INTERNET DOCUMENT INFORMATION FORM

A . Report Title Quality Control Review of KPMG Peat Marwick LLP and the Defense Contract Audit Agency The Smithsonian Institution Fiscal Year Ended September 30, 1996

B. DATE Report Downloaded From the Internet: 02/24/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 02/24/99**

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.

Oversight Report

QUALITY CONTROL REVIEW OF KPMG PEAT MARWICK LLP
AND THE DEFENSE CONTRACT AUDIT AGENCY
THE SMITHSONIAN INSTITUTION
FISCAL YEAR ENDED SEPTEMBER 30, 1996

Report Number PO 98-6-008 March 20, 1998

Office of the Inspector General
Department of Defense

DTIC QUALITY INSPECTED 4

DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

20000224 130

AQI00-05-1341

Additional Copies

To obtain additional copies of this report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, Home Page at: WWW.DODIG.OSD.MIL

Suggestions for Future Audits or Evaluations

To suggest ideas for or to request future audits or evaluations, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

DCAA	Defense Contract Audit Agency
GAS	Government Auditing Standards
KPMG	KPMG Peat Marwick LLP
OMB	Office of Management and Budget
SAO	Smithsonian Astrophysical Observatory

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

March 20, 1998

Board of Regents
Smithsonian Institution
955 L'Enfant Plaza, SW
Suite 7400
Washington, DC 20560

Mr. Herbert Folpe
Partner-in-Charge, Public Services Practice
KPMG Peat Marwick LLP
345 Park Avenue
New York, NY 10154-0004

Director, Defense Contract Audit Agency
8725 John J. Kingman Road, Suite 2135
Fort Belvoir, VA 22060-6219

SUBJECT: Quality Control Review of KPMG Peat Marwick LLP
and the Defense Contract Audit Agency
The Smithsonian Institution
Fiscal Year Ended September 30, 1996
Report No. PO98-6-008 (Project No. 8OA-9008.03)

Introduction

We are providing this report for your information. The Washington, D.C. office of KPMG Peat Marwick LLP (KPMG), and the Landover, Maryland, office of the Defense Contract Audit Agency (DCAA) performed the coordinated single audit for the Smithsonian Institution (Smithsonian), Washington, D.C. The audit was required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions." For the fiscal year ended September 30, 1996, the Smithsonian reported total Federal expenditures of $53,657,000, representing $1,375,000 for the Department of Defense (DoD) and $52,282,000 for other Federal agencies.

The KPMG audit report, dated January 17, 1997, includes reports on internal controls, compliance, and the Schedule of Federal Awards. The auditors issued an unqualified opinion on the financial statements and Schedule of Federal Awards. The DCAA issued several reports, including a report (September 30, 1997) on compliance for the

Smithsonian Astrophysical Observatory (SAO), a component of the Smithsonian, and reports (October 3, 1997) on internal controls for the Smithsonian and SAO.

KPMG issued positive and negative assurance statements on compliance with general requirements. Positive assurance means that, with respect to the items tested, the results of auditors' procedures disclosed no material instances of noncompliance. Negative assurance means that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that the Smithsonian had not complied in all material respects.

The auditors obtained an understanding of the internal controls related to the financial statements and Federal awards. The audit report describes the auditors' scope of work in obtaining that understanding and in assessing control risk. The report on internal controls further describes the significant internal controls and control structure that provide reasonable assurance that Federal awards are being managed in accordance with applicable laws and regulations.

Quality Control Review Results

The coordinated audit performed by KPMG and DCAA meets the applicable guidance and regulatory requirements in OMB Circular A-133 and its related Compliance Supplement, which incorporate Government Auditing Standards (GAS) and generally accepted auditing standards.

Quality Control Review Objective

The objective of a quality control review is to ensure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A-133. As the Federal cognizant agency for the Smithsonian, we conducted a quality control review of the KPMG and DCAA audit working papers. We focused our review on the following qualitative aspects of the audit: due professional care, planning, supervision, independence, quality control, internal controls, substantive testing, general and specific compliance testing, and the Schedule of Federal Awards.

We reviewed the most recent peer review letter for KPMG issued by Price Waterhouse LLP on November 8, 1996. The peer review letter states that KPMG met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that KPMG complied with the standards during the fiscal year ended March 31, 1996.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) that was approved by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and field work audit standards and the required elements of a single audit. The Guide is further divided into the substantive audit work performed during the audit of financial statements and the specific program compliance testing for major programs. In addition, we supplemented the Guide to include additional review of transaction testing. Our quality control review covered areas related to the financial statements, major programs, and nonmajor programs. Our review was conducted from January 5 through 16, 1998.

Results of Prior Quality Control Reviews

We identified minor quality control review findings and recommendations at two of the eight KPMG locations we visited at various times from January 1, 1995, through July 31, 1997. The affected offices were notified, and no significant, further action is necessary.

Background

The Inspector General Act of 1978, Public Law 95-452, as amended, prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspector General is required to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments whose total annual expenditures are $100,000 or more with respect to Federal financial assistance programs; establish uniform requirements for audits of Federal financial assistance; promote efficient and effective use of audit resources; and ensure that Federal departments and agencies rely on and use the audit work done under the Act, to the maximum extent practicable.

The Single Audit Act Amendments of 1996, based on 12 years of experience under the 1984 Act, are intended to strengthen the usefulness of single audits by increasing the audit threshold from $100,000 to $300,000 in Federal financial assistance before an audit is required under the Act; by selecting programs to be audited on the basis of risk assessment rather than the amount of funds involved; and by improving the contents and timeliness of single audits. The Amendments also bring nonprofit organizations, previously covered by similar requirements in the OMB Circular A-133, under the Single Audit Act.

The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal awards are or exceed $100,000. The Circular provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. An agency must rely on the audit to the extent that it provides the information and assurances that an agency needs to implement its overall responsibilities. The coordinated audit approach provides for the independent public accountant, Federal auditor, and other non-Federal auditors to consider each other's work in determining the nature, timing, and extent of their respective audit procedures. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. The revised Circular was issued on June 24, 1997, to incorporate the changes in the Single Audit Act Amendments of 1996. Its provisions apply to audits of fiscal years beginning after June 30, 1996.

Discussion of Results

During our quality control review, we reviewed and took no exception to the working papers supporting the following reports and schedules.

Independent Auditors' Report. The auditor is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. We reviewed the audit program and the testing of evidential matter to determine whether testing was sufficient, based on assessment of control risk, to warrant the conclusion reached and whether the working papers supported the conclusion.

Report on the Internal Control Structure Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. The auditor is required to obtain an understanding of the internal control structure that is sufficient to plan the audit and to assess control risk for the assertions embodied in the financial statements. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the substantive testing performed.

Report on Compliance with Laws, Regulations, Contracts, and Grants Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on the determination of financial statement amounts. We reviewed the audit program for the appropriate procedures, the working paper documentation, its support, and the compliance tests performed.

Report on Schedule of Federal Awards. The auditor is required to subject the schedule to the auditing procedures applicable to the audit of the financial statements

and to ensure that the amounts are fairly stated in relation to the basic financial statements. Our review was included in the steps of evaluation of the audit working papers related to the Independent Auditors' Report.

Report on Internal Control Structure Used in Administering Federal Awards. The auditor is required to assess control risk to determine whether to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance, to review the system for monitoring subrecipients and obtaining and acting on subrecipient audit reports, and to determine whether controls are effective to ensure that direct and indirect costs are calculated and billed in accordance with the general and specific requirements in the Compliance Supplement. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the results of the testing of controls.

Report on Compliance with General Requirements. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditors' procedures were limited to those prescribed in the OMB Circular A-133 Compliance Supplement, except for allowable costs/cost principles, which were audited by DCAA. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

Report on Compliance with Specific Requirements Applicable to Major Programs. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on its major Federal programs. The requirements included types of services allowed or unallowed; eligibility; matching, level of effort, and/or earmarking requirements; special reporting requirements; and special tests and provisions. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

Management Letter on Immaterial Findings. The auditor is not required to, but may report immaterial findings in the audit report or report them to the recipient in writing in a separate communication. The recipient is responsible for forwarding the findings to the Federal grantor agencies, where applicable. The issues raised in the management letter do not relate to Federal awards.

Report on OMB Circular A-133 Audit of Fiscal Year 1996 Compliance with Requirements Applicable to Federal Awards (Smithsonian Institution). The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditors' procedures were limited to general and specific requirements for the allowable costs/cost principles as prescribed in the OMB Circular A-133 Compliance Supplement. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, and reviewed the compliance tests performed.

Report on OMB Circular A-133 Audit of Fiscal Year 1996 Compliance with Requirements Applicable to Federal Awards (Smithsonian Astrophysical Observatory). The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditors' procedures were limited to general and specific requirements for the allowable costs/cost principles as prescribed in the OMB Circular A-133 Compliance Supplement. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, and reviewed the compliance tests performed.

Report on OMB Circular A-133 Review of Fiscal Year 1996 Internal Control Used in Administering Federal Awards (Smithsonian Institution). The auditor is required to assess control risk to determine whether to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. The auditors' tests were limited to controls over allowable costs/cost principles. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the results of the testing of controls.

Report on OMB Circular A-133 Review of Fiscal Year 1996 Internal Control Used in Administering Federal Awards (Smithsonian Astrophysical Observatory). The auditor is required to assess control risk to determine whether to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. The auditors' tests were limited to controls over allowable costs/cost principles. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the results of the testing of controls.

Comments

Because this report does not contain findings or recommendations, written comments are not required. If you have questions on this report, please contact Mrs. Barbara Smolenyak, Program Director, at (703) 604-8761. The report distribution is in the Enclosure.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

The Smithsonian Institution
Fiscal Year Ended September 30, 1996

Distribution List

Board of Regents
Smithsonian Institution
955 L'Enfant Plaza, SW
Suite 7400, MRC 903
Washington, DC 20560

Mr. Richard McKinless
KPMG Peat Marwick LLP
2001 M Street, NW
Washington, DC 20036

Branch Manager
Defense Contract Audit Agency
District Branch Office
8181 Professional Place, Suite 112
Landover, MD 20785-2218

Commander
Defense Contract Management Command
8725 John J. Kingman Road, Suite 4539
Fort Belvoir, VA 22060-3060

Director, Defense Contract Audit Agency
8725 John J. Kingman Road, Suite 2135
Fort Belvoir, VA 22060-6219

Director, Defense Procurement
Office of the Under Secretary of Defense
for Acquisition and Technology
3060 Defense Pentagon
Washington, DC 20301-3060

Director, Defense Research and Engineering
Office of the Under Secretary of Defense
for Acquisition and Technology
3030 Defense Pentagon
Washington, DC 20301-3030

Chief, Office of Naval Research
800 North Quincy Street
Arlington, VA 22217-5660

Enclosure

Evaluation Team Members

This report was prepared by the Financial and Performance Audits Directorate, Office of the Deputy Assistant Inspector General for Audit Policy and Oversight, DoD.

Barbara E. Smolenyak
Donald D. Steele
Andrew Katsaros
Sunil R. Kadam
Nancy C. Cipolla
Janet C. Johnson

INTERNET DOCUMENT INFORMATION FORM

A . Report Title Quality Control Review of KPMG Peat Marwick LLP and the Defense Contract Audit Agency The Smithsonian Institution Fiscal Year Ended September 30, 1996

B. DATE Report Downloaded From the Internet: 02/24/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): **OAIG-AUD (ATTN: AFTS Audit Suggestions)**
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 02/24/99**

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.