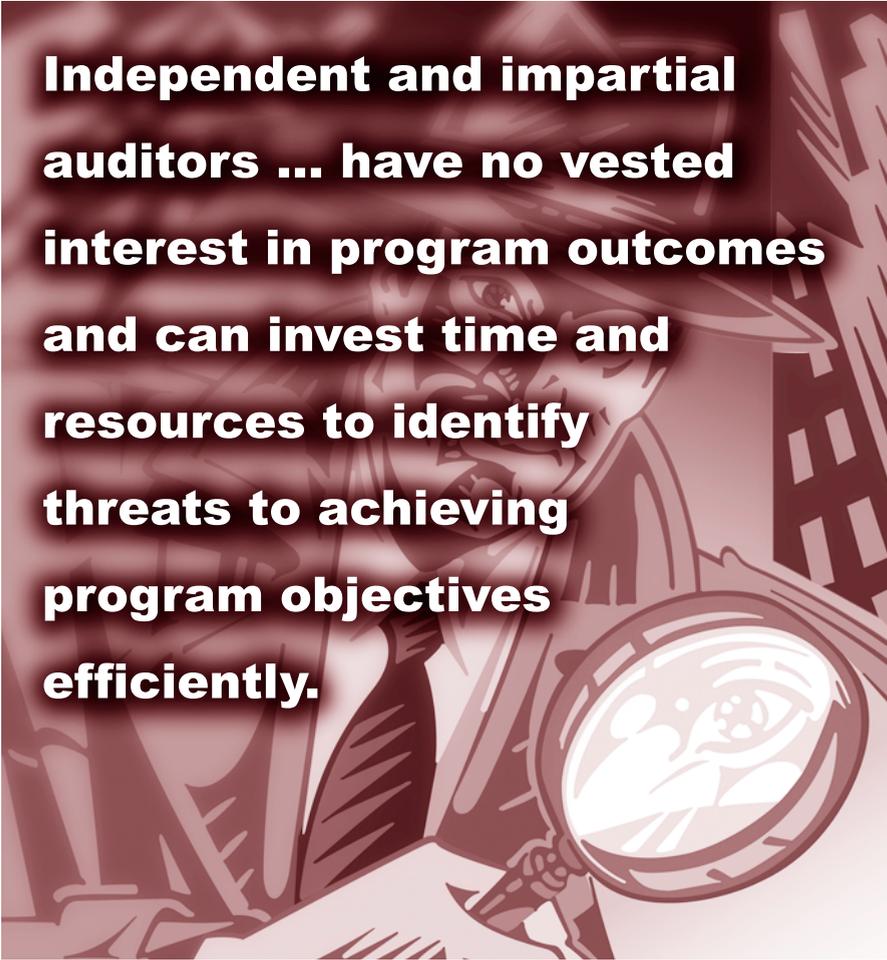


Just How Independent Are Internal Auditors in DoN?

The Naval Audit Service

Randall Exley



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“demand” access to any personnel, information, and documents we want at any time? If the Naval Audit Service is independent of DoN leadership, who provides oversight to ensure the auditors follow the rules?

These questions have been asked many times over the years and have been the subject of much confusion. This article attempts to clear up the confusion and explain how the auditor general and I, as his deputy, view the Audit Service’s independence.

Why Does it Matter?

It is essential to note that auditor independence should be as important to Department leaders as it is to the auditors themselves. Having independent auditors review and evaluate systems, activities, programs, functions, and funds ensures those leaders get an impartial and objective assessment of program effectiveness and efficiency, and of program compliance with laws and regulations. It’s human nature for program managers to present their programs’ status in the most positive terms possible. They have a vested interest (in terms of

What do we in the Naval Audit Service mean by our “independence,” when we use the term as internal auditors? Why is independence important to auditors, and why should it be important to Department of the Navy leaders? Is the Naval Audit Service independent of the DoN chain of command? Does independence mean the Naval Audit Service can decide what we audit with no input from DoN senior leaders? Does it mean Naval Audit Service resources are off limits to budget cuts? Can we

their annual performance evaluations, career advancement, and earnings potential) in showing their programs as proceeding on or ahead of schedule, within budget, and as meeting or exceeding performance objectives.

It is also possible the program managers are simply unaware of problems their programs are facing because they are so busy with macro-level management concerns or, at any given time, heavily focused on detailed aspects of certain parts of their programs. They may be too close to

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the programs to see the problems, or they may not have the time and resources an independent audit brings to bear to thoroughly evaluate their programs and identify problems. Even if they are aware of problems, they may feel (sometimes over optimistically) that it is within their power to correct them; thus—in their view—there is no need to make those problems known to senior leaders. Independent and impartial auditors don't have to wrestle with these conflicts. They have no vested interest in program outcomes and can invest time and resources to identify threats to achieving program objectives. Through their audit work, they get the facts and draw their conclusions based on well-documented evidence, without introducing personal bias into their assessments.

What Do the Audit Standards Require?

As internal auditors, we are *not* independent of DoN, we are part of it. The auditor general, as the official solely responsible for internal audit within DoN, reports to the secretary and under secretary of the Navy. That reporting relationship provides organizational independence, which is what is called for by the Government Accountability Office's Generally Accepted Government Auditing Standards. The independence standard reads, in part: "In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence."

The purpose of the standard is to establish credibility so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. The standards state that

a government internal audit organization can be presumed to be free from organizational impairments to independence when reporting internally to management, if the head of the audit organization meets all of the following criteria:

- Is accountable to the head or deputy head of the government entity (in our case, the secretary or under secretary of the Navy)
- Is required to report the results of the audit organization's work to the head or deputy head of the entity; (the auditor general and other Naval Audit Service senior leaders meet with DoN senior leaders regularly throughout the year and at semiannual Oversight Planning Board (OPB) meetings, and copies of final audit reports are sent to the under secretary)
- Is located organizationally outside the staff or line management function of the unit under audit (the Naval Audit Service is part of the Secretary of the Navy staff).

The Naval Audit Service does meet all of these criteria.

Are We Free From Influence of Those We Audit?

Does organizational independence mean the Naval Audit Service is absolutely free from any influence by those we audit? No, that would be unrealistic. Like other DoN organizations, the Naval Audit Service has to compete for budget, personnel, and facilities support—and when budget and personnel cuts are levied on the Department, the Naval Audit Service often takes its fair share. Decisions in those areas are made by the people we audit, in their efforts to manage the organization as a whole and balance requirements: the assistant secretary of the Navy (ASN) (financial management and comptroller) oversees the DoN budget; DoN senior military and civilian leaders, including the Naval Audit Service's supporting Budget Submitting Office, shape budget proposals; the ASN (manpower and reserve affairs) manages personnel resources and pay; and the ASN (installations and environment) oversees facilities and support. All of these organizations and officials can impact our resources and daily operations—and the Naval Audit Service has audit responsibilities for all of them.

Organizational independence does mean that if decisions are made that the Naval Audit Service considers to be inappropriate or unfair, the auditor general can challenge them with the secretary and under secretary of the Navy—and has done so successfully on occasion.

Who are our Customers?

Does being organizationally independent mean the Naval Audit Service can audit whatever it wishes? The answer is "no." The Naval Audit Service is established in law to serve the secretary of the Navy—not the taxpayers, not the Congress, and not even the Office of the Secretary of Defense. If we do our jobs correctly and objectively, all of

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Independence does not mean freedom from control.

those stakeholders benefit from our work, but they are not our primary customers. Further, although (per secretary of the Navy instruction) no official other than the secretary and under secretary can ultimately tell the auditor general what to audit—or perhaps more important, what *not* to audit—the organizations we audit influence what the Naval Audit Service does in positive and constructive ways. Through the annual risk assessment and numerous meetings with the auditor general, deputy auditor general, and the assistant auditors general, those who are audited play a key role in helping us decide what to audit each year. Having their input allows the Naval Audit Service to perform audits that address the DoN’s significant risks and the most critical concerns of its senior leaders. The Naval Audit Service’s annual audit plan is reviewed by the OPB, which is made up mostly of leaders we audit (the ASNs, vice chief of naval operations, assistant commandant of the Marine Corps, Department of the Navy chief information officer, and general counsel), and is chaired by the under secretary of the Navy. Although the individual OPB members, other than the under secretary, cannot direct the auditor general to do or not do any audit, they do have influence on the content of the audit plan. The same is true for the Senior Review Board. That board, which includes many of the same members as the OPB, oversees DoN classified programs and reviews our audit plan in that area.

Ultimately, the outcome of this collaboration has been that every audit in our annual plan is either requested or agreed to by a DoN senior executive or flag officer. That buy-in from senior leaders gives the plan credibility with lower echelon commands when we do our audit work.

What the Naval Audit Service does want is independence from “inappropriate” influence by those we audit. Per secretary of the Navy instruction, those we audit should not be able to control what we audit, the scope of our audits, our access to information, or the people we talk to during an audit. Those we audit should also not be able to control our resources, promotions, and bonuses without our having the ability to go to the secretary or under secretary for a final adjudication. As noted previously, we have that ability. We want to be impartial in our work, and our audit reports should provide fair, objective, balanced, and truthful assessments of what we find.

Who Audits the Auditors?

Independence does not mean freedom from control. The Naval Audit Service receives oversight from:

- **The Department of Defense Inspector General**—which sets audit policy within the DoD, conducts quality assurance reviews of our work, and oversees peer reviews of DoD audit organizations
- **The Army Audit Agency**—which performs triennial peer reviews on our work
- **The Government Accountability Office**—which sets the audit standards for all government audit organizations and has authority to audit/evaluate the Naval Audit Service’s performance and compliance with standards.

Those organizations are in a position to ensure we meet the independence standards and, if we do not, to address their concerns at higher levels of DoD.

How Independent are Public Accounting Firms?

The Naval Audit Service’s independence is not absolute, but even external auditing firms cannot operate free of influence. For example, Certified Public Accounting firms have to concern themselves with getting the next contract. If they don’t work with management constructively and present their findings fairly, the auditee may look elsewhere the next time. Independent firms must walk a fine line between serving the company managers, stockholders, and the Securities and Exchange Commission, and not becoming so independent that they lose the next engagement.

Our Message

The message the auditor general and I want to convey is that we are entitled to have organizational independence under the audit standards—and having the auditor general report directly to the secretary and under secretary of the Navy provides that. Conversely, we want DoN leader input on our audit plan, and we want most—if not all—audit topics we address to be requested or agreed to by DoN senior leaders. The auditor general needs some limited ability to select audits over the objections of senior leaders below the secretary and under secretary when he or she feels the risks warrant coverage. The under secretary has given the auditor general that ability.

Ultimately, the Naval Audit Service is not absolutely independent and is not intended to be. Naval Audit Service auditors are internal, not external, auditors—and even external auditors are not absolutely independent. However, by virtue of our organizational placement, the Naval Audit Service has the degree of independence intended and necessary to do our job.

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