Oversight Report

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

Report Number D-2002-6-002 December 11, 2001

Office of the Inspector General
Department of Defense

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Acronyms

AICPA	American Institute of Certified Public Accountants
D&T	Deloitte & Touche LLP
OMB	Office of Management and Budget
ONR	Office of Naval Research

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

December 11, 2001

Assistant Vice President for Finance
Carnegie Mellon University

Partner-in-Charge
Deloitte & Touche LLP

SUBJECT: 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
(Report No. D2002-6-002)

We are providing this report for your information and use. The firm of Deloitte & Touche LLP (D&T) performed the single audit for Carnegie Mellon University (Carnegie Mellon), a private, independent, non-profit research university located in Pittsburgh, Pennsylvania. The audit is required by the Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" (Circular A-133). Carnegie Mellon expended approximately $141.1 million against Federal awards, representing $75.1 million for the DoD and $66 million for other Federal agencies in the fiscal year ended June 30, 1999.

Quality Control Review Objective. As the Federal cognizant agency for Carnegie Mellon, the Office of the Inspector General, DoD, performed a quality control review of the FY 1999 report that Carnegie Mellon submitted to the Single Audit Clearinghouse. The purpose of the review was to determine whether the FY 1999 report met the applicable reporting standards and whether D&T conducted the audit as required by applicable standards and the OMB Circular A-133. See Appendix A for a discussion of the scope, prior quality control reviews and audits related to D&T, and single audit requirements.

Review Results. D&T complied with OMB Circular A-133 in performing the audit of internal controls and compliance requirements; however, the auditors did not adequately document the work performed (finding A). Also, D&T auditors did not report a known noncompliance with property standards as an audit finding in the "Schedule of Findings and Questioned Costs" (finding B). Carnegie Mellon complied with all OMB Circular A-133 requirements, except the Schedule of Expenditures of Federal awards did not identify the pass-through entities for subrecipient expenditures (finding C).

Finding A. Documentation of Audit Work. D&T personnel did not adequately document the work they performed on internal controls or compliance requirements related to the Research and Development major program cluster at Carnegie Mellon. This condition occurred because D&T personnel were unaware of the more stringent workpaper documentation requirements for OMB Circular A-133 audits, which states that audits must be conducted in accordance with generally accepted government auditing standards. As a result, we were unable to determine how the D&T auditors reached their conclusions based on the working papers. Although we eventually concluded that the controls were effective (through retesting and discussions with D&T audit managers), a question remained regarding the thoroughness of D&T work.

Generally accepted government auditing standards state "working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments." However, D&T personnel were not aware of the documentation criteria related to government auditing. In addition, D&T audit managers felt comfortable that personnel had performed the audit steps planned in the audit program and believed that the working paper documentation was sufficient to answer the audit steps.

During the review, we were unable to follow the documentation from detailed working papers to the conclusions reached by the D&T auditors. D&T auditors did not thoroughly explain the purpose or nature of testing on detailed working papers (linking it back to the audit step[s] that the testing would answer). In addition, D&T auditors did not provide the purpose, source, and conclusions reached by the auditors on each detailed working paper. Because of these conditions, we needed to re-perform the tests conducted by D&T and conduct extensive discussions with the D&T audit manager, to reach the same conclusions as the auditors. As a result of discussions during the review, D&T managers agreed to increase the documentation of audit steps and working papers to comply with OMB Circular A-133 and generally accepted government auditing standards.

Recommendation

A. We recommend that the Partner-in-Charge, Deloitte & Touche provide formal training for personnel working on future Office of Management and Budget Circular A-133 audits regarding documentation of working papers in accordance with generally accepted government auditing standards.

Deloitte and Touche Comments. Although Deloitte & Touche believed its staff was aware of more stringent documentation requirements, they agreed to reemphasize the importance of working paper documentation in all future GAS audits (see page 11). The proposed action is generally responsive to the intent of the recommendation.

Finding B. Reporting Audit Findings. D&T did not report Carnegie Mellon's known noncompliance with property standards as an audit finding in the "Schedule of Findings and Questioned Costs." This occurred because D&T managers believed work being performed by Carnegie Mellon mitigated the risk of the issue. As a result,

Federal agencies providing awards to Carnegie Mellon may not be aware of a lack of required inventories and problems with tracking asset location that may impact their programs.

In an August 1999 report, the Office of Naval Research (ONR) cited Carnegie Mellon's property system as unsatisfactory because of the continued existence of the following two deficiencies first noted in a review conducted in FY 1996:

- failure to perform physical inventories every 2 years; and
- inaccurate property records.

Carnegie Mellon's proposed corrective actions in response to the original 1996 report included a plan to complete an inventory by department over a 3-year cycle. ONR approved this deviation from the requirements of OMB Circular A-110, "Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-Profit Organizations." OMB Circular A-110 requires that the recipient (Carnegie Mellon) perform a physical inventory of equipment acquired under Federal awards at least once every 2 years. However, the ONR August 1999 report stated that the physical inventory was still not completed, with only approximately 50 percent of Federal government titled items inventoried. ONR also reported continued inaccurate property records and noted that this was likely a result of the degree of completion of the inventory. The report noted that Carnegie Mellon appeared to be aggressively working to complete the inventory and restated its prior recommendation for timely completion of the inventory.

In addition, the Carnegie Mellon internal audit department had similar findings in a review of the Materials Science & Engineering Department in September 1999. The report noted that internal controls over administration of property needed to be strengthened.

D&T working papers from the 1999 OMB Circular A-133 audit document their review of the ONR and internal audit reports, Carnegie Mellon's corrective action plan, and D&T testing of the issues. D&T audit procedures included discussions with the Property and Space Administrator in charge of overseeing the property inventory count and a review of selected departmental property audits. Although the working papers document the inventory at 50 percent completion, D&T auditors concluded that the Carnegie Mellon property system was in compliance with OMB Circular A-110 standards.

We discussed this issue with the D&T audit managers. D&T managers did not believe it was necessary to report the property system findings since Carnegie Mellon was actively addressing the fixed asset management issues and D&T audit tests did not disclose any significant exceptions. However, without the disclosure of the finding, Federal agencies providing awards to Carnegie Mellon may not be aware of a lack of required inventories and problems with tracking asset location that may impact their programs.

OMB Circular A-133 requires the auditor 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. The determination to report an audit finding is made by assessing the significance of the deficiency in internal control, or the noncompliance, in relation to a compliance requirement (that is, equipment and real property management) or an audit objective identified in the OMB Circular A-133 Compliance Supplement. Because of Carnegie Mellon's continued questionable internal controls, including the lack of a completed physical inventory and inaccurate property records, this noncompliance would be material in relation to the audit objective, and should have been reported as an audit finding.

Based on our Quality Control Review, we do not believe that the results of the audit were questionable. D&T auditors considered the ONR findings in planning and performing their audit. In addition, we were advised by the ONR that as of March 2001, they have confirmed that Carnegie Mellon is now in compliance with the property standard requirements. D&T management was responsive to our recommendation that all findings should be included in the OMB Circular A-133 Schedule of Findings and Questioned Costs.

Recommendation

B. We recommend that the Partner-in-Charge, Deloitte & Touche ensure that future Office of Management and Budget Circular A-133 audit reports include all findings that meet the Office of Management and Budget Circular A-133 reporting criteria in the Schedule of Findings and Questioned Costs.

Deloitte & Touche Comments. Management concurred with the recommendation. Deloitte & Touche personnel agreed to reemphasize the importance of reporting all instances of noncompliance and that the status of all prior findings are appropriately reported and disclosed (See page 11).

Finding C. Presentation of Pass-Through Expenditures. Carnegie Mellon did not present the pass-through awards in the Schedule of Federal Expenditures in accordance with OMB Circular A-133. This condition occurred because Carnegie Mellon was not aware of the specific pass-through presentation requirements of OMB Circular A-133. As a result, non-Federal entities may not be able to identify from the OMB Circular A-133 report the amount of Federal awards passed-through to Carnegie Mellon.

OMB Circular A-133 defines pass-through entities as non-Federal entities that provide a Federal award to a subrecipient to carry out a Federal program. OMB Circular A-133 requires the auditee Carnegie Mellon to prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included. In addition, the American Institute of Certified Public Accountants (AICPA) requires that the schedule of expenditures of Federal awards identify the total amount provided to subrecipients by pass-through entities. Non-Federal entities need to rely on subrecipient OMB Circular A-133 audit reports as part of their subrecipient monitoring responsibilities.

If they are unable to identify their programs in the Schedule of Expenditures of Federal Awards, there is no assurance that the program was included in the OMB Circular A-133 audit. Carnegie Mellon personnel stated that they were unaware of the presentation requirement. In addition, Carnegie Mellon personnel stated that D&T provided input on the presentation of expenditures. D&T managers also stated that they were unaware of the presentation requirement. Both Carnegie Mellon and D&T personnel agreed to our suggestion to present the subrecipient expenditures in future OMB Circular A-133 reports.

Recommendation

C. We recommend that the Carnegie Mellon University Manager of Sponsored Research and Deloitte & Touche Partner-in-Charge ensure that the Schedule of Expenditures of Federal Awards contains the required information for awards received by Carnegie Mellon University as a subrecipient in future Office of Management and Budget Circular A-133 reports. The schedule must provide the name of the pass-through entity and identifying number assigned by the pass-through entity.

Carnegie Mellon Comments. Management concurred with the recommendation. Carnegie Mellon and Deloitte & Touche personnel agreed to ensure that the Schedule of Federal Awards contain the pass-through entity and identifying number assigned by the pass-through entity for all subrecipient funding received. Carnegie Mellon and Deloitte & Touche will implement this change for all future Office of Management and Budget Circular A-133 reports commencing with the fiscal year ended June 30, 2001 (See page 13).

We appreciate the courtesies extended during the review. If you have questions on this report, please contact Mr. Wayne Berry at (703) 604-8789 or Mr. Martin T. Heacock at (703) 604-8756. The report distribution is at Appendix B. 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 Deloitte & Touche LLP audit of Carnegie Mellon University for the fiscal year ended June 30, 1999, and the resulting reporting submission to the Single Audit Clearinghouse dated May 16, 2000 (Project No. D2001-OA-0077). We performed our review using the 1999 edition of the "Uniform Quality Control Guide for the A-133 Audits" (the Guide). The Guide applies to any single audit that is subject to the requirements of OMB Circular A-133, revised June 24, 1997. The Guide is the approved checklist of the President's Council on Integrity and Efficiency for performing the quality control review procedures. Our review was conducted from February 2001 through November 2001 and covered areas related to the financial statements and the one major program, research and development. The project was suspended from June 28, 2001 until November 21, 2001. As the cognizant audit agency for Carnegie Mellon, we focused our review on the following qualitative aspects of the single audit:

- Qualifications of auditors,
- Independence,
- Due professional care,
- Quality control,
- Planning and supervision,
- Internal controls and compliance testing,
- Schedule of Expenditures of Federal Awards,
- Schedule of Findings and Questioned Costs, and
- Data Collection Form.

In conducting the review, we reviewed all working papers prepared by the D&T auditors, discussed the audit with the auditor and Carnegie Mellon cognizant personnel, and retested selected audit procedures.

Prior Quality Control Reviews

Since 1997, we have issued three quality control reviews of Deloitte & Touche LLP. Copies of these reports may be obtained by accessing www.dodig.osd.mil.

Single Audit Requirements

The OMB Circular A-133 establishes policies to guide implementation of the Single Audit Act 1984 (Public Law 98-502) and the Amendments of 1996 and provides an administrative foundation for uniform audit requirements for non-Federal entities that administer Federal awards. In addition, OMB Circular A-133 serves to ensure 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, a complete reporting package on each single audit is submitted to the Single Audit Clearinghouse from the auditee (non-Federal entity) that 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 controls 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 assists the auditors in determining the audit scope for OMB Circular A-133 requirements for review of internal control. For each compliance requirement, the Supplement describes the objectives of internal control and certain characteristics that when present and operating effectively may ensure compliance with program requirements. The Supplement gives examples of the common characteristics for the five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring) for each compliance requirement. The following 14 compliance requirements applicable to the various Federal programs are identified in the Supplement:

A. Activities Allowed/Unallowed*

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/Relocation Assistance*

L. Reporting*

M. Subrecipient Monitoring*

N. Special Tests and Provisions*

* Applicable at Carnegie Mellon University during FY 1999 OMB Circular A-133 audit.

Appendix B. Report Distribution

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Deloitte
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November 13, 2001

Ms. Laura Rainey
Senior Auditor
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400 Army Navy Drive
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Subject: Discussion Draft of a Proposed Report on Quality Control Review of Deloitte and Touche LLP Office of Management and Budget Circular A-133 Audit of Carnegie Mellon University, Fiscal Year Ended June 30,1999

Dear Ms. Rainey:

We appreciate the opportunity to comment on the discussion draft on the above mentioned Quality Control Review (QCR). We also appreciate the collegiality and professionalism of you and your staff throughout the QCR process.

Deloitte & Touche takes great pride in our Audit and Assurance Services, especially work performed in accordance with Government Audit Standards (GAS). We approach such work with the full recognition that the Government is also our client and relies on the work we perform. Indeed, for the past decade we have in place a network of Compliance Audit Specialists whose responsibility is to insure that our work on any engagement performed in accordance with GAS meets Government expectations. Nevertheless, there are always opportunities for improvement and we appreciate your comments and will communicate them throughout our Firm network.

As part of our effort to meet and exceed client expectations on GAS audits, we verify all staff assigned to such engagements are trained and qualified to perform the work to which they are assigned and the specific requirements of such audits. Our automated work papers were designed to insure GAS audits are in accordance with those standards, documented and appropriately reviewed and supervised. We are pleased that your QCR concluded that we met those standards, however we do have some explanatory comments on your tentative findings and would be pleased to discuss them further at your pleasure.

Finding A: Documentation

"D&T personnel did not adequately document the work they performed on internal controls on compliance requirements related to the Research and Development major program cluster at Carnegie Mellon."

Deloitte
Touche
Tohmatsu

We believe our staff was aware of the more stringent work paper documentation requirements for OMB Circular A-133 audits. However, your comments indicate that what was presented could be improved. Therefore, we will reemphasize the importance of work paper documentation in all GAS audits to all Deloitte & Touche staff assigned to such engagements.

Finding B: Reporting Noncompliance

"D&T did not report Carnegie Mellon's known noncompliance with property standards as an audit finding in the "Schedule of Findings and Questioned Costs."

We are pleased that you noted, "Based on our Quality Control Review we do not believe that the results of the audit were questionable." Nevertheless, we will re-emphasize to all Deloitte & Touche staff the importance of reporting all instances of noncompliance and that the status of all prior findings are appropriately reported and disclosed. If the question of noncompliance is unclear or ambiguous, we will emphasize to the staff that disclosure and discussion of the question should nevertheless be provided so the Government is aware of the circumstances and can form its own evaluation of the situation.

Thank you again for the opportunity to comment on the discussion draft.

Sincerely,

Robert G. Goetz
Director

Carnegie Mellon University Comments

From: William G. Laird [wlaird@andrew.cmu.edu]
Sent: Monday, November 05, 2001 5:46 PM
To: Laura Rainey
Cc: Bob Goetz; Bolton, Jeff; Burkett, Susan; Eagan, Tom
Subject: Discussion Draft Project No. D2001-OA-0077

Laura,

I reviewed your draft management letter comment concerning your review of quality control of Deloitte & Touche LLP work on our A-133 audit report for the year ended June 30, 1999. We agree with your recommendation that the Carnegie Mellon University Manager of Sponsored Research and Deloitte & Touche ensure that the Schedule of Federal Awards contain the pass-through entity and identifying number assigned by the pass-through entity for all subrecipient funding received. We will implement this change for all future A-133 reports commencing with the year ended June 30, 2001.

I have discussed this with both Tom Eagan and Bob Goetz who will make the recommended change. Thank you for the opportunity to review your draft report and please do not hesitate to call if you have any questions or comments.

Best regards,
Bill

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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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