



OFFICE OF THE INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **FY 2006 Quality Assurance Report**

# **Report on Compliance with Government Auditing Standards in the Audit of EPA's Fiscal 2004 and 2003 Financial Statements**

**May 17, 2006**

**Report Contributors:**

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**Abbreviations**

AIG	Assistant Inspector General
GAO	Government Accountability Office
GAGAS	Generally Accepted Government Auditing Standards
GAS	Government Auditing Standards
OA	Office of Audit
OMB	Office of Management and Budget
PCIE	President's Council on Integrity and Efficiency
QAR	Quality Assurance Review



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Review

We conducted this QAR of the *Audit of EPA's Fiscal 2004 and 2003 Financial Statements* (FY 2004 FS Audit) to determine whether the work complied with Government Auditing Standards (GAS) contained in the Government Accountability Office (GAO) 2003 revision of the "Yellow Book"; OIG policies and procedures; and other applicable guidance.

## Background

Government Auditing Standards require, "Each audit organization performing audits and/or attestation engagements in accordance with GAGAS should have an appropriate internal quality control system in place..." Part of EPA OIG's Quality Assurance System includes conducting Quality Assurance Reviews of its work products. EPA OIG's Quality Assurance System encompasses its organizational structure and the policies and procedures established to provide it with reasonable assurance of complying with *Government Auditing Standards*. EPA OIG is responsible for the design of its quality assurance system and compliance with it, including the quality of its products.

## **FY 2006 Quality Assurance Review of the Audit of EPA's Fiscal 2004 and 2003 Financial Statements**

### What We Found

For this Quality Assurance Review (QAR), 5 cycles were judgmentally selected from a total of 31 cycles in the FY 2004 FS Audit. The cycles selected were Obligations, Accounts Receivable, Cost Accounting, Property, and Accounts Payable/Accrued Liabilities. (See Scope and Methodology Section). Overall we found that the work performed on this audit of EPA's fiscal 2004 and 2003 financial statements generally complied with applicable Government Auditing Standards (GAS), OIG policies and procedures, and other guidance. We conducted the entrance conference on July 5, 2005, and completed fieldwork on March 31, 2006.

This report is the second in the series of Quality Assurance Review reports issued in 2005 and 2006. The first report, *FY 2005 Quality Assurance Report: Report on Compliance with Government Auditing Standards*, dated November 9, 2005, covered internal controls in place and work products issued by the Office of Audit, Office of Program Evaluation, and Office of Congressional and Public Liaison for the period from October 1, 2003, to September 30, 2004.

Most problems found during the QAR of the FY 2004 FS Audit were minor and have been adequately addressed through recommendations in our previous QAR report. However, one issue, Auto Audit approvals, was not addressed previously. Preserving documentation of reviews and approvals is necessary to demonstrate OIG compliance with standards and OIG policy.

### What We Recommend

- Establish a process for preserving documentation of original working paper reviews and approvals in the event that a working paper must be reopened or moved to another Auto Audit location.

The Office of Audit agreed with the recommendation.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

OFFICE OF  
INSPECTOR GENERAL

May 17, 2006

**MEMORANDUM**

**SUBJECT:** FY 2006 Results from the Quality Assurance Review of the Audit of EPA's Fiscal 2004 and 2003 Financial Statements

**FROM:** Howard Cantor/s/  
Assistant Inspector General  
Office of Planning, Analysis, and Results

**TO:** Bill A. Roderick  
Acting Inspector General

Attached is the final report of the Quality Assurance Review (QAR) of the *Audit of EPA's Fiscal 2004 and 2003 Financial Statements* (FY 2004 FS Audit). Our review of 5 cycles (see Scope and Methodology Section) found that the work performed on this audit of EPA's fiscal 2004 and 2003 financial statements generally complied with applicable Government Auditing Standards (GAS), OIG policies and procedures, and other guidance.

We issued our draft report on April 12, 2006. On May 11, 2006 we received your response. This report is the second in the series of QAR reports issued in 2005 and 2006. The first report, *FY 2005 Quality Assurance Report: Report on Compliance with Government Auditing Standards*, dated November 9, 2005, covered internal controls in place and work products issued by the Office of Audit, Office of Program Evaluation, and Office of Congressional and Public Liaison for the period from October 1, 2003, to September 30, 2004.

Most problems found during the QAR of the FY 2004 FS Audit were minor and have been adequately addressed through recommendations in our previous QAR report. The response outlined actions which we believe will have a positive effect on improving OIG operations. We will track the progress of the corrective actions in the quarterly Management Action Plan. We have incorporated your response in the report.

We appreciate the assistance provided by the financial statement team and were impressed by the professionalism of the staff in conducting, coordinating, summarizing, and analyzing a large amount of work. Their cooperation contributed significantly to our review. If you have any questions regarding the attached report, please contact me at 202-566-2649 or Deborah Heckman at 202-566-2643.

cc: Deputy Inspectors General  
Assistant Inspector General for Audit  
Director of Financial Audits

# Quality Assurance Review of the Audit of EPA's Fiscal 2004 and 2003 Financial Statements

## Purpose

We conducted this Quality Assurance Review (QAR) of the *Audit of EPA's Fiscal 2004 and 2003 Financial Statements* (FY 2004 FS Audit) to determine whether the work complied with Government Auditing Standards (GAS) contained in the Government Accountability Office (GAO) 2003 revision of the "Yellow Book"; OIG policies and procedures; and other applicable guidance.

For this QAR, 5 cycles were judgmentally selected from a total of 31 cycles in the FY 2004 FS Audit. The cycles selected were Obligations, Accounts Receivable, Cost Accounting, Property, and Accounts Payable/Accrued Liabilities. (See Scope and Methodology Section)

This report is the second in the series of Quality Assurance Review reports issued in 2005 and 2006. The first report, *FY 2005 Quality Assurance Report: Report on Compliance with Government Auditing Standards*, dated November 9, 2005, covered internal controls in place and work products issued by the Office of Audit, Office of Program Evaluation, and Office of Congressional and Public Liaison for the period from October 1, 2003, to September 30, 2004.

## Summary of Results

Our review of the FY 2004 FS Audit found that the work performed generally complied with applicable GAS, OIG policies and procedures, and other guidance. The QAR team recognizes the professionalism of the financial statements audit team, the severe time constraints in conducting the audit, and the tremendous amount of work involved in an audit of EPA's Financial Statements. Nonetheless, we noted a few areas where we believe improvements could be made:

- Working paper documentation
- Independent referencing
- Supervisory review
- AutoAudit processes

We reviewed the Office of Audit's response and found it responsive to our recommendation. Most problems found during the QAR of the FY 2004 FS Audit were minor and have been adequately addressed through recommendations in our previous QAR report, issued November 9, 2005. The response outlined corrective action to retain evidence of all supervisory reviews in Auto Audit. We believe the implementation of this corrective action will have a positive effect on documenting supervisory review thus improving OIG operations. We have incorporated (italic text) the response after the recommendation.

### ***Working Paper Documentation Could Be Improved***

Although we found that working paper documentation could have been improved in some cases, many of the working papers we reviewed were completed properly. The problems described

below were not material to the findings and conclusions in the report and did not significantly impact the quality of the work performed.

In the review of one cycle, the reviewer was unable to understand the work performed or trace conclusions to supporting working papers without assistance from the auditor who worked on the cycle. The Yellow Book standard for audit documentation (GAGAS 4.22) states: “Audit documentation related to planning, conducting, and reporting on the audit should contain sufficient information to enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors significant judgments and conclusions.” There were no findings in the audit report for this cycle. Therefore, the working papers did not go through independent referencing, which might have helped improve documentation of this cycle. Although work and conclusions should have been more clearly documented for review purposes, there was no impact on support for findings and conclusions in the report.

Support for statements in the audit report for two additional cycles should have been more thorough. The “cause” in a finding for one cycle was not thoroughly supported by the cross-index to a summary working paper. After a review of working papers for this cycle, the reviewer concluded that cause was adequately supported by the work performed, but the summary working paper was not completed properly. In addition, other facts concerning this cycle in the report should have been more thoroughly supported, and working paper source information was not always complete. For another cycle, working paper support for a statement in the report was somewhat confusing. In this case, the working paper should have provided additional clarifying information.

In addition, we suggest that Web sites not be relied upon for locating primary source documents. During later reviews of the working papers by a Peer Review or QAR, the Web site might no longer exist or the document might have been removed from the site. We found one working paper where a Web site was cited for “Source” but the primary source documents supporting the working paper conclusion were not attached or copied into the working paper.

We discussed these documentation issues with staff who worked on the cycles reviewed. They agreed with our suggestions for improvements.

### ***Independent Referencing Process Should Be More Thorough***

The issues discussed in the section above were not identified by the independent referencers who reviewed support for report findings and conclusions. We were told that independent referencers had one or two days for independent referencing on this audit report, which did not allow enough time for a detailed, in-depth review of support.

One independent referencer said it would have been helpful if she had been given a few days ahead of time to become familiar with the cycle and criteria before she received the position paper for review. She also mentioned that the OIG project management course, which she took after independent referencing on this audit, was very helpful in understanding the role of the independent referencer.

The OIG Project Management Handbook, June 21, 2004, revision, requires the independent referencer to “determine whether recommendations logically follow from the facts and conclusions presented in the draft product.” We determined that a recommendation in one of the report findings does not follow from facts and conclusions in the report. The cycle coordinator who wrote the finding said he thought the recommendation was self-explanatory, and, in addition, the auditees in the Office of the Chief Financial Officer understood the recommendation. However, there should have been at least a short explanation in the report as to why the recommendation was necessary. The independent referencer can provide a valuable “cold reader” perspective when the auditor is too close to an issue to realize that the reason for making a recommendation has not been explained in the report.

Training in project management and independent referencing currently being provided to OIG staff should help strengthen the independent referencing process. However, the time constraints on the Financial Statements Audit present an additional challenge for the independent referencers. To improve the effectiveness of this important quality control process, we suggest that independent referencers be given time to become familiar with the cycle(s) they will be reviewing as well as current guidance for independent referencing before they receive position papers or report sections to review.

### ***Documentation of Supervisor Comments Found Generally Adequate***

In general, we found sufficient documentation of supervisor comments in the working papers reviewed. However, for one cycle, there were few documented comments by the supervisor. The cycle coordinator said that she and her supervisor had exchanged e-mails and discussed the audit verbally. We suggest that, in the future, e-mails and verbal discussions about the audit work be documented in the working papers. This issue was addressed in the previous QAR report, issued November 9, 2005. As a result, the upcoming revision to the OIG Project Management Handbook, currently in draft, will require supervisory review comments to be documented in a working paper review sheet.

### ***Some Processes in AutoAudit Should Be Improved***

It is important to maintain a record of who initially reviewed or approved a working paper and the review or approval date. The Project Management Handbook states that “All working papers must be reviewed by a member of the team who did not prepare the working paper,” and “Evidence of working paper review must be recorded in the working papers.”

Due to problems with the approval process in AutoAudit, a permanent record of working paper approvals is not always maintained. The approval process in AutoAudit results in working papers being closed out, and changes cannot be made to a closed-out working paper. In order to make a change, the working paper must be reopened by someone with that authority. Reopening causes original approvals and edit histories in working papers to be deleted. We found that some of the Audit Guides had not been approved in AutoAudit. We were told by one assignment manager that there is a reluctance to approve Audit Guides because the approval closes them out.

We also found that a summary working paper, used to support a report finding, showed an approval date that was after the date the audit report was issued. In that case, the working paper

had been reopened. The original approval, which was before report issuance, was deleted, and the working paper was approved again after the report was issued.

Another problem occurred with AutoAudit approvals when the working papers for one cycle had to be moved from one section to another causing the approvals to be deleted. Therefore, the approval dates showing in AutoAudit were not the original approval dates.

An alternative method for working paper reviews has been used successfully on other OIG assignments. Instead of using the AutoAudit approval function, reviewers type their names and review dates in AutoAudit working papers. When this method is used, the reviewers name and review date are preserved if the working paper is closed and reopened or moved. If any changes are made to the working paper at a later date, a second review can be done and recorded the same way.

Another solution would be to type the original approval name and date at the top of the working paper only if it must be reopened after being closed. This method is somewhat less satisfactory because the history record in AutoAudit is lost when working papers are reopened.

We also found that electronic document links in AutoAudit are not reliable. The links for the FY 2004 FS Audit appeared to be working during independent referencing but were not working during the QAR. The OIG Project Management Handbook is in the process of being revised and will recommend that all document links be labeled with working paper index numbers. During our review, one document link, which was labeled, was to a working paper from the previous year's financial statements audit working papers. The working paper could not be located in AutoAudit. We suggest that working papers that are not part of the current audit be copied into the current audit working papers so that reviewers can locate them easily.

## **Recommendation**

As noted previously, most problems found during the QAR of the FY 2004 FS Audit were minor and have been adequately addressed through recommendations in our previous QAR report. However, one issue, AutoAudit approvals, was not addressed previously. Preserving documentation of reviews and approvals is necessary to demonstrate OIG compliance with standards and OIG policy.

We recommend that the Assistant Inspector General for Audit establish a process for preserving documentation of original working paper reviews and approvals in the event that a working paper must be reopened or moved to another AutoAudit location.

## **OA Response**

*We intend to pursue a software change with the contractor to prevent deletion of approvals and edit histories in the event that a locked working paper is unlocked. Until this can be accomplished, the Acting Inspector General will issue a memorandum to working paper preparers throughout the OIG directing that they insert the reviewer's initials and dates of reviews on any working paper that is unlocked. Also, preparers will be provided instructions on how to copy working papers to lessen the need for working papers to be unlocked. By taking these actions, evidence of all supervisory review will be retained.*



## ***Scope and Methodology***

Our review covered the internal controls over the *Audit of EPA's Fiscal 2004 and 2003 Financial Statements* (FY 2004 FS Audit), report issued 11/15/04, and five judgmentally selected accounting cycles in the FY 2004 FS Audit: Obligations, Accounts Receivable, Cost Accounting, Property, and Accounts Payable/Accrued Liabilities. We conducted this QAR of the FY 2004 FS Audit to determine whether the audit work and report complied with Government Auditing Standards (GAS) contained in the June 2003 revision of the Government Accountability Office (GAO) "Yellow Book"; OIG policies and procedures; and other applicable guidance.

The QAR was conducted using the President's Council on Integrity and Efficiency *Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General*, April 2005 version, Appendix D "Checklist for Review of Financial Statement Audits Performed by Inspectors General." We also reviewed for compliance with applicable OIG Project Management Handbook requirements.

This QAR report focuses exclusively on the FY 2004 FS Audit. A previous QAR report, *FY 2005 Quality Assurance Report: Report on Compliance with Government Auditing Standards*, dated November 9, 2005, covered internal controls in place and work products issued by the Office of Audit, Office of Program Evaluation, and the Office of Congressional and Public Liaison for the period from October 1, 2003, to September 30, 2004. Our FY 2005 QAR concluded that work performed generally complied with applicable GAS, OIG policies and procedures, and other guidance. We identified opportunities and made recommendations for improving quality. The OIG is taking appropriate actions in response to our recommendations.

Since AutoAudit is the required application for electronic working papers, we used it as evidence as it contains most assignment working papers. If applicable, hard copy working papers were also reviewed. We discussed issues found during the QAR with assignment teams and considered their comments when we prepared our report conclusions.

### ***Prior Reviews***

Prior reviews of audits of EPA's financial statements were *Final Results of the 2002 Quality Assurance Review of the Audit of EPA's Fiscal Year 2001 and 2000 Financial Statement*, dated January 3, 2003, and *Report on the External Quality Control Review of the Environmental Protection Agency's Office of Inspector General Audit Organization*, dated December 19, 2003 (Financial Audits section). These reports were reviewed during the current QAR.