



System Review Report

July 14, 2010

Honorable Arnold Fields, Inspector General
Special Inspector General for Afghanistan Reconstruction

We have reviewed the system of quality control for the audit organization of the Special Inspector General for Afghanistan Reconstruction (SIGAR) in effect for the year ended March 31, 2010. A system of quality control provides the audit organization with reasonable assurance of conformity with *Government Auditing Standards* (commonly referred to as the Yellow Book). The elements of quality control are described in the Yellow Book.

SIGAR is responsible for designing a system of quality control and complying with it to provide SIGAR with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. SIGAR's system of quality control consists of its audit organization, headed by the Assistant Inspector General for Audit (AIGA), and its policies and procedures, as articulated in its Audit Policy and Procedures Manual (APPM) and carried out by the audit staff working both in the United States and Afghanistan.

We conducted our review in accordance with the Yellow Book and guidelines established by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). During our review, we interviewed personnel in SIGAR offices located in Arlington, Virginia, and Kabul, Afghanistan, to obtain an understanding of the nature of SIGAR's audit organization and the design of SIGAR's system of quality control to assess the risks implicit in its audit function. Based on our assessments, we reviewed all audit engagements and selected administrative files to test for conformity with the Yellow Book and compliance with SIGAR's system of quality control. Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it. Prior to concluding the review, we met with SIGAR management on June 18, 2010, to discuss the results of our review. Enclosure 1 to this report identifies the engagements we reviewed.

There are inherent limitations in the effectiveness of any system of quality control and therefore noncompliance with the system of quality control 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 the policies or procedures may deteriorate.

Our responsibility is to express an opinion on the design of the system of quality control and SIGAR's compliance therewith based on our review. We believe the process we followed and the procedures we performed provide a reasonable basis for our opinion.

In our opinion, the system of quality control for SIGAR's audit organization in effect for the year ended March 31, 2010, was suitably designed. Further, except for the deficiencies described below, SIGAR complied with its system of quality control and has reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. SIGAR has received a peer review rating of *pass with deficiencies*.¹

System of Quality Control Was Suitably Designed

SIGAR filled the AIGA, Deputy Assistant Inspector General for Audit (DAIGA), and two other audit positions by February 2009. The DAIGA is the senior audit position in Kabul, and established the audit presence in the region. Audit staff gradually increased over time and, as of June 18, 2010, SIGAR's audit organization was comprised of 34 staff, with 23 located in Arlington, Virginia, and 11 in Kabul, Afghanistan.

To guide the audit organization from the start, SIGAR adopted, for the most part, the policies and procedures of the Special Inspector General for Iraq Reconstruction and operated using those policies from February to May 2009. In May 2009, SIGAR formally issued its own draft APPM, which it updated and issued in final form on March 27, 2010. SIGAR recently issued two audit directives on continuing professional education and quality assurance and a policy statement on freedom from external impairments. SIGAR performed audit work and issued the reports covered in our review pursuant to the draft versions of the APPM.

Deficiencies Noted in the Compliance with the System of Quality Control

Our review identified five deficiencies in SIGAR's compliance with its system of quality control. A deficiency is one or more findings that the review team has concluded, due to the nature, causes, pattern, or pervasiveness, including the relative importance of the finding to the audit organization's system of quality control taken as a whole, could create a situation in which the audit organization would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. These deficiencies are as follows:

1. Implementing a Quality Assurance Program - The Yellow Book considers monitoring of quality as an ongoing, periodic assessment of work completed on audits and provides that an audit organization should analyze and summarize results of its monitoring procedures at least annually, to identify any systemic issues needing improvement and recommend corrective actions. A quality assurance program ensures that work performed adheres to established policies and procedures; meets established standards of performance, including applicable professional standards; and is carried out economically, efficiently, and effectively.

¹ Federal audit organizations can receive a rating of *pass*, *pass with deficiencies*, or *fail*.

The SIGAR APPM in effect over the period of our review did not expressly provide for a quality assurance program and those responsibilities were not being performed. As such, SIGAR had not conducted any quality assurance reviews for our team to review.

On March 29, 2010, SIGAR reassigned a Senior Audit Manager to the newly established position of Quality Control Director and, on May 24, 2010, issued a directive, *Quality Control and Assurance*, which provides that the Quality Control Director develop a plan to inspect, at least annually, a sample of reports and summarize the results. At the meeting on June 18, the Quality Control Director indicated that a quality assurance program had not been implemented sooner due to demands for productivity and timely issuance of audit reports. The AIGA also informed us that a process for reviewing quality control files of completed audits had begun and that one review had been completed. These reviews will be summarized in a quarterly report identifying any systemic issues needing improvement along with recommendations for corrective action.

Recommendation 1: As part of the emerging Quality Assurance Program, the AIGA should require use of the CIGIE peer review guide performance audit checklist (Appendix E) as a methodology for quality assurance reviews of completed audits.

Views of Responsible Official: Concur. The AIGA will require the use of Appendix E in the CIGIE Peer Review Guide as the methodology for conducting its annual quality assurance reviews. The APPM will be modified accordingly. The Quality Control Director has already begun using the guide.

Recommendation 2: The AIGA should meet the Yellow Book's annual summary requirements for the past year by soliciting auditors-in-charge and referencers to identify any systemic Yellow Book and APPM issues needing improvement and take appropriate corrective action.

Views of Responsible Official: Concur. The AIGA has directed the Quality Control Director to solicit comments to identify systemic issues needing improvement and will make recommendations to the AIGA for corrective action, as appropriate, and at least on a quarterly basis. The Quality Control Director has already begun this process.

2. Planning - Audit planning is critical to the audit process. The audit plan provides the roadmap to conclude on audit objectives and reduces audit risk to an appropriate level to provide reasonable assurance that the evidence is sufficient and appropriate to support the auditors' findings, conclusions, and recommendations. During our review, we noted two particular areas where the APPM had established the policies and procedures to be followed but compliance with these policies and procedures was inconsistent.
 - The APPM requires that four planning elements for internal control; computer-processed data; compliance with laws, regulations, and provisions of contracts; and fraud risk be considered to determine their significance to the audit objectives. When significance is established, auditors are required to plan procedures and obtain sufficient, appropriate evidence to support their

conclusions. In the 10 audit plans supporting the 12 audits we reviewed, 5 of the 10 did not have evidence that these 4 elements were considered.

- The APPM also requires that audit plans be approved prior to the conduct of significant fieldwork. The 10 audit plans were either not approved or were approved close to the final report issuance date. Specifically, 8 audit plans were never approved and 2 others were approved 4 days and 31 days before the final report issuance date.

At the June 18 meeting, audit organization leadership commented that there were usually no formal meetings to specifically support audit plan development and that they chose to focus on productivity rather than implementing quality control activities. The representatives indicated that they were aware of these issues and have adopted a current process providing for audit plan development based on meetings, staff input, and formal approval. They also noted that, with the addition of more audit staff members, Senior Audit Managers now have increased involvement with audit planning, as they are now primarily supervising rather than performing the audits.

Recommendation 3: The AIGA should reiterate to the audit staff the Yellow Book and APPM requirements for (a) considering whether the four planning elements are significant to the audit objective, and, if so, preparing documentation of the detailed audit steps needed to obtain sufficient, appropriate evidence to support their conclusions and (b) approving audit plans prior to conducting significant fieldwork.

Views of Responsible Official: Concur. The AIGA will implement this recommendation through a memo to staff and at the next staff meeting. The memo will also be provided and explained to all future staff as part of their in-processing package. In addition, the AIGA is hiring additional Senior Audit Managers to ensure that supervisory review is conducted in a timely and appropriate manner, including the preparation of the audit plan and consideration of the four planning elements. Finally, the Quality Control Director will review the audit plan as part of the Quality Control File review for each engagement to ensure that (1) the appropriate documentation has been prepared to meet the requirements and (2) appropriate approval of audit plans occur prior to significant fieldwork.

3. Documentation and Supervision - The APPM states that audit documentation (commonly called work papers) are records developed while performing an audit, which provide sufficient detail to enable an experienced auditor having no previous connection to the audit to understand from the audit documentation the nature, timing, extent, and results of audit procedures performed, the audit evidence obtained and its source, and the conclusions reached, including evidence supporting the auditors' significant judgments and conclusions. SIGAR's APPM also states that all work papers should be clearly identified with the preparer's name, date prepared, title, source, and purpose; and finally it states that supervisors should review audit documentation for Yellow Book compliance and overall sufficiency and appropriateness of evidence. Incomplete audit documentation can reduce the effectiveness of audit supervision and other quality

control measures designed to ensure that findings, conclusions, and recommendations are supported.

Based on our review, work papers for 4 of 12 audits were not prepared and organized consistent with the APPM. A majority of the work papers we reviewed lacked documentation of purpose, source, and conclusion, and the work papers did not identify the preparer and reviewer, which serves as evidence of supervisory review, and the dates these activities were completed.

The final version of the APPM, issued March 27, 2010, provides for further assurance, stating that each document should also include the name of the reviewer, and the Quality Control Director will review audit documentation for conformity with standards and the APPM.

Recommendation 4: The AIGA should take steps to enforce adherence to the APPM and its quality control system and place increased emphasis on ensuring that (a) audit documentation clearly indicates the nature, timing, and extent of audit procedures, consistent with Yellow Book requirements and (b) supervisory review of the audit work that supports the findings, conclusions, and recommendations occurs and is documented.

Views of Responsible Official: Concur. The AIGA will communicate the importance of adherence to the APPM in a memo to staff and at the next staff meeting. The memo will also be provided and explained to all future staff as part of their in-processing package. Furthermore, documentation capabilities will be facilitated through the development and deployment of a document management system that the AIGA expects will allow secure, timely, accurate transfer and storage of data files between Arlington, Virginia and Kabul, Afghanistan. Having an effective document management system and hiring additional Senior Audit Managers will help to ensure that audit documentation procedures are followed and supervisory review of the audit work has occurred and been documented. Finally, the Quality Control Director will review audit documentation as part of the Quality Control File review for each engagement to ensure that the proper supervisory steps were taken.

4. Reporting - SIGAR's APPM requires that audit objectives be communicated in a clear, specific, neutral, and unbiased manner. The APPM also requires that all four finding elements - criteria, condition, cause, and effect - be described in the report and recommendations should logically flow from findings and conclusions and clearly state the corrective action to be taken. The APPM further requires that reports include an explanation of any significant internal controls assessed, the scope of the assessment work, and any significant deficiencies. When auditors meet these requirements, readers of SIGAR's audit reports will be presented with a clear and concise summarization of the audit process, findings, conclusions, and recommendations.

Our review determined that SIGAR's audit reports were not always prepared in accordance with the APPM. Specifically we found that:

- Objectives for 6 of 12 reports were not expressed in a clear and concise manner.
- The 4 finding elements necessary to address objectives were not clearly presented in 7 of the 12 reports. Further, recommendations did not flow logically from findings and conclusions in 6 of the 7 reports.
- The scope of work on internal control was not described in any of the 12 reports.

Recommendation 5: The AIGA should ensure that, in accordance with the APPM, audit objectives are expressly (a) identified in a clear and concise manner in the first paragraph of the report and the Scope and Methodology appendix and (b) concluded upon in a results of audit section in the report body.

Recommendation 6: The AIGA should ensure that all finding elements are developed unless determined during planning and fieldwork that certain finding elements are not necessary in relation to the audit objectives. The AIGA should also ensure that report recommendations logically flow from the findings and conclusions and that audit reports explain the extent of the internal control assessment and deficiencies.

Views of Responsible Official: Concur 5 and 6. The AIGA will communicate the importance of reporting in a memo to staff and at the next staff meeting. In addition, the AIGA hired a writer/editor in February 2010 to provide substantive review on reports throughout report development and writing. The AIGA also plans to hire a full-time report reviewer to support auditors in reporting the findings and ensuring that the report clearly and concisely states the audit objectives, recommendations flow logically from the findings and conclusions, and internal controls are assessed, noting any deficiencies found.

5. Independent Referencing - The APPM provides that independent referencing is an integral part of the audit quality control process that helps to ensure the draft and final reports are accurate and adequately supported by the audit documentation. In our review, we found that independent referencing was not completed for five audits. In one audit, the independent referencing process ceased after the audit team addressed 14 of the 54 referencing comments. SIGAR issued both the draft and final reports of this audit without addressing the unanswered referencing comments. In the 4 other audits with open referencing comments, one had 4 open comments from a universe of 53, another had 4 open comments from a universe of 18, a third had 27 open comments from a universe of 86, and the fourth had 24 open comments from a universe of 240.

Audit organization leadership acknowledged that early in SIGAR's history, other pressing priorities prevented a strong commitment to complete independent referencing reviews. We were advised that difficulties in independent referencing also resulted from hiring staff from various agencies and conducting work in two locations (and time zones), some auditors had not previously referenced, and others used different processes for referencing. However, audit organization leadership asserted that reports will not be issued in the future without completed independent referencing reviews.

Recommendation 7: The AIGA should reiterate the APPM requirements for completing the independent referencing process for draft and final reports.

Recommendation 8: The AIGA should (a) provide independent referencer training to audit staff and (b) develop and implement an independent referencer checklist to help ensure that audit quality initiatives are met.

Views of Responsible Official: Concur 7 and 8. The AIGA will reiterate the independent referencing requirements to audit staff at the next staff meeting and in a memo to staff and has included a referencing module in the 2-day training for auditors in August 2010. A referencing checklist will be developed by September 30 to help ensure audit quality. The AIGA is also considering hiring a full-time auditor dedicated to referencing.

Enclosure 2 includes SIGAR's full response to the recommendations in this report.

As is customary, we have issued a letter dated July 14, 2010 that sets forth findings that were not considered to be of sufficient significance to affect our opinion expressed in this report. SIGAR's response to that letter is included as an enclosure to the letter.

/Signed/

Jon T. Rymer
Inspector General and
Chair, Audit Committee
Council of the Inspectors General on Integrity and Efficiency

Enclosures

SCOPE AND METHODOLOGY (Enclosure 1)

We tested compliance with the SIGAR audit organization’s system of quality control to the extent we considered appropriate. These tests included a review of the 12 audit reports issued by SIGAR during the period April 1, 2009 through March 31, 2010. The SIGAR APPM in effect over the period of our review did not expressly provide for a quality assurance program and those responsibilities were not being performed. As such, SIGAR had not conducted any quality assurance reviews of the audits issued during our review period.

The CIGIE *Guide for Conducting External Peer Reviews of the Audit Organizations of Federal Offices of Inspector General*, dated March 2009, was used in the conduct of the review. We visited SIGAR’s offices in Arlington, Virginia, and Kabul, Afghanistan.

Reviewed Audit Reports Issued by SIGAR

No.	Date	Title
09-1	05/19/2009	<i>Contract Oversight Capabilities of the Defense Department’s Combined Security Transition Command - Afghanistan (CSTC-A) Need Strengthening</i>
09-3 ²	07/30/2009	<i>A Better Management Information System Is Needed to Promote Information Sharing, Effective Planning, and Coordination of Afghanistan Reconstruction Activities</i>
09-4	08/27/2009	<i>Actions Needed to Resolve Construction Delays at the Counter-Narcotics Justice Center</i>
09-5	09/9/2009	<i>Increased Visibility, Monitoring, and Planning Needed for Commander’s Emergency Response Program in Afghanistan</i>
09-6	9/22/2009	<i>Strategy and Resources Needed to Sustain Afghan Electoral Capacity</i>
09-7	09/30/2009	<i>Documenting Detention Procedures Will Help Ensure Counter-Narcotics Justice Center Is Utilized As Intended</i>
10-1	10/28/2009	<i>Barriers to Greater Participation by Women in Afghan Elections</i>
10-2	12/16/2009	<i>Afghanistan’s High Office of Oversight Needs Significantly Strengthened Authority, Independence, and Donor Support to Become an Effective Anti-Corruption Institution</i>
10-3	12/18/2009	<i>Actions Needed for a More Strategic Approach to U.S. Judicial Security Assistance</i>
10-4	01/15/2010	<i>Afghanistan Energy Supply has Increased, but an Updated Master Plan is Needed, and Delays and Sustainability Concerns Remain</i>
10-6 ³	01/20/2010	<i>Contract Delays Led to Cost Overruns for the Kabul Power Plant, and Sustainability Remains a Key Challenge</i>
10-7	03/01/2010	<i>The Tojg Bridge Construction Is Nearly Complete, but Several Contract Issues Need to Be Addressed</i>

² Report 09-2 was identified as a “letter report” and did not state that the work was performed in accordance with the Yellow Book; therefore, it was excluded from our count.

³ SIGAR did not use report number 10-5.

SIGAR RESPONSE TO DRAFT SYSTEM REVIEW REPORT (Enclosure 2)



SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN RECONSTRUCTION

Main: 703-602-3840
400 Army Navy Drive
Arlington, VA 22202-4704
www.sigar.mil

Arnold Fields, Inspector General

July 9, 2010

Honorable Jon T. Rymer
Inspector General, Federal Deposit Insurance Corporation and
Chair, Audit Committee, Council of the Inspectors General
on Integrity and Efficiency (CIGIE)

Thank you for the opportunity to comment on the draft System Review Report, which stated that SIGAR's audit organization was suitably designed for the year ending March 31, 2010. This report concluded that, with the exception of 5 deficiencies, SIGAR complied with its system of quality control and has reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

SIGAR is appreciative of having been evaluated by the peer review team early in the life of our organization so that problems could be surfaced early and corrective actions taken promptly. We believe it is important to note that SIGAR's first auditor was hired in January 2009, and by June 2010 SIGAR had recruited and hired 35 auditors and analysts for the audit directorate. The rapid growth in staff, coupled with the need to develop procedures and simultaneously conduct fieldwork, constrained our ability to properly document all the actions necessary to conduct frequent quality control checks and review activities. However, we expect to conduct quality assurance reviews in a timely manner and analyze and summarize the results of our monitoring procedures at least annually, as required. In addition, SIGAR has developed other quality control and assurance measures to ensure that key audit steps are taken and documented.

We concur with all of the recommendations in the report. We have already taken some actions to implement the recommendations and plan to complete implementation by September 30, 2010. Moreover, we recognize that quality control and assurance is a continuous function requiring vigilance. The Assistant Inspector General for Audits (AIGA) is taking a multi-faceted approach to correct the deficiencies you have identified. We have established an ongoing quality assurance program to continually monitor our performance. In August, we plan a two-day training course on auditing standards, practices, and procedures to address issues highlighted by the peer review team. Other measures include:

- discussing peer review results at the next all-hands staff meeting in August 2010,
- developing checklists, such as for independent referencing,
- modifying the policy manual,
- clarifying guidance as appropriate,
- providing quality assurance and audit skills training to all audit staff, and
- conducting follow-up on peer review recommendations.

Implementing a Quality Assurance Program

Recommendation 1: As part of the emerging Quality Assurance Program, the AIGA should require use of the CIGIE peer review guide performance audit checklist (appendix E) as a methodology for quality assurance reviews of completed audits.

Response: Concur. AIGA will require the use of Appendix E in the CIGIE Peer Review Guide as the methodology for conducting its annual quality assurance reviews. The Audit Policy and Procedures Manual (APPM) will be modified accordingly. The Quality Control Director has already begun using the guide.

Recommendation 2: The AIGA should meet the Yellow Book's annual summary requirements for the past year by soliciting auditors-in-charge and referencers to identify any systemic Yellow Book and APPM issues needing improvement and take appropriate corrective action.

Response: Concur. The AIGA has directed the Quality Control Director to solicit comments to identify systemic issues needing improvement and will make recommendations to AIGA for corrective action, as appropriate, and at least on a quarterly basis. The Quality Control Director has already begun this process.

Planning

Recommendation 3: The AIGA should reiterate to the audit staff the Yellow Book and APPM requirements for (a) considering whether the four planning elements are significant to the audit objective, and if so, preparing documentation of the detailed audit steps needed to obtain sufficient, appropriate evidence to support their conclusions and (b) approving audit plans prior to conducting significant fieldwork.

Response: Concur. The AIGA will implement this recommendation through a memo to staff and at the next staff meeting. The memo will also be provided and explained to all future staff as part of their in-processing package. In addition, the AIGA is hiring additional Senior Audit Managers to ensure that supervisory review is conducted in a timely and appropriate manner, including the preparation of the audit plan and consideration of the four planning elements. Finally, the Quality Control Director will review the audit plan as part of the Quality Control File review for each engagement to ensure that (1) the appropriate documentation has been prepared to meet the requirements and that (2) appropriate approval of audit plans occur prior to significant fieldwork.

Documentation and Supervision

Recommendation 4: The AIGA should take steps to enforce adherence to the APPM and its quality control system and place increased emphasis on ensuring that (a) audit documentation clearly indicates the nature, timing, and extent of audit procedures, consistent with Yellow Book requirements and (b) supervisory review of the audit work that supports the findings, conclusions, and recommendations occurs and is documented.

Response: Concur. The AIGA will communicate the importance of adherence to the APPM in a memo to staff and at the next staff meeting. The memo will also be provided and explained to all future staff as part of their in-processing package. Furthermore, documentation capabilities will be facilitated through the development and deployment of a document management system that AIGA expects will allow secure, timely, accurate transfer and storage of data files between Arlington, Virginia; and Kabul, Afghanistan. Having an effective document management system and hiring additional senior audit managers will help to ensure that audit documentation procedures are followed and supervisory review of the audit work has occurred and been documented. Finally, the Quality Control Director will review audit documentation as part of the Quality Control File review for each engagement to ensure that the proper supervisory steps were taken.

Reporting

Recommendation 5: The AIGA should ensure that, in accordance with APPM, audit objectives are expressly (a) identified in a clear and concise manner in the first paragraph of the report and the Scope and Methodology appendix, and (b) concluded upon in a results of audit section in the report body.

Recommendations 6: The AIGA should ensure that all finding elements are developed unless determined during planning and fieldwork that certain finding elements are not necessary in relation to the audit objectives. The AIGA should also ensure that report recommendations logically flow from the findings and conclusions and that audit reports explain the extent of the internal control assessment and deficiencies.

Response: Concur (5) and (6). The AIGA will communicate the importance of reporting in a memo to staff and at the next staff meeting. In addition, the AIGA hired a writer/editor in February 2010 to provide substantive review on reports throughout report development and writing. The AIGA also plans to hire a full-time report reviewer to support auditors in reporting the findings and ensuring that the report clearly and concisely states the audit objectives, recommendations flow logically from the findings and conclusions, and internal controls are assessed, noting any deficiencies found.

Independent Referencing

Recommendation 7: The AIGA should reiterate the APPM requirements for completing the independent referencing process for draft and final reports.

Recommendation 8: The AIGA should (a) provide independent referencing training to audit staff and (2) develop and implement an independent referencing checklist to help ensure that audit quality initiatives are met.

Response: Concur (7) and (8). AIGA will reiterate the independent referencing requirements to audit staff at the next staff meeting and in a memo to staff and has included a referencing module in the two-day training for auditors in August 2010. A referencing checklist will be developed by September 30 to help ensure audit quality. AIGA is also considering hiring a full-time auditor dedicated to referencing.

Thank you again for the opportunity to comment and for responding to my request for assistance so quickly and professionally.

Sincerely yours,

/Signed/

Arnold Fields, Inspector General
Special Inspector General for Afghanistan Reconstruction