Policy and

Oversight

Financial and Performance Audit Directorate

Quality Control Review

Deloitte & Touche LLP
Oregon Graduate Institute of Science and Technology
Fiscal Year Ended June 30, 1996

Report Number PO 97-036

June 30, 1997

Office of the Inspector General
Department of Defense

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Acronyms

CFDA	Catalog of Federal Domestic Assistance
DoD	Department of Defense
GAS	Government Auditing Standards
GAAS	Generally Accepted Auditng Standards
OGI	Oregon Graduate Institute of Science and Technology
OMB	Office of Management and Budget
R&D	Research and Development

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June 30, 1997

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SUBJECT: Quality Control Review of Deloitte & Touche LLP
Oregon Graduate Institute of Science and Technology
Fiscal Year Ended June 30, 1996
Report No. PO97-036

Introduction

We are providing this report for your information and response. Your Portland, Oregon, office performed the single audit for the Oregon Graduate Institute of Science and Technology (OGI), Beaverton, Oregon, a private nonprofit school for science and engineering. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." For the fiscal year ended June 30, 1996, the OGI reported total Federal expenditures of $12,316,829, representing $5,871,739 for the Department of Defense (DoD) and $6,445,090 for other Federal agencies.

Deloitte & Touche LLP issued its audit report September 6, 1996, which includes individual reports on internal controls, compliance, and the Schedule of Federal Awards. The auditors issued an unqualified opinion on the financial statements, Schedule of Federal awards, and compliance with specific requirements applicable to major programs. Deloitte & Touche LLP 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 OGI 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 audit report describes the auditor's scope of work in obtaining that understanding and assessing control risk. The report on internal control further

describes the significant internal controls and control structure, including the controls that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations.

Quality Control Review Results

Except for the Schedule of Federal Awards and note No. 2 to that schedule, the OMB Circular A-133 audit performed by Deloitte & Touche LLP meets the applicable guidance and regulatory requirements in the OMB Circular A-133 and its related Compliance Supplement, which incorporate the Government Auditing Standards (GAS) and Generally Accepted Auditing Standards (GAAS). We found that the Schedule of Federal Awards prepared by OGI does not separately identify Federal funds passed through from other recipients. The President's Council on Integrity and Efficiency, Position Statement No. 6, "Questions and Answers on OMB Circular A-133," question number 29, requires the identification of Federal funds that are passed through and their Catalog of Federal Domestic Assistance (CFDA) number.

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 Federal oversight agency for OGI, we conducted a quality control review of the Deloitte & Touche LLP audit working papers. We focused our review on the following qualitative aspects of the audit: due professional care, planning, supervision, independence, quality control, internal controls, substantive testing, general and specific compliance testing, and the Schedule of Federal Awards.

We reviewed the most recent peer review letter, dated November 25, 1996, issued by Ernst & Young LLP. The peer review found that Deloitte & Touche LLP 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, 1996. However, recommendations for improvements were noted in two areas: supervision and independence.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) that was approved by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and field work audit standards and the required elements of a single audit. The Guide is further divided into the substantive 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 in May 1997.

We limited the scope of our quality control review to the audit working papers covering areas related to DoD expenditures, the financial statements, and the research and development (R&D) program. The R&D program expenditures were about $11 million and accounted for 91 percent of Federal award expenditures of the OGI.

Results of Prior Quality Control Reviews

We identified a minor quality control review finding and recommendation at one of the Deloitte & Touche LLP locations we visited from January 1, 1995, through December 31, 1996. We notified the affected office 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; to establish uniform requirements for audits of Federal financial assistance; to promote efficient and effective use of audit resources; and to 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 Single Audit Act Amendments of 1996 also bring nonprofit organizations, previously covered by similar requirements under the OMB Circular A-133.

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 implement its overall responsibilities. The independent public accountant, Federal auditor, and other non-Federal auditors must 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. When the OMB has not assigned a cognizant agency, then the Federal agency that provides the predominant amount of direct funding to a recipient is designated as the oversight agency. The oversight agency is responsible for providing technical advice and counsel to institutions and independent auditors when requested by the recipient and may assume all or some of the responsibilities normally performed by the cognizant agency. The Circular is being revised to incorporate the changes in the Single Audit Act Amendments of 1996.

Discussion of Findings

During our quality control review, we reviewed and took exception to the following schedule.

Schedule of Federal Awards. The recipient, OGI, is responsible for creating the Schedule of Federal Awards. 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.

Our review of the Schedule of Federal Awards and related notes disclosed that certain pass-through awards were not identified. Note 2, to the Schedule of Federal Awards identified $1,419,168 as amounts passed through to other institutions. Based on information provided by Deloitte & Touche LLP, the OGI personnel, and OGI accounting books and records for fiscal year ended June 30, 1996, we found that the $1,419,168 should have been identified by OGI as pass-through funds received from other Federal award recipients. The President's Council on Integrity and Efficiency, Position Statement No. 6, "Questions and Answers on OMB Circular A-133," question number 29, states, "Federal funds passed through from other recipients should be identified as pass-through funds and include the name of the awarding organization, the program identifying number, and the CFDA number." The identification of pass-through awards is necessary for the DoD, as an oversight Federal agency of OGI, to facilitate its oversight responsibilities over the audits of direct Federal funds, and for other prime recipients to monitor the funds they award to OGI. Also, identification of pass-through awards is necessary to identify pass-through funds to ensure appropriate compliance testing by the auditors. Deloitte & Touche LLP should have detected that OGI was a recipient of pass-through awards because the dollar amount is material with regard to the total Schedule of Federal Awards.

Recommendation for Corrective Action

Recommendation 1. We recommend that the Oregon Graduate Institute of Science and Technology prepare its Schedule of Federal Awards in accordance with the President's Council on Integrity and Efficiency, Position Statement No. 6, for the fiscal year ended June 30, 1996. The corrected schedule should separately identify pass-through funds from direct funds. Also, note No. 2 to the Schedule of Federal Awards should be corrected to reflect that Oregon Graduate Institute of Science and Technology is a recipient of pass-through awards. The corrected Schedule of Federal Awards should be provided to all Federal agencies who provided direct awards and to all prime recipients who provided indirect awards.

Recommendation 2. We recommend that Deloitte & Touche LLP review the corrected Schedule of Federal Awards and issue a revised audit opinion, if required.

Discussion of Results

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

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

Independent Auditors' Report on the Schedule of Federal Awards. The auditor is required to subject the schedule to the auditing procedures applicable to the audit of the financial statements and to ensure that the amounts are fairly stated in relation to the basic financial statements. Our review was included in the steps of evaluation of the audit working papers related to the "Independent Auditors' Report."

Independent Auditors' Report on the Internal Control Structure Based on an Audit of Financial Statements. 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.

Independent Auditors' Report on Compliance Based on an Audit of the Financial Statements. 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.

Independent Auditors' Report on the Internal Control Structure Used in Administering Federal Awards. The auditor is required to obtain an understanding of the internal control structure 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 general requirements in the Compliance Supplement. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the test of controls performed.

Independent Auditors' Report on Compliance With the General Requirements Applicable To Federal Awards. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditors' procedures were limited to those prescribed in the OMB Circular A-133 Compliance Supplement. 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 are audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

Independent Auditors' Report on Compliance With Specific Requirements Applicable to Major Federal Award Programs. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on its major Federal programs. The requirements included types of services allowed or unallowed; eligibility; matching, level of effort, and/or earmarking requirements; special reporting requirements; and special tests and provisions. We reviewed the audit program for the appropriate procedures, 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, reviewed the compliance tests performed, and reevaluated selected compliance items.

Independent Auditors' Report on Compliance With Specific Requirements Applicable to Nonmajor Federal Award Program Transactions. The auditor is required to issue a report on nonmajor programs that provides "a statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested." If the auditor has not selected any nonmajor program transactions or if the entity has no nonmajor programs, no report is required. If the

auditor has selected such transactions, they should be tested for compliance with the specific requirements that apply to the individual transactions. We did not review the auditors' work on nonmajor program transactions because major program transactions represented 99.48 percent of the OGI Federal award expenditures.

Schedule of Findings and Questioned Costs. The auditor is not required to, but may report immaterial findings in the audit report or report them to the recipient in writing in a separate communication. The recipient is responsible for forwarding the findings to the Federal grantor agencies. We traced the findings in the working papers to the audit report to make sure that the report includes all findings identified in the working papers and that the findings are properly supported. We noted that there were three repeat immaterial findings, such as untimely filing of reports and an inadequate fixed asset system. A complete list of all the immaterial findings is in enclosure (1).

Comments

Because, this report contains a finding and a recommendation, written comments are required within 60 days of the date of this report. In addition, we are sending a letter to OGI, requiring its response to the findings identified in the enclosure and emphasizing the need to eliminate repeat findings in future audit reports. 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 Mr. Sunil R. Kadam at (703) 604-8735. The report distribution is at enclosure (2).

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Enclosures

Oregon Graduate Institute of Science and Technology
Fiscal Year Ended June 30, 1996

Schedule of Findings

Finding No.	Title	Agency
1.	R&D Technical ReportingRequirements * (dollar value of instances of noncompliance = $196,118)	ONR
2.	General Compliance Federal Financial Reports * (dollar value of instances of noncompliance = $52,254)	ONR
3.	Drug-Free Workplace (dollar value of instances of noncompliance = $79,822)	ONR
4.	Davis Bacon Act (dollar value of instances of noncompliance = $224,622)	ONR
5.	General Compliance PropertyRecords *	ONR
6.	Special Reporting - Insurance (dollar value of instances of noncompliance = $75,309)	ONR

* Repeat of similar findings made in fiscal year 1995.

ONR - Office of Naval Research

Enclosure 1

Oregon Graduate Institute of Science and Technology
Fiscal Year Ended June 30, 1996

Distribution List

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Enclosure 2

Evaluation Team Members

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

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