review

Government Auditing Standards (GAS 6.46) requires auditors to obtain sufficient, competent, and relevant evidence. However, of 23 performance audit reports and related work paper documentation, we found that as few as 6 and as many as 15 instances of deficiencies in the areas of supervision, numeric verification, quality control, support for statements, universe and sample disclosure, cross-indexing, and work paper documentation. Specifically, issues raised in supervisory reviews were not adequately addressed, numeric computations were not independently verified, quality control checklists were not completed, statements in reports could not be traced to source documents, the relationship between the universe and what was audited was not disclosed, work papers were not cross-indexed or indexed to source documents, and work papers had insufficient information for the reader to determine the relevance or significance of the documents.

Also, for one financial audit, completion of the cost accounting cycle audit program was not documented and, in one case, auditors made a projection of results based on a judgmental sample. Only a statistical sample should be used for projecting results.

In its January 26, 1998 response to Education's recommendations in its peer review report on work paper preparation and review, the Treasury OIG said that "the issues of documentation and timely supervisory review were identified through our internal control process and were discussed as part of our internal quality assurance reviews." It also said that a bulletin would be issued to all supervisors, reminding them to comply with requirements for documenting audit work. In February 1998, the Treasury OIG issued a memorandum to all regional directors, stating that they would review its policies and procedures and revise and update this guidance "as deemed necessary." The memorandum also directed managers to discuss with their staffs the need to comply with policies relating to documenting supervision (including work paper reviews

of indexing and cross-indexing) and to sign audit programs, draft and final reports. During our review, we found that no additional guidance had been issued on work paper preparation.

We recommend that the Treasury OIG reevaluate the need for additional guidance and monitor implementation of procedures to ensure that work paper documentation and review is sufficient and reliable with regard to the following: (1) supervisory review comments on work papers are adequately addressed; (2) numeric computations are verified; (3) quality control checklists are completed; (4) statements in reports are based on source documents; (5) the relationship between the universe and the items reviewed is disclosed; (6) work papers are cross-indexed to support documents; and (7) work papers include sufficient information on the purpose, source, scope, or conclusions for the reader to understand the relevance of the document. We also recommend that projections are based on statistical samples and that audit program completion is documented.

Training

We found that additional actions are needed to ensure that employees meet their continuing professional education (CPE) requirements. Although Treasury OIG maintained training records at regional and field offices, maintenance of the records did not ensure that employees received required training. Of 116 training records reviewed, we identified 9 employees who did not meet the minimum 80-hour CPE requirement for the 2-year period and 8 employees who did not meet the minimum 20-hour CPE requirement for a 1-year period.[1]

We recommend that the Treasury OIG implement controls to ensure that all employees complete the required CPE training.

In its October 22, 2001 response to our draft "Comments" (see Appendix 2), Treasury OIG concurred with our recommendations and stated that actions would be taken to correct the areas in which improvements are needed.

[1] Although two employees who did not meet the 80-hour training requirement for the 2-year period retired, they did not retire until January 2001, which was after the expiration of the 2-year period.

SELECTED AUDIT REPORTS
Department of the Treasury
Office of Inspector General
Peer Review

	Report Number	Date Issued	Report Title
1.	00-076	03/27/00	BPD's Compliance with the GPRA
2.	00-120	08/20/00	Effectiveness of OCC's Procurement Operations
3.	99-092	06/16/99	Review of the Bureau of ATF's High Intensity Drug Trafficking Area Program at Puerto Rico and Miami
4.	00-092	06/27/00	Department of the Treasury D.C. Pensions Projects' FY 1999 Financial Statements
5.	00-066	03/06/00	Customs Automated Commercial System Cargo Selectivity
6.	00-109	07/17/00	Customs Support for the Business Anti-Smuggling Coalition
7.	00-015	12/30/99	Customs Oversight of Foreign Trade Zones Activity
8.	99-090	06/15/99	Interagency Review of Export Licensing Procedures
9.	00-111	07/31/00	USCS Has Undercharged Couriers for the Cost of Inspector Services
10.	00-047	02/01/00	Opportunities for the BEP to Improve the Processing of Mutilated Currency
11.	00-027	01/03/00	Office of the Comptroller of the Currency Bank Secrecy Act Examinations Did Not Always Meet Requirements
12.	00-086	05/26/00	Improvements Needed in the Bureau of AFT Explosives Inspection Program
13.	00-099	06/27/00	USCS's Management Inquiry Process
14.	00-064	03/06/00	Audit Report on the Review of Internal Controls Over Collections and the Imprest Fund at the Federal Law Enforcement Training Center
15.	99-050	02/18/00	Report on the USCS' Fiscal Years 1999 and 1998 Financial Statements
16.	00-119	08/21/00	Final Report on the Bureau of ATF's Implementation of the Youth Crime Gun Interdiction Initiative
17.	00-093	06/16/00	Final Report on the Bureau of ATF Conversion of the Firearms Tracing System
18.	99-093	06/16/99	Selected Counterfeit Performance Measures of the USSS
19.	00-016	02/07/00	Final Report on Review of Controls Over Refunds of Harbor Maintenance Tax on Exports
20.	99-094	06/26/99	USCS Controls Over High Intensity Drug Trafficking Area Funds
21.	00-098	06/27/00	OCC's Supervision of Banks Selling Insurance
22.	99-085	05/26/99	USCS Background Investigations of Inspectors
23.	00-065	03/06/00	Audit of OCC GPRA Performance Data Reliability and Validity
24.	99-008	07/27/99	Customer Awareness Disclosures OCC
25.	00-122	09/15/00	BPD's Change Control Procedures

OFFICE OF
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 22, 2001

Mr. Roger La Rouche
Assistant Inspector General for Audits
Office of Inspector General
U.S. Department of the Interior
Washington, D.C. 20240

Dear Mr. La Rouche:

Thank-you for the opportunity to comment on your draft report dated August 30, 2001, on the results of your office's External Peer Review of the Department of the Treasury Office of Inspector General (OIG), Office of Audit. We also wish to express our appreciation for the professionalism your team demonstrated in conducting this review.

We are pleased that your office has concluded that our system for quality control in effect during the period covered by the review complies with the President's Council on Integrity and Efficiency standards and provides reasonable assurance of conformance with professional standards in the conduct of our audits. We are also pleased that no issues were noted with regard to auditor independence and the timeliness and quality of our Quality Assurance Review (QAR) process. Furthermore, we appreciate the observations in the draft letter of comment of areas where improvements can be made in our operations, and we generally concur with your findings and recommendations and have taken or planned corrective actions as appropriate.

We noted that the draft report states that many of instances where there could have been better adherence to standards are attributed to reviewed audits that were performed by our Southern Region. I would like to point out that since your office's review, we have, among other things: (1) redirected additional audit resources to this strategically important region and (2) hired well-qualified individuals for the key management positions of Regional Inspector General for Audit and audit manager for our Miami office. It should be noted that the audit manager position in Miami had been vacant for a number of years for a variety of reasons. These changes have already resulted in improved operational effectiveness and adherence to standards by this region.

While we generally concur with your findings, we do want to comment on one issue raised in the draft report. Specifically, the draft states that for one audit of the Office of the Comptroller of the Currency (OCC), the objective of the audit was "to determine the adequacy of issues pertaining to supervision of bank insurance activities" and that the auditors relied on the unverified work of others and did not disclose this limitation in the scope of the audit report. The actual objective of this audit was to determine if OCC's supervision provided adequate coverage of safety and soundness and consumer protection issues relating to national bank insurance activities. It should be noted that we performed this audit in response to recent financial reform legislation that removes many barriers between banks and insurance companies. In that regard, this forward-looking review of the potential risks posed by removal of these barriers and OCC's response to these increased risks is not an area that was the subject of traditional empirical audit evidence. We believe that our report adequately identified the sources of our information and the basis for our conclusions. It should also be noted that although OCC initially did not concur with several recommendations in our report, it has subsequently taken or planned corrective actions that are responsive to these recommendations.

Our specific responses to the draft report recommendations are as follows:

We recommend that the OIG establish controls to ensure that (1) the objective of the audit is addressed in the report and if it is not fully addressed, define the revised objective and include in the text of the report a discussion of the reasons for the change in scope; (2) information from outside sources, which is used to support findings, is verified or that the report discloses that such information has not been verified; and (3) sufficient work is performed to support findings.

We concur in most part with this recommendation. While we certainly agree that the audit report should fully address the stated audit objectives, it should be noted that for some performance audits, the audit objectives may change from those established at the beginning of the audit as the audit fieldwork evolves. In this regard, we generally do not see the need to discuss the reasons for changes in the audit

objectives in the report. This type of information is not specifically required by the reporting standards and may be confusing to the users of our audit reports. We would agree, however, that the basis for any change to an audit objective should always be documented in the audit work papers.

Enclosed is a memorandum I have issued to our managers that discusses the results of your findings and reemphasizes the need for them to ensure that our audit work and reporting adheres to generally accepted government auditing standards and our implementing policies and procedures.

In that memorandum, I am also outlining certain changes to our quality assurance review (QAR) program to better monitor compliance with these requirements on a more real-time basis. Briefly, our QAR program in the past has principally involved cyclical reviews, generally on a 2- or 3-year cycle, of the field and headquarters audit components during which selected audits are reviewed. While we will continue onsite reviews, we will select individual audits performed by each component for QARs by staff independent of the component throughout the year. Also, we are developing procedures to subject each audit report to an independent review.

We recommend that the OIG reevaluate the need for additional guidance and monitor implementation of procedures to ensure that work paper documentation and review is sufficient and reliable with regard to the following: (1) supervisory review comments on work papers are adequately addressed; (2) numeric computations are verified; (3) quality control checklists are completed; (4) statements in report are based on source documents; (5) the relationship between the universe and the items reviewed is disclosed; (6) work papers are cross-indexed to support documents; and (7) work papers include sufficient information on the purpose, source, scope, or conclusions for the reader to understand the relevance of the document. We also recommend that projections are based on statistical samples and the audit program completion is documented.

We concur with this recommendation. I have asked our managers to reemphasize these existing requirements as discussed in the enclosed memorandum. Compliance will be monitored through our QAR process.

Page 4

We recommend that the OIG implement controls to ensure that all employees complete the required CPE training.

We concur with this recommendation. We previously recognized that there were inconsistent interpretations of CPE requirements by our regional and headquarters audit components and that certain staff had not timely met CPE requirements. In response, we issued a memorandum to our managers in June 2000 clarifying these requirements and implementing procedures to centralize the monitoring of CPE training by my immediate office. A copy of this memorandum was provided to the External Peer Review team during its review.

If you have any questions about our comments, please contact me at (202) 927-5400.

Sincerely,

Marla A. Freedman
Assistant Inspector General for Audit

Enclosure

cc: Dennis Schindel
Deputy Inspector General

[The Office of Inspector General is not including the Enclosure.]