



# INSPECTOR GENERAL

*Department of Defense*

AUGUST 29, 2013



## Quality Control Review of the PricewaterhouseCoopers, LLP FY 2011 Single Audit of SRI International

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August 29, 2013

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SRI International

Audit Partner  
PricewaterhouseCoopers, LLP

**SUBJECT: Quality Control Review of the PricewaterhouseCoopers, LLP FY 2011  
Single Audit of SRI International (Report No. DODIG-2013-125)**

We are providing this report for your information and use. As the cognizant Federal agency for SRI International, we performed a review of the PricewaterhouseCoopers, LLP single audit and supporting work papers for the fiscal year ended December 31, 2011. The purpose of our review was to determine whether the single audit was conducted in accordance with government auditing standards, the American Institute of Certified Public Accountants' auditing standards, and the auditing and reporting requirements of Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Appendix A contains additional criteria, scope, and methodology of the review; and Appendix B lists the compliance requirements that PricewaterhouseCoopers determined to be applicable to the FY 2011 audit.

The PricewaterhouseCoopers, LLP audit generally met auditing standards and OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," requirements. However, we identified deficiencies related to the review of the special tests and provisions requirement, work paper documentation, and the preparation of the data collection form that need to be addressed in future single audits. SRI International generally met OMB Circular A-133 requirements except the data collection form was not accurate and complete because it did not identify the name of the pass-through entity.

We considered management comments on the draft of this report. The management comments were responsive; therefore, additional comments are not required.

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 "R. Stone", with a long horizontal flourish extending to the right.

Randolph R. Stone  
Deputy Inspector General  
Policy and Oversight

# Contents

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## Introduction

Background	1
Review Results	1
Management Comments and DoDIG Response	1

## Finding A

Federal Program Audit Performance and Documentation	2
Special Tests and Provisions Requirement	2
Work Paper Documentation	3
Recommendations, Management Comments, and Our Response	3

## Finding B

Data Collection Form Preparation	5
Recommendations, Management Comments, and Our Response	5

## Appendixes

Appendix A. Quality Control Review Process	7
Appendix B. Compliance Requirements	9

## Management Comments

PricewaterhouseCoopers, LLP	10
SRI International	13

Acronyms and Abbreviations	14
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# Introduction

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## Background

SRI International (SRI) is an independent, nonprofit research institute headquartered in Menlo Park, California. SRI conducts client-sponsored research and development for government agencies, commercial businesses, foundations, and other organizations. SRI expended \$424.2 million in Federal awards for the fiscal year ended December 31, 2011, under one Federal program, the research and development cluster. Of the \$424.2 million, \$295.2 million was expended for Department of Defense programs.

## Review Results

The PricewaterhouseCoopers, LLP (PwC) audit generally met auditing standards<sup>1</sup> and Office of Management Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," requirements. However, we identified deficiencies related to the review of the special tests and provisions requirement, work paper documentation, and the preparation of the data collection form (Findings A and B). These deficiencies need to be addressed for future single audits. SRI generally met OMB Circular A-133 requirements except the data collection form was not accurate and complete because it did not identify the name of the pass-through entity (Finding B).

## Management Comments and DoDIG Response

PwC and SRI agreed to take the recommended actions. Management comments were responsive and no additional comments are needed. Management comments are included in their entirety at the end of the report.

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<sup>1</sup> Auditing standards include both government auditing standards and the American Institute of Certified Public Accountants' auditing standards.

## Finding A

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### Federal Program Audit Performance and Documentation

PwC did not document adequate audit procedures to support its conclusions on SRI's internal control and compliance with special tests and provisions. In addition, the documentation of the Federal program audit did not always provide a clear description of audit procedures performed and evidence obtained to support the conclusions on allowable costs/cost principles and the non-applicable compliance requirements.

Auditing standards 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 support the significant judgments and conclusions. In addition, audit documentation should be appropriately organized to provide a clear link to the findings, conclusions, and recommendations.

### ***Special Tests and Provisions Requirement***

PwC adequately obtained an understanding of internal controls to ensure compliance with special tests and provisions and properly identified key personnel as a special provision that would need to be tested. However, PwC did not adequately document the audit procedures performed to test internal control over and compliance with key personnel requirements. As a result, the auditors were required to provide additional verbal explanations and documentation to support their audit conclusions.

The work paper documentation did not provide a clear audit trail to the internal control testing performed. In addition, the work papers included some evidence of internal control and compliance testing, but the documentation did not provide sufficient detail for a reviewer to evaluate the adequacy of the audit procedures performed and the sufficiency of the audit evidence for the testing of key personnel. In response to our inquiries, additional documentation and explanations were provided to support conclusions on the key personnel requirements. The auditors explained that they performed internal control testing by verifying that the SRI project briefs accurately reflected Federal award information, including key personnel requirements. Our review of the work paper showed that although the auditors documented verification of some

information on the SRI project briefs to the Federal award, the auditors did not document key personnel requirements. Through our own analysis, we were able to verify that SRI project briefs properly included key personnel information. For compliance testing, the work paper documentation referenced the testing of compensation costs performed under the allowable cost principles compliance requirement; however, the referenced work paper did not identify the contracts with key personnel requirements, the key personnel being tested, or the specific audit procedures performed related to the objectives of the key personnel requirement. Based on our own review, we were able to identify that the auditors tested some key personnel for compliance with the requirement.

As a result of our additional analysis and discussions with the auditors, we were able to conclude that the auditors' failure to document adequate audit procedures did not negatively impact the overall audit and that additional audit procedures do not need to be performed for the current year audit to support the auditors' conclusions on the special tests and provisions requirement. Nevertheless, for future audits, PwC must identify in the work papers the contracts being tested that contain key personnel requirements and must document the specific audit procedures performed for the internal control and compliance testing related to the objectives of the key personnel requirement.

### ***Work Paper Documentation***

The PwC auditors correctly identified the cost principles used for the allowable cost/cost principles compliance testing, but the auditors did not identify the specific section and subsection of the cost principles under which the allowability of each item of cost was evaluated. In addition, while PwC identified the Davis Bacon and Real Property and Relocation Assistance compliance requirements as not applicable to SRI's major program, the auditors did not adequately document the audit procedures performed to support their conclusions. As a result, we had to obtain additional documentation and verbal explanations in order to conclude that there was sufficient evidence to support their conclusions.

## **Recommendations, Management Comments, and Our Response**

### ***Recommendation A1***

We recommend that, in future single audits, the Audit Partner, PwC:

- Identify in the work papers the contracts being tested that contain key personnel requirements and document the specific audit procedures

performed for the internal control and compliance testing related to the objectives of the key personnel requirement.

- Document the specific sections and subsections of the cost principles that were used to determine the allowability of each item of cost tested during the allowable cost/cost principles testing.
- Document audit procedures performed to support conclusions on the compliance requirements determined to be not applicable.

### *PwC Comments*

The Audit Partner, PwC, agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

### *Our Response*

PwC comments were responsive to our recommendation. No additional comments are needed.

## **Recommendation A2**

We recommend that the Audit Partner, PwC, provide the Department of Defense Office of Inspector General with the work paper documentation from the FY 2012 single audit that demonstrates corrective action taken to address the deficiencies related to the special tests and provisions, allowable cost/cost principles, and the non-applicable compliance requirements.

### *PwC Comments*

The Audit Partner, PwC, agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

### *Our Response*

PwC comments were responsive to our recommendation. No additional comments are needed.

## Finding B

### Data Collection Form Preparation

PwC auditors did not correctly prepare the data collection form because they failed to include the name of the pass-through entity for the Federal awards that SRI received as a subrecipient. In addition, the SRI certifying official signed the data collection form, stating that the information included in the form was accurate and complete, even though the name of the pass-through entity was not included. An accurate data collection form is necessary to allow pass-through entities to use the form in their monitoring of awards provided to subrecipients.

OMB Circular A-133 §\_\_.320(b)(2)(x) requires that individual programs within a cluster of programs be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards. OMB Circular A-133 §\_\_.310(b)(2) requires that for awards received as a subrecipient, the schedule of expenditures of Federal awards include the name of the pass-through entity and the identifying number assigned by the pass-through entity. OMB Circular A-133 and the data collection form instructions require the auditors to complete and sign specific sections of the data collection form and a senior-level representative of the auditee to sign a statement on the form certifying that the form is accurate and complete. As a result, for future audits, PwC should include the name of the pass-through entity in the data collection form and the SRI certifying official should verify that the information included in the data collection form is accurate and complete.

### Recommendations, Management Comments, and Our Response

#### **Recommendation B1**

We recommend that the Audit Partner, PwC, prepare the data collection form according to the OMB Circular A-133 requirements for future single audits. Specifically, the data collection form should include the name of the pass-through entity for awards that SRI receives as a subrecipient.

#### *PwC Comments*

The Audit Partner, PwC, agreed to take the recommended actions. Management comments are included in their entirety at the end of this report.

*Our Response*

PwC comments were responsive to our recommendation. No additional comments are needed.

**Recommendation B2**

We recommend that the Executive Director of Financial Operations, SRI, verify that the information contained in the data collection form is accurate and complete before certifying the form in accordance with OMB Circular A-133 requirements.

*SRI Comments*

The Executive Director of Financial Operations, SRI, agreed to take the recommended actions. Management comments are included in their entirety at the end of this report

*Our Response*

SRI comments were responsive to our recommendation. No additional comments are needed.

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## Appendix A

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### 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. OMB 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 OMB Circular A-133. Therefore, they must have an annual single or program-specific audit performed in accordance with government auditing standards and submit a complete reporting package to the Federal Audit Clearinghouse.

We reviewed the PwC’s FY 2011 single audit of SRI submitted to the Federal Audit Clearinghouse on July 9, 2012, using the 2010 edition of the “Guide for Quality Control Reviews of OMB Circular A-133 Audits.” The Guide is the approved Council of Inspectors General on Integrity and Efficiency checklist for performing quality control reviews of single audits. We performed the review from October 2012 through May 2013 in accordance with the Council of Inspectors General on Integrity and Efficiency Quality Standards for Inspection and Evaluation. 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, 2008, we performed two quality control reviews of PwC OMB Circular A-133 audits. One review contained deficiencies resulting in findings and recommendations on PwC's audit performance and work paper documentation. Unrestricted IG DoD reports can be accessed at <http://www.dodig.mil/audit/reports>.

### ***DODIG Reports***

DODIG Report No. DODIG-2013-048, "Quality Control Review of the PwC and the Defense Contract Audit Agency FY 2010 Single Audit of the Institute for Defense Analyses," February 20, 2013

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

## Appendix B\*

### Compliance Requirements

OMB Circular A-133 Compliance Requirements	Applicable	Not Applicable/ Not Material
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	

\* This chart reflects PwC's determination of the compliance requirements that are applicable and material to the major program.

# Management Comments

## PricewaterhouseCoopers, LLP



July 31, 2013

Randolph R. Stone  
Deputy Inspector General  
Policy & Oversight  
Department of Defense  
4800 Mark Center Drive  
Alexandria, Virginia 22350-1500

Dear Mr. Stone:

Thank you for providing a draft of the proposed report, Quality Control Review of the PricewaterhouseCoopers LLP FY 2011 Single Audit of SRI International (the "Draft Report"). We have reviewed the draft report and draft recommendations based on the quality audit review performed by Felicia Fuller from October 2012 through June 2013. We appreciate the opportunity to provide additional information and clarification on the potential findings noted therein.

### **Review Results**

The Draft Report indicated that the PricewaterhouseCoopers audit generally met auditing standards (which includes both Government Auditing Standards and the American Institute of Certified Public Accountants' auditing standards) and that except for certain matters of documentation noted below, the audit documentation contained sufficient information to enable an auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditor's judgments and conclusions. The draft report indicates that the documentation matters noted below did not negatively impact the overall audit and that additional audit procedures do not need to be performed to support our conclusion on the special tests and provisions requirement. The quality deficiencies noted are to be corrected in future audits. The deficiencies identified related to the review of special tests and provisions requirement, work paper documentation and the preparation of the data collection form.

### Finding A – Special Tests and Provisions Requirement

The Draft Report states that PwC adequately obtained an understanding of internal controls to ensure compliance with special tests and provisions and properly identified key personnel as a special provision that would need to be tested. And, while it was determined that PwC did sufficiently test special tests and provisions, it was not clear to the reviewer that key personnel requirements were properly addressed. Generally accepted auditing standards require 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 support the significant judgments and conclusions. The work paper documentation did not provide a clear audit trail to the internal control testing performed. In addition, the work papers included some evidence of internal control and compliance testing, but the documentation did not provide sufficient detail for a reviewer to evaluate the adequacy of the audit procedures performed and the sufficiency of the audit evidence for the testing of key personnel. For instance the specific names of key personnel tested were not listed on the working papers.

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## PricewaterhouseCoopers, LLP (cont'd)



The auditors explained that they performed internal control testing by verifying that the SRI project briefs accurately reflected Federal award information, including key personnel requirements. Our review of the working paper showed that although the auditors documented verification of some information on the SRI project briefs to the Federal award, the auditors did not document specifically key personnel requirements. Through their own analysis, the Department of Defense reviewer was able to verify that SRI project briefs properly included key personnel information. Further, the Draft Report correctly identified the cost principles used for the allowable cost principles compliance testing, the auditors, however, did not list the specific section and subsection reference used to evaluate allowability of each type of cost. Finally the auditors did not explain adequately their basis for correctly determining that the compliance requirements -- Davis Bacon Act, Real Property and Relocation Assistance -- were not applicable.

### *Inspector General Department of Defense Recommendation:*

We recommend that in future single audits the Audit Partner, PricewaterhouseCoopers, LLP:

- Identify in the work papers the contracts being tested that contain key personnel requirements and document the specific audit procedures performed for the internal control and compliance testing related to the objectives of the key personnel requirement.
- Document the specific sections and subsections of the cost principles that were used to determine the allowability of each item of cost tested during the allowable cost/cost principles testing.
- Document audit procedures performed to support conclusions on the compliance requirements determined to be not applicable.
- The Audit Partner, PricewaterhouseCoopers, LLP provide the Department of Defense Office of Inspector General with the work paper documentation from the FY 2012 single audit that demonstrates corrective action taken to address the deficiencies related to the special tests and provisions, allowable cost/cost principles, and the non-applicable compliance requirements.

### *PwC Response*

Included in our documentation of our audit procedures performed for the FY 2011 SRI International Single Audit, we (1) selected a sample of 25 projects to ensure that the project briefs set up in Cost Point properly included the information in the contract; (2) tested 60 employees to, among other objectives, read the grants/contracts for special or specific personnel provisions and requirements, and verified that all requirements were met; (3) tested 60 cost transfers; and (4) additionally believe we obtained audit comfort over the special tests and provisions requirement through our testing of Separate Accountability for ARRA Funding, indirect cost testing and subrecipient monitoring procedures. We believe, as you have noted, that these tests adequately document the compliance audit requirements for direct cost testing and special tests and provisions. However, we understand the recommendation made above and will enhance our documentation over special tests and provisions, specifically as it relates to key personnel. We will also document more comprehensively why and how we concluded that any particular compliance requirement is not applicable. For instance, based upon our reading of the award agreement and objectives; and through discussion with management, we have concluded that the compliance requirements Davis Bacon Act, Real Property and Relocation Assistance are not applicable to SRI.

## PricewaterhouseCoopers, LLP (cont'd)



Additionally, while we do not believe it is specifically required to document the specific section and subsections of the applicable cost principles we referred to beyond stating referral to the FAR, we will ensure that we add that specific documentation to our audit documentation going forward.

We plan to share with Felicia Fuller the documentation included in our fiscal 2012 A-133 audit work of our implementation of the recommendations above prior to our release of the FY 2012 Single Audit for SRI International.

### Finding B – Data Collection Form Preparation

PwC auditors did not correctly prepare the data collection form because they failed to include the name of the pass-through entity for the Federal awards that SRI received as a subrecipient.

### *Inspector General Department of Defense Recommendation:*

We recommend that the Audit Partner, PricewaterhouseCoopers, LLP prepare the data collection form according to the OMB Circular A-133 requirements for future single audits. Specifically, the data collection form should include the name of the pass-through entity for awards that SRI receives as a subrecipient.

### *PwC Response*

We have discussed this with management of SRI International and will coordinate with them to ensure that the information included in the data collection form is consistent with the Department of Defense Office of Inspector General interpretation of the requirements of OMB Circular A-133 for the FY 2012 filing.

We would also like to respectfully suggest that the Department of Defence Inspector General consider issuance of a communication to the auditor community, as well as recipients of Department of Defense awards that explains their view that with respect to pass through awards, the data collection form must include in part three the names of the pass through entities and the pass through award number assigned by the pass through entities.

Overall, while we believe that the audit documentation related to the FY 2011 Single Audit for SRI International was sufficient to support our judgements and testing of compliance requirements, we do recognize the importance of clear documentation and will ensure that internal control and compliance testing documentation in future years audits will enable an experienced auditor, with no previous connections to the audit to understand the audit procedures performed.

Thank you for your consideration of our responses included above. We appreciate the professionalism of Felicia Fuller throughout this process and would be pleased to discuss our letter with you at your convenience.

Very truly yours,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

By: Michael A. MacBryde  
Engagement Partner

## SRI International



July 9, 2013

Mr. Randolph R. Stone  
Deputy Inspector General  
Policy and Oversight  
Inspector General  
Department of Defense  
4800 Mark Center Drive  
Alexandria, Virginia 22350-1500

Subject: Quality Control Review of the PricewaterhouseCoopers, LLP FY 2011 Single Audit of SRI International (Project No. D2013-DAPOSA-0033)

Dear Mr. Stone:

SRI acknowledges the importance of an accurate data collection form and the necessity for the name of the pass-through entity to be included on the form. We have revised our procedures to ensure that the data collection form is reviewed prior to submission and certification. Please note that this information has been included on our data collection form for fiscal year 2012.

If you have any questions, please feel free to call me at (650) 859-4419.

Sincerely,

A handwritten signature in black ink, appearing to read "Luther Lau". The signature is fluid and cursive, written over a light blue horizontal line.

Luther Lau  
Executive Director Financial Operations,

**SRI International**

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## Acronyms and Abbreviations

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**AICPA** American Institute of Certified Public Accountants

**OMB** Office of Management and Budget

**PwC** PricewaterhouseCoopers, LLP

**SRI** SRI International

# **Whistleblower Protection**

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