

March 28, 2002



Audit Oversight

Report on Quality Control Review of
KPMG, LLP and Defense Contract
Audit Agency Office of Management
and Budget Circular No. A-133 Audit
Report of Illinois Institute of
Technology Research Institute,
Fiscal Year Ended June 30, 1997
(D-2002-6-004)

Department of Defense
Office of the Inspector General

Quality

Integrity

Accountability

Report Documentation Page

Report Date 28Mar2002	Report Type N/A	Dates Covered (from... to) -
Title and Subtitle Audit Oversight: Report on Quality Control Review of KPMG, LLP and Defense Contract Audit Agency Office of Management and Budget Circular No. A-133 Audit Report of Illinois Institute of Technology Research Institute Fiscal Year Ended June 30, 1997	Contract Number	
	Grant Number	
	Program Element Number	
Author(s)	Project Number	
	Task Number	
	Work Unit Number	
Performing Organization Name(s) and Address(es) OAIG-AUD (ATTN: AFTS Audit Suggestions) Inspector General, Department of Defense 400 Army Navy Drive (Room 801) Arlington, VA 22202-2884	Performing Organization Report Number D-2002-6-004	
Sponsoring/Monitoring Agency Name(s) and Address(es)	Sponsor/Monitor's Acronym(s)	
	Sponsor/Monitor's Report Number(s)	
Distribution/Availability Statement Approved for public release, distribution unlimited		
Supplementary Notes		
Abstract		
Subject Terms		
Report Classification unclassified	Classification of this page unclassified	
Classification of Abstract unclassified	Limitation of Abstract UU	
Number of Pages 20		

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Acronyms

DCAA	Defense Contract Audit Agency
GAS	Government Auditing Standards
IITRI	Illinois Institute of Technology Research Institute
JSC	Joint Spectrum Center Support Group
OMB	Office of Management and Budget



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-4704

March 28, 2002

Senior Vice President and Chief Financial Officer
Illinois Institute of Technology Research Institute

Partner in Charge
KPMG, LLP

Director
Defense Contract Audit Agency

SUBJECT: Report on Quality Control Review of KPMG, LLP and Defense Contract Audit Agency Office of Management and Budget Circular No. A-133 Audit Report of Illinois Institute of Technology Research Institute, Fiscal Year Ended June 30, 1997 (Report No. D-2002-6-004)

We are providing this report for your information and use. The firm of KPMG, LLP (KPMG) and the Defense Contract Audit Agency (DCAA) performed the single audit for the Illinois Institute of Technology Research Institute (IITRI), a non-profit research organization located in Chicago, Illinois. The Office of Management and Budget (OMB) Circular No. A-133, "Audits of States, Local Governments, and Non-Profit Organizations," (OMB Circular A-133) requires the audit. IITRI expended approximately \$97.1 million of Federal awards, of which \$75.5 million was for DoD and \$21.6 million for other Federal agencies, during the fiscal year that ended September 30, 1997.

Quality Control Review Objective. As the Federal cognizant agency for IITRI, the Office of the Inspector General, DoD, performed a quality control review to determine whether the FY 1997 report that IITRI submitted to the Single Audit Clearinghouse met the applicable reporting standards and whether KPMG and DCAA conducted the audit as applicable standards and OMB Circular A-133 require. See Appendix A for a discussion of the scope of this review and the requirements for an OMB Circular A-133 single audit.

Review Results. KPMG complied with OMB Circular A-133 and applicable auditing standards in performing the financial audit of IITRI for the fiscal year that ended September 30, 1997. However, the DCAA audit was not adequately planned,

coordinated, and documented. The DCAA failed to ensure coverage for all of the Federal expenditures in the OMB Circular A-133 audit (finding A) and did not adequately document the review on internal control over compliance, compliance with major program requirements, and the Schedule of Expenditures of Federal Awards (finding B). Through extensive oral explanations and written narratives, DCAA demonstrated that it generally complied with OMB Circular A-133 in performing the review of internal control and the audit of compliance requirements. IITRI complied with OMB Circular A-133 reporting requirements, with the exception that the Schedule of Expenditures of Federal Awards did not include notes that described the significant accounting policies used to prepare the schedule. In addition, the Data Collection form did not list the individual programs within the Research and Development Cluster in the same level of detail presented in the Schedule of Expenditures of Federal Awards (finding C).

Finding A. Audit Planning and Coordination. DCAA Chicago Branch Office did not adequately plan and coordinate an OMB Circular A-133 audit for all of the IITRI Federal expenditures. As a result, about 46 percent (\$44.5 million) of Federal expenditures (\$97.1 million) under the audit cognizance of other DCAA offices was not adequately reviewed.

OMB Circular A-133, § 1.500(a) states that “the audit shall cover the entire operations of the auditee.” IITRI reported Federal expenditures of \$97.1 million for FY 1997. However, contracts for \$38.1 million for the Joint Spectrum Center Support Group (JSC) in Annapolis, Maryland, and classified contracts valued at \$6.4 million for a total of \$44.5 million or 46 percent of the \$97.1 million were under the audit cognizance of other DCAA offices. The DCAA Chicago Branch Office did not coordinate or request audit assistance for an OMB Circular A-133 audit of the JSC operations. However, the DCAA Columbia Branch Office, Columbia, Maryland, in the normal course of operations, performed an audit at the JSC. Although the audit report states that the audit was conducted in accordance with OMB Circular A-133, the JSC audit was not planned and performed according to OMB Circular A-133 requirements. The JSC auditors informed us that they reviewed one compliance requirement (Allowable Cost/Cost Principles). The other 13 compliance requirements were not reviewed. Determination of all applicable compliance requirements is an essential step in planning and performing an OMB Circular A-133 audit.

Although the DCAA Chicago Branch Office arranged for audit coverage of classified contracts, the DCAA Field Detachment audit report did not indicate that audit coverage was accomplished according to the requirements of OMB Circular A-133. Unless the audit of the entire operation was conducted according to the OMB Circular A-133 requirements, the auditor cannot render an opinion on compliance with major program requirements. To ensure the audit is performed on the entire operations of the auditee,

the DCAA Chicago Branch Office needs to plan and coordinate the OMB Circular A-133 audit with Columbia Branch Office and Field Detachment auditors.

Recommendation A. We recommend that the Branch Manager, Chicago Branch Office, Defense Contract Audit Agency plan and coordinate all future Office of Management and Budget Circular A-133 audits to cover the entire operations of Illinois Institute of Technology Research Institute.

Management Comments. Management concurred with the recommendation. The Branch Manager, Chicago Branch Office stated that they improved the overall planning and coordination process beginning with the FY 1999 audit. The improvements are intended to ensure adequate coverage of the IITRI operations. Assist audit requests will provide the information needed for the assisting office to plan their audit to meet OMB Circular A-133 requirements.

Finding B. DCAA Report on Internal Control Over Compliance, Opinion on Compliance With Major Program Requirements, and the Schedule of Expenditures of Federal Awards. The DCAA working papers did not adequately document the review and audit conclusions for internal control over compliance, compliance with major program requirements, and the Schedule of Expenditures of Federal Awards. In addition, minimal evidence of supervisory involvement in the audit was present. Although the DCAA auditors met the training requirement for the Government Auditing Standards (GAS), DCAA should consider providing OMB Circular A-133 training to ensure that internal control and compliance testing are performed correctly.

Working Papers. The DCAA audit of internal control and compliance was based on a determination that 10 of the 14 compliance requirements were applicable to IITRI. However, the audit working papers for 8 of the 10 compliance requirements were not adequate to support the audit conclusions for the Report on Internal Control Over Compliance, the opinion on Compliance With Major Program Requirements, and the Schedule of Expenditures of Federal Awards. DCAA adequately tested and documented internal control over compliance and compliance with two compliance requirements—Activities Allowed or Unallowed and Allowable Costs/Cost Principles. However, we were unable to identify from the working papers how DCAA tested for key internal controls and compliance objectives for the remaining eight compliance requirements. OMB Circular A-133 requires auditors to obtain an understanding of the non-Federal entity's internal control over Federal program requirements sufficient to plan the audit. The working papers consisted mainly of audit programs with yes or no answers, copies of contracts, contract modifications, contractor records, independent public accountant working papers, and printed account information, but no explanation of how the documents answered the audit program steps. Although the audit program steps were drawn from the compliance supplement, we could not ascertain what was

done and how it related to the compliance supplement objectives. The working papers did not contain the methodology, the description of transactions, or the records tested that would enable an experienced auditor to understand what was accomplished. In a number of instances, DCAA included the independent public accountant's work but no discussion of how or what they did to rely on someone else's work was present.

GAS, Chapter 6.46 requires that auditors obtain sufficient, competent, and relevant evidence to use as a basis for the findings and conclusions. A record of an auditor's work should be retained in the form of working papers and should contain sufficient information that will enable an experienced auditor who has no previous connection with the audit to ascertain from the papers evidence that supports an auditor's significant conclusions and judgments. Working papers should document the objectives, scope, and methodology and include any sampling criteria that was used. For 8 of 10 compliance requirements (Equipment and Real Property; Matching, Level of Effort, and Earmarking; Period of Availability; Procurement and Suspension and Debarment; Program Income; Reporting; Subrecipient Monitoring; and Special Test and Provisions), we were unable to determine how the working papers supported the audit conclusions.

For the Schedule of Expenditures of Federal Awards, the audit working papers did not show how DCAA concluded that the auditee identification of Federal programs was complete and appropriate. The working papers consisted of contractor records without any explanation. Without adequate working papers, we were unable to understand how the conclusions were reached.

DCAA provided extensive supplemental oral explanations and written narratives that described the audit procedures used and the significance of the supporting evidence in the working papers. The additional explanations and narratives were necessary for us to determine that the audit was performed according to OMB Circular A-133 requirements.

Supervision. The working papers contained minimal evidence of supervisory review. GAS, Chapter 6 states that the audit staff shall be properly supervised. Elements of supervision include instructing staff members, keeping informed of significant problems encountered, reviewing the work performed, and providing effective on-the-job training. The working papers consisted mostly of printed account information with highlighted numbers. Most of the working papers were neither signed, dated, nor reviewed and did not have any explanation of purpose, scope, or conclusions. Supervisory involvement should have ensured that the audit was adequately documented in accordance with GAS and performed in compliance with the OMB Circular A-133 requirements.

Training. To confirm compliance with GAS standards on professional qualifications, we reviewed the training records of DCAA Chicago Branch Office auditors who participated in the FY 1997 single audit of IITRI. DCAA was in compliance with the GAS training requirements. However, only one of the auditors had received recent OMB Circular A-133 training. The working papers, significant additional oral explanations, and written narratives demonstrated that auditors did not clearly understand some of the concepts and requirements of the OMB Circular A-133 audit. For example, the auditor incorrectly assessed IITRI as a low-risk auditee because the auditor failed to recognize that 3 years of late OMB Circular A-133 audits result in a high-risk auditee designation. OMB Circular A-133 audits are due no later than 9 months after the end of the recipient's fiscal year. At the start of the FY 1997 audit of Federal programs, IITRI audits for FY 1996, FY 1997, and FY 1998 were overdue. In another instance, the auditor failed to recognize that the requirement to monitor subrecipients does not depend on the amount of Federal awards given. As a result, the auditor incorrectly determined that IITRI did not have subrecipient monitoring responsibilities for two universities based on the level of Federal awards passed through by IITRI.

Recommendation B.1. We recommend that the Branch Manager, Chicago Branch Office, DCAA ensure that the working papers adequately document the objectives, scope, methodology, sampling criteria, and audit conclusions to comply with Government Auditing Standards for future OMB Circular A-133 audits.

Management Comments. Management concurred with our recommendation. The Branch Manager, Chicago Branch Office stated that they will adequately document the audit objective, scope, conclusion, and sampling methodology to comply with GAS for future audits at IITRI.

Recommendation B.2. We recommend that the Branch Manager, Chicago Branch Office, DCAA ensure that adequate supervision is provided to auditors who perform the OMB Circular A-133 audit.

Management Comments. Management concurred with our recommendation. The Branch Manager, Chicago Branch Office stated that the supervisor was involved in the FY 1997 audit but that the supervisory documentation did not meet internal expectations and can be improved. Open and future assignments will include improved supervisory documentation.

Recommendation B.3. We recommend that the Branch Manager, Chicago Branch Office, DCAA provide training on the requirements of the OMB Circular A-133 audit to the audit staff who participate in the IITRI audit.

Management Comments. Management concurs with our recommendations. The Branch Manager, Chicago Branch Office stated that OMB Circular A-133 training was provided to audit staff in December 2001 and additional training is scheduled for May 2002.

Finding C. OMB Circular A-133 Reporting Package and Data Collection Form Requirements. IITRI did not include all required information in the Schedule of Expenditures of Federal Awards and the Data Collection Form that were submitted to the Federal Audit Clearinghouse. The Schedule of Expenditures of Federal Awards did not include notes that describe the significant accounting policies used to prepare the Schedule as OMB Circular A-133, section .310(b)(4) requires. In addition, the Data Collection Form did not list the individual programs within the Research and Development Cluster in the same level of detail as presented in the Schedule of Expenditures of Federal Awards as OMB Circular A-133, section .320(b)(2)(x) requires.

Recommendation C. We recommend that the Assistant Vice President for Government Accounting, Illinois Institute of Technology Research Institute for future OMB Circular A-133 audit reports, include the appropriate notes to the Schedule of Federal Awards and provide the required level of detail for the program information provided in the Data Collection Form.

Management Comments. Management concurred with our recommendation. IITRI management stated that omission of the note in the FY 1997 report was an oversight and that all of the future OMB Circular A-133 submissions will include the notes that are required for the Schedule of Expenditures of Federal Awards. Management also stated that in the future the Data Collection Form will be presented in the same detail as the Schedule of Expenditures of Federal Awards.

Other Matters of Interest

For Official Use Only Report Markings. The IITRI report submission included pages marked For Official Use Only on the pages of DCAA Audit Report No. 3141-99I10250001. Because the report is a public document, DCAA should remove For Official Use Only markings from reports that are used for OMB Circular A-133 report submissions if appropriate, or the For Official Use Only information should be redacted from the reports.

Late OMB Circular A-133 Audit Reports. IITRI has not submitted single audit reports to the Federal Audit Clearinghouse within OMB Circular A-133 required time frames. Reports should be filed no later than 9 months after the end of the fiscal year. In April 2001, after 16 months of discussion with IITRI Assistant Vice President for Government Accounting, we participated in a teleconference with IITRI Senior Vice

President and Chief Financial Officer. We reached agreement on a plan that will bring IITRI into compliance with the reporting requirements. IITRI has made significant progress and expects to have all overdue reports as well as the FY 2001 report filed by July 2002.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Janet Stern at (703) 604-8750 (DSN 664-8750) (jstern@dodig.osd.mil) or Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) (wberry@dodig.osd.mil). See Appendix B for the report distribution. The review team members are listed inside the back cover.



Patricia A. Brannin
Deputy Assistant Inspector General for
Audit Policy and Oversight

Appendix A. Quality Control Review Process

Scope and Methodology

We conducted a quality control review of the KPMG, LLP and DCAA audit of IITRI for the fiscal year that ended September 30, 1997, and the reporting submission to the Single Audit Clearinghouse on January 11, 2001 (Project No. D2001-OA-0107). We performed our review using the 1999 edition of the “Uniform Quality Control Guide for the OMB Circular A-133 Audits” (the Guide). The Guide applies to single audits subject to the requirements of OMB Circular A-133, revised June 24, 1997. The Guide is the President’s Council on Integrity and Efficiency approved checklist used for performing the quality control reviews. Our review was conducted from May 2001 through March 2002 and covered areas that related to the financial statements and the one major program, the Research and Development Cluster. As the cognizant audit agency for the IITRI, we focused our review on the following qualitative aspects of the single audit:

- qualification of auditors
- independence
- due professional care
- quality control
- planning and supervision
- internal control and compliance testing
- Schedule of Expenditures of Federal Awards
- Schedule of Findings and Questioned Costs
- Data Collection Form

In conducting the review, we reviewed the working papers that KPMG LLP and DCAA auditors prepared and discussed the audit with the auditors and IITRI responsible personnel. In addition, we obtained significant oral explanations and reviewed additional written narratives that DCAA provided.

Prior Quality Control Reviews

Since June 1997, we have issued 12 quality control reviews of DCAA single audits and 4 quality control reviews of KPMG, LLP single audits. We have also issued six quality control reviews of audits that were performed jointly by DCAA and KPMG, LLP. Copies of the reports are available on the Office of the Inspector General, DoD, Web pages (www.dodig.osd.mil).

Single Audit Requirements

The OMB Circular A-133 establishes policies to guide implementation of the Single Audit Act of 1996 (Public Law 98-502) amendments and provides an administrative foundation for uniform audit requirements for non-Federal entities that administer Federal awards. In addition, OMB Circular A-133 requires that Federal departments and agencies rely on and use the audit work to the maximum extent practicable. To meet the intent of the law and OMB Circular A-133, the auditee (non-Federal entity) submits a complete reporting package on each single audit to the Single Audit Clearinghouse. The reporting package includes the following:

- Data Collection Form, certified by the auditee that the audit was completed in accordance with the OMB Circular A-133;
- financial statements and related opinion;
- Schedule of Expenditures of Federal Awards and related opinion;
- report on internal control over compliance and on compliance with laws, regulations, and the provisions of contracts or grant agreements, and related opinion on compliance of major programs; and
- Schedule of Findings and Questioned Costs.

OMB also issues a Compliance Supplement (the Supplement). The Supplement is used to assist auditors in determining the audit scope of the OMB Circular A-133 requirements for review of internal control. For each compliance requirement, the Supplement describes the related audit objectives that the auditor shall consider in each audit conducted under OMB Circular A-133 as well as suggested audit procedures. The Supplement describes the objectives of internal control and characteristics that, when present and operating effectively, may ensure compliance with program requirements. The following 14 compliance requirements applicable to the various Federal programs are identified in the Supplement:

-
- | | | | |
|----|---|----|---|
| A. | Activities Allowed/Unallowed* | H. | Period of Availability of Federal Funds* |
| B. | Allowable Costs/Cost Principles | I. | Procurement and Suspension and Debarment* |
| C. | Cash Management | J. | Program Income* |
| D. | Davis-Bacon Act | K. | Real Property Acquisition and Relocation Assistance |
| E. | Eligibility | L. | Reporting* |
| F. | Equipment and Real Property Management* | M. | Sub recipient Monitoring* |
| G. | Matching, Level of Effort, Earmarking* | N. | Special Tests and Provisions* |

*Identifies compliance requirements applicable to IITRI.

Appendix B. Report Distribution

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Defense Contract Audit Agency Comments



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IN REPLY REFER TO

PQA 225.4 (D2001-OA-0107)

February 21, 2002

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL, AUDIT POLICY
AND OVERSIGHT, DEPARTMENT OF DEFENSE, INSPECTOR
GENERAL

SUBJECT: DCAA Comments on the Discussion Draft of DoDIG Report on the
Quality Control Review of IITRI's FY 1997 OMB Circular A-133 Audit,
Project No. D2001-OA-0107

Thank you for the opportunity to respond to the discussion draft report. The subject report provides the results of your office's quality control review of the OMB Circular A-133 audit performed at the Illinois Institute of Technology Research Institute (IITRI) for fiscal year (FY) 1997. KPMG LLP and DCAA performed the audit on a coordinated basis.

DCAA concurs with the four recommendations presented in the subject report. Enclosed are our comments to each of the two discussion draft quality control findings supporting your four recommendations. We will ensure that future FY audits at IITRI include appropriate consideration for each of the reported findings.

If you have any questions, please contact me at (703) 767-3280 or Marc Parvin, Program Manager, PQA at (703) 767-2250. Our e-mail addresses are larry.uhlfelder@dcaa.mil and marc.parvin@dcaa.mil.

FOR

A handwritten signature in cursive script that reads "Robert DiMuccio".

Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Enclosure:
a/s

Defense Contract Audit Agency (Central Region) Comments



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February 14, 2002

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL,
AUDIT POLICY AND OVERSIGHT,
DEPARTMENT OF DEFENSE INSPECTOR GENERAL

ATTENTION: *Janet Stern*

SUBJECT: Comments on Discussion Draft Quality Control Review Report of DCAA
OMB Circular A-133 Audit Report of
Illinois Institute of Technology Research Institute
Fiscal Year Ended June 30, 1997
DoD IG Project No. D2001-OA-0107

Thank you for discussing the content of your February 7, 2002 Discussion Draft with us. In summary, we agree with your assessment that with the additional explanations and narratives "the audit was performed according to Circular A-133 requirements." Our specific comments on your recommendations are as follows:

A. We recommend that the Branch Manager, Chicago Branch Office, Defense Contract Audit Agency, plan and coordinate future Office of Management and Budget Circular A-133 audits to cover the entire operations of Illinois Institute of Technology Research Institute.

DCAA Response. We concur. In fact, we have improved the overall planning along with coordination of assist audits commencing with the current open assignment (FY 1999). This improvement is intended to assure adequate coverage of the entire operations of IITRI. Our assist audit request now informs the assisting office to plan their audit to meet the requirements of A-133, lists the awards to review, dollars expended on these awards during the year, and requests coverage of all applicable compliance requirements.

B. We recommend that the Branch Manager, Chicago Branch Office, Defense Contract Audit Agency:

1. Ensure that future Circular A-133 audits adequately document the objectives, scope, methodology, sampling criteria, and audit conclusions to comply with Generally Accepted Government Auditing Standards.

DCAA Response. We concur and we will ensure that future audits at IITRI will adequately document the audit objective, scope, conclusion and sampling methodology to

Enclosure

SUBJECT: Comments on Discussion Draft Quality Control Review February 14, 2002
Report of DCAA OMB Circular A-133 Audit Report of
Illinois Institute of Technology Research Institute
Fiscal Year Ended June 30, 1997
DoD IG Project No. D2001-OA-0107

comply with GAGAS. Documentation in this audit did not meet with Chicago Branch or DCAA expectations. We will improve the documentation on all open and future assignments.

2. Ensure supervision is provided in performing the Circular A-133 Audit.

DCAA Response. We concur. Although there was supervisory involvement in the FY 1997 audit and documentation of supervision, the supervisory documentation can be improved. As stated in my response to recommendation B.1. above, documentation, including supervisory documentation, did not meet our internal expectations. We will improve the supervisory documentation on all open and future assignments.

3. Provide Circular A-133 training to the audit staff participating in the IITRI audit.

DCAA Response. We concur. Training on Circular A-133 was provided during December 2001 to the audit staff participating in the A-133 IITRI audit, and we will continue to train as needed. In addition, our auditors will attend DCAA Headquarters' sponsored training in May 2002.

Thank you again for working with our FAO on the findings and providing me with an opportunity to comment on the Discussion Draft. If you have any questions, please contact Ms. Harriet Coorssen, Regional Audit Manager, at (972) 753-2518 or the undersigned at (630) 268-8590.

/Signed/
Harvey L. Smith
Branch Manager

Illinois Institute of Technology Research Institute Comments

Stern, Janet

From: Gibson Ronald C [RGibson@IITRI.ORG]
Sent: Thursday, March 07, 2002 3:46 PM
To: Jstern@dodig.osd.mil
Subject: Revised Respsne to Report Recommendation



DOD OIG
Response.doc

Janet,

Here's the revised response to the report recommendation.

Ron

<<DOD OIG Response.doc>>

Finding C

Contractor's Response

The Schedule of Expenditures of Federal Awards for the Fiscal Year ended September 30, 1998, the year subsequent to the year reviewed by DODOIG, did include a note describing the significant accounting policies used in preparing the schedule. The omission in Fiscal Year 1997, the year reviewed by the DODOIG, was an oversight. All future OMB Circular No. A-133 submissions will include the required note.

The Fiscal Year 1999 Data Collection Sheet has been revised to list all individual programs rather than an R & D cluster. This, however, is considered unnecessarily redundant since the same detail is stated in the Schedule of Expenditures of Federal Awards included in the OMB Circular No. A-133 submission. All future Data Collection Sheets will be presented in the same detail as the Schedule of Expenditures of Federal Awards.

Evaluation Team Members

The Deputy Assistant Inspector General for Audit Policy and Oversight, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report, are listed below.

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