
December 16, 2005



Oversight Review

Report on Quality Control Review of the PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the RAND Corporation, Fiscal Year Ended September 29, 2002 (Report No. D-2006-6-002)

Department of Defense
Office of the Inspector General

Quality

Integrity

Accountability



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

DEC 16 2005

Board of Directors
The RAND Corporation

Partner-in-Charge
Los Angeles Office
PricewaterhouseCoopers, LLP

Branch Manager
Defense Contract Audit Agency
San Fernando Valley Branch Office

SUBJECT: Report on Quality Control Review of the PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the RAND Corporation, Fiscal Year Ended September 29, 2002 (Report No. D-2006-001-002)

We are providing this report for your information and use.

PricewaterhouseCoopers, LLP (PWC), and the Defense Contract Audit Agency (DCAA) performed the FY 2002 single audit for the RAND Corporation, located in Santa Monica, California. Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations" (OMB Circular A-133), requires the audit. The RAND Corporation expended \$127.5 million in Federal awards under the Research and Development cluster during the fiscal year that ended September 29, 2002 (FY 2002). Of the \$127.5 million, \$82.5 million was expended for DoD research and development programs.

Background. The RAND Corporation is a nonprofit institution performing independent research and analysis under contracts and grants from government agencies and other institutions. The RAND Corporation manages three DoD-sponsored Federally Funded Research and Development Centers (FFRDCs) - Project Air Force, the Arroyo Center, and the National Defense Research Institute. The RAND Corporation also manages the Science and Technology Policy Institute FFRDC that the National Science Foundation sponsors.

The PWC office in Los Angeles, California, and the DCAA office in San Fernando Valley, California, performed a coordinated OMB Circular A-133 audit for FY 2002. A division of audit responsibilities is discussed in Appendix B.

Quality Control Review Objective. As the cognizant Federal agency for the RAND Corporation, the Department of Defense Office of Inspector General (DoD OIG) performed a quality control review of the single audit report and supporting work papers for the FY 2002 RAND Corporation single audit. The objectives of the review were to determine whether the audit was conducted according to Government Auditing Standards (GAS) and the auditing and reporting requirements of OMB Circular A-133. The scope and methodology for the review are in Appendix A.

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OAIG-APO
Department of Defense Inspector General
400 Army Navy Drive (Room 1016)
Arlington, VA 22202-4704

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.mil; or by writing to the Defense Hotline, The Pentagon, Washington, DC 20301-1900. The identity of each writer and caller is fully protected.

DEPARTMENT OF DEFENSE

hotline

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Send written complaints to: Defense Hotline, The Pentagon, Washington, DC 20301-1900
Phone: 800.424.9098 e-mail: hotline@dodig.mil www.dodig.mil/hotline

Acronyms

DCAA	Defense Contract Audit Agency
DOD OIG	Department of Defense Office of Inspector General
FFRDC	Federally Funded Research and Development Centers
GAS	Government Auditing Standards
OMB	Office of Management and Budget
PWC	PricewaterhouseCoopers
SEFA	Schedule of Expenditures of Federal Awards

Review Results. PWC and DCAA auditors generally met GAS and OMB Circular A-133 requirements for the single audit of the RAND Corporation for FY 2002. However, coordination, planning, performance, and documentation could be improved for future single audits (findings A and B). The RAND Corporation generally complied with OMB Circular A-133 reporting requirements except that the Schedule of Expenditures of Federal Awards (SEFA) did not include time and material contracts (finding C).

Management Comments. PWC and DCAA management concurred with the recommendations. Management comments are included in its entirety at the end of this report.

Findings

Finding A. Audit Coordination for Single Audit. PWC and DCAA auditors could improve coordination to avoid duplication of audit efforts for the Allowable Costs/Cost Principles compliance requirement. While PWC and DCAA had coordination meetings where they discussed audit responsibilities for the FY 2002 single audit, the division of work resulted in a duplication of audit efforts. Because PWC was responsible for grants and DCAA for contracts, both tested internal controls and compliance for the same requirement. In addition, the audit coordination did not address responsibility for the SEFA; therefore, PWC and DCAA duplicated audit efforts for the SEFA. Closer audit coordination between PWC and DCAA will eliminate duplication and achieve a more efficient audit.

Recommendation A. We recommend that the Partner-In-Charge, PricewaterhouseCoopers, LLP, and the Branch Manager, Defense Contract Audit Agency, San Fernando Valley Branch Office provide closer audit coordination and reassess the division of audit responsibilities to ensure a more efficient audit for future single audits.

PWC Comments. PWC management concurred with the recommendation.

DCAA Comments. DCAA management concurred with the recommendation.

Finding B. Planning, Performing, and Documentation. PWC and DCAA auditors should enhance their audit procedures for planning, performing, and documenting the work performed for future single audits.

Planning and Performing the Single Audit. We identified during our quality control review of the FY 2002 single audit the following issues related to planning and performance:

Reporting Compliance Requirement. PWC auditors did not plan to verify the completeness and accuracy of the financial reports for the Reporting compliance requirement. However, the PWC audit manager provided us with verbal explanations as well as additional information of audit procedures performed and documented under the financial statement audit to satisfy this requirement. Future single audits must include audit steps for the audit of the major Federal program to verify the completeness and accuracy of the financial reports, or cross-referenced to work performed under the financial statement audit for the Reporting compliance requirement.

Compliance Testing for Special Tests and Provisions. PWC auditors did not adequately identify and test compliance with special contract terms for determining RAND compliance with the Special Tests and Provisions compliance requirement. While PWC auditors performed audit procedures that tested compliance with special contract terms identified, the auditors did not identify special contract terms and conditions for the National Science Foundation contract. The contract contained terms and conditions related to maximum payments for consultants; requirements for use of subcontractors; and insurance liability to third parties. The PWC audit manager provided documentation for audit procedures performed on insurance liability to third parties under the financial statement audit; however, no information existed for the other two special contract terms and conditions. PWC must identify special contract terms and conditions as well as perform compliance testing for all contracts and grants selected for review in future single audits.

Consideration of Other Federal Agency Acquisition Supplement. The DCAA auditors did not consider other Federal agency acquisition supplements to the Federal Acquisition Regulation in planning and performing the test of direct costs for the Allowable Costs/Cost Principles compliance requirement. As a result of our quality control review, the DCAA auditors reviewed the other agency acquisition supplements and concluded that no additional audit efforts were warranted.

Documentation of Work Performed. We identified the following issues related to documentation during our quality control review for the FY 2002 single audit:

Special Tests and Provisions Compliance Requirement. PWC auditors did not adequately document the test of internal controls for the Special Tests and Provisions compliance requirement. The work papers did not include any documentation on the understanding of the five components of internal control or the identification and test of key controls. However, the PWC audit manager did show audit procedures performed on internal controls under the financial statement audit and for the Activities Allowed/Unallowed and the Allowable Costs/Cost Principles compliance requirements to enable us to conclude that certain attributes of internal controls related to Special Tests and Provisions were addressed.

Procurement, Suspension and Debarment Compliance Requirement. PWC auditors did not adequately document the compliance testing for the procurement aspect of the Procurement, Suspension, and Debarment compliance requirement. Although the work papers did not document audit procedures performed to determine whether procurements were made in accordance with applicable procurement regulations and RAND purchasing policies and procedures, we substantiated the PWC audit manager's explanation of the work performed through the audit documentation on internal controls, the Subrecipient Monitoring compliance requirement, and from RAND purchasing policies and procedures.

Internal Control for Allowable Costs/Cost Principles. DCAA auditors did not clearly identify key internal controls for the Allowable Costs/Cost Principles compliance requirement, and work papers did not provide a clear audit trail for the testing performed. The DCAA technical specialist had to provide verbal and written explanations specifying when the internal control testing was performed and specific work paper references in various audit assignments to enable us to conclude that DCAA performed adequate audit procedures to test internal controls for the Allowable Costs/Cost Principles compliance requirement.

Recommendation B.1. We recommend that the Partner-In-Charge, PricewaterhouseCoopers, LLP, plan, document, and cross-reference audit coverage that meets Office of Management and Budget Circular A-133 objectives for future single audits.

PWC Comments. PWC management agreed to take the action recommended.

Recommendation B.2. We recommend that the Branch Manager, Defense Contract Audit Agency, San Fernando Valley Branch Office:

a. Review and consider the applicable Federal agency acquisition supplements for future single audits.

b. Enhance documentation on internal controls so key controls are clearly identifiable and audit procedures comply with Government Auditing Standards and Office of Management and Budget Circular A-133 requirements.

DCAA Comments. DCAA management agreed to take the action recommended.

Finding C. Schedule of Expenditures of Federal Awards. The RAND Corporation did not report all Federal awards on the SEFA for FY 2002 because it did not contain \$1.3 million in time and material contracts. RAND Corporation personnel originally included time and material contracts in their draft SEFA but was advised by DCAA to exclude them. The DCAA auditors provided incorrect advice based on their OMB A-133 audit program. DCAA headquarters agreed to correct their OMB A-133 audit program. As a result of our quality control review, RAND Corporation included time and material contracts in their SEFA for the most recent reporting package filed with the Federal Audit Clearinghouse.

Recommendation C. We recommend that the Director, Defense Contract Audit Agency, Headquarters correct the Office of Management and Budget Circular A-133 audit program and include time and material contracts in the program.

DCAA Comments. DCAA management concurred with the recommendation.

Other Matters of Interest. We also identified the following issues and PWC will implement corrective action for future single audits.

Sampling Methodology. PWC auditors sampled 7 pre-selected contracts and grants from 3 Federal agencies to test internal controls and compliance for the applicable compliance requirements, except for the Activities Allowed/Unallowed and Allowable Costs/Cost Principles compliance requirements. Based on the SEFA, RAND received awards from thirteen Federal agencies. According to the American Institute of Certified Public Accountants Statements Auditing Standards AU §350.24, sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected.

PWC Comments. PWC management stated that their sampling methodology has significantly evolved since the FY 2002 single audit and that their current methodology would provide for sample selections to be representative of the population and that all items within the population would have the opportunity to be selected.

Calculation of Threshold. The PWC auditors did not properly calculate the dollar threshold amount to distinguish between Type A and Type B programs for audit. OMB Circular A-133 §__520 requires the auditor to calculate a threshold based on the total Federal awards expended. Because RAND has only one major program, the research and development cluster, calculation of the threshold does not impact the adequacy of the audit. However, calculation of the threshold is necessary for the Schedule of Findings and Questioned Costs and the Data Collection Form.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Janet Stern at (703) 604-8750 (DSN 664-8750) or Mr. Wayne Berry at (703) 604-8789 (DSN 664-8789). See Appendix C for the report distribution.



Patricia A. Brannin
Assistant Inspector General
Audit Policy and Oversight

Appendix A. Quality Control Review Process

Scope and Methodology

We conducted a quality control review of the PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency audits of the RAND Corporation for FY 2002 and the resulting reporting package that was submitted to the Federal Audit Clearinghouse dated September 2, 2003. We performed our review using the 1999 edition of the “Uniform Quality Control Guide for the A-133 Audits” (the Guide) and the project instruments the Department of Education Inspector General office developed. The Guide applies to any single audit subject to the requirements of OMB Circular A-133 and is the approved President’s Council on Integrity and Efficiency checklist used for performing the quality control reviews. Our review was conducted from June through October 2005 and covered areas related to the RAND Corporation research and development cluster. As the cognizant agency for the RAND Corporation, we focused our review on the following qualitative aspects of the single audit:

- qualification of auditors,
- independence,
- due professional care,
- 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, and
- Data Collection Form.

In conducting our review, we reviewed the work papers PWC and DCAA prepared. We discussed the audit with the PWC and DCAA audit teams and the RAND Corporation personnel.

Prior Quality Control Reviews

Since October 1, 1998, we have performed seven quality control reviews of PWC OMB Circular A-133 audits. One of the seven reports contained deficiencies resulting in findings and recommendations on audit planning, performance, and documentation, and three reports contained suggestions for improvements to audit documentation and continuing professional education.

Since October 1, 1998, we have performed eight quality control reviews of DCAA OMB Circular A-133 audits. Of the eight reports, five contained deficiencies resulting in findings and recommendations on audit planning, performance, and documentation.

Single Audit Requirements

The intention of the Single Audit Act, Public Law 98-502, as amended, and OMB Circular A-133 is to improve the financial management of State and local Governments and non-profit organizations. The Single Audit Act and OMB Circular A-133 establish one uniform set of auditing and reporting requirements for all 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 administering 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. Entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) 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 have an annual single or program-specific audit performed under 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 submission includes the following:

- a Data Collection Form, certified by the auditee that the audit was completed in accordance with OMB Circular A-133;
- 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 for major programs;
- report on compliance with requirements for major programs and related opinion;
- Schedule of Findings and Questioned Costs;
- Summary Schedule of Prior Audit Findings; and
- a corrective action plan, when appropriate.

The OMB Compliance Supplement (the Supplement) assists auditors identify compliance requirements 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 each audit conducted under OMB Circular A-133, 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 following 14 compliance requirements identified in the Supplement are applicable to the research and development cluster.

- A. Activities Allowed or 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 and Relocations Assistance;
- L. Reporting;
- M. Subrecipient Monitoring; and
- N. Special Tests and Provisions.

The Statement of Position 98-3, “Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards,” published by the American Institute of Certified Public Accountants, provides guidance on auditor responsibilities for conducting audits according to the Single Audit Act and OMB Circular A-133 (the American Institute of Certified Public Accountants converted the Statement of Position into an audit guide in May 2003). In general, the Statement of Position 98-3 provides auditors with an understanding of the unique planning, performance, and reporting considerations for single audits performed under GAS. In addition, the Statement of Position 98-3 uses summary tables and detailed discussions to provide the auditor with an understanding of the additional general, fieldwork, and reporting requirements under GAS, including the additional standards relating to quality control systems, continuing professional education, work papers, audit follow-up and reporting.

The Statement of Position 98-3 emphasizes that when planning an audit to meet the requirements of OMB Circular A-133, several factors should be considered in addition to those ordinarily associated with an audit of financial statements in accordance with Generally Accepted Auditing Standards and GAS. 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;
- determining compliance requirements;
- gaining an understanding of internal control over financial reporting and the 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 financial reporting and on each major program; and
 - satisfying the additional requirements of the Single Audit Act and OMB Circular A-133 regarding work papers, audit follow-up, and reporting.

Appendix B. Coordinated Audit Responsibilities

Audit Responsibilities

OMB Circular A-133 Compliance Requirements	DCAA	PWC
Activities Allowed/Unallowed		X
Allowable Costs/Cost Principles	X(Contracts Only)	X(Grants Only)
Cash Management		X
Davis-Bacon Act		X
Eligibility		X
Equipment and Real Property Management		X
Matching, Level of Effort, Earmarking		X
Period of Availability of Federal Funds		X
Procurement, Suspension, and Debarment		X
Program Income		X
Real Property Acquisition and Relocation Assistance		X
Reporting		X
Subrecipient Monitoring		X
Special Tests and Provisions		X

Appendix C. Report Distribution

Office of the Secretary of Defense

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Branch Manager, Defense Contract Audit Agency San Fernando Branch Office

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Air Force Audit Agency

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Chief, Office of Naval Research
Audit Liaison, Assistant Secretary of the Navy
Financial Management and Comptroller
Naval Inspector General

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Office of the Inspector General, Department of Education
Office of the Inspector General, Department of Energy
Office of the Inspector General, Department of Health and Human Services
Office of the Inspector General, Department of Justice
Office of the Inspector General, Department of State
Office of the Inspector General, Department of Veteran Affairs
Office of the Inspector General, Environmental Protection Agency
Office of the Inspector General, National Aeronautics and Space Administration
Office of the Inspector General, National Science Foundation
Office of the Inspector General, Social Security Administration
Office of the Inspector General, U.S. Agency for International Development

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Board of Directors, RAND Corporation

Audit Committee, RAND Corporation.
Treasurer, RAND Corporation
Director of Financial Reporting and Accounting, RAND Corporation
Partner-in-Charge, PricewaterhouseCoopers, LLP
Audit Manager, PricewaterhouseCoopers, LLP

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 Committee on Homeland Security and 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 and Financial Management
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census

Defense Contract Audit Agency Comments



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PQA 225.4 (D2005-DIPOAC-0212)

November 29, 2005

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

SUBJECT: DCAA Comments on the Draft DoDIG Report on the Quality Control Review of
PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency FY 2002
OMB Circular A-133 Report of the RAND Corporation (Project No.
D2005-DIPOAC-0212)

Thank you for the opportunity to respond to the draft report. The subject report provides the results of your office's quality control review of the OMB Circular A-133 audit performed at RAND Corporation for fiscal year 2002. PricewaterhouseCoopers, LLP, and DCAA performed the audit on a coordinated basis. Our response to the individual report recommendations follow:

IG Finding A – Audit Coordination for Single Audit

Recommendation A. We recommend that the Partner-In-Charge, PricewaterhouseCoopers, LLP, and the Branch Manager, Defense Contract Audit Agency, San Fernando Valley Branch Office provide closer audit coordination and reassess the division of audit responsibilities to ensure a more efficient audit for future single audits.

DCAA. Concur. Enclosed is our response from the South Bay Branch Office, who now has the audit cognizance of the RAND Corporation, with additional comments.

IG Finding B – Planning, Performing, and Documentation

Recommendation B.2. We recommend that the Branch Manager, Defense Contract Audit Agency, San Fernando Valley Branch Office:

- a. Review and consider all applicable Federal agency acquisition supplements for future single audits.
- b. Enhance documentation on internal controls to clearly identify key controls and the audit procedures performed to comply with Government Auditing Standards and OMB Circular A-133 requirements.

PQA 225.4 (D2005-DIPOAC-0212)

November 29, 2005

SUBJECT: DCAA Comments on the Draft DoDIG Report on the Quality Control Review of PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency FY 2002 OMB Circular A-133 Report of the RAND Corporation (Project No. D2005-DIPOAC-0212)

DCAA. Concur. Enclosed is our response from the South Bay Branch Office, who now has the audit cognizance of the RAND Corporation, with additional comments. In addition, DCAA Headquarters is currently revising the OMB A-133 standard audit program to clarify the audit steps to prompt better audit execution for these audit areas. The revised standard audit program should be finalized in January 2006.

IG Finding C - Schedule of Expenditures of Federal Awards

Recommendation C. We recommend that the Director, Defense Contract Audit Agency, Headquarters correct the OMB Circular A-133 audit program to include time and material contracts.

DCAA. Concur in part. The standard audit program did not specifically state to exclude time and material contracts from the awards listed in the SEFA or from awards subject to testing for OMB Circular A-133 compliance. The statement in the audit program that was incorrectly relied upon related to audit threshold determinations for the Single Audit Act. We plan to make the necessary clarification to the standard audit program by January 2006.

If you have any questions, please contact Mr. Doug Sexton, Program Manager, Policy Quality Assurance Division, at (703) 767-2298 or Mr. Dave Fleming, Program Manager, Policy Programs Division, at (703) 767-2273.

/Signed/
Earl J. Newman
Assistant Director
Policy and Plans

Enclosure:

Western Region Response Dated November 18, 2005



RAND Memo to
PQA.doc



WESTERN REGION
DEFENSE CONTRACT AUDIT AGENCY
16700 VALLEY VIEW AVENUE, SUITE 300
LA MIRADA, CALIFORNIA 90638-5833

IN REPLY REFER TO

RD-4/225.4

November 18, 2005

MEMORANDUM FOR DIRECTOR, DCAA

ATTENTION: PQA

SUBJECT: Response to Draft DoD IG Report on Quality Control Review of
PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency Office of
Management and Budget Circular A-133 Audit Report of the RAND Corporation,
Fiscal Year Ended September 29, 2002 (D2005-DIP0AC-0212)

Enclosed is our response to the subject draft report prepared by the South Bay Branch
Office.

Should you have any questions, please contact Mr. Cliff Cameron, Branch Manager,
South Bay Branch Office, at (310) 516-6395 or Ms. Josephine Flinn, Regional Audit Manager, at
(714) 228-7004.

/Signed/
CHRISTOPHER M. ANDREZZE
Regional Director

Enclosure: a/s



FY 2002 RAND - FAO
Response.doc

Copy furnished:
Mr. Cliff Cameron, Branch Manager, SBBO
Ms. Ellen Hoffer, RQA-4



SOUTH BAY BRANCH OFFICE
WESTERN REGION
DEFENSE CONTRACT AUDIT AGENCY
1149 West 190th Street, Suite 2022
GARDENA, CALIFORNIA 90248-4303

4421/290.7

November 7, 2005

MEMORANDUM FOR REGIONAL DIRECTOR, DCAA WESTERN REGION

ATTENTION: RQA-4

THRU: RAMA-4 /s/ *J.L. Flinn, 11-8-05*

SUBJECT: Contact with Department of Defense, Office of Inspector General (DoD OIG) RE:
DoD OIG Quality Control Review of the FY 2002 RAND Corporation A-133
Single Audit Project Number (D2005-DIP0AC-0212)

From June 20-24, 2005 the DoD OIG performed the field work for its quality control review of DCAA's FY 2002 A-133 audit at the RAND Corporation (RAND). Representing the DoD OIG were Ms. Sharon Vasquez, Single Audit Technical Specialist and Ms. Felicia Fuller, Single Audit Technical Specialist. The DoD OIG performed the review on behalf of the Department of Education's government-wide A-133 Single Audit Act review. The DoD OIG also reviewed the Independent Public Accountant's (IPA) work of RAND in July 2005.

In the draft report provided to us at exit conference on November 1, 2005, the DoD IG concluded that the audit was properly planned and supervised and contained adequate documentation related to testing of internal controls and A-133 compliance. However, the DoD IG identified in the draft audit report the following concerns: (1) PWC and DCAA auditors could improve coordination to avoid duplication of audit effort for the Allowable Costs/Cost Principles compliance requirement, (2) audit coordination did not address responsibility for the Schedule of Expenditures of Federal Awards (SEFA), therefore, PWC and DCAA duplicated audit efforts for the SEFA, (3) DCAA auditors did not consider other Federal agency acquisition supplements to the Federal Acquisition Regulation in planning and performing the test of direct costs for the Allowable Costs/Cost Principles compliance requirement and (4) DCAA auditors did not clearly identify key internal controls for the Allowable Costs/Cost Principles compliance requirement and the work papers did not provide a clear audit trail for the testing performed. We agreed with all of the findings. Regarding finding number 1, we are coordinating with the PWC auditors to determine the appropriate division of responsibilities to avoid duplication of effort in preparation for audit of the FY 2005 A-133 submission. In response to finding number 2, we implemented corrective action during the audit of RAND's FY 2004 A-133 submission. PWC has accepted responsibility for reporting on the SEFA. Finding number 3 was corrected during our audit of RAND's FY 2004 submission. We included consideration of all applicable Federal agency supplements in our testing of direct cost. In response to finding number 4, we have taken action to provide a clear audit trail for documentation and testing of internal controls. We are enhancing our

SUBJECT: Contact with Department of Defense, Office of Inspector General (DoD OIG) RE:
DoD OIG Quality Control Review of the FY 2002 RAND Corporation A-133 Single Audit Project
Number (D2005-DIP0AC-0212)

procedures to document the key internal controls for the Allowable Costs/Cost Principles
requirement.

The IG provided its draft report to DCAA on November 1, 2005 and expects a response by
November 18, 2005. The final report will be issued to the Department of Education by February 3,
2006.

Any questions regarding this memorandum should be directed to Donald S. Gensemer,
Supervisory Auditor at (310) 336-7210 or by email at donald.gensemer@dcaa.mil or to me at
(310) 516-6395 or by email at cliff.cameron@dcaa.mil.

/signed/
Clifford D. Cameron
Branch Manager
DCAA South Bay Branch Office

PricewaterhouseCoopers Comments



December 2, 2005

OAIG-APO
Department of Defense Inspector General
400 Army Navy Drive (Room 1016)
Arlington, VA 22202-4704

PricewaterhouseCoopers LLP
350 South Grand Avenue
Los Angeles CA 90071
Telephone (213) 356 6000
Facsimile (813) 637 4444

Attention: Felecia M. Fuller, Single Audit Technical Specialist

SUBJECT: Report on Quality Control Review of PricewaterhouseCoopers LLP and Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audit Report of the RAND Corporation, Fiscal Year Ended September 29, 2002

We appreciate the opportunity to respond to your draft report and the findings you have identified.

Recommendation A:

Audit Coordination for Single Audit.

PwC and the DCAA have always been forward thinking about the coordinated audit and we work throughout the year to communicate on issues that may be appropriate to RAND and on issues that are relevant to audits conducted under government auditing standards. It is particularly rewarding to effect a change that encourages efficiencies that will be realized by the auditee.

We concur with your observations and recommendation for PricewaterhouseCoopers LLP (PwC) and the Defense Contract Audit Agency (DCAA), San Fernando Valley Branch Office to provide closer audit coordination and thereby eliminate redundancies. This recommendation is being incorporated for the Office of Management and Budget Circular A-133 Audit Report of the RAND Corporation (RAND), Fiscal Year Ended September 25, 2005 in that our preliminary plan provides for the DCAA to report on compliance with Activities Allowed/Unallowed and Allowable Costs/Cost Principles for all federal awards. The preliminary plan provides for PwC to report on compliance with all other applicable compliance requirements for all federal awards. This plan is subject to approval by the Engagement Partner at PwC and Branch Manager at DCAA.

Recommendation B:

Reporting Compliance Requirement.

We concur with your observations and recommendations with respect to our audit plan to verify the completeness and accuracy of financial reports. This work is routinely



performed as part of our audit procedures for the financial statements, and we agree that a clear cross reference of how and where the testing for the Reporting compliance requirement is addressed should be documented and evident in the A-133 work papers.

Compliance Testing for Special Tests and Provisions.

We do not agree with your assessment of our testing of special contract terms and conditions for the National Science Foundation (NSF) contract. Based on our evaluation and testing of controls associated with payroll, specifically: hiring policies, salary approval, oversight as evidenced by our examination of annual review for all selected employees; and on our evaluation and testing of information technology controls to support the completeness and accuracy of project detail, we determined the risk of non-compliance for consultants (adjunct employees) to be paid and charged in excess of a contractual salary cap is low, and therefore additional tests were not performed. This conclusion is consistent with tests performed in prior years when privately funded salaries were examined and found to be infrequent and immaterial. We agree that our documentation to support this conclusion can be improved and we are committed to provide clear rationale for our scope and testing decisions as a result of your observations

Based on evaluation and testing of controls and substantive testing of compliance requirement M Subrecipient monitoring, sub-contractors agreements and related payments for the NSF contract were examined and noted as approved by the contract administrator and allowable under the contract. During other tests of controls performed during the audit of financial statements and elsewhere as noted in your report, we have concluded that the contract administrator and personnel associated with the NSF contracts are responsible to ensure that any special contract provisions are met. RAND has sustained a relationship with the NSF for several years and has received material funding for Research and Development from this agency. Communication within the unit responsible for NSF projects is frequent and timely; RAND personnel are knowledgeable, familiar with the agency and subject to the RAND code of conduct and other protocols that would reasonably prevent non-compliance in this area. We agree that specific reference should have been made to the special contractual requirements during our tests of controls and tests of details as performed in M Subrecipient monitoring.

Documentation of Work Performed.

We agree that our documentation for internal controls for the Special Tests and Provisions compliance requirement should address the five components of internal control and tests of relevant key controls. We agree that our documentation with respect to Procurement, Suspension and Debarment compliance requirement can be improved. When tests of controls or substantive tests that support compliance are performed during our audit of the financial statements we agree that a clear cross reference of how and where the testing for the compliance requirement is addressed should be documented and evident in the A-133 work papers.



Other Matters of Interest:

Our sampling methodology has significantly evolved since the work was performed for the RAND audit for Fiscal Year Ended September 29, 2002. We believe our current methodology would provide for sample selections to be representative of the population and that all items within the population would have the opportunity to be selected. During the planning for the RAND audit for Fiscal Year Ended September 25, 2005 we have stratified the population of projects and selected a sample that is representative of the funding agencies. The realignment of responsibility as discussed in Recommendation A does encourage PwC to select and examine federal awards from representative agencies without regard to their status as a "grant" or "contract", and this significantly improves the appropriateness of the sampling selections.

Summary:

As a result of the quality review performed by auditors from the Department of Defense as described in this report, we have had the opportunity to improve our audit approach and to enhance our understanding of the sensitivity of the Inspector General for Office of Management and Budget Circular A-133 Audit Reports. We appreciate the opportunity to contribute to improved methodology and to the overall quality of this work.

Sincerely,

A handwritten signature in cursive script that reads "Nancy E. Shelmon".

Nancy E. Shelmon
Partner