AUDIT REPORT ON THE SACRAMENTO ARMY DEPOT
INTERNAL REVIEW AND AUDIT COMPLIANCE OFFICE'S
"AUDITS OF WARRANTIES, QUALITY DEFICIENCY REPORTS,
AND REPORTS OF DISCREPANCIES"

Report Number 92-045

February 12, 1992

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Department of Defense
The following acronyms are used in this report.

SAAD.........................Sacramento Army Depot
OMB.....................................Office of Management and Budget
PQDR....................................Product Quality Deficiency Report
ROD......................................Reports of Discrepancy
AMC.....................................Army Materiel Command
DESCOM..........................Depot Systems Command
GAO..........................General Accounting Office
AAA..........................Army Audit Agency
February 12, 1992

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
COMMANDER, ARMY MATERIEL COMMAND
COMMANDER, SACRAMENTO ARMY DEPOT

SUBJECT: Audit Report on the Sacramento Army Depot Internal Review and Audit Compliance Office's "Audits of Warranties, Quality Deficiency Reports, and Reports of Discrepancies" (Report No. 92-045)

We are providing this final report for your information and use. Comments on a draft of this report were considered in preparing the final report. We made the audit at the request of Congressman Vic Fazio.

Comments on a draft of this report conformed to the requirements of DoD Directive 7650.3 and there are no unresolved issues. Therefore, no additional comments are required.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Salvatore D. Gulii, Program Director, at (703) 614-6285, (DSN 224-6285) or Mr. C. J. Richardson, Project Manager at (703) 614-7300, (DSN 224-7300). The planned distribution of this report is listed in Appendix G.

Robert J. Lieberman
Assistant Inspector General for Auditing

Enclosure

cc:

Secretary of the Army
Commander, Army Depot Systems Command
Assistant Inspector General for Audit Policy and Oversight
Office of the Inspector General, DoD

AUDIT REPORT NO. 92-045
(Project No. OCF-0062.01)                February 12, 1992

FINAL AUDIT REPORT ON THE SACRAMENTO ARMY DEPOT INTERNAL
REVIEW AND AUDIT COMPLIANCE OFFICE'S "AUDIT OF WARRANTIES,
QUALITY DEFICIENCY REPORTS, AND REPORTS OF DISCREPANCIES"

EXECUTIVE SUMMARY

Introduction. The Sacramento Army Depot (SAAD) Internal Review and Audit Compliance Office (Internal Review) issued an audit report, "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," on July 20, 1990. The Internal Review audit was performed in response to internal allegations of mismanagement. The Internal Review auditor who performed the audit and prepared a working draft report claimed that material information was deleted from the final report to cover up waste and mismanagement. This allegation was reported to Congressman Vic Fazio, who requested that the Secretary of Defense review the allegation (Appendix A).

The General Accounting Office was reviewing similar Hotline allegations. To avoid duplication, the Department of Defense Inspector General (DoDIG) agreed to review the allegations and respond to Congressman Fazio. We found that the complainants did not have sufficient evidence to support their claims, and we reported this to Congressman Fazio on May 21, 1991 (Appendix B). Our review also showed that the evidence the complainants presented (the Internal Review audit report and the associated working papers) did not comply with government auditing standards.

Objective. The audit objective was to determine the extent to which the SAAD Internal Review audit report did not comply with government auditing standards.

Audit Results. The SAAD Internal Review audit report and associated working papers did not comply with government auditing standards applicable to the field work, reporting, and general standards. Thus, the audit report and associated working papers could not be relied on as evidence to support the allegations of a cover-up of waste and mismanagement at SAAD. The Internal Review audit report incorrectly claimed $424,000 of monetary benefits.

Internal Controls. Government auditing standards require audit organizations to have an appropriate internal quality control system in place. Two primary controls, supervision and planning, were lacking during the SAAD Internal Review entitled "Audit of Warranties, Quality Deficiency Reports, and Reports of
Discrepancies." Consequently, there was not reasonable assurance that applicable auditing standards would be followed. Additional details regarding internal controls are included in Part I, page 3.

Potential Benefits of Audit. This audit will result in management improvements needed for conducting more reliable Internal Review audits in the Army Depot Systems Command. A summary of the potential benefits are included in Appendix E. The potential benefits were all nonmonetary.

Summary of Recommendations. We recommended that oversight reviews be conducted, that invalid potential monetary benefits ($424,000) be disclaimed, and that a statement be issued to disclaim the validity of the SAAD Internal Review and Audit Compliance Office audit report, dated July 20, 1990.

Management Comments. The Army concurred with all of the recommendations and conducted oversight reviews of Army Depot Internal Review organizations, disclaimed $424,000, and issued a statement on October 10, 1990, that rescinded the SAAD Internal Review and Audit Compliance Office audit report.
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This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 693-0340.
PART I - INTRODUCTION

Background

The Internal Review and Audit Compliance Office (Internal Review) at the Sacramento Army Depot (SAAD) issued an audit report entitled "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," on July 20, 1990. The audit was initiated in August 1989 at the request of the SAAD Civilian Executive Assistant in response to internal allegations of mismanagement. A GS-511-11 auditor was assigned to perform the audit. GS-11 Internal Review auditors at SAAD are responsible for performing a variety of audit assignments from low to medium complexity. Each assignment includes conducting research, conducting entrance conferences with management, performing survey work to identify potential problems, accomplishing audit steps, writing and presenting draft audit reports, and following-up on agreed-to findings and recommendations. The job description requires the auditor to comply with government auditing standards when performing the work. To ensure that the standards are followed, GS-11 auditors are supervised throughout an audit.

The auditor who performed the audit and prepared a working draft report criticized the final version of the report, claiming that material portions of the working draft report were deleted to cover up waste and mismanagement at SAAD. The auditor made this complaint to Congressman Vic Fazio. The Congressman requested that the Secretary of Defense review the allegations of a possible cover-up (Appendix A). At the same time, the General Accounting Office (GAO) was reviewing similar allegations of fraud, waste, and abuse made by another employee at SAAD. The GAO transferred the review to the DoDIG, to avoid duplication of effort. The DoDIG agreed to address the allegations of both complainants and respond to Congressman Fazio. The complainants did not have any evidence to support their claims of fraud, waste, and abuse. We included that fact in our May 21, 1991, response to Congressman Fazio (Appendix B). In reviewing the allegations, we found that the Internal Review audit report and the associated working papers did not comply with government auditing standards. Thus, we initiated this audit to determine the extent of noncompliance with those standards.

The SAAD is under the command of the U.S. Army Depot Systems Command (DESCOM), a subordinate command of Headquarters, U.S. Army Materiel Command (AMC). The AMC Internal Review Office is responsible for providing oversight and for monitoring the effectiveness of all Internal Review offices within AMC. As part of that responsibility, AMC Internal Review will provide staff advice and assistance to all Internal Review organizations within the command. To ensure uniform interpretation and application of policies, techniques, and standards of performance, AMC Internal
Review performs periodic quality assurance visits to its major subordinate commands Internal Review offices. DESCOM is one of these major subordinate commands. DESCOM Internal Review is responsible for providing oversight and evaluating the adequacy and effectiveness of Internal Review performance at the individual depots under its control. The surveillance of Internal Review operations by AMC and DESCOM is facilitated through on-site reviews of professional standards of performance, adequacy of work accomplished, and Internal Review responsiveness to management needs. Any deficiencies noted are discussed with the Internal Review personnel during the quality assurance visits, and recommendations to correct noted deficiencies are provided to the local commander. A written report is issued requesting a plan of corrective action to alleviate any deficiencies found during the evaluation.

Objective

The objective of this audit was to determine the extent that the SAAD Internal Review Office's July 20, 1990, report, "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," did not comply with government auditing standards. We performed the audit because the Internal Review audit report was used to support allegations of fraud, waste, and abuse, as well as, charges of mismanagement.

Scope

We limited our review to the SAAD Internal Review audit report and the associated working papers. We also interviewed the people who made the allegations to GAO and to Congressman Fazio. We discussed the problems related to Warranty and Product Quality Deficiency Report (PQDR) Program administration with SAAD employees and managers. We did not extend our audit beyond the SAAD Internal Review audit and audit report because we did not have the audit resources available to address issue areas that were addressed in prior reviews by DESCOM Internal Review and by the Army Audit Agency. Therefore, we did not conduct tests of the Warranty, PQDR or the Reports of Discrepancy (ROD) Programs to determine if there was fraud, waste and abuse. We did not review prior reviews of SAAD Internal Review operations conducted by DESCOM. Also, we did not rely on computerized data to formulate our finding and conclusions.

This program results audit was conducted from January to April 1991, in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included sufficient tests of internal controls over SAAD Internal Review audit work
needed to satisfy our audit objectives. Activities visited or contacted during the audit are listed in Appendix F.

Internal Controls

The audit evaluated the internal quality control system that ensures that Government audit organizations adapt and follow government auditing standards. Specifically, we reviewed two basic internal controls, supervision and planning, which were needed during SAAD's Internal Review audit. The audit showed that internal controls were not established or effective to ensure that Internal Review audits were conducted in accordance with government auditing standards. Recommendation 1., if implemented, will correct the internal control weaknesses. We have determined that monetary benefits will not be realized by implementing Recommendation 1.

Prior Audits and Other Reviews

The Army Audit Agency issued Report No. NE 91-201, "Army Warranty Program, U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey," December 3, 1990, which included administration of night vision devices and other warranty program items at SAAD, but the report did not address warranty administration problems at SAAD.

Specifically, the report covered warranty acquisition, warranty administration, and warranty databases at the Communications-Electronics Command. The audit showed that cost-effectiveness analyses did not support decisions to acquire warranties for five weapon systems. The analyses were either inaccurate or showed that warranties were not effective in terms of costs or failure thresholds.

The Army Communications-Electronics Command did not effectively monitor the execution of contract provisions; track claim actions to make sure the Government received benefits; assess the benefits derived from warranties; and report accurate, complete information to the AMC. In addition, the two databases used to monitor weapon system warranties under the Army Warranty Program were neither complete nor accurate. The Army Audit Agency made 18 recommendations to the Army Communications-Electronics Command for corrective actions in the areas of warranty acquisition, warranty administration, and warranty databases. Management concurred with all 18 recommendations and stated that corrective actions would be taken on each recommendation.

The Army Audit Agency also issued Report No. WE 91-2 "Supply Operations, Sacramento Army Depot," April 9, 1991, which covered supply operations at SAAD. Audited areas included the receipt, storage, and issue of materiel and the management of the depot's installation supply activity. The report concluded that the
procedures for issuing material and supplies generally were adequate but improvements were needed in supply management. The installation supply activity's accountable records could be understated by about $100 million. Assistance was requested from the Army Materiel Command to reconcile the differences in two different supply management reports. In addition, the procedures for identifying and reporting excess material were not adequate to ensure that about $17 million of unneeded items were reported to item managers for redistribution or disposal. Command agreed to the recommendations made to correct the conditions cited in the report. The Army Audit Agency audit coverage included sufficient tests of fraud, waste, and abuse to preclude the need for further coverage in the Sacramento Army Depot supply operations by the office of the Inspector General, DoD.
PART II- FINDING AND RECOMMENDATIONS

GOVERNMENT AUDITING STANDARDS

The SAAD Internal Review Office's audit report on the "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," was not prepared in accordance with government auditing standards. The audit report did not include qualifying statements which would have disclosed that various field work, reporting, and general standards were not followed. The standards were not followed because the Internal Review audit was not properly supervised or adequately planned. The audit report did not present a reliable audit evaluation of the administration of the Warranty, PQDR, and ROD programs at SAAD. The report also claimed a cost avoidance of $424,000, which was not supported.

DISCUSSION OF DETAILS

Background

The Inspector General Act of 1978, as amended, and the Office of Management and Budget Circular A-73, require the DoDIG to provide policy direction for audits of the programs and operations of the DoD. In carrying out these policy formulation responsibilities, the DoDIG is also required to ensure that DoD audits comply with standards established by the Comptroller General of the United States. The DoDIG is authorized to develop uniform standards, policies, and procedures to improve the efficiency and effectiveness of DoD internal audit activities and provide a consistent basis for measuring the quality and effectiveness of internal audit operations. As part of these functions, the DoDIG is responsible for developing, publishing, and maintaining a DoD internal audit manual that sets forth the uniform standards, policies, and procedures. In addition, Circular A-73 requires the DoD internal audit organizations to develop detailed procedures to implement the DoD Internal Audit Manual.

The DoD Internal Audit Manual (DoD 7600.7-M) establishes uniform policies and procedures to be followed when conducting internal audits of DoD operations, systems, programs, and functions. The Manual is designed to assist DoD auditors and internal auditors in complying with the auditing standards, policies, and procedures promulgated by the Congress, Comptroller General of the United States, and the DoD.

Internal Review Audit Report

The Internal Review audit report stated that the audit report was prepared in accordance with government auditing standards; however, these standards were not followed. The statement should have been qualified to state that it did not comply with
government auditing standards that govern field work, reporting, and general standards. In addition, the report did not indicate the reasons these applicable standards were not followed or what effect the modified standards had on audit results.

The Internal Review audit objectives were to determine whether warranties, PQDRs, and RODs were processed in compliance with the prescribed policies, procedures, and responsibilities for reporting within the AMC as established by applicable regulations. The Internal Review audit report concluded that the Warranty Program was not effectively or efficiently managed, PQDRs were not processed in a timely manner, and the Internal Control Program, as it pertained to Warranties, PQDRs, and RODs, was not effective. The report did not address RODs except in an internal control finding, which called for establishing an internal control checklist for RODs. A summary of the Internal Review audit report is provided in Appendix C.

In our opinion, the overall conclusions of the Internal Review audit report that the Warranty and PQDR Programs were not effectively managed were generally correct. However, the report's conclusions were not supported by an audit that answered basic parts of the audit objectives regarding specific deficiencies in processing warranties. Consequently, the report lacked a description of the causes of the problem and meaningful recommendations. The absence of meaningful recommendations and the failure to identify the causes for the processing deficiencies reflect the lack of supervision and planning of the Internal Review audit. Ultimately, inadequate supervision and planning led to noncompliance with field work, reporting, and general audit standards.

Based on our review of the working draft, the final SAAD Internal Reviews audit report, and the supporting working papers, we concluded that the changes and deletions to the working draft were generally justified and resulted in a more concise final report. We also noted that a $10 million cost avoidance included in the working draft report was changed to $424,000 in the final report. However, the reason and the support for the change was not documented. We question the validity of including any cost avoidance amount because implementation of the recommendations in the report will not result in specific cost avoidances. The $424,000 cost avoidance was inappropriately included in the Department of the Army's Semiannual Report to the DoDIG for inclusion in the Semiannual Report to the Congress. A synopsis of the deficiencies applicable to each audit standard is presented below. Details of the SAAD Internal Review's deficiencies regarding government auditing standards are in Appendix D.
Field work standards. The SAAD Internal Review audit was not adequately planned or supervised in accordance with government auditing standards for audit field work. Additionally, the audit was not designed to provide reasonable assurance of detecting abuse or illegal acts, and the audit working papers were inadequate. Therefore, the field work supporting the Internal Review audit report was not reliable.

Planning. The planning standard states that the work is to be adequately planned. Adequate planning should include consideration of audit objectives, scope, methodology, and skill and knowledge of the personnel to staff the assignment. We determined that the audit program used to accomplish the audit objectives did not adequately describe the audit work needed to satisfy the objectives or the methodology used during the audit. Additionally, the Internal Review audit was not adequately staffed with competent personnel.

Supervision. The supervision standard states that the staff is to be properly supervised. Proper supervision should be provided from the beginning of the planning phase through completion of audit work and report writing. The Internal Review supervisor was not involved in the audit process until the writing of the final report.

Legal and regulatory requirements. The legal and regulatory requirements standard states that an assessment is to be made of compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives. Auditors should design the audit to provide reasonable assurance of detecting abuse or illegal acts that significantly affect the audit objectives. The Internal Review audit program did not include audit steps to test for indications of fraud, waste, and abuse.

Working papers. The working papers standard states that working papers are the link between field work and the audit report. The working papers should contain the evidence to support the findings, judgments, and conclusions in the report. The standard also requires that working papers be cross-referenced to the audit program, signed and dated by the auditor, concise, easily understandable, summarized, and contain evidence of supervisory review. The Internal Review working papers did not meet the standard for working paper preparation and did not support the Internal Review audit report. The working papers were not summarized, cross-referenced, reviewed by a supervisor, or prepared in a concise and easily understandable form.

Reporting standards. We determined that the Internal Review audit report did not comply with two of the reporting standards. The statements of audit scope and the cause and recommendations were incomplete.
Statement of scope. The reporting standard requires that the statement of audit scope describe the depth and coverage of audit work conducted to accomplish the audit objectives. The audit scope statement should, as applicable, explain the relationship between the universe and what was audited, the kinds and sources of evidence used, and any problems with quality of evidence. The scope cited in the Internal Review audit report did not accurately describe the audit coverage, the principal sources of information, or the extent of audit work performed to detect fraud and illegal acts. The scope contained an unqualified statement that the Internal Review audit was made in compliance with government auditing standards. The Internal Review audit report did not indicate that several important auditing standards were not, in fact, followed during the audit and in writing the subsequent audit report.

Cause and recommendations. The reporting standard for cause and recommendations requires that the report include the cause of problems and recommendations to correct those problems and to improve operations. The presentation of the findings, causes, and recommendations were not complete in the Internal Review report. Several causes and related recommendations were not included in the finding. Causes were stated that did not have any corresponding recommendations, and recommendations were made that were unrelated to stated conditions.

General standards. The SAAD Internal Review auditor assigned to the audit was not fully qualified to conduct an unsupervised audit of Warranty, PQDR and ROD Programs. The Internal Review audit was not conducted with due professional care, and an effective quality control system was not followed during the Internal Review audit.

Staff qualifications. The staff qualifications standard requires that the staff assigned to conduct the audit should collectively possess adequate professional proficiency for the tasks required. The GS-11 auditor who conducted the audit did not demonstrate the knowledge and experience needed for the required work.

Due professional care. The due professional care standard requires that care should be used in conducting the audit and in preparing related reports. Auditors and audit organizations are responsible for following all applicable standards in conducting Government audits. Exercising due professional care means using sound judgment in establishing the scope, selecting the methodology, and choosing tests and procedures for the audit. The same sound judgment should be applied in conducting tests and in evaluating procedures and reporting the audit results. Additionally, a supervisory review should be made of the work conducted, the judgments made, and the audit report. Neither the Internal Review supervisor nor the
assigned auditor applied adequate consideration and sound judgment to the audit or followed the field work standards for planning, assessing legal and regulatory requirements, and working papers. Also, the reporting standards for statement of scope, and cause and recommendations were not followed. Consequently, we determined that the due professional care standard was not followed.

**Quality control.** The quality control standard requires that audit organizations have an internal quality control system to ensure that it has adopted and is following government auditing standards. Two primary internal controls, planning, and supervision were lacking. As a result, the quality control standard was not met.

**Conclusion**

The findings in the Internal Review audit report were not fully supported with facts or competent audit work. Therefore, the report should be withdrawn. The severe limitations of the audit work and the resulting report should have been disclosed in the scope of the report. The failure to disclose the limitations makes it doubtful that effective internal controls exist over Internal Review audit work and that SADD Internal Review audit reports comply with government auditing standards.

**RECOMMENDATIONS FOR CORRECTIVE ACTION**

1. We recommend that the Commander, Army Materiel Command direct a special internal oversight review of the Army Depot Systems Command and the Sacramento Army Depot Internal Review and Audit Compliance Office to determine the extent to which Internal Review reports are not complying with government auditing standards. The reviews should also determine the need for additional controls.

2. We recommend that the Commander, Army Materiel Command disclaim the potential monetary savings of $424,000 reported to the Department of Defense, Inspector General for inclusion in the September 1990 Semiannual Report to the Congress.

3. We recommend that the Commander, Sacramento Army Depot issue a statement that the report on the "Audit of Warranties, Quality Deficiency Reports and Reports of Discrepancies," July 20, 1990, is not reliable because it was not supported by a competent audit or prepared in accordance with government auditing standards.

**MANAGEMENT COMMENTS**

The Assistant Secretary of the Army (Financial Management) concurred with the command responses provided by Headquarters, U.S. Army Materiel Command.
The Chief, Internal Review and Audit Compliance Office, U.S. Army Materiel Command concurred with Recommendation 1. and stated that quality assurance reviews of the SAAD Internal Review and Audit Compliance Office occurred in June and July 1991, and that additional controls were needed to ensure compliance with Government auditing standards. The Chief also concurred with Recommendation 2. and stated that a disclaimer of the monetary benefits was sent to the office of the Inspector General, DoD in September 1991. The U.S. Army Depot Systems Command concurred with Recommendation 3, and stated that the Commander, SAAD issued a statement on October 10, 1991, rescinding the audit report on the "Audit of Warranties, Quality Deficiency Reports and Reports of Discrepancies," July 20, 1990.
PART III- ADDITIONAL INFORMATION

APPENDIX A - Request from Congressman Fazio

APPENDIX B - Response to Congressman Fazio

APPENDIX C - Summary of Internal Review Report

APPENDIX D - Noncompliance with Government Auditing Standards at SAAD

APPENDIX E - Summary of Potential Benefits Resulting from the Audit

APPENDIX F - Activities Visited or Contacted

APPENDIX G - Report Distribution
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APPENDIX A: REQUEST FROM CONGRESSMAN FAZIO

Mr. Richard Cheney
Secretary of Defense
Department of Defense
The Pentagon
Washington, D.C. 20301-1153

RE: Department of Defense Inspector General Case # 89-G46430

Dear Secretary Cheney:

I am writing to you regarding allegations of fraud, waste and abuse at the Sacramento Army Depot, Sacramento California. These allegations were brought to my attention by several of my constituents.

It is my understanding that there is an investigation currently being conducted into these allegations and the case has been assigned the above case number. My constituent * contends that she has evidence to add to the investigation.

According to * she took part in an internal audit that uncovered many problems. * contends that many of the internal management problems she uncovered were covered up or ignored by Sacramento Army Depot officials. * is prepared to supply this information if it is requested.

I will appreciate your looking into * allegations of fraud, waste and abuse. Please direct your response to the attention of my staff assistant Alex Terrazas, in my Sacramento office whom I have asked to assist me with this case.

Thank you for your time and attention to this matter.

Sincerely,

Vic Fazio
Member of Congress

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APPENDIX B: RESPONSE TO CONGRESSMAN FAZIO

MAY 23 1991

HONORABLE VIC FAZIO
Member, United States
House of Representatives
Suite 330
2525 Natoma Park Drive
Sacramento, California 95833

Dear Congressman Fazio:

This is in response to your letter of November 29, 1990 to the Secretary of Defense concerning allegations by [redacted] of fraud, waste and abuse at the Sacramento Army Depot, Sacramento, California.

We conducted a review of the allegations and interviewed [redacted]. The evidence provided by [redacted] was contained in working papers and a draft report, prepared by the Internal Review Office, Sacramento Army Depot, as part of its audit of warranties, quality deficiency reports, and reports of discrepancies. The [redacted] provided no additional evidence to support their allegations.

We found no evidence of fraud or coverup of mismanagement, waste or abuse at the Depot, and the actions taken by management to correct past problems were appropriate. However, we concluded that the audit performed by the Internal Review Office and the resulting report, "Warranties, Quality Deficiency Reports, and Reports of Discrepancy," did not satisfy Government Auditing Standards. We are preparing an audit report addressing the inadequacies in the Sacramento Army Depot Internal Review Office audit and will provide you a copy of the report at the time it is issued.

If you have any questions, please contact me or Mr. John R. Crane, Office of Congressional Liaison, at (703) 695-6549.

Sincerely,

SIGNED

Susan J. Crawford
Inspector General

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APPENDIX C: SUMMARY OF INTERNAL REVIEW REPORT

The Internal Review audit report contained findings in three areas: the Warranty Program, the PQDR Program, and Internal Controls. The first finding stated that the Warranty Program at SAAD was not efficiently or effectively managed. Warranty claims and credits were allowed to expire on defective merchandise because management and the Communications-Electronics Command failed to monitor and control the program. Thus, defective items under warranty were not reported, and many of these items ended up being returned to the Defense Reutilization and Marketing Office and sold for scrap. The report contained seven recommendations regarding the Warranty Program. SAAD management concurred with all seven recommendations primarily because corrective action was implemented for six recommendations before the Internal Review draft report was issued. Generally, the recommendations did not address corrective actions for warranty claims that were allowed to expire or to improve the effectiveness or efficiency of Warranty Program management.

The second finding stated that PQDRs on defective material were not reported, processed, or resolved promptly. Untimely processing could result in the loss of money because asset defect claims were not litigated, and the assets could eventually be scrapped. The Internal Review report gave six recommendations to correct administrative problems. SAAD management concurred with five of the six recommendations, but did not concur that an internal control review checklist was necessary to effectively manage the PQDR process. Generally, the recommendations for improving the administration of PQDRs did not correlate with the narrative in the finding.

The third finding stated that the internal control program was not completely effective. Internal control review checklists were not completed properly or applied adequately. The report made two recommendations that checklists be prepared and used in the Warranty, PQDR, and ROD Programs. SAAD management did not concur with these recommendations, stating that an automated system was installed to monitor warranty assets on a weekly basis.
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APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS
AT SAAD

We found that the following government audit standards, as promulgated by the Comptroller General of the United States, were not followed by the SAAD Internal Review in the audit of Warranties, PQDR and ROD Programs. The applicable standard, an explanation of the standard, and the reason for our conclusions are provided after each standard that was not followed.

Field Work Standards

The SAAD Internal Review audit was not adequately supervised or planned. Additionally, the audit was not designed to provide reasonable assurance of detecting abuse or illegal acts, and the working papers were inadequate. Therefore, the field work supporting the SAAD Internal Review audit report was not reliable.

**Supervision.** The supervision standard places responsibility on the audit supervisor and audit organization for seeing that staff who are involved in accomplishing the objectives of the audit receive appropriate guidance and supervision to ensure that the audit work is properly conducted and that the audit objectives are accomplished.

The most effective way to ensure the quality and to expedite the progress of an assignment is by exercising proper supervision from the start of the planning phase to the completion of audit work and reporting. Supervision adds seasoned judgment to the work performed by less experienced staff and provides necessary training for them.

Assigning competent auditing staff is important to achieve the audit objectives. Since skills and knowledge vary among auditors, work assignments must be commensurate with abilities. Supervisors should satisfy themselves that staff members clearly understand their assigned tasks before starting the work.

Supervisory reviews of audit work and the audit report should be prompt to determine whether conformance with audit standards is obtained. The reviews should determine if the audit work has been conducted with due professional care, if the working papers adequately support findings and conclusions, and if the audit objectives were met. The reviews should also determine if sufficient data exist to prepare a meaningful report. Supervisory reviews of the work conducted should be documented in the working papers.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

The Internal Review audit supervisor told the DoDIG audit team that he did not supervise the "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," and that he did not review the working papers or the working draft audit report. Our audit confirmed that the audit supervisor did not provide supervision to the auditor assigned to the audit. Additionally, there was no evidence of supervisory review of working papers, the audit program, or the working draft Internal Review report. However, the audit report was reviewed by the supervisor before it was issued as a final report.

Planning. Adequate planning should include consideration of audit objectives, scope, and methodology; skill and knowledge of the personnel to staff the assignment; compliance with laws and regulations; and consideration of potential abuse and illegal acts.

The supervisor and the auditor are responsible for thoroughly planning an audit. Planning includes defining the audit objectives and determining how they can be attained. Planning is important to ensure that the audit results will satisfy the objectives of the audit. Adequate planning is especially important in performance audits because the methodology, implementing steps, and procedures employed in such audits are varied and complex. The details of the plan for the audit should be included in the audit program.

The DoD Internal Audit Manual (DoD 7600.7-M) states that an audit program should be prepared for each audit and is essential in conducting efficient and effective audits. The audit program should include an introduction and background, purpose and scope of the audit, objectives of the audit, definitions of terms, special instructions, audit procedures and methods to be used to gather and analyze data, information on the general format to be followed in the audit report, and appropriate cross-referencing to the supporting working papers.

The Internal Review audit was poorly planned. The audit program used to perform the audit was inadequate in that it did not reflect adequate research of the Warranty and PQDR Programs, regulatory guidance to identify appropriate audit steps, and procedures for the audit. Also, the audit program did not provide a logical description of the methodology and procedures to be used to accomplish the audit objectives.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

The Internal Review audit working papers contained two audit programs. Both programs were incomplete and inconsistent. Most of the audit steps were not referenced to working papers, and the audit program did not contain definitions for terms and acronyms that were highly specialized. Also, the objectives and scopes described in the two audit programs differed. The first audit program stated that the objective was to determine the possibilities of fraud, waste, and abuse in the Directorate of Product Assurance in processing warranties, PQDRs, and RODs. The scope was to interview the Director of Product Assurance and other key personnel.

The purpose and scope of the second audit program was to determine whether SAAD warranties, PQDRs, and RODs were processed in compliance with prescribed policies and procedures. The general objective of the program was to ascertain whether the procedures for reporting, processing and resolving warranties, PQDRs and RODs were adequately implemented, managed, and controlled in accordance with the regulatory requirements.

The audit steps in the audit program were simple statements lacking purpose. The steps reflected conclusions rather than work to be performed. For example, the first two steps for the Warranty Program were "Warranty Program was not efficiently or effectively managed," and "Warranty claims and credit were allowed to expire." The program should have stated, "Determine if the Warranty Program was efficiently and effectively managed." A number of specific substeps should have been developed to describe the audit tests and actions needed to make the determination.

The audit program was not reviewed by the Internal Review audit supervisor to ensure that the audit was adequately planned. A realistic appraisal of the audit objectives should have resulted in the assignment of a more experienced and capable staff and an adequate audit program to meet the audit objectives. The Warranty and PQDR Programs have a history of problems. Thus, a more experienced audit staff with increased audit supervision was necessary.

Legal and regulatory requirements. An assessment is to be made of compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives. Auditors should design the audit to provide reasonable assurance of detecting abuse or illegal acts that significantly affect the audit objectives.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

The SAAD Internal Review audit did not provide reasonable assurance that fraud, waste, and abuse did not exist at SAAD. The audit program did not contain specific audit steps to test for indicators of fraud, waste, and abuse. The auditor should maintain sufficient knowledge of the characteristics of fraud, techniques used to commit fraud, and the types of fraud associated with the activities being audited. This knowledge is necessary so that suspicions can be correctly and effectively resolved. The DoD Internal Audit Manual describes missing or incomplete documentation and alteration of documents or accounts as indicators of fraud. The guidance in the manual was not followed for the review of applicable requirements of laws and regulations during the Internal Review audit.

Working papers. Working papers are the link between field work and the audit report and should contain the evidence to support the findings, judgments, and conclusions in the report. Audit organizations need to establish policies and procedures for the preparation and maintenance of working papers, including safe custody and retention for a time sufficient to satisfy legal and administrative requirements.

The working paper standard also requires that working papers be cross-referenced to the audit program, signed and dated by the auditor, concise and easily understandable, and be summarized. There should be documented supervisory reviews of the working papers. The Internal Review working papers did not meet the standard for working paper preparation and were not useful for supporting the Internal Review audit report. The working papers were not summarized, cross-referenced, reviewed by a supervisor, or prepared in a concise, easily understandable form. For example, one set of working papers labeled "Analysis of ROD, PQDRs and Warranties 1986-1989," did not contain a purpose, source, scope, or conclusion. The working papers appeared to contain warranty cost information regarding mission and internal PQDRs. The working papers arrived at a $29.1 million amount for PQDRs, Warranties, and frozen items (code L). Without an explanation, however, there is no way to determine if the methodology employed to arrive at the amount was logical or sound.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

Reporting Standards

The SAAD Internal Review audit report did not comply with two of the reporting standards. The statement of audit scope was incomplete, as was information on causes and recommendations associated with the audit findings.

Scope. The statement of scope should describe the depth and coverage of audit work conducted to accomplish the audit's objectives. It should, as applicable, explain the relationship between the universe and what was audited, identify organizations and geographic locations at which audit work was conducted, and the time period covered. The scope should also include the kinds and sources of evidence used and explain any problems with the quality of the evidence. If unverified data are used, this needs to be stated. Any constraints imposed on the audit approach by data limitations or scope impairments are to be disclosed. The audit scope statement in the Internal Review audit report does not accurately describe the audit coverage, the main sources of information, and the audit work performed to detect fraud and illegal acts. For instance, the scope states that a 100-percent examination of the closed files of warranties for 1988 and 1989 was conducted. However, Finding A narrative states that a 100-percent examination of 700 closed warranty files of night vision devices for 1988 and 1989 was conducted. Night vision devices account for only part of the 51 National Stock Numbered items included in the SAAD Warranty Program. The audit scope statement implies much broader coverage and could mislead report readers about the conclusions drawn by the auditor.

The scope also contained a conclusion that there were not any indications of fraud in the areas reviewed. Yet, it did not describe the scope of work performed to make that determination, nor was there a description anywhere else in the report. Also, the audit scope contained the statement that the review was in compliance with government auditing standards; however, the statement was not qualified. The statement of scope of the audit should have been qualified to state that it did not comply with applicable government auditing standards governing audit field work, to include planning, supervision, legal and regulatory requirements and working papers; or the standards governing reporting, to include statement of scope, and cause and recommendations; or the general standards, to include qualifications, due professional care, and quality control.

Cause and recommendations. The report should include the cause of the problem areas noted in the audit and the recommendations needed to correct the problem areas and improve operations.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

The causes and recommendations contained in the findings in the Internal Review audit report were not complete. Recommendations were made without a corresponding cause statement, or cause statements were made without a corresponding recommendation.

General Standards

The SAAD Internal Review audit was not staffed with an auditor fully qualified to conduct the audit, and the audit was not conducted with due professional care. For this reason, the SAAD Internal Review audit report on the "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," could not be relied on as a basis for management decisions, and should be qualified to specifically state each general standard that was not followed in performing the review.

Qualifications. The staff assigned to conduct the audit should collectively possess adequate professional proficiency for the tasks required.

The GS-511-11 auditor who conducted the audit did not possess the knowledge or the experience appropriate for the audit work required. The job description for a GS-11 auditor at SAAD states that the auditor will be assigned to audits of low to moderate complexity. The audit areas were complex with a high degree of difficulty. The auditor needed a good working knowledge of the Warranty, PQDR, and ROD Programs, and of the DoD Supply System in order to competently conduct an audit that evaluated problems with processing warranties, PQDRs, and RODs.

Based on our interviews with the Internal Review auditor, the auditor's supervisor, and managers at SAAD involved with the auditor's work, and our review of the workpapers, we determined that the auditor could not adequately communicate observations and problems related to the audit. The lack of conclusions in the auditor's working papers and the statements of the SAAD managers who attempted to explain the Warranty Program to the auditor, led us to conclude that the auditor did not possess a good working knowledge of how warranties were administered and processed at SAAD. Also, the auditor's working draft report and audit working papers demonstrated an inability to comprehensively
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

discuss or write about problems regarding the audited areas. For example, when describing the specifics regarding an allegation of fraud, the Internal Review auditor wrote:

The employee was responsible in initiating the QDRs in the DATABASE. He was also responsible in processing QDRs. However, the allegee, there was fraud against the Government through exchanges. The exchange was made by taking ISA assets and placing it into "A". This "A" assets were removed and were returned to the customer. He further alleged that he was forced to commit fraud and misuse of the program by following orders from the person hired by the management to clean up the backlog. Short cuts are being used to perform his tasks.

The narrative in the example does not describe potential fraud, and it reflects poorly on the auditor's ability to properly conduct an audit. The draft report contained numerous examples of poor writing, to include a sentence stating, "A record of the failure is important even if it seems unimportant." Additionally, the report contained a paragraph stating: "Another example worth mentioning is Contract Number DAAAB07-84-C-E050. The test result from this contract has resulted 10 cosmentially unsuitable for Foreign Military Sale (FMS)."

**Due professional care** Due professional care should be exercised in conducting the audit and in preparing related reports.

Auditors and audit organizations are responsible for following all applicable standards in conducting Government audits. Auditors should use professional judgment in determining the standards that are applicable to the work to be conducted. Situations may occur where Government auditors are not able to follow an applicable standard and are not able to withdraw from the audit. In these situations, the auditors should disclose in the scope section of the audit report that an applicable standard was not followed and the reasons and known effect of not following the standard. The auditor's determination that certain standards do not apply to the audit should be documented in the working papers. Exercising due professional care means using sound judgment in establishing the scope, selecting the methodology, and choosing tests and procedures for the audit. The same sound judgment should be applied in conducting the tests and procedures and in evaluating and reporting on the audit results.
APPENDIX D: NONCOMPLIANCE WITH GOVERNMENT AUDITING STANDARDS AT SAAD (Continued)

The Internal Review supervisor and the assigned auditor did not apply adequate consideration and sound judgment in performing the audit. For example, the scope of the audit report should have disclosed that several applicable government auditing standards were not followed. The scope statement in the Internal Review audit report did not provide information about omitted audit tests. The scope statement included a conclusion that fraud was not found; however, there was no evidence of tests for fraud. Also, there was no evidence of any supervisory involvement in the audit. As previously discussed, the Internal Review audit process did not comply with field work and reporting standards. It appears that due professional care was totally lacking for the Internal Review audit.

Quality control. Government audit organizations should have an appropriate internal quality control system in place, which provides reasonable assurance that it has adopted, and is following, applicable auditing standards. Two internal control factors, supervision and planning, were lacking during the SAAD Internal Review audit. Consequently, the SAAD's internal quality control system failed during the SAAD audit of Warranties, PQDRs, and RODs. Detailed descriptions of the lack of supervision and planning can be found on pages 19 and 20, respectively.
**APPENDIX E: SUMMARY OF POTENTIAL BENEFITS RESULTING FROM THE AUDIT**

<table>
<thead>
<tr>
<th>Recommendation Reference</th>
<th>Description of Benefit</th>
<th>Type of Benefit</th>
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<tbody>
<tr>
<td>1.</td>
<td>Compliance with government auditing standards, which will improve Internal Review reports.</td>
<td>Nonmonetary</td>
</tr>
<tr>
<td>2.</td>
<td>Compliance with Federal Statute.</td>
<td>Nonmonetary</td>
</tr>
<tr>
<td>3.</td>
<td>Compliance with government auditing standards, which will improve Internal Review reports.</td>
<td>Nonmonetary</td>
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APPENDIX G: FINAL REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Public Affairs)

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Commander, Army Materiel Command
Commander, Army Depot Systems Command
Commander, Sacramento Army Depot

Non DoD Activities

Office of Management and Budget
General Accounting Office, NSIAD, Technical Information Center

Congressional Committees:
  Senate Subcommittee on Defense, Committee on Appropriations
  Senate Committee on Armed Services
  Senate Committee on Governmental Affairs
  Senate Ranking Minority Member, Committee on Armed Services
  House Committee on Appropriations
  House Subcommittee on Defense, Committee on Appropriations
  House Ranking Minority Member, Committee on Appropriations
  House Committee on Armed Services
  House Committee on Government Operations
  House Subcommittee on Legislation and National Security, Committee on Government Operations

Other

The Honorable Vic Fazio, House of Representatives
U.S. General Accounting Office, Hotline Center
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PART IV - MANAGEMENT COMMENTS

Assistant Secretary of the Army (Financial Management)

Headquarters, U.S. Army Material Command
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MEMORANDUM FOR THE INSPECTOR GENERAL

SUBJECT: Draft Report on the Audit of the Sacramento Army Depot Internal Review and Audit Compliance Office's Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies (Project OCF-0062.01)

Reference: SAIG-PA memorandum, 24 October 1991, SAB.

I concur with the command response as provided by Headquarters, U. S. Army Material Command (enclosed).

If you have any questions, please contact Mr. Gregory or Mr. O'Hare at extension 32909.

Douglas A. Brook
Assistant Secretary of the Army
(Financial Management)

Enclosure
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MEMORANDUM FOR HQDA (SAIO-PA) WASH DC 20310-1700

SUBJECT: DODIG Draft Report, Sacramento Army Depot Internal Review and Audit Compliance Office's Audit of Warranties Quality Deficiency Reports, and Reports of Discrepancies, Project OPC-0008.01 (AMC No. D0033)

1. We are forwarding the AMC position on subject report IAM AR 36-2.

2. The command reply to recommendations 1 and 2 (Enclosure 1) was prepared by HQ AMC. Command reply to recommendation 3 (Enclosure 2) was prepared by the U.S. Army Depot System Command (DESCOM). We concur with actions taken or proposed by DESCOM.

3. Point of contact for this action is Mr. Robert Kurzer, 703/774-0023.

FOR THE COMMANDER:

[Signature]

LEONARD H. MAGUIRE
Chief, Internal Review and Audit Compliance Office

Encs

as
FINDING: GOVERNMENT AUDITING STANDARDS

The HAAD Internal Review Office's audit report on the "Audit of Warranties, Product Quality Deficiency Reports (PQDR), and Reports of Discrepancies (ROD)," was not prepared in accordance with Government auditing standards. The audit report did not include qualifying statements which have disclosed that various field work, reporting, and general standards were not followed. The standards were not followed because the internal review audit was not supervised nor adequately planned. The audit report did not present a reliable audit evaluation of the administration of the Warranty, PQDR, and ROD Programs at HAAD. The report also claimed a cost avoidance of $426,000, which was not supported.

RECOMMENDATION AND ACTIONS TAKEN.

RECOMMENDATION 1. We recommend that the Commander, AMC direct a special internal oversight review of the Army Depot System Command (DESCOM) and the HAAD Internal Review and Audit Compliance Office (IRAC) to determine the extent to which Internal Review reports are not complying with Government auditing standards. The review should also determine the need for additional controls.

ACTION TAKEN. Concurs. A special quality assurance visit was made to the DESC0M IRAC Office by the 60 AMC IRAC Office on 13 June 01. During this review, we discussed the subject report with the DESC0M IRAC Chief and planned corrective actions to ensure that all IRAC audit reports comply with Government auditing standards. Additionally, we reviewed the IRAC quality assurance review performed by the DESC0M IRAC office of HAAD IRAC office. Based on the results of their review, a determination was made that no additional controls are needed at this time to ensure that IRAC audit reports comply with Government auditing standards.

A follow up visit was made to the DESC0M IRAC office on 9 July 01. This visit was made to express our concern on the results of the subject audit to the new HAAD IRAC Chief. We plan to visit the HAAD IRAC office in conjunction with DESC0M IRAC to ensure that internal review audit reports are in compliance with the Government auditing standards. This quality assurance visit is planned for the February - March 1993 timeframe. Also, we will participate with DESC0M IRAC in additional quality assurance visits to other depots to ensure their compliance with the Government auditing standards.

We voiced our concerns on compliance with the Government auditing standards at a recent Combined AMC/DESC0M Internal Review Conference. Participants included all DESC0M IRAC chiefs as well as IRAC chiefs from all other AMC major subordinate commands. We informed the participants that an audit report and associated working papers at an AMC activity was found not to comply with Government auditing standards. The seriousness of this was conveyed to all participants and we indicated that this would be an area of emphasis during quality assurance visits.
RECOMMENDATION 1. We recommend that Commander, AMC disclaim the potential monetary savings of $424,000 reported to DOD IG for inclusion in the Semiannual Report to the Congress in September 1990.

ACTION TAKEN. Concur. The potential monetary savings of $424,000 was disclaimed and an adjustment made to the potential monetary savings reported to the Department of Defense, Inspector General for inclusion in the Semiannual Report to the Congress in September 1991.
U.S. Army Depot System Command Reply

To

DODIG Draft Report, Sacramento Army Depot Internal Review and Audit Compliance Office's Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies. Project OPE-0062.01 (ANC No. D5033)

Finding - Government Auditing Standards

The Sacramento Army Depot (SAAD) Internal Review Office's audit report on the "Audit of Warranties, Quality Deficiency Reports, and Reports of Discrepancies," was not prepared in accordance with government auditing standards. The audit report did not include qualifying statements which would have disclosed that various field work, reporting, and general standards were not followed. The standards were not followed because the Internal Review audit was neither supervised nor adequately planned. The audit report did not present a reliable audit evaluation of the administration of the Warranty, LODR, and GRO Programs at SAAD. The report also claimed a cost avoidance of $424,000, which was not supported.

Additional Facts. We concur with the basic finding as stated on page 9 of the report. However, we disagree with the conclusion stated on pages 17 and 18 of the draft report "The failure to disclose the limitations makes it doubtful that effective internal controls exist over Internal Review audit work and that SAAD (sic) internal audit reports comply with government auditing standards." As noted by the DODIG on page 19, audit reports should explain the relationship between the universe and what was audited, the kinds and sources of evidence used, and any problems with quality of evidence. As near as can be determined from the draft report, the DODIG only examined the situation surrounding one Internal Review report at one depot. From this limited review, the DODIG apparently concludes that compliance with government auditing standards may be lacking throughout the Depot System Command (DESCOM). There is no indication in the report that the DODIG audited the oversight reviews performed by DESCOM or examined other reports issued by Sacramento Army Depot. The draft report recognizes this limited review in their Scope paragraph on page 4 where it is stated that DODIG limited their review to the SAAD Internal Review audit report and associated working papers.

Notwithstanding the fact that the DODIG failed to explain the relationship between the universe and what was audited, we view the finding at SAAD as a serious matter. Accordingly, future DESCOM oversight reviews will include increased emphasis on reviewing working papers and reports for compliance with government auditing standards.
Recommendation 3. We recommend that the Commander, SAAD, issue a statement that the "Audit of Warranties, Quality Deficiency Reports and Reports of Discrepancies," July 20, 1990, report was not reliable because it was not supported by a competent audit or prepared in accordance with government auditing standards.

List of Audit Team Members

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