MEMORANDUM FOR The Auditor General of the Navy (Acting)


1. We have reviewed the Naval Audit Service’s (NAVAUDSVC’s) system of quality control in effect for the period 1 January 2014 through 31 December 2017. A system of quality control encompasses NAVAUDSVC’s organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming with generally accepted government auditing standards (GAGAS). The elements of quality control are described in GAGAS. NAVAUDSVC is responsible for establishing and maintaining a system of quality control that provides it with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements in all material respects. Our responsibility was to express an opinion, based on our review, on the design of the system of quality control and NAVAUDSVC’s compliance.

2. Our review was conducted in accordance with GAGAS and the Council of the Inspectors General on Integrity and Efficiency’s Guide for Conducting Peer Reviews of Audit Organizations of Federal Offices of Inspector General. During our review, we interviewed NAVAUDSVC personnel and obtained an understanding of the NAVAUDSVC’s audit organization and the design of its system of quality control sufficient to assess the risk implicit in its audit functions. Based on our assessment, we selected eight audits and one attestation engagement (collectively referred to herein as audits) and administrative files to test for conformity with professional standards and compliance with NAVAUDSVC’s statement of quality control. The selected audits represented a reasonable cross-section of NAVAUDSVC’s audit function, with emphasis on higher risk audits. Before concluding our peer review, we reassessed the adequacy of the scope of the peer review procedures and regularly met with NAVAUDSVC management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.
3. We tested compliance with policies and procedures to the extent we considered appropriate. These tests covered the application of NAVAUDSVC policies and procedures on the selected audits. Our review was based on selected tests, so it wouldn’t necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

4. There are inherent limitations in the effectiveness of any system of quality control and, therefore, noncompliance may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions or because the degree of compliance with policies or procedures may deteriorate. Enclosure 1 identifies NAVAUDSVC offices we visited and the audits we reviewed.

5. We noted a deficiency during our review. Specifically, the system of quality control for NAVAUDSVC’s audit function in effect for the peer review period wasn’t suitably designed or didn’t provide reasonable assurance that NAVAUDSVC performed and reported on audits and attestation engagements in full conformity with applicable professional standards. Notably, the organizational alignment of the Auditor General of the Navy and NAVAUDSVC significantly impeded NAVAUDSVC’s audit independence. While we didn’t find evidence that any of the eight audits in our sample had been unduly influenced or compromised, in our opinion, since the organizational alignment that created the independence impediment remained in place until 4 March 2017 and corrective actions hadn’t been taken until after the review period, it warrants an overall “fail” rating for the peer review. However, as discussed in paragraph 11, the Acting Naval Auditor General took immediate corrective actions based on our 20 March 2018 notice of concern by establishing safeguards and adding disclosures to affected reports to mitigate the independence issue. Accordingly, we believe that successfully implementing the safeguards to NAVAUDSVC’s current operational environment and organizational alignment and adding appropriate report disclosures have sufficiently addressed the independence concerns we identified during the peer review.

   a. GAGAS 3.31 lists a number of criteria that must be satisfied for internal auditors who work under the direction of the audited entity’s management to be considered independent. The criteria in GAGAS 3.31a and 3.31b weren’t fully satisfied during the entire period of this peer review.

   (1) GAGAS 3.31a requires the head of the internal audit organization to be accountable to the head or deputy head of the entity. Beginning in March 2013, while the position of Under Secretary of the Navy was vacant, the Naval Auditor General position reported to the General Counsel of the Navy who hadn’t been charged with
governance over the entire Department of the Navy. During this period and under this organizational reporting alignment, NAVAUDSVC didn’t maintain audit organizational independence from all operational and staff elements within the Navy. The Auditor General position continued to report to the General Counsel of the Navy through January 2017.

(2) GAGAS 3.31b requires the head of the internal audit organization to report audit results both to the head or deputy head of the government entity and to those charged with governance. Because the Auditor General of the Navy position effectively reported to the General Counsel alone rather than to the Secretary of the Navy or Under Secretary of the Navy, the Auditor General didn’t regularly report audit results to the head or deputy head of the Navy. We reviewed nine reports to identify the distribution and recipients. The Secretary of the Navy wasn’t furnished a copy or included in the distribution list for seven of these reports. We couldn’t verify that the Secretary received the other two reports because the reports didn’t have distribution or copy furnished lists.

(3) Furthermore, the Secretary of the Navy wasn’t involved in discussing results before reports were released. Secretary of the Navy Instruction 7510.7F (Department of the Navy Internal Audit), dated 27 December 2005, required the Auditor General to report directly to the Under Secretary of the Navy. Whenever that position was vacant, the Auditor General was to report directly to the Secretary of the Navy. According to NAVAUDSVC personnel, the Under Secretary held monthly meetings with the Auditor General about ongoing audit results and other issues regarding the NAVAUDSVC. However, in the absence of the Under Secretary of the Navy, the General Counsel continued the standard monthly meetings the Auditor General typically had with the Under Secretary of the Navy and covered the same issues that would have been briefed to the Under Secretary. In our opinion, this shows that the Auditor General was reporting to the General Counsel rather than through the General Counsel to the Secretary of the Navy.

b. Navy officials didn’t view these organizational reporting alignments as actual or apparent impediments to independence. Therefore, NAVAUDSVC didn’t establish adequate safeguards, disclosures, or disclaimers to address and overcome the threats to organizational independence created by these inappropriate oversight and direct reporting relationships.

c. NAVAUDSVC also didn’t establish any special procedures to avoid the appearance of threats to its independence, including appropriate disclosures and disclaimers on applicable audit reports.
Because audit independence was significantly impeded, NAVAUDSVC’s system of quality control from March 2013 through December 2017 couldn’t reasonably ensure that NAVAUDSVC could perform and report on audits in full compliance with GAGAS and Navy auditing policy.

6. GAGAS 3.14g states that a structural threat to independence is a threat that an audit organization’s placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization’s ability to perform work and report results objectively. We determined that the General Counsel of the Navy was actively involved in NAVAUDSVC operations. Therefore, although guidance directed the Auditor General of the Navy and NAVAUDSVC to report “through” the General Counsel to the Secretary of the Navy, in practice, they reported solely “to” the General Counsel.

   a. NAVAUDSVC officials provided support that the Navy General Counsel:

      (1) Met monthly with the Auditor General or Acting Auditor General to discuss annual audit plans and ongoing audit results and didn’t meet with the Secretary of the Navy.

      (2) Provided input and signed NAVAUDSVC’s Department of the Navy Audit Oversight Plan for Fiscal Year 2016 rather than obtaining the Secretary of the Navy’s approval and signature.

      (3) Was the annual appraisal rater for the Auditor General position from March 2013 through January 2017.

   b. The General Counsel’s responsibilities and duties related to NAVAUDSVC operations presented a structural threat to NAVAUDSVC’s organizational independence. NAVAUDSVC doesn’t have its own legal office, so the General Counsel’s office may have been required to provide legal advice to Navy auditors in support of an audit. Because audit results were then reported “to” rather than “through” the General Counsel, the auditors’ ability to objectively report results that conflicted with this advice might have been impaired. Despite this possible threat to independence, NAVAUDSVC didn’t establish any GAGAS-required safeguards to ensure that the threat was eliminated or reduced to an acceptable level.

   c. At a minimum, to ensure that NAVAUDSVC and the Auditor General position maintained audit independence while reporting to the General Counsel and to
overcome the structural threat to audit independence, NAVAUDSVC should have developed safeguards by establishing and documenting procedures for:

1. Resolving disputed findings.

2. Resolving potential disagreements between the General Counsel and the Auditor General or Acting Auditor General.

3. Elevating Auditor General concerns directly to the Secretary of the Navy.

4. Obtaining input and approval from the Secretary of the Navy concerning annual audit plans.

5. Regularly discussing audit results directly with the Secretary and other senior leaders charged with governance of the Navy.

6. Removing the General Counsel from the Auditor General’s rating chain.

d. In paragraph 11 of this report, we discuss corrective actions NAVAUDSVC leaders implemented immediately based on our 20 March 2018 notice of concern.

e. During 2017, the Auditor General reported to two Navy officials who were performing the duties of the Under Secretary of the Navy. While performing these duties, both individuals were “dual hatted” with assignment to another high-level position within the Department of the Navy: Deputy Chief Management Officer (January to February 2017) and Deputy Assistant Secretary of the Navy, Expeditionary Programs and Logistics Management (February to March 2017), respectively. As a result, the ability of Navy auditors and the Auditor General to perform audit work that involved the non-secretarial duties of these officials and report the results to them objectively was threatened. The Navy should have taken additional measures to mitigate this structural threat to auditor independence. For example, discussions for any audits involving the dual-hatted officials’ non-secretarial responsibilities should have been directed to the Secretary of the Navy, and the Secretary should have formally established this safeguard in advance. Such a procedure would have both accounted for structural threats to auditor independence under GAGAS 3.14g and prevented any tension or conflict between the secretarial and non-secretarial roles of the dual-hatted employees.

Appendix 8G(h)(2)(B), audits of the programs or operations of an activity in the Executive Branch, such as the Department of the Navy, must be conducted in accordance with GAGAS. Both DoD Instruction 7600.02 (Audit Policies), dated 15 March 2016; and DoD Manual 7600.07 (DoD Audit Manual), dated 3 August 2015, require independent audits and attestation engagements of DoD organizations, programs, activities, and functions to be conducted in accordance with DoD Manual 7600.07 and GAGAS. Therefore, a Military Department doesn’t have the authority to waive the applicability of GAGAS to its internal audit program. GAGAS 3.09 states that if safeguards aren’t in place to eliminate an unacceptable threat or to reduce the threat to an acceptable level, audit independence should be considered impaired. Since NAVAUDSVC hadn’t identified an independence threat and established safeguards, its audit independence was impaired throughout the 4.5-year period of March 2013 through December 2017. In addition, GAGAS 3.04 states that an audit organization must maintain independence so that its opinions, findings, conclusions, judgment, and recommendations will be viewed as impartial by a reasonable and informed third party.

8. Navy officials didn’t follow their own policy and guidance when establishing NAVAUDSVC’s organizational reporting alignments. Specifically, instead of following established Navy guidance that required NAVAUDSVC and the Auditor General to report directly to the Secretary or Under Secretary, the Auditor General reported to the General Counsel from March 2013 through January 2017. In the absence of sufficient safeguards and disclosures, this impaired NAVAUDSVC’s audit independence throughout the period.

a. On 27 December 2005, the Secretary of the Navy issued Instruction 7510.7F (Department of the Navy Internal Audit), which addressed concerns about the independence and impartiality of the audit function within the Navy. The instruction required the Auditor General to report directly to the Under Secretary. Whenever that position was vacant, the Auditor General was to report directly to the Secretary. The instruction also had guidance on addressing and resolving audit disputes, stating that the Under Secretary would oversee internal audits through the Office of the Auditor General and resolve any disputed audit findings. However, from March 2013 through March 2016 while the position of Navy Under Secretary was vacant, the Navy Auditor General was directed to report “through” the Navy General Counsel. And, from March 2016 through January 2017, although the Navy Under Secretary position was occupied, the Auditor General continued to report “through” the Navy General Counsel. As previously discussed, although guidance directed the Auditor General and NAVAUDSVC to report “through” the General Counsel to the Secretary of the Navy, in practice, they reported “to” the General Counsel alone.
b. The change in the NAVAUDSVC’s and Auditor General’s reporting relationship was prompted by a 19 March 2013 memorandum issued by the Secretary of the Navy. The memo allocated limited duties and responsibilities of the Under Secretary, including the audit function, to the Navy General Counsel. Since we found no guidance at that time superseding Instruction 7510.7F, this reassignment conflicted with Navy policy requiring an independent and impartial NAVAUDSVC. The Secretary’s memo also didn’t provide guidance on how the General Counsel would resolve disputed audit findings or establish any other safeguards. Instruction 7510.7F stated:

(1) Internal audit is a staff function, which to be effective must be independent of line operations. Navy auditors don’t exercise command authority over organizations they audit. Likewise, line organizations don’t exercise command authority over the internal audit function.

(2) Within the Navy, the Under Secretary oversees internal audits (through the Office of the Auditor General) and resolves disputed audit findings.

(3) To ensure the independence and impartiality of the audit function, the Auditor General reports directly to the Under Secretary. Whenever that position is vacant, the Auditor General reports directly to the Secretary. Within the Navy, only the Secretary and Under Secretary may provide direction to NAVAUDSVC.

c. On 28 October 2014, the Secretary of the Navy issued Instruction 5215.1E. The instruction stated, “memos and letters shall not be used to establish SECNAV [Secretary of the Navy] policy.”

d. From March 2013 through January 2017, when NAVAUDSVC reported to the General Counsel, the office continued providing or supervising the provision of legal services within subordinate commands, organizations, and activities. These services involved the areas of acquisition, business and commercial law, real and personal property law, intellectual property law, fiscal law, civilian personnel and labor law, environmental law, standards of conduct and ethics, and intelligence law. The office was also charged with providing such other legal services as may be required to support the mission of the Navy and the Marine Corps. During this period, NAVAUDSVC continued to audit and publish reports covering these legal areas. Because of this organizational alignment, NAVAUDSVC’s audit independence was significantly impaired. Since the Auditor General reported to the Navy General Counsel, it’s reasonable to question whether NAVAUDSVC could objectively opine on
any significant adjustments made to Navy policy by the General Counsel or the
effectiveness of operations governed by that policy.

e. In December 2016, NAVAUDSVC issued a handbook that included its
viewpoint on audit independence. According to the handbook, to ensure organizational
independence, the Auditor General would report directly to the Under Secretary of the
Navy and would provide results to the Under Secretary in regular, recurring meetings.
In addition, the Auditor General established and maintained policies and procedures to
ensure the independence of the internal audit process in the Navy. The handbook’s
viewpoints on audit independence were clearly inconsistent with NAVAUDSVC’s
inappropriate organizational reporting alignments that had developed from the March
2013 Secretary Memo.

f. On 12 January 2017, the Secretary issued Instruction 7510.7G (Department of the
Navy Internal Audit), which perpetuated the audit independence and impartiality
impairments introduced by the Secretary’s March 2013 memo. According to Instruction
7510.7G—which canceled Instruction 7510.7F—the Auditor General was to again report
directly to the Under Secretary. However, the new instruction failed to recognize the need
to maintain independence as the prior instruction had done and language covering this
was omitted. The January 2017 instruction also had a significant organizational reporting
loophole. It allowed the Auditor General to report to a Secretary designee at the discretion
of the Secretary. The revised policy’s “designee” clause created a situation in which
NAVAUDSVC could potentially lose its audit independence again.

g. On 14 February 2018, in response to a recommendation from a DoD Inspector
General hotline report, the Secretary agreed to remove the “designee” clause from
Instruction 7510.7G to avoid a future structural threat to NAVAUDSVC’s audit
independence. The Secretary removed the reference to his/her designee effective
1 February 2018.

9. In summary, we assessed NAVAUDSVC’s audit independence in terms of GAGAS
and Navy policy and determined that its organizational alignment from March 2013
through December 2017 impeded the Navy’s internal audit independence. Specifically:

a. Permitting the Auditor General of the Navy to report to the Navy General
Counsel rather than, as directed, through the General Counsel to the Secretary of the
Navy significantly impeded NAVAUDSVC’s audit independence.
b. The inappropriate corporate alignments violated GAGAS provisions concerning audit organizational independence and contradicted Navy policy requiring an impartial and independent internal audit function.

c. NAVAUDSVC didn’t establish adequate safeguards, disclosures, or disclaimers to address and overcome this significant threat to auditor independence.

10. On 20 March 2018, we issued a notice of concern to alert DoD and Department of the Navy management of this significant finding that required immediate attention. On 6 April 2018, the Acting Auditor General of the Navy responded by referencing the recently issued DoDIG Hotline report, “Hotline Allegations Regarding the Actions of Department of the Navy Officials on the Naval Audit Service Audit of Alleged Sexual Assault Victims’ Career Paths” (DoDIG-2018-091), dated 28 March 2018. Though that report addressed the structural threat to independence, it concluded that the subject audit wasn’t affected by that threat. Nonetheless, the Acting Auditor General recognized and agreed there was a perception of impairment due to an organization alignment between March 2013 and 4 December 2017. While the Acting Auditor General believed no “actual impairment” existed and disagreed with our planned peer review rating of “fail,” she did concur with our recommendations and proactively took immediate corrective actions.

11. To comply with GAGAS, we made three recommendations to the Auditor General of the Navy. Below are the recommendations and NAVAUDSVC’s reply as well as corrective actions it has taken:

a. Recommendation a: Add disclosures to all audit reports published 13 March 2013 through 4 December 2017. Additionally, add disclosures to all future published reports that will have relied in whole or in part on work performed during that period. At a minimum, disclose:

• Organizational reporting alignment during the audit.

• Noncompliance with Navy policy and GAGAS regarding independence.

• Potential threats to audit independence.

(1) NAVAUDSVC Reply. The Naval Audit Service developed a “Notice of Disclosure.” For published reports maintained internally at the NAVAUDSVC and on its website, the “Notice of Disclosure” will be attached to the report. For published reports already distributed externally, it will send a blanket email to all report addressees that will contain a copy of the “Notice of Disclosure” and explain that it applies to all NAVAUDSVC reports published 13 March 2013 through 4 December
2017. For reports not yet published that will have relied in whole or in part on work performed 13 March 2013 through 4 December 2017, NAVAUDSVC will modify the GAGAS statement to include language similar to the language contained in the “Notice of Disclosure.” The language might be slightly different to clarify that not all of the work was performed from 13 March 2013 through 4 December 2017. The estimated completion date was 4 May 2018.

(2) Corrective Actions: NAVAUDSVC reported that it incorporated the “Notice of Disclosure” on reports numbered N2013-0018, dated 19 March 2013, through report numbered N2018-0029, dated 4 April 2018, maintained internally on the NAVAUDSVC shared drive. We didn’t verify this information. NAVAUDSVC stated also that report number N2018-0030 and all future reports will contain the modified GAGAS statement in the “Auditing Standards” section of the report. NAVAUDSVC reported and we verified that all audit reports published 13 March 2013 through 4 December 2017 and saved on the NAVAUDSVC website (FOIA Reading Room) have been updated to include the “Notice of Disclosure.”

b. Recommendation b: Review all audit reports published 13 March 2013 through 4 December 2017 and add disclaimers based on the organizational reporting alignment at the time. Additionally, add disclaimers to all future published reports that will have relied in whole or in part on work during that period. Disclaimers should include:

• Specific threats to audit independence.
• A statement that the audit report may be unreliable and reason(s) why.

(1) NAVAUDSVC Reply: NAVAUDSVC will review all audit reports published 13 March 2013 through 4 December 2017 and determine which, if any, reports require disclaimers to be added based on the organizational reporting alignment at the time. Similarly, it will review all projects in progress and determine which, if any, reports require disclaimers to be added based on the organizational reporting alignment at the time. For those audit reports identified as requiring a disclaimer statement, NAVAUDSVC will add a disclaimer statement that describes the specific threat to audit independence and a statement that the audit report may be unreliable and reason(s) why. If a disclaimer statement is required, the application of the disclaimer statement would be handled in same manner as the “Notice of Disclosure” as outlined in NAVAUDSVC’s response to Recommendation a. The estimated completion date was 30 September 2018.

(2) Corrective Actions: NAVAUDSVC reported that it identified and conducted a review of 240 projects that were either published or ongoing 13 March 2013
through December 2017. We didn’t verify this review. NAVAUDSVC explained that each audit directorate was provided a series of questions to be used to conduct the “Disclaimer Review” that listed the projects that fell within the universe. Each checklist had the same questions. The directorate’s reviewer then applied the checklist to that directorate’s projects. The checklist review resulted in identifying five projects that had a “yes” response to at least one question. NAVAUDSVC assessed the “yes” responses and determined that, in its professional judgment, none of these five projects warranted a disclaimer. It should be noted that for one of the five projects, the “yes” response from the directorate’s reviewer indicated that there was undue influence by one of the individuals performing the duties of the Under Secretary. This project (Alleged Sexual Assault Victims’ Navy Career Path) had been the subject of a DoDIG investigation. That investigation concluded that DoDIG “did not find any evidence that this structural independence threat impaired the NAVAUDSVC’s ability to perform work or report results objectively for the Victims’ Career Path Audit.” It was determined that none of the projects warranted a disclaimer.

c. Recommendation c: Require GAGAS training related to audit independence for all NAVAUDSVC auditors, especially higher-level officials.

   (1) NAVAUDSVC Reply: NAVAUDSVC has developed GAGAS training related to audit independence. All auditors will be required to certify that they have completed the training. The GAGAS audit independence training will begin in April 2018 and completion will be required by no later than 30 September 2018. NAVAUDSVC will track the certifications to ensure all auditors complete the training. The estimated completion date was 30 September 2018.

   (2) Corrective Actions: NAVAUDSVC reported it developed GAGAS training related to audit independence. All auditors (Federal Job Series 511 and 599) were required to complete the mandatory training and certify completion of training in NAVAUDSVC’s information management system. As of 29 May 2018, there were 273 auditors assigned to NAVAUDSVC. NAVAUDSVC obtained and provided a spreadsheet validating that 272 auditors completed the training (1 auditor was in a leave without pay status). We verified that these actions were taken.

12. Enclosure 2 has the verbatim response by NAVAUDSVC to the notice of concern we issued on 20 March 2018.

13. As is customary for external peer reviews, we’ll issue a letter of comments that discusses other findings from our review that weren’t considered to be of sufficient significance to affect our opinion expressed in this report.
14. We appreciate the courtesies and cooperation extended during the review. If you have any questions, please contact Mr. George Sunderland. He can be reached at 703.223.4691 or by email at george.r.sunderland2.civ@mail.mil.

ANNE L. RICHARDS
The Army Auditor General

CF:
Department of Defense Office of the Inspector General, Assistant Inspector General (Audit Policy and Oversight)
SCOPE AND METHODOLOGY

We tested compliance with NAVAUDSVC audit organization’s system of quality control to the extent we considered appropriate. These tests included a review of nine audit reports issued from July 2016 through October 2017. We performed the review in accordance with:

- The external peer review memorandum of understanding between The Auditors General of the Army and Navy signed on 4 November 2016.

We conducted the review at NAVAUDSVC Headquarters, Washington Navy Yard, DC, and the service’s field offices in Norfolk, Virginia; and San Diego, California. To determine if NAVAUDSVC suitably designed its system of quality control and complied with it, we reviewed its policies and procedures for implementing government auditing standards, organizational independence, auditors’ continuing professional education achievement, and the audit documentation that supported these audit reports:

<table>
<thead>
<tr>
<th>Report Number</th>
<th>Title</th>
<th>Directorate</th>
<th>Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>N2016-0041</td>
<td>Summary of Naval Audit Service Ammunition and Explosives Storage Facilities Audits</td>
<td>Energy, Installations, and Environment (EIE)</td>
<td>Norfolk</td>
</tr>
<tr>
<td>N2016-0047</td>
<td>United States Marine Corps Childcare Background Check Initiatives</td>
<td>Manpower and Reserve Affairs (MRA)</td>
<td>Washington Navy Yard</td>
</tr>
<tr>
<td>N2016-0052</td>
<td>Internal Controls over the Government Commercial Purchase Card Programs at Naval Special Warfare Groups One and Two</td>
<td>Internal Controls and Investigation Support (ICIS)</td>
<td>Washington Navy Yard</td>
</tr>
<tr>
<td>N2017-0002</td>
<td>Marine Corps Community Services at Selected Marine Corps Commands</td>
<td>Financial Management and Comptroller (FMC)</td>
<td>San Diego</td>
</tr>
</tbody>
</table>
VERBATIM COMMENTS BY NAVAL AUDIT COMMAND
TO THE NOTICE OF CONCERN

DEPARTMENT OF THE NAVY
NAVAL AUDIT SERVICE
1906 BEATTY PLACE SE
WASHINGTON NAVY YARD, DC 20374-5005

7510
6 Apr 18

From: Auditor General of the Navy (Acting)
To: The Army Auditor General
(Attn: Ms. Anne L. Richards)

Subj: NAVAL AUDIT SERVICE'S RESPONSE TO THE ARMY AUDITOR GENERAL'S NOTICE OF CONCERN

Ref: (a) Notice of Concern: Naval Audit Service's Organizational Alignment and the Potential Impact on its Audit Independence (Project A-2018-ZBZ-0119.000) dated 20 March 2018

Encl: (1) Naval Audit Service’s Official Response
       (2) Notice of Disclosure

1. Reference (a) requested responses to the recommendations in the Notice of Concern.

2. Enclosure (1) provides our response.

3. The Naval Audit Service has proactively taken significant corrective actions to overcome potential threats to organizational independence that may occur in the future.

4. We recognize there is a ‘perception’ of impairment due to an organizational alignment between 13 March 2013 and 4 December 2017. However, there was no ‘actual’ impairment as demonstrated in Report No. DODIG-2018-091 where DoDIG stated, “…we identified a structural threat to the NAVAUDSVIC’s independence. However, we did not find any evidence that this structural independence threat impaired the NAVAUDSVIC’s ability to perform work or report results objectively.”

5. We strongly believe the lack of impairment should factor into the final rating. Therefore, we disagree with the Peer Review rating of “fail.”

6. We appreciate the opportunity to respond to the Notice of Concern. If you have any questions, please contact me at (202) 433-5533 or donette.l.gilmore@navy.mil.

DONETTE L. GILMORE

Enclosure 2
AAA NOTICE OF CONCERN: NAVAL AUDIT SERVICE’S ORGANIZATIONAL ALIGNMENT AND THE POTENTIAL IMPACT ON ITS AUDIT INDEPENDENCE
DATED 20 MARCH 2018
A-2018-Z8719.000

NAVAL AUDIT SERVICE’ RESPONSES TO AAA RECOMMENDATIONS

RECOMMENDATION a: AAA recommends that the Auditor General of the Navy: Add disclosures to all audit reports published 13 March 2013 through 4 December 2017. Additionally, add disclosures to all future published reports that will have relied in whole or in part on work performed during that period. At a minimum, disclose:

- Organizational reporting alignment during the audit.
- Noncompliance with Navy policy and GAGAS regarding independence.
- Potential threats to audit independence.

NAVAL AUDIT SERVICE RESPONSE: Concur. The Naval Audit Service developed a “Notice of Disclosure.” (See Enclosure 2)

- For published reports maintained internally at the NAVAUDSVC and on our website, the “Notice of Disclosure” will be attached to the report.
- For published reports already distributed externally, the NAVAUDSVC will send a blanket e-mail to all report addressees. The e-mail will contain a copy of the “Notice of Disclosure” and explain that it applies to all NAVAUDSVC reports published during the 13 March 2013 through 4 December 2017 timeframe.
- For reports not yet published that will have relied in whole or in part on work performed during the 13 March 2013 through 4 December 2017 timeframe, NAVAUDSVC will modify the GAGAS statement to include language similar to the language contained in the “Notice of Disclosure.” The language might be slightly different in order to clarify that not all of the work was performed from 13 March 2013 through 4 December 2017.

Estimated completion date: 4 May 2018.

RECOMMENDATION b: AAA recommends that the Auditor General of the Navy: Review all audit reports published 13 March 2013 through 4 December 2017 and add disclaimers based on the organizational reporting alignment at the time. Additionally, add disclaimers to all future published reports that will have relied in whole or in part on work performed during that period. Disclaimers should include:

- Specific threat to audit independence.
- Statement that the audit report may be unreliable and reason(s) why.

Enclosure 1
Page 1 of 2
NAVAL AUDIT SERVICE RESPONSE: Concur. The Naval Audit Service will review all audit reports published 13 March 2013 through 4 December 2017 and determine which, if any, reports require disclaimers to be added based on the organizational reporting alignment at the time. Similarly, we will review all projects in progress and determine which, if any, reports require disclaimers to be added based on the organizational reporting alignment at the time.

For those audit reports identified as requiring a disclaimer statement, NAVAUDSVC will add a disclaimer statement that describes the specific threat to audit independence and a statement that the audit report may be unreliable and reason(s) why. If a disclaimer statement is required, the application of the disclaimer statement would be handled in same manner as the “Notice of Disclosure” as outlined in our response to Recommendation a.

Estimated completion date: 30 September 2018.

RECOMMENDATION c: AAA recommends that the Auditor General of the Navy: Require GAGAS training related to audit independence for all NAS auditors, especially higher level officials.

NAVAL AUDIT SERVICE RESPONSE: Concur. The Naval Audit Service has developed GAGAS training related to audit independence. All NAVAUDSVC auditors will be required to certify that they have completed the training. The GAGAS audit independence training will begin immediately starting April 2018. Completion of the training will be required by no later than 30 September 2018. NAVAUDSVC will track the certifications to ensure all auditors complete the training.

Estimated completion date: 30 September 2018.

ADDITIONAL CORRECTIVE ACTION: The Naval Audit Service is in the process of strengthening our guidance and procedures to ensure that adequate safeguards, disclosures, and disclaimers are established to address and overcome significant threats to auditor independence.

Estimated completion date: 31 May 2018.
NOTICE OF DISCLOSURE

A recent Peer Review of the NAVAUDSVC determined that from 13 March 2013 through 4 December 2017, the NAVAUDSVC experienced a potential threat to audit independence due to the Department of Navy organizational structure in effect during this timeframe. Specifically, instead of reporting to the Secretary of the Navy or Under Secretary of the Navy, the Auditor General of the Navy reported to lower level officials who had not been charged with governance over the entire Department of the Navy to include certain non-delegable statutory functions. This alignment did not comply with generally accepted government auditing standards (GAGAS) and the Department of the Navy policy regarding independence. On 4 December 2017, the Auditor General of the Navy once again reported to the Under Secretary of the Navy in accordance with GAGAS. The Navy policy on independence was revised to clarify that the Auditor General of the Navy reports directly to the Under Secretary of the Navy (or to the Secretary of the Navy whenever the position of the Under Secretary of the Navy is vacant.)

With the exception of the potential structural threat outlined above, we believe that the projects performed from 13 March 2013 through 4 December 2017, complied with all other generally accepted government auditing standards.
Our Mission

To serve the Army’s evolving needs by helping senior leaders assess and mitigate risk, and by providing solutions through independent internal auditing services, for the benefit of Army Soldiers, Civilians, and Families.

To Suggest or Request Audits

To suggest or request audits, contact the Strategic Audit Planning Office of the Principal Deputy Auditor General at 703.545.5882 or email usarmy.pentagon.hqda-aaa.mbx.audit-requests1@mail.mil.

Additional Copies

We distribute each report in accordance with the requirements of Government Auditing Standards, GAO-12-331G, December 2011. To obtain additional copies of this report or other U.S. Army Audit Agency reports, visit our website at https://www.aaa.army.mil. The site is available only to military domains and the U.S. Government Accountability Office. Other activities may request copies of Agency reports by contacting our Audit Coordination and Followup Office at usarmy.pentagon.hqda-aaa.mbx.aaa-acfo@mail.mil.