

November 8, 2002



Oversight

Summary of Quality Control Reviews of Office of Management and Budget Circular A-133 Audits (D-2003-6-002)

Office of the Inspector General
of the Department of Defense

Quality

Integrity

Accountability

Report Documentation Page

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Acronyms

AICPA	American Institute of Certified Public Accountants
GAS	Government Auditing Standards
OMB	Office of Management and Budget
SOP	Statement of Position



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

November 8, 2002

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE CONTRACT MANAGEMENT
AGENCY
CHIEF, OFFICE OF NAVAL RESEARCH
BOARD OF DIRECTORS, AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

SUBJECT: Summary of Quality Control Reviews of Office of Management and Budget
Circular A-133 Audits (Report No. D-2003-6-002)

We are providing this report for your information and use. This report discusses audit deficiencies found during quality control reviews performed by the Inspector General of the Department of Defense from October 1, 1998, through September 30, 2002. This report contains no recommendations; therefore, written comments are not required.

For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877) or Ms. Janet Stern at (703) 604-8750 (DSN 664-8750). See Appendix E for the report distribution. Summary report team members are listed inside the back cover.


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Office of the Inspector General of the Department of Defense

Report No. D-2003-6-002

(Project No. D2002-OC-0207)

November 8, 2002

Summary of Quality Control Reviews of Office of Management and Budget Circular A-133 Audits

Executive Summary

Who Should Read This Report and Why? This report is intended for Federal agencies, non-Federal entities, independent public accounting firms, and government auditors that award, receive, and audit Federal awards subject to audit requirements of the Single Audit Act and Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The report discusses audit deficiencies our office found during quality control reviews. By identifying areas for improvement, we hope to provide non-Federal entities and auditors tools that will improve the quality of OMB Circular A-133 audits (single audits).

Background. The Office of the Inspector General of the Department of Defense is responsible for assuring the quality of audits that non-Federal and Government auditors perform. The responsibility is mandated in the Inspector General Act of 1978. This summary report compiles the results of quality control reviews that were performed to determine whether single audits met applicable auditing and reporting standards as well as OMB Circular A-133 requirements.

Results. Our analysis of the quality control reviews performed between October 1, 1998, and September 30, 2002, found that single audits that independent accounting firms and Government auditors conducted contained deficiencies affecting the reliability of the audits. Of the 12 reports reviewed, deficiencies were identified in the following areas: audit planning and execution (6 reports); documentation of work performed (8 reports); reporting requirements (2 reports); audit coordination (3 reports); and the Schedule of Expenditures of Federal Awards presentation (3 reports).

As a result of those issues, the ability of Federal agencies to effectively monitor and manage their programs is impaired because they cannot rely on and use the audit reports to the maximum extent practicable. Furthermore, assurance that non-Federal entities are managing Federal awards in compliance with laws, regulations, and contract and grant provisions is reduced. Improvement in audit quality is needed before Federal agencies can be expected to rely on single audits as a tool for monitoring and managing Federal programs.

Management Comments. This report is for informational purposes only and contains no recommendations; therefore, no written response to this report is required.

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Background

Single Audit Requirements. The Single Audit Act, Public Law 98-502 as amended (Single Audit Act) and OMB Circular A-133 are intended to improve the financial management of State and local governments and non-profit organizations that receive Federal awards. The Single Audit Act and OMB Circular A-133 establish a uniform set of auditing and reporting requirements for all of the Federal award recipients required to obtain a single audit. OMB Circular A-133 establishes policies that guide implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities that administer Federal awards. OMB Circular A-133 requires that Federal departments and agencies rely on and use the single audit work to the maximum extent practicable to monitor and manage Federal programs. Entities that expend \$300,000 or more of Federal awards in a fiscal year are subject to the Single Audit Act and the audit requirements in OMB Circular A-133 and, therefore, must either have an annual single or program-specific audit performed under Government Auditing Standards (GAS). To meet the intent of the law and OMB Circular A-133 requirements, the auditee (non-Federal entity) submits to the Federal Audit Clearinghouse a complete reporting package and a Data Collection Form on each single audit. The auditee submission includes the following:

- Data Collection Form, certified by the auditee that the audit was completed according to OMB Circular A-133 requirements;
- Financial statements and related opinion;
- Schedule of Expenditures of Federal Awards and related opinion;
- Report on compliance and internal control over financial reporting;
- Report on internal control over compliance with laws, regulations, and the provisions of contracts or grant agreements;
- Report on compliance with requirements for major programs and related opinion;
- Schedule of Findings and Questioned Costs;
- Summary Schedule of Prior Audit Findings; and
- Corrective action plan that addresses the report findings.

The OMB Compliance Supplement (the Supplement) assists auditors identify compliance requirements that the Federal Government expects to be considered as part of the single audit. For each compliance requirement, the Supplement describes the related audit objectives that the auditor should consider in the single audit as well as suggested audit procedures. The Supplement also

describes the objectives of internal control and characteristics that, when present and operating effectively, may ensure compliance with program requirements. The Supplement identifies the following 14 compliance requirements applicable to most Federal programs.

- A. Activities Allowed or Not Allowed
- B. Allowable Costs/Cost Principles
- C. Cash Management
- D. Davis-Bacon Act
- E. Eligibility
- F. Equipment and Real Property Management
- G. Matching, Level of Effort, Earmarking
- H. Period of Availability of Federal Funds
- I. Procurement and Suspension and Debarment
- J. Program Income
- K. Real Property Acquisition and Relocation Assistance
- L. Reporting
- M. Sub-recipient Monitoring
- N. Special Tests and Provisions

American Institute of Certified Public Accountants Guidance for Performing Single Audits. Statement of Position (SOP) 98-3, “Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards,” published by the American Institute of Certified Public Accountants (AICPA), provides guidance on auditor responsibilities for conducting audits according to the Single Audit Act and OMB Circular A-133. In general, the Single Audit Act and OMB Circular A-133 provide auditors with an understanding of the unique planning, performance, and reporting considerations for single audits performed under GAS. In addition, the SOP 98-3 uses summary tables and detailed discussions designed to provide the auditor with an understanding of the additional general fieldwork and reporting requirements under GAS that include the additional standards relating to quality control systems, continuing professional education, working papers, audit follow-up, and reporting.

The SOP 98-3 emphasizes that in planning an audit to meet the requirements of OMB Circular A-133, auditors should consider several factors in addition to those ordinarily associated with an audit of financial statements in accordance with Generally Accepted Auditing Standards and GAS. Several of the factors include but are not limited to:

- determining that the Schedule of Expenditures of Federal Awards is presented fairly in relation to the financial statements;
- determining major programs for audit using a risk-based approach;
- gaining an understanding of internal control over Federal programs;
- testing internal control over major programs;
- determining compliance with laws, regulations, and the provisions of contract or grant agreements that have a direct and material effect on each major program; and

-
- satisfying the additional requirements of the Single Audit Act and OMB Circular A-133 regarding working papers, audit follow-up, and reporting.

Clusters of Programs. The OMB Compliance Supplement defines a cluster of programs as a grouping of closely related programs that share common compliance requirements. A cluster of programs should be considered as one program for the purpose of meeting OMB Circular A-133 audit requirements. One type of cluster of programs is categorized as Research and Development. The majority of DoD awards to non-profit organizations is for research and development programs.

Objective

The objective of this report is to summarize the audit quality deficiencies reported in the 12 quality control review reports our office issued. See Appendix A for the discussion of the scope and methodology. Appendix B contains a listing of the reports our office issued.

Quality Control Reviews

The Inspector General of the Department of Defense (IG DoD), issued 12 quality control review reports of single audits between October 1, 1998, and September 30, 2002. The reports address the results of our quality control reviews of single audits independent public accounting firms and Government auditors performed. The objectives of the reviews were to determine whether the reporting package submitted to the Federal Audit Clearinghouse met the applicable reporting standards and whether the audits were conducted in accordance with applicable auditing standards and OMB Circular A-133 requirements. A list of oversight reports is included in Appendix B. A matrix of audit quality deficiencies is included in Appendix C. Within the 12 oversight reports reviewed, we identified audit quality deficiencies in the following areas:

- audit planning and execution (6 reports),
- working paper documentation (8 reports),
- report requirements (2 reports);
- audit coordination (3) reports); and,
- schedule of expenditures of Federal awards presentation (3 reports).

Of the 12 quality control review reports issued, only 3 reports did not have significant deficiencies. The deficiencies identified were with audits both independent public accounting firms and the Government auditors performed. Those audit quality deficiencies impair the ability of DoD awarding agencies and other users to rely on and use the single audit for monitoring and managing their programs. Auditors need to improve the quality of the single audits so that awarding agencies can rely on the single audit process to ensure that: non-Federal entities are maintaining effective internal control over Federal awards; Federal awards are managed in compliance with laws, regulations, and provisions of contract and grant agreements; and financial information is reliable. Our recommendations included requiring that auditors perform additional audit work, revise and resubmit the single audit report, and in two cases refund a portion of the audit fee. Appendix D provides information on Federal award expenditures by the non-Federal entities covered in our quality control reviews.

Audit Planning and Execution. Of the 12 quality control review reports issued, 6 reports identified that auditors did not adequately plan and perform the audit of internal controls over compliance and compliance with the requirements for major Federal programs. In one instance, the auditor did not have sufficient knowledge of the single audit requirements and was not properly supervised. OMB Circular A-133 requires that the audit cover the entire operation of the auditee and that the auditor should perform procedures to obtain an understanding of internal controls over Federal programs. Furthermore, the tests of controls and compliance should include tests of transactions and auditing procedures necessary to provide the auditor sufficient evidence that support an opinion or conclusion.

Specifically, we found that the auditors did not adequately:

- plan review of internal controls and compliance to include all programs in the research and development cluster;
- identify major programs using the risk-based approach as OMB Circular A-133 requires;
- identify the applicable compliance requirements for review;
- plan and perform review of internal controls over compliance for applicable compliance requirements;
- perform sufficient audit work that supports their opinion on compliance with major program requirements; and
- perform procedures to justify relying on non-auditor work.

Those conditions occurred in a number of circumstances and for a variety of reasons. For example, in a number of cases auditors relied on the review of internal controls related to financial statement assertions, which are quantitative. Auditors did not perform a separate review of internal control over Federal program compliance requirements. A separate review, which OMB Circular A-133 requires, would address the objectives of internal control over compliance, which are qualitative. As a result, auditors did not have a reasonable basis for determining the nature and extent of compliance testing needed to support the audit opinion. In other audits, audit opinions were based on an inadequate coverage of programs in the research and development cluster. In those cases, auditors tested a small number of programs while inappropriately excluding many individual programs from internal control and compliance testing. Because each award in the research and development cluster is negotiated with specific requirements, all of the awards should be provided an opportunity to be selected for testing. As a result, the audit evidence was not sufficient to support the audit opinion on the research and development cluster. During our reviews, we had to obtain from the auditors significant verbal explanations as well as perform additional review procedures to determine that the single audit of Federal programs met the intent of OMB Circular A-133 requirements.

Working Paper Documentation. Of the 12 quality control review reports issued, 8 identified problems with inadequate documentation of work performed. GAS requires that working papers contain documentation of the work performed that support significant conclusions and judgments, including descriptions of transactions and records examined. The working papers did not contain sufficient information for the reviewers to determine if the audit procedures supported the auditor's opinion on compliance with Federal program requirements. In each case, extensive verbal explanations from the auditors were needed to support their judgments and conclusions. In several cases, the auditors had to perform additional audit work or had to prepare supplemental working papers that would support for the reviewers the audit opinions.

Specifically, we found that the working papers did not:

- include explanations for compliance requirements excluded from testing;
- contain descriptions of procedures performed or evidence reviewed to determine whether program expenditures on the Schedule of Expenditures of Federal Awards were appropriate and complete;
- document the auditor’s understanding of internal controls and the specifics of the testing of internal control over compliance requirements;
- contain descriptions of transactions tested and specific criteria used to test compliance with requirements; and
- include a description of the population, characteristics, and objectives of the sampling plan used to test for compliance with the compliance requirements.

The lack of clear documentation occurred, in part, because auditors did not adhere to the working paper documentation requirements in GAS. Because of inadequate documentation, the time that the IG DoD reviewers and auditors spent to establish the adequacy of the audit significantly increased. For example, in one instance it took the auditors 5 months to provide the IG DoD reviewers with sufficient information to support the audit opinion on Federal programs. During this period both the audit firm and the IG DoD reviewers spent considerable time discussing performed audit procedures as well as preparing and reviewing additional audit working papers.

Reporting Requirements. Of the 12 quality control review reports issued, 2 identified that the auditors did not include all of the audit findings in the Schedule of Findings and Questioned Costs. In addition, one of those two reports did not contain the required language for the financial statement audit report. OMB Circular A-133 requires auditors to report as audit findings reportable conditions in internal control over major programs and material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to major programs. OMB Circular A-133 also requires auditors report known or likely questioned costs greater than \$10,000 for a compliance requirement related to a major program.

In one review, the auditors failed to report a documented finding of \$70,000 in questioned costs related to noncompliance with allowable cost criteria in OMB Circular A-122, “Cost Principles for Non-Profit Organizations.” The auditors also did not include the required statement that the audit was conducted in accordance with GAS in the audit report on financial statements.

For the other review, the auditors did not report a known noncompliance with the property standards in OMB Circular A-110, “Uniform Administrative Requirements for Grant and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations.” Specifically, the auditors failed to report that the university did not perform the required physical inventory and

was not maintaining accurate property records. As a result of reporting deficiencies, Federal agencies were not aware of the noncompliance issues and could not evaluate the impact on programs.

Audit Coordination. Of the 12 quality control review reports issued, 3 identified a lack of audit coordination among the non-Federal entities, the independent public accounting firms, and the Government auditors. In one audit, a \$4.7 million major program was excluded from the audit because the non-Federal entity did not task either the independent public accounting firm or the Government auditors to perform a risk based analysis of the non-Federal entity's Federal programs. In another audit, the working papers demonstrated that the public accountants reviewed the work of Government auditors but did not consider the audit results in their planning process. That condition resulted in a duplication of audit effort. As a result of a lack of audit coordination between the non-Federal entities and the various audit organizations, audits did not meet the intent of the Single Audit Act designed to promote the efficient and effective use of audit resources, avoid duplication of audit effort, and reduce audit burdens on non-Federal entities.

Schedule of Expenditure of Federal Awards Presentation. Of the 12 quality control review reports issued, 3 identified information on the Schedule of Expenditures of Federal Awards (the Schedule) that did not meet OMB Circular A-133 reporting requirements. In one single audit report, the Schedule presented \$11 million of expenditures for multiple pass-through awards as one category, "Miscellaneous Pass-Through Awards." OMB Circular A-133 requires that the Schedule include, at a minimum, the name of each pass-through entity award and the assigned award identification number. In the same report, the Schedule listed "Other Federal Awards" as one line item with expenditures of \$13 million. The \$13 million represents expenditures for multiple awards from separate Federal programs. For the research and development cluster, OMB Circular A-133 requires that the Schedule show Federal awards by either individual programs or Federal agency. As a result of the deficiencies, pass-through entities and Federal awarding agencies cannot properly monitor programs because they cannot identify individual program awards.

Conclusion

As shown in the 12 oversight reports issued between October 1, 1998, and September 30, 2002, independent public accounting firms and Government auditors need to improve the planning, execution, and reporting of single audits. Moreover, non-Federal entities need to better coordinate between the independent public accounting firms and Government auditors the single audit. Many of the deficiencies are consistent with the findings for the quality control reviews other Federal Offices of Inspector Generals performed and reported. We believe that the quality of single audits needs to be improved for DoD agencies and other users to be able to rely on and use audits as a tool for monitoring and managing Federal programs.

Appendix A. Scope and Methodology

This report summarizes the results of quality control reviews of single audits performed by independent public accounting firms and Government auditors. Our reviews were performed from October 1, 1998, through September 30, 2002. During that period, the OIG DoD issued 12 oversight reports. We analyzed the reports to identify common and recurring audit quality issues. We did not conduct additional fieldwork.

Guidance Used for Quality Control Reviews. The quality control reviews were conducted using the 1999 edition of the “Uniform Quality Control Review Guide for A-133 Audits” (the Guide). The Guide applies to single audits subject to the requirements of OMB Circular A-133 and is the President’s Council on Integrity and Efficiency approved checklist used to perform quality control reviews. Quality control reviews are performed for the purpose of determining whether the single audit was conducted according to government auditing standards and applicable OMB Circular A-133 requirements. The quality control reviews were performed on single audits of non-Federal entities that expended more than \$25 million of Federal awards in a year that DoD was the cognizant agency for audit. (See Appendix D for a list of Federal award expenditures for the non-Federal entity audits included in this report). A quality control review covers the general, fieldwork, and reporting standards as applied to the audit of financial statements and major Federal programs. Specifically, the quality control review focuses on the following qualitative aspects of the Circular A-133 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
- Summary Schedule of Prior Audit Findings
- Data Collection Form

Appendix B. Listing of Quality Control Review Reports

During the period of October 1, 1998, through September 30, 2002, the Inspector General of the Department of Defense (IG DoD) issued 12 quality control review reports of Circular A-133 audits. Unrestricted IG DoD reports can be accessed over the Internet at <http://www.dodig.osd.mil/audits/reports>.

IG DoD Report No. D-2002-6-004, "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," March 28, 2002

IG DoD Report No. D-2002-6-003, "Report on Quality Control Review of Defense Contract Audit Agency and KPMG LLP Office of Management and Budget Circular A-133 Audit Report of SRI International Fiscal Year Ended December 25, 1999," January 14, 2002

IG DoD Report No. D-2002-6-002, "Report on Quality Control Review of Deloitte & Touche LLP Office of Management and Budget Circular A-133 Audit Report of Carnegie Mellon University, Fiscal Year Ended June 30, 1999," December 11, 2001

IG DoD Report No. D-2001-6-005, "Quality Control Review of Deloitte & Touche, LLP, and Defense Contract Audit Agency for Office of Management and Budget Circular A-133 Audit Report of Pennsylvania State University, Fiscal Year Ended June 30, 1999," May 01, 2001

IG DoD Report No. D-2001-6-004, "Report on Quality Control Review of PricewaterhouseCoopers, LLP, and Defense Contract Audit Agency for Office of Management and Budget Circular A-133 Audit Report of Massachusetts Institute of Technology, Fiscal Year Ended June 30, 1999," March 22, 2001

IG DoD Report No. D-2001-6-002, "Report on Quality Control Review of Grant Thornton LLP, for Office of Management and Budget Circular A-133 Audit Report of Concurrent Technologies Corporation, Fiscal Year Ended June 30, 1998," February 23, 2001

IG DoD Report No. D-2001-6-001, "Report on Quality Control Review of Arthur Anderson, LLP, for OMB Circular No. A-133 Audit Report of the Henry M. Jackson Foundation for the Advancement of Military Medicine, Fiscal Year Ended September 30, 1998," February 02, 2001

IG DoD Report No. D-2000-6-008, "Quality Control Review of PricewaterhouseCoopers, LLP, for OMB Circular A-133 Audit Report of Institute for Defense Analyses, Fiscal Year Ended September 25, 1998," August, 14, 2000

IG DoD Report No. D-2000-6-002, "Quality Control Review of PricewaterhouseCoopers, LLP, California Institute of Technology, Fiscal Year Ended September 30, 1997," November 19, 1999

IG DoD Report No. D-2000-6-001, "Quality Control Review of PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency, California Institute of Technology, Fiscal Year Ended September 30, 1996," November 19, 1999

IG DoD Report No. PO-99-6-008, "Quality Control Review of PricewaterhouseCoopers, LLP, Stanford University, Fiscal Year Ended August 31, 1997," September 08, 1999

IG DoD Report No. PO-99-6-003, "Quality Control Review of KPMG Peat Marwick, LLP, the University of Delaware, Fiscal Year Ended June 30, 1998," March 26, 1999

Appendix C. Matrix of Audit Quality Issues

Report Number	Planning and Execution	Working Paper Documentation	Report Requirements	Audit Coordination	Schedule Presentation
D-2002-6-004	X	X			
D-2002-6-003	X	X			X
D-2002-6-002		X	X		X
D-2001-6-005					
D-2001-6-004	X			X	
D-2001-6-002		X	X		
D-2001-6-001	X	X		X	
D-2000-6-008	X	X		X	
D-2000-6-002					
D-2000-6-001					
PO-99-6-008	X	X			X
PO-99-6-003		X			
Total Reports	6	8	2	3	3

Appendix D. Federal Award Expenditures

Non-Federal Entity	Fiscal Year	Total Federal Expenditures	DoD Expenditures
California Institute of Technology	1996	\$1,258,649,621	\$24,167,524
California Institute of Technology	1997	209,451,263	32,729,941
Carnegie Mellon University	1999	141,083,649	75,109,141
Concurrent Technologies Corporation	1998	92,877,573	90,302,605
Henry M. Jackson Foundation for the Advancement of Military Medicine	1998	63,944,441	53,024,213
Illinois Institute of Technology Research Institute	1997	97,104,042	75,531,374
Institute for Defense Analyses	1998	109,951,862	109,951,862
Massachusetts Institute of Technology	1999	720,518,266	391,054,495
Pennsylvania State University	1999	293,521,688 ¹	87,683,820
SRI International	1999	131,397,308	91,984,500
Stanford University	1997	561,717,912	54,331,576
University of Delaware	1998	49,940,917 ²	10,099,703
Total Expenditures		\$3,730,158,542	\$1,095,970,754

¹ The \$293,521,688 in Federal awards does not include \$241,743,886 in Federal loans.

² The \$49,940,917 in Federal awards does not include \$40,129,355 in Federal loans.

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Defense Procurement

Department of the Air Force

Director, Office of the Assistant Secretary (Financial Management and Controller)

Department of the Army

Deputy Assistant Secretary of the Army for Financial Management & Comptroller

Department of the Navy

Chief, Office of Naval Research

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Contract Management Agency
Director, Defense Advance Research Projects Agency

Other Federal Agencies

Director, Financial Management and Assurance, General Accounting Office

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Subcommittee on Acquisition and Technology, Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member Cont'd

House Subcommittee on National Security, Veterans Affairs, and International Relations,
Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on
Government Reform

Other Non-Federal Organizations

Partner, KPMG, LLP
Senior Manager, Grant Thornton, LLP
Partner, Deloitte & Touche, LLP
Director, PricewaterhouseCoopers, LLP
Partner, Ernst & Young, LLP
Audit Committee, President's Council on Integrity and Efficiency
Board of Directors, National Association of State Boards of Accountancy
Audit Committee, National Association of State Boards of Accountancy
Board of Directors, American Institute of Certified Public Accountants
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