

Policy and

Oversight



Financial and Performance Audit
Directorate

Quality Control Review

Coopers and Lybrand, L.L.P.
The Charles Stark Draper Laboratory, Inc.
Fiscal Year Ended June 30, 1995

Report Number PO 97-035

June 30, 1997

Office of the Inspector General
Department of Defense

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Acronyms

DCAA	Defense Contract Audit Agency
OMB	Office of Management and Budget



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
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June 30, 1997

Chairman, Non-Profit Industry Group
Coopers & Lybrand L.L.P.
1301 Avenue of the Americas
New York, New York 10019-6013

SUBJECT: Quality Control Review of Coopers & Lybrand L.L.P.
The Charles Stark Draper Laboratory, Inc.
Fiscal Year Ended June 30, 1995
Report No. PO97-035

Introduction

We are providing this report for your information and response. Your Boston, Massachusetts, suboffice, in coordination with the Defense Contract Audit Agency (DCAA), performed the single audit for The Charles Stark Draper Laboratory, Inc. (the Lab), Cambridge, Massachusetts, a membership (nonstock), nonprofit Massachusetts corporation. The Lab engages in activities that contribute to the support and advancement of scientific research, technology, and development and in educational activities in the sciences and allied subjects. The audit is required by the Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." The Lab reported total Federal expenditures of \$219,716,858 for the fiscal year ended June 30, 1995, representing \$197,433,414 for the Department of Defense and \$22,283,444 for other Federal agencies and classified contracts.

Coopers & Lybrand L.L.P. issued its audit report September 8, 1995, which includes individual reports on internal controls, compliance and the Schedule of Federal Awards. The DCAA issued its audit report July 26, 1996 that questioned \$55,910 related to the value of land that is not allocated to the building's commercial occupants. Coopers & Lybrand L.L.P. issued an unqualified opinion on the financial statements, Schedule of Federal Awards, and compliance with specific requirements applicable to major programs. Coopers & Lybrand L.L.P. issued positive and negative assurance statements on compliance with general requirements. Positive assurance states that, with respect to the items tested, the results of the auditors' procedures disclosed no

material instances of noncompliance. Negative assurance states that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that the Lab has not complied in all material respects. The auditors also obtained an understanding of the internal controls related to the financial statements and Federal awards. The internal control audit reports describe the auditors' scope of work in obtaining that understanding and assessing control risk. The report on internal controls over Federal awards further describes the significant internal controls or control structure, including the controls established to provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations.

Desk Review Results

Our desk review of the DCAA audit report disclosed that the report did not meet the requirements of the Circular. Specifically, the report did not identify the general and specific requirements audited, give an opinion on specific requirements, and include the correct report wording agreed to by the President's Council on Integrity and Efficiency and the American Institute of Certified Public Accountants. We requested that DCAA correct the deficiencies and they issued a letter on March 14, 1997, to supplement the report. On April 14, 1997, we issued a desk review letter, accepting the FY 1995 OMB Circular A-133 coordinated audit report performed by Coopers & Lybrand L.L.P. and the DCAA. The Coopers & Lybrand L.L.P. audit report is qualified for awards subject to limited testing by the auditors because of their sensitive nature. Those awards, totaling \$526,902, are listed as "Other Government" in the Schedule of Federal Awards and are subject to a separate audit by the Federal Government. Therefore, our desk review results were also qualified, because they address only the Coopers & Lybrand L.L.P. audit scope. We assigned the Defense Logistics Agency the responsibility for resolving the findings in the DCAA Audit Report No. 2175-96T10150001, July 26, 1996.

Quality Control Review Results

The OMB Circular A-133 audit performed by Coopers & Lybrand L.L.P., excluding "Other Government" awards, met the applicable guidance and regulatory requirements in the OMB Circular A-133, its related Compliance Supplement, Government Auditing Standards, Generally Accepted Auditing Standards, and the provisions of the Federal award agreements except with regard to management representation letters.

We found that Coopers & Lybrand L.L.P. did not obtain the required representations related to the audit of Federal awards. The American Institute of Certified Public Accountant's Statement on Auditing Standards Number 19, "Client Representations," requires the auditor to obtain written representations from management as part of evidential matter. The representations allow the auditor to apply procedures specifically designed to obtain corroborating information concerning matters that are also the subject of the written representations. Also, failure to obtain the appropriate representations from management may effect the auditors' ability to properly understand and assess and quantify control risk in order to determine the extent of substantive testing.

Recommendation for Corrective Action:

We recommend that Coopers & Lybrand L.L.P. obtain the following management representations related to the audit of Federal awards in all audits conducted in accordance with the Office of Management and Budget Circular A-133:

- o Management has identified in the Schedule of Federal Awards all awards provided by Federal agencies in the form of grants, contracts, loans, loan guarantees, property, cooperative agreements, interest subsidies, insurance, or direct appropriations.**

- o Management has identified the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, earmarking; reporting (including any special provisions); claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to its major Federal programs, which are identified in the Schedule of Federal Awards.**

- o Management has complied with the reporting requirements in connection with Federal awards.**

- o Information presented in the Federal reports and claims for advances and reimbursements is supported by the books and records from which the basic financial statements have been prepared.**

- o Amounts claimed or used for matching were determined in accordance with the applicable cost principles.**

- o Management has identified and disclosed to the auditor all amounts questioned and known noncompliance with requirements that could have a material effect on a major Federal program.**

Quality Control Review Objective

The objective of a quality control review is to assure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A-133. As the cognizant agency for the Lab, we conducted a quality control review of the Coopers & Lybrand L.L.P. audit working papers. Our review focused on the 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, dated September 23, 1994, and performed by Ernst and Young L.L.P., that found that Coopers & Lybrand L.L.P. met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that the standards were being complied with during the fiscal year ended March 31, 1994. Ernst & Young L.L.P. commented on the need to update management representation letters, to tailor the letters to the engagement circumstances, and to comply with the Coopers & Lybrand L.L.P. policies regarding the review of unaudited interim financial information.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) issued 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 work performed during the audit of the 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 review was conducted on October 17 and 18, 1996.

We limited the scope of our quality control review to the Coopers & Lybrand L.L.P. audit working papers covering areas related to Department of Defense expenditures, the financial statements, and the research and development program, excluding "Other Government" awards. All the expenditures shown in the Schedule of Federal Awards represent the research and development major program. About 90 percent of the \$219,716,858 in total expenditures relate to the Department of Defense.

Results of Prior Quality Control Reviews

We identified minor quality control review findings and recommendations at 3 of the 10 Coopers & Lybrand L.L.P. locations we visited from January 1, 1995, through December 31, 1996. We notified the affected offices and no further action is necessary.

Background

The Inspector General Act of 1978, Public Law 95-452, 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 with respect to Federal financial assistance programs 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 under 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. It 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 carry out 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 Circular is being revised to incorporate the changes in the Single Audit Act Amendments of 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.

Report of Independent Accountants. 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 of Independent Accountants 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 "Report of Independent Accountants."

Schedule of Federal Awards. The recipient is responsible for creating the schedule. The auditor is required to audit the information in the schedule and to ensure that it identifies major programs as defined by OMB Circular A-133 and total expenditures for each program. We reviewed the audit program for the appropriate procedures, reviewed a selected number of footings and cross-footings, and traced some of the amounts to the Subsidiary Ledger and/or Trial Balance.

Report of Independent Accountants on the Internal Control Structure Based on an Audit of the 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 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 of Independent Accountants on the Internal Control Structure Used in Administering Federal Awards. The auditor is required to obtain an understanding of the internal control structure and to assess control risk to determine whether the auditor intends 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 requirements in the Compliance Supplement. We reviewed the Coopers & Lybrand L.L.P. audit program for the appropriate procedures, the working paper documentation, and the test of controls performed.

Report of Independent Accountants on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of the 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 of Independent Accountants 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 any of its major Federal programs. The requirements include 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, checked the audit program steps to those in the Compliance Supplement to make sure that all areas are audited, reviewed the working paper documentation and its support, and reviewed the compliance tests performed.

Report of Independent Accountants 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 auditor's procedures were limited to those 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.

Independent Accountants Schedule of Findings. The auditor is required to report material findings of noncompliance in the audit report in their proper perspective: the size of the universe in number of items and dollars, the number

and dollar amount of transactions tested by the auditors, and the number and corresponding dollar amount of instances of noncompliance. We reviewed the working papers for unreported findings to make sure that the report included all current year findings identified in the working papers and that the findings were properly supported. We also traced the prior year's findings in the working papers to the audit report.

Comments

Since this report contains findings and recommendations, written comments are required within 60 days from the date of this report. We appreciate the courtesies extended during the review. If you have questions on this report, please contact Mr. Donald Steele, Project Manager, at (703) 604-8705 or Ms. Vera Garrant at (703) 604-8743. See the Enclosure for the report distribution.

A handwritten signature in black ink, appearing to read "Russell A. Rau". The signature is fluid and cursive, with a large loop at the beginning and a long horizontal stroke at the end.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Enclosure

**The Charles Stark Draper Laboratory, Inc.
Fiscal Year Ended June 30, 1995**

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Enclosure

Evaluation Team Members

This report was prepared by the Financial Management and Planning Directorate, Office of the Assistant Inspector General for Policy and Oversight, DoD.

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