

Inspector General

United States
Department of Defense



Quality Control Review of the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses

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Acronyms and Abbreviations

AICPA	American Institute of Certified Public Accountants
CAM	Contract Audit Manual
DCAA	Defense Contract Audit Agency
FOUO	For Official Use Only
OMB	Office of Management and Budget
R&D	Research and Development



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
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February 20, 2013

Director
Defense Contract Audit Agency

Branch Manager
Chesapeake Bay Branch Office
Defense Contract Audit Agency

Treasurer
Institute for Defense Analyses

SUBJECT: Quality Control Review of the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses (Report No. DODIG-2013-048)

We are providing this report for your review and comment. We considered management comments on a draft of this report when preparing the final report. DCAA management comments were partially responsive; therefore we request additional comments on Recommendation 1a. by March 22th, 2013. As the cognizant Federal agency for the Institute for Defense Analyses (the Institute), we performed a review of the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency (DCAA) single audit and supporting working papers for the audit period September 26, 2009, through September 24, 2010. The purpose of our review was to determine whether the single audit was conducted in accordance with auditing standards¹ and the auditing and reporting requirements of the Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Appendix A contains additional background, scope, and methodology of the review.

Background. The Institute is a nonprofit corporation, in Alexandria, Virginia, that operates three federally funded research and development (R&D) centers to provide objective analyses of national security issues, requiring scientific and technical expertise, and to conduct related research on other national challenges. Two of the federally funded R&D centers are sponsored by DoD and one is sponsored by the National Science Foundation. The Institute expended \$226.8 million in Federal awards for the fiscal year ended September 24, 2010, under one Federal program, the R&D cluster. Of the \$226.8 million, \$215.8 million was expended for DoD programs.

¹ Auditing standards include both Government Auditing Standards and the American Institute of Certified Public Accountants' audit standards.

The PricewaterhouseCoopers office in McLean, Virginia, and the DCAA Chesapeake Bay Branch Office performed a coordinated audit. PricewaterhouseCoopers was responsible for the audit of the financial statements and the Schedule of Expenditures of Federal Awards. DCAA performed the audit of the R&D program cluster. Appendix B lists the compliance requirements that the DCAA considered applicable to the FY 2010 single audit.

Review Results. DCAA did not comply with Circular A-133 requirements, auditing standards, and DCAA guidance for the FY 2010 single audit. Specifically, the auditors did not adequately plan, perform, and document the audit procedures to support their conclusions on the ten compliance requirements applicable to the R&D cluster (Finding A). We also identified deficiencies in the performance of fraud risk assessment procedures (Finding A) and the completion of the Circular A-133 report (Finding B). Therefore, additional audit work is needed before Federal agencies can rely on the audit for assurance that the Institute managed Federal awards in compliance with laws, regulations, and award provisions.

The PricewaterhouseCoopers audit of the financial statements and Schedule of Expenditures of Federal Awards met auditing standards and Circular A-133 requirements.

The Institute generally met Circular A-133 requirements except that the corrective action plan was not submitted with the single audit reporting package when it was initially filed with the Federal Audit Clearinghouse (Finding B).

Management Comments and DoDIG Response. The Defense Contract Audit Agency and the Institute agreed to take the recommended actions. DCAA management comments were partially responsive; therefore additional comments are requested on Recommendation 1a. Management comments are included in their entirety at the end of this report.

Finding A. Planning, Performance, and Documentation of the Federal Program Audit

DCAA did not adequately plan the audit because the sampling methodology did not comply with auditing standards and Circular A-133 requirements for testing internal control over and compliance with each applicable compliance requirement in the R&D program cluster. In addition, the DCAA auditors did not perform and document adequate internal control review procedures or compliance testing to support audit conclusions on each requirement. The auditors also did not plan and perform adequate fraud risk assessment procedures. Because of these deficiencies, the audit lacked sufficient and appropriate evidence to support DCAA's conclusions on internal control and opinion on compliance. Additionally, the audit does not provide Federal program managers with information needed to ensure accountability over program funds. As a result, Federal agencies cannot rely on the audit to manage and monitor program awards.

Audit Planning. DCAA did not adequately plan the audit because the sampling approach did not ensure that the auditors' sample was representative of the universe of R&D awards. Guidance on sampling is contained in the auditing standards and the American Institute of

Certified Public Accountants (AICPA) Audit Guide, “Government Auditing Standards and Circular A-133 Audits,” (AICPA Circular A-133 Audit Guide). The guidance provides sampling considerations and documentation requirements to ensure that the sampling approach used in the single audit provides sufficient and appropriate evidence. The guidance covers ensuring that the sample population is appropriate for the audit objective, that the sample size is consistent with the determined risk of noncompliance, and that the sample selection process results in a sample that is representative of the universe. In addition, the Circular A-133 Compliance Supplement Part 5, “Clusters of Programs,” provides specific sampling guidance for the R&D program cluster and states that the sample selected should come from a variety of award sizes, types, and funding sources. This guidance is intended to address the unique factor that the cluster is normally composed of awards from many Federal agencies and also ensures that the sample is drawn from the entire universe of awards to provide appropriate coverage for all Federal agencies.

The Institute’s awards and contracts are all considered to be a part of one major program, the R&D cluster. Based on our review of the working papers and discussions with DCAA, we concluded that the auditors did not have a clear understanding of the R&D program cluster and the testing required to be performed. The sampling approach did not ensure that the auditors’ sample was representative of the universe of R&D awards. Rather, DCAA performed a risk-based assessment of the Institute’s awards and concluded that only three contracts needed to be tested. As a result, the sample was not representative of the universe because all Federal agency awards did not have an equal chance of being included in the transaction test sample. Therefore, the testing performed did not provide appropriate evidence to support the auditors’ opinion on compliance with the requirements.

Performance and Documentation of Internal Control and Compliance Testing of Federal Requirements. In addition to the overall deficiency in the sampling approach used, DCAA failed to perform the review of internal controls and compliance of the R&D cluster in accordance with Circular A-133 requirements, auditing standards, and DCAA guidance. Specifically, the auditors did not perform and document adequate procedures on internal controls and compliance with activities allowed/allowable cost principles; cash management; period of availability; procurement, suspension, and debarment; subrecipient monitoring, and the special tests and provisions requirements. DCAA also did not perform adequate compliance testing for the equipment and real property requirement or internal control testing for the level of effort and reporting requirements. During our site visit, we gave the auditors opportunities to provide additional explanations and support for the audit procedures performed; however, the auditors were unable to provide additional information to mitigate the deficiencies identified.

Auditing standards and Circular A-133 require the auditor to perform risk assessment procedures to obtain an understanding of internal control over compliance and to evaluate the design and implementation of internal controls over compliance for each applicable requirement. The purpose of the procedures is to determine whether the controls are capable of preventing, detecting, and correcting material noncompliance. As part of the review of internal controls, the auditor must also identify and test the operating effectiveness of key internal controls they intend to rely on in order to assess the risk of noncompliance due to the control environment. The auditor is required to document the risk assessment procedures performed, the results obtained,

and the conclusions reached. This assessment is used to establish the nature, timing, and extent of compliance testing needed to obtain sufficient and appropriate evidence to support the audit conclusions on compliance with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on its major program.

Auditing standards and DCAA policies and procedures require that audit documentation be appropriately detailed to provide a clear understanding of the work performed, the evidence obtained, and the conclusions reached. The documentation and audit evidence should be in sufficient detail to enable an experienced auditor with no previous connections to the audit to understand the nature, timing, extent, and results of audit procedures performed that supports the significant judgments and conclusions. In addition, audit documentation should be appropriately organized to provide a clear link to the findings, conclusion, and recommendations.

Activities Allowed/Unallowed and Allowable Costs/Cost Principles Compliance Requirements. The DCAA auditors did not perform adequate audit procedures to determine the Institute's internal control over and compliance with the activities allowed/unallowed and allowable costs/cost principles compliance requirements. DCAA obtained an understanding of the Institute's internal controls over compliance, but the working paper documentation did not provide evidence of any internal control testing performed. In addition, the DCAA auditors did not perform adequate tests of compliance on FY 2010 labor costs. As stated in the Audit Planning section of this report, the DCAA auditors planned to test three contracts to support conclusions on internal control over and compliance with requirements. However, for the activities allowed/unallowed and allowable costs/cost principles compliance requirements, the auditors limited the testing of direct labor costs to only one contract. As a result, DCAA excluded \$70 million of direct labor costs, representing 31 percent of total Federal expenditures from the testing population. The R&D program cluster is composed mainly of labor costs; therefore, DCAA should perform additional testing of labor charges to the Federal program to ensure the Institute was in compliance with the activities allowed/allowable cost principles.

During our review, we also noted inconsistencies between the working papers and audit report related to questioned costs. Specifically, DCAA did not report all questioned costs or document in the working papers the basis for not reporting the questioned costs. When asked, the DCAA auditors explained that some items were mistakenly excluded from the report, and other costs were excluded because they were considered minimal. DCAA should clearly document in the working papers the basis for any questioned costs not included in the audit report.

Cash Management. The DCAA auditors did not perform adequate audit procedures to determine the Institute's internal control over and compliance with the cash management requirements for cost-reimbursement contracts. The objective of this requirement for organizations funded on a reimbursement basis is to verify that program costs are paid for by the organization before reimbursement is requested from the Federal Government.

The DCAA auditors obtained and documented an understanding of the Institute's internal controls; however, the working paper documentation did not provide evidence that DCAA identified and performed tests of key internal controls that the Institute had in place to ensure

compliance with cash management requirements. According to the supervisory auditor, the testing of internal controls was limited to reviewing the Institute's policies and procedures and verifying that billings were prepared in accordance with the Institute's established billing practices. Although there is evidence in the DCAA working papers that the auditors performed these reviews, there is no documentation to support that the reviews included the testing of key internal controls relevant to the objectives of the cash management compliance requirement. DCAA's compliance testing did not demonstrate that the auditors verified that program costs were paid before reimbursement was requested from the Federal Government. The supervisory auditor stated the testing was limited to verifying that the costs contained in the vouchers selected for review were supported by the Institute's accounting records. This testing is not relevant to the objectives for this requirement because it does not provide any evidence that the Institute paid the costs before requesting reimbursement from the Government.

Period of Availability. The DCAA auditors did not gain an adequate understanding of internal controls or perform internal control and compliance testing for the period of availability requirement. The only documentation in the audit files for the understanding of internal control was the identification of control characteristics rather than the specific controls the Institute has in place to ensure compliance with this requirement. There was no documentation to support that the auditor interviewed Institute personnel, inspected internal control manuals, or observed activities to gain an understanding of the control processes. The documentation also did not provide evidence that the auditor identified and evaluated the design and implementation of any internal controls or identified key controls for testing. The DCAA auditors concluded that the Institute did not have contracts that ended in FY 2010; therefore, they did not perform any audit procedures for the review of internal control and compliance for the period of availability requirement. Our independent review identified one contract that ended in FY 2010 that DCAA excluded from their testing as noted in the Audit Planning section of this report. In addition, the Circular A-133, "Compliance Supplement," and DCAA audit program guidance require the auditors to test transactions and adjustments that were recorded during the period of availability and verify that the underlying obligations occurred within the period of availability. However, there was no evidence in the working paper documentation that this testing was performed. As a result, there is no evidence to support that the Institute is complying with period of availability requirements. The failure to properly test compliance with the period of availability compliance requirement could result in unallowable costs being charged to Federal programs.

Procurement, Suspension, and Debarment. The DCAA auditors review of internal controls and compliance was not adequate to support audit conclusion on this requirement because the audit sampling was not performed and documented in accordance with Circular A-133 requirements and DCAA guidance. The AICPA Circular A-133 Audit Guide provides the guidance for planning, performing, and evaluating audit samples. In addition, the guide provides suggested minimum sample sizes designed to provide sufficient appropriate audit evidence to support conclusions on internal controls over and compliance with requirements. Auditors may use professional judgment to determine whether larger sample sizes are warranted, based on the results of other procedures performed and the risks and complexities of the sampling population. The DCAA Contract Audit Manual (CAM) Chapter 4, "General Audit Requirements," section 600, "Audit Sampling and Other Analytical Procedures," provides guidance for selecting appropriate sample sizes. The guidance states that auditors should

document a sampling plan and that the sample sizes should be sufficiently large enough to reasonably provide sample results reflective of the true universe results.

To test the Institute's internal controls and compliance with this requirement, the DCAA auditors selected a sample of 4 items from a universe of 1,980 procurement transactions. The working paper documentation did not include a sampling plan to explain the basis for how the sample size selected would provide sufficient appropriate evidence to support audit conclusions. The DCAA auditors did not follow the AICPA Circular A-133 Audit Guide on minimum sample sizes or DCAA's policy when documenting and selecting the sample size for testing internal controls and compliance. As a result, the working papers did not include sufficient evidence to support DCAA's conclusions on the Institute's compliance with Federal procurement regulations.

Subrecipient Monitoring. The DCAA auditors did not perform and document adequate procedures to support their conclusions on the Institute's internal controls over and compliance with the subrecipient monitoring requirement. The objectives of this compliance requirement include determining whether the pass-through entity properly identified Federal award information and compliance requirements to the subrecipient, monitored subrecipient activities during the award period to provide reasonable assurance that the subrecipient administered Federal awards in compliance with requirements, and ensured that required subrecipient audits were performed and reviewed.

The working paper documentation indicates that the Institute uses a procurement checklist to monitor their subrecipients. However, based on our review of the checklist, we could not determine how it was used to satisfy the objectives of subrecipient monitoring. Specifically, the procurement checklist did not document the Institute's monitoring to ensure that the subrecipients used Federal awards for authorized purposes; complied with laws, regulations, and the provisions of contracts and grant agreements; and achieved performance goals. As a result, there is no evidence in the working papers to support the Institute was monitoring subrecipient activities during the award. The DCAA auditors documented a review of subrecipient audit files to determine whether the Institute maintained copies of the subrecipient audit reports or a copy of the subrecipient notification that no findings were reported. The DCAA auditors review noted that the subrecipient audit reports and notifications were not being maintained in the audit files. DCAA documented in the working papers that the Institute's management asserts that they are not notified of subrecipient audits results because they can monitor the outcomes through the Federal Audit Clearinghouse. As a result, DCAA concluded that the Institute was complying with the objectives of this requirement based on management's assertions. However, the DCAA working papers did not document evidence of audit procedures performed to verify the assertions made by management.

Auditing standards require the auditors to obtain sufficient appropriate audit evidence by performing audit procedures to support their conclusions. Inquiry of management alone ordinarily does not provide sufficient appropriate audit evidence and is not sufficient to test the operating effectiveness of controls. We asked the DCAA auditors what their basis was for concluding that the Institute was reviewing subrecipient audit reports and were informed that there was no explanation other than no findings were noted on the Institute's program. The

auditor's explanation is not considered sufficient to support conclusions that the Institute is reviewing subrecipient audit reports.

The working paper documentation notes the Institute is responsible for monitoring \$12 million dollars in subrecipient expenditures. Based on our analysis of the working papers and discussions with the auditors, we determined there is insufficient evidence to support the auditors' conclusions on the Institute's compliance with subrecipient monitoring requirements. As a result, there is no assurance that the \$12 million dollars in subrecipient expenditures were used for authorized purposes and in compliance with laws, regulations, and contract and grant agreements.

Special Tests and Provisions. The DCAA auditors did not obtain an adequate understanding of internal controls or perform audit procedures to test internal controls and compliance with this requirement. The specific requirements for special tests and provisions are unique to each Federal program and are in the laws, regulations, and the provisions of contract or grant agreements pertaining to the program. The DCAA auditors documented their review of the Institute's federally funded research and development center sponsoring agreements and contracts. However, due to a lack of understanding of the special tests and provisions requirement, DCAA identified multiple standard contract clauses that they planned to test in other compliance requirements, but failed to properly identify and review any special tests and provisions.

We determined that the sponsoring agreements included a special provision requiring the Institute to obtain prior written approval from the sponsoring agency before Institute personnel can work on contracts from agencies other than sponsoring agency (Federal Acquisition Regulation 35.017, "Federally Funded Research and Development Center"). We also identified other special tests and provisions in the Institute's contracts such as key personnel requirements and prior approval of consultant costs. As a result, we concluded that the procedures performed by the DCAA auditors were not sufficient to identify the existence of special tests and provisions.

Equipment and Real Property. DCAA did not perform adequate audit procedures to determine the Institute's compliance with the equipment and real property compliance requirement. The objectives of this requirement include verifying that the organization maintains proper records, adequately safeguards and maintains equipment, and disposes of equipment in accordance with Federal requirements.

The DCAA audit program and the AICPA Circular A-133 Audit Guide direct the auditor to select a sample from the property records of all equipment identified as acquired under Federal awards and physically inspect the equipment, including whether the equipment is appropriately safeguarded and maintained. However, the DCAA auditors limited their sample population and testing to only equipment items purchased on one contract during FY 2010.

To assess the significance of total equipment costs, we requested a listing of equipment purchased with Federal funds. Based on the listing provided, the Institute is responsible for safeguarding and maintaining equipment valued at \$42 million. The DCAA auditors selected

their sample from a population valued only at \$422,982, which represents approximately one percent of the total Federal equipment. As a result, we determined that the auditor's testing was not sufficient to support their conclusions on the Institute's compliance with this requirement.

In addition, the DCAA auditors' working papers indicated that the Institute did not dispose of any Federal equipment in fiscal year 2010; therefore, no audit procedures were performed. Based on our independent inquiry with the Institute, we also found that the Institute was authorized to make equipment dispositions in FY 2010. Therefore, the auditors should have determined the materiality of equipment dispositions, and planned and performed further audit procedures as needed to verify that dispositions were properly classified and reflected in the property records.

Based on our review, we concluded that the DCAA audit procedures did not provide sufficient evidence to support the conclusions on the Institute's compliance with equipment requirements for the use, management, and disposition of equipment acquired under Federal awards. Due to the significance of the equipment costs, DCAA should perform additional procedures to assess the Institute's compliance with the equipment compliance requirement.

Level of Effort and Reporting Compliance Requirements. DCAA obtained an understanding of the Institute's internal controls over compliance for the level of effort and reporting requirements. However, there was no documentation to support that the auditor performed any procedures for the review and testing of internal controls. The working papers did not provide an audit trail between the description of internal controls, the controls to be tested, and the evidence of the internal control testing performed. Because the auditor did not perform an adequate review of internal controls over compliance, the auditor had no basis for establishing the nature, timing, and extent of compliance testing needed to obtain sufficient evidence to support the audit conclusions on compliance. In addition, the auditors did not adequately document the compliance testing that was performed. The supervisory auditor had to provide additional explanations and clarification on the work performed to determine the Institute's compliance with these requirements.

Fraud Risk Assessment Procedures. DCAA did not perform sufficient fraud risk assessment procedures during the planning and performance of the audit. The DCAA Circular A-133 audit program procedures required the auditor to evaluate only the fraud risk indicators identified in the DoD IG, "Handbook on Fraud Indicators for Contract Auditors." The working papers documented that the evaluation of fraud indicators was limited to a review of "Handbook on Fraud Indicators for Contract Auditors." Based on this review, DCAA concluded that there were no identified fraud risks.

Circular A-133 requires that the single audits be performed in accordance with government auditing standards applicable to financial statements, which incorporate the AICPA auditing standards. The AICPA auditing standard, AU §316, "Consideration of Fraud in a Financial Statement Audit," requires the auditor to plan and perform the audit to obtain reasonable assurance that material misstatements and noncompliance, whether caused by error or fraud, are detected. Specifically, as a means of obtaining information needed to identify fraud risk areas,

the standards require, among other procedures, inquiries of management during the planning process to determine if they have knowledge of any fraud or suspected fraud affecting the entity.

The need to update the Contract Audit Manual terminology on communicating matters related to internal control was previously reported in DODIG Report No. D-2011-6-004, “Report on Quality Control Review of the PricewaterhouseCoopers LLP and the Defense Contract Audit Agency FY 2008 Single Audit of the Charles Stark Draper Laboratory, Incorporated,” February 28, 2011, and DODIG Report No. D-2011-6-002, “Report on Quality Control Review of the Deloitte & Touche and the Defense Contract Audit Agency FY 2008 Single Audit of the Aerospace Corporation,” October 29, 2010.

DCAA management concurred with our findings and recommendations and has taken corrective actions. DCAA has revised its’ Circular A-133 standard audit program to include the procedures required by AU §316. DCAA also revised CAM Chapter 13, “Audits at Educational Institutions, Nonprofit Organizations, and Federally Funded Research and Development Centers (FFRDCs),” to include guidance on performing fraud risk assessment procedures and reporting in the Circular A-133.

Conclusion. The DCAA auditors’ work does not meet the requirements of the auditing standards and Circular A-133 audit requirements. As a result, Federal agencies and pass-through entities cannot rely on the audit for assurance that the Institute managed Federal awards in compliance with laws, regulations, and award provisions. Additional audit procedures must be performed before the audit report can be used by Federal agencies and pass-through entities to monitor and manage awards to the Institute. In addition, the deficiencies disclosed by our review and prior quality control reviews, noted in Appendix A, indicate DCAA management needs to implement more effective quality control procedures for the Circular A-133 audits and provide additional training in auditing standards and Circular A-133 requirements to auditors performing Circular A-133 audits.

Finding B. Circular A-133 Reporting Package

DCAA did not obtain and incorporate in their report the Institute’s comments on the findings as required by auditing standards and Circular A-133 requirements. In addition, the Institute did not include its corrective action plan in the reporting package submitted to the Federal Audit Clearinghouse (the Clearinghouse). Also, DCAA did not comply with DoD regulations when marking the report “For Official Use Only” (FOUO) and did not correctly prepare the data collection form.

Corrective Action Plan. The DCAA auditors did not obtain the views from the responsible officials’ at the Institute on the reported findings and any planned corrective actions. The audit report indicated that the Institute’s corrective action plan in response to the findings would not be incorporated because it was not practical due to the additional time required to complete the audit work. Based on discussions with DCAA and the Institute, the auditors did not provide the Institute the final reported findings until June 21, 2011. Consequently, the Institute did not have sufficient time to review the findings, develop and incorporate a comprehensive corrective action plan, and submit the Circular A-133 reporting package by the June 24, 2011, filing deadline.

Instead, the Institute submitted the reporting package without the corrective action plan required by Circular A-133 reporting requirements.

Circular A-133 and auditing standards require auditors to obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, and planned corrective actions. The auditors should include in the report an evaluation of the comments provided and an explanation for any disagreements. Obtaining the views of responsible officials helps the auditors develop a report that is fair, complete, and objective. In addition, it provides auditors the opportunity to address any disagreements with the auditee, which assists contracting officers in their follow-up actions on reported findings. Circular A-133 requires the auditee to prepare a corrective action plan to address each audit finding and to include it with the reporting package submitted to the Clearinghouse.

The Institute took corrective actions on the FY 2010 single audit and submitted a revised reporting package, including a corrective action plan, to the Clearinghouse on September 26, 2011. The Institute's actions were sufficient to address the deficiency. However, because the corrective action plan was submitted after the DCAA audit report was issued, DCAA has not addressed the Institute's comments on the findings, conclusions, and recommendations. As a result, DCAA should revise its report to address an evaluation of the Institute's comments, reasons for disagreements, or modifications to the report as required by auditing standards.

For Official Use Only. DCAA auditors prepared a Circular A-133 report that contained an FOUO marking and informed the Institute they had no objection to the Institute removing the marking. This procedure is not in compliance with DoD regulations and does not safeguard the report from alteration. Further, a report marked FOUO limits the Institute's ability to comply with Circular A-133 requirements that require auditees to make the single audit report available for public inspection.

The DCAA guidance requires that all audit reports not containing classified information be marked as FOUO. Further, the guidance states that auditors should provide an electronic version of Circular A-133 report and advise the auditee to remove the FOUO restrictions from the report prior to incorporation in the reporting package submitted to the Clearinghouse. The FOUO marking restricts release of the report to the public because the report may contain information that is exempt from mandatory disclosure under the Freedom of Information Act. DoD Manual 5200.01, "Information Security Program," January 1997, states that it is the responsibility of the document's originator to determine at the time a document is created whether the information may qualify for FOUO status and to ensure markings are applied as required. When FOUO status is not warranted, the marking shall be removed by lining-through or other appropriate means prior to the report being released outside of the Department of Defense. When withholding criteria are met, the records shall be marked FOUO and the recipient provided an explanation for the marking.

The DCAA guidance does not comply with DoD regulations because DCAA is identifying the report as FOUO but directing the auditee to remove the marking. At the time the report is created, DCAA must make a determination whether the FOUO marking applies and should not include the marking when it is not warranted. To protect the integrity of reports, DCAA should

not allow anyone other than an authorized DCAA official to change an audit report. Because DCAA is providing an electronic copy of the report, auditees can redact or change pertinent information in the report. DCAA must revise their current guidance regarding Circular A-133 audit reports to ensure report integrity and to comply with DoD regulations and Circular A-133 requirements.

Data Collection Form. The DCAA auditors did not correctly prepare the data collection form because they failed to mark all the Institute’s contracts as part of the major program. Circular A-133 states that the R&D cluster shall be considered one program. The Institute’s contracts are all included in the R&D cluster. Since the Institute has only one major program, all contracts should have been identified as part of the major program. Due to a lack of understanding of the R&D cluster, DCAA failed to accurately identify several contracts as part of the major program. As a result, the data collection form is not accurate and should be updated to properly reflect the major program.

Recommendations, Management Comments, and Our Response

1. We recommend that the Director, Defense Contract Audit Agency:

- a. Revise the Defense Contract Audit Agency Contract Audit Manual Chapter 13, “Audits at Educational Institutions, Nonprofit Organizations, and Federally Funded Research and Development Centers (FFRDCs),” to ensure the guidance conforms with DoD Regulation 5200.01 and Circular A-133 reporting requirements and protects the integrity of the audit report.**

DCAA Comments. The Director, Defense Contract Audit Agency, office concurred to the recommendation. DCAA agreed to protect the integrity of the audit report by no longer advising the auditee to remove the FOUO restrictions from the report. However, DCAA stated they would continue their policy to place the FOUO restrictive marking on all audit reports, including Circular A-133 audit reports to prevent unauthorized public disclosure of sensitive, confidential, or proprietary data. Management comments are included in their entirety at the end of this report.

Our Response. The DCAA comments were partially responsive to our recommendation. The DCAA planned action to continue placing the FOUO restrictive marking on Circular A-133 audit reports does not meet the intent of the Single Audit Act or its implementation in Circular A-133. The Single Audit Act and Circular A-133 require the audit report be made available for public review. Therefore, Circular A-133 audit reports differ from other audit reports prepared by DCAA for the contracting officer’s use in contract administration. In addition, Circular A-133 requires auditees that are subrecipients to submit the audit report to pass-through entities² when

² A pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

the report discloses audit findings relating to the Federal awards the pass-through entity provided. By issuing an audit report with an FOUO marking, DCAA is restricting the auditee's ability to comply with these requirements. As a result, DCAA should have a separate policy for Circular A-133 audit reports. We request that DCAA reconsider its position on including the FOUO restrictive marking on Circular A-133 audit reports.

- b. Develop or obtain a training program for auditors performing single audits, assess the technical abilities of auditors and supervisors assigned to perform single audits, and ensure that the appropriate level of supervision is commensurate with the technical assessment to ensure that the audits comply with Circular A-133 requirements.**

DCAA Comments. The Director, Defense Contract Audit Agency, office agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

Our Response. DCAA comments were responsive to our recommendation. No additional comments are needed.

2. We recommend that the Branch Manager, Chesapeake Bay Branch Office:

- a. Perform additional audit procedures in accordance with the requirements of Circular A-133 and government auditing standards to address the deficiencies in this report and determine the adequacy of the Institute for Defense Analyses' internal controls over and compliance with requirements.**
- b. Revise the reporting package to reflect, at a minimum, the date the revised audit work was completed, the evaluation of the Institute's corrective action plan, and the correction of the data collection form to reflect the identification of all contracts as part of the major program.**
- c. Provide the revised audit reporting package to the Institute for submission to the Federal Audit Clearinghouse.**

DCAA Comments. The Branch Manager, Chesapeake Bay Branch office agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

Our Response. DCAA comments were responsive to our recommendation. No additional comments are needed.

3. We recommend that the Treasurer, Institute for Defense Analyses:

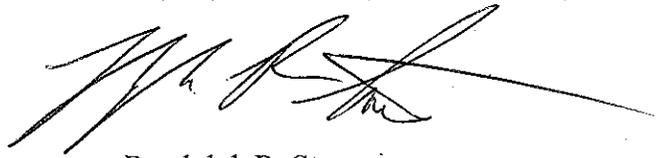
- a. Include the corrective action plan in all future reporting packages in accordance with Circular A-133 reporting requirements.**

- b. Submit the revised FY 2010 Circular A-133 reporting package and data collection form to the Federal Audit Clearinghouse and promptly notify the DoD Office of Inspector General when the submission actions are completed.**

The Institute Comments. The Treasurer, Institute for Defense Analyses agreed to take the recommended actions. Management comments are included in their entirety at the end of this report

Our Response. The Institute comments were responsive to our recommendation. No additional comments are needed.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Carolyn R. Davis at (703) 604-8877 (DSN 664-8877).

A handwritten signature in black ink, appearing to read 'Randolph R. Stone', with a long horizontal flourish extending to the right.

Randolph R. Stone
Deputy Inspector General
Policy and Oversight

Appendix A. Quality Control Review Process

Criteria, Scope, and Methodology

Public Law 98-502, “The Single Audit Act of 1984,” as amended, was enacted to improve the financial management of State and local governments and nonprofit organizations by establishing a uniform set of auditing and reporting requirements for all Federal award recipients required to obtain a single audit. Circular A-133 establishes policies that guide the implementation of the Single Audit Act and provides an administrative foundation for uniform audit requirements of non-Federal entities administering Federal awards. Entities that expend \$500,000 or more in a year are subject to the Single Audit Act and audit requirements in Circular A-133. Therefore, they must have an annual single or program-specific audit performed under government auditing standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency FY 2010 single audit of the Institute for Defense Analyses and the reporting package that was submitted to the Federal Audit Clearinghouse on September 16, 2011, using the 2010 edition of the “Guide for Quality Control Reviews of OMB Circular A-133 Audits.” The Guide applies to any single audit that is subject to the requirements of Circular A-133 and is the approved Council of Inspectors General on Integrity and Efficiency checklist for performing quality control reviews. The review was conducted in accordance with the Quality Standards for Inspection and Evaluation. We performed the review from September 2011 through October 2012. The review focused on the following qualitative aspects of the single audit:

- Qualification of Auditors,
- Independence,
- Due Professional Care,
- Planning and Supervision,
- Audit Follow-Up,
- Internal Control and Compliance testing,
- Schedule of Expenditures of Federal Awards, and
- Data Collection Form.

Prior Quality Control Reviews

Since October 1, 2007, we performed two quality control reviews of DCAA Circular A-133 single audit and two of PricewaterhouseCoopers Circular A-133 audits. All audits contained deficiencies resulting in findings and recommendations on audit planning/coordination, performance, reporting, and documentation. Unrestricted IG DoD reports can be accessed at <http://www.dodig.mil/audit/reports>.

DODIG Reports

DODIG Report No. D-2011-6-004, "Report on Quality Control Review of the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency FY 2008 Single Audit of the Charles Stark Draper Laboratory, Incorporated" February 28, 2011

DODIG Report No. D-2011-6-002, "Report on Quality Control Review of the Deloitte & Touche and the Defense Contract Audit Agency FY 2008 Single Audit of the Aerospace Corporation," October 29, 2010

DODIG Report No. D-2008-6-003, "Report on Quality Control Review of FY 2006 Single Audit of Logistics Management Institute," March 19, 2008

DODIG Report No. D-2008-6-002, "Quality Control Review of FY 2006 Single Audit of Syracuse Research Corporation," January 25, 2008

Appendix B. Compliance Requirements

OMB Circular A-133 Compliance Requirements	Applicable	Not Applicable
Activities Allowed/Unallowed	X	
Allowable Costs/Cost Principles	X	
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	

Institute for Defense Analyses Comments



C. Dean Graves, Jr., Treasurer and Director of Finance

November 2, 2012

Inspector General
Department of Defense
Attn: Ms. Felicia M. Fuller, M.S.A.
4800 Mark Center Drive, RM11C2703
Alexandria, VA 22350-1500

Subject: Quality Control Review of the PricewaterhouseCoopers, LLP and the Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses (Project No. D2011-DIPOAC-0266.000)

Dear Ms. Fuller,

In response to the subject report, this letter addresses the finding that applies to IDA as detailed in Finding B.

- 1) IDA will include the corrective action plan in all future reporting packages in accordance with Circular A-133 reporting requirements
- 2) Upon receipt of a revised audit report from DCAA, IDA will submit the revised FY 2010 Circular A-133 reporting package and data collection form to the Federal Audit Clearinghouse and promptly notify the DoD Office of Inspector General when the submission actions are completed.

Should you have any questions or require any additional information, please feel free to contact me directly.

Sincerely,

A handwritten signature in black ink, appearing to read 'C. Dean Graves', is written over a horizontal line.

C. Dean Graves

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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

PPD 225.4 (D2011-DIP0AC-0266.000)

January 22, 2013

MEMORANDUM FOR DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR
GENERAL, DEPUTY INSPECTOR GENERAL FOR AUDIT
POLICY AND OVERSIGHT

ATTENTION: Mr. Randolph R. Stone

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft
Report, *Quality Control Review of the PricewaterhouseCoopers, LLP and Defense
Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses*,
dated October 12, 2012, (Project No. D2011-DIP0AC-0266.000)

Thank you for the opportunity to respond to the subject draft report, *Quality Control
Review of the PricewaterhouseCoopers, LLP and Defense Contract Audit Agency FY 2010
Single Audit of the Institute for Defense Analyses*. The following are DCAA's comments and
responses to each of the recommendations impacting DCAA.

DoDIG Recommendation 1.a: We recommend that the Director, Defense Contract Audit
Agency, revise the Defense Contract Audit Agency Contract Audit Manual Chapter 13, "Audits
at Educational Institutions, Nonprofit Organizations, and Federally Funded Research and
Development Centers (FFRDCs)," to ensure the guidance conforms with DoD Regulation
5200.01 and Circular A-133 reporting requirements and protects the integrity of the audit report.

DCAA Response: Concur. By January 2013, we will update CAM Chapter 13-706.7 to require
field audit offices (FAOs) to issue all Circular A-133 audit reports, in Portable Document Format
(PDF), with digitally secured signatures to avoid alteration by others and to protect the integrity
of our audit reports in compliance with DoD regulations and consistent with the guidance issued
under MRD No. 11-OTS-039(R), dated August 12, 2011. In addition, DCAA current policy is to
continue placing FOUO restrictive markings on all audit reports, including Circular A-133 audit
reports, to help prevent unauthorized public disclosure of sensitive, confidential, or proprietary
data by a Government agency or activity in violation of the Freedom of Information Act (FOIA)
and 18 USC 1905. However, we will update CAM Chapter 13-706.7 to no longer provide the
auditee with an electronic version of the Circular A-133 report or advise the auditee to remove
the FOUO restrictions from the report prior to incorporation into the reporting package submitted
to the Clearinghouse.

DoDIG Recommendation 1.b: We recommend that the Director, Defense Contract Audit
Agency, develop or obtain a training program for auditors performing single audits assess the
technical abilities of auditors and supervisors assigned to perform single audits, and ensure that

PPD 225.4 (D2011-DIP0AC-0266.000)

January 22, 2013

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Quality Control Review of the PricewaterhouseCoopers, LLP and Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses*, dated October 12, 2012, (Project No. D2011-DIP0AC-0266.000)

the appropriate level of supervision is commensurate with the technical assessment to ensure that the audits comply with Circular A-133 requirements.

DCAA Response: Concur. By June 2013, we will perform a study of the technical abilities of auditors and supervisors assigned to perform single audits and determine if adjustments to our training program are necessary. The training program requires the audit team (e.g., auditor, technical specialist, supervisor, FAO manager) to maintain sufficient professional competence to perform these audits through continuing education requirements (reference MRD 08-PPD-031(R)). In addition, we conduct a technical training workshop every three years. The workshops provide auditors, supervisors, and technical specialists with specialized knowledge, skills, and abilities related to the audits of educational institutions and non-profit organizations. The next workshop is planned for April 2013. DCAA and the Office of Naval Research will develop the training under a joint initiative to improve the quality of audits performed in accordance with professional standards. In addition, the workshop will discuss relevant training resources sponsored by professional organizations such as the AICPA, state boards, societies of CPAs and commercial organizations. In addition, in late 2012, the DCAA Integrity and Quality Assurance Directorate provided training to all supervisors on the supervisory review process, which included the Agency's expectations and training related to supervisor involvement during the audit planning, fieldwork and reporting phases. Training considered the experience of the supervisory staff and complexity of the engagement. The DoDIG-APO monitored two of these training sessions.

DoDIG Recommendation 2.a: We recommend that the Branch Manager, Chesapeake Bay Branch Office, Defense Contract Audit Agency perform additional audit procedures in accordance with the requirements of Circular A-133 and government auditing standards to address the deficiencies in the report and determine adequacy of the Institute for Defense Analyses' internal controls over and compliance with requirements.

DCAA Response: Concur. By March 29, 2013, the Chesapeake Bay Branch Office will perform additional audit procedures to address the deficiencies cited in the DoDIG report.

DoDIG Recommendations 2.b: We recommend that the Branch Manager, Chesapeake Bay Branch Office, Defense Contract Audit Agency revise the reporting package to reflect, at a minimum, the date the revised audit work was completed, the evaluation of the Institute's corrective action plan, and the correction of the data collection form to reflect the identification of all contracts as part of the major program.

DCAA Response: Concur. By March 29, 2013, the Chesapeake Bay Branch Office will revise the reporting package to reflect, at a minimum, the date the revised audit work was completed, the evaluation of the Institute's corrective action plan, and the correction of the data collection form to reflect the identification of all contracts as part of the major program.

PPD 225.4 (D2011-DIP0AC-0266.000)

January 22, 2013

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, *Quality Control Review of the PricewaterhouseCoopers, LLP and Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses*, dated October 12, 2012, (Project No. D2011-DIP0AC-0266.000)

DoDIG Recommendations 2.c: We recommend that the Branch Manager, Chesapeake Bay Branch, Defense Contract Audit Agency provide the revised audit reporting package to the Institute for submission to the Federal Audit Clearinghouse.

DCAA Response: Concur. By March 29, 2013, the Chesapeake Bay Branch Office will provide the revised audit report to the Institute for submission to the Federal Clearing House.

Please direct any questions regarding this memorandum to Ms. Esther M. Fischer, Chief, Policy Programs Division at (703) 767-1004.

/s/

Donald J. McKenzie
Assistant Director
Policy and Plans



Inspector General Department of Defense

