Policy and Oversight

Financial and Performance Audit Directorate

Quality Control Review

Coopers and Lybrand, L.L.P.
The MITRE Corporation
Fiscal Year Ended September 30, 1994

Report Number PO 97-043 September 15, 1997

Office of the Inspector General
Department of Defense

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Acronyms

DCAA	Defense Contract Audit Agency
DLA	Defense Logistics Agency
OMB	Office of Management and Budget

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DEPARTMENT OF DEFENSE
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September 15, 1997

Chairman, Non-Profit Industry Group
Coopers & Lybrand L.L.P.
1301 Avenue of the Americas
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SUBJECT: Quality Control Review of Coopers & Lybrand L.L.P.
The MITRE Corporation
Fiscal Year Ended September 30, 1994
Report No. PO97-043

Introduction

We are providing this report for your information. Your Boston, Massachusetts, and McLean, Virginia, offices, in coordination with the Defense Contract Audit Agency (DCAA), performed the single audit for The MITRE Corporation (MITRE), McLean, Virginia. MITRE is a nonstock, nonprofit corporation that performs research, development, engineering, and advisory services of a scientific nature. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." MITRE reported total Federal expenditures of $581,393,080 for the fiscal year ended September 30, 1994, representing $451, 795,873 for the Department of Defense and $129,597,207 for other Federal agencies.

The Coopers & Lybrand L.L.P. audit report is dated December 20, 1994. The auditors questioned no costs and issued an unqualified opinion on the financial statements and the Schedule of Federal Awards. The auditors issued positive and negative assurance statements on compliance with the general requirements of civil rights, Drug-Free Workplace Act, Davis-Bacon Act, cash management, and the administrative requirements, except procurement. Positive assurance states that, with respect to the items tested, the results of the auditors' procedures disclosed no material instances of noncompliance. Negative

assurance states that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that MITRE has not complied in all material respects.

The auditors also obtained an understanding of the internal controls related to the financial statements and Federal awards. The audit reports describe the auditors' scope of work in obtaining that understanding and in assessing control risk. The report on internal controls for Federal awards further describes the significant internal controls or control structure, including the controls established that provide reasonable assurance that Federal awards are being managed in compliance with applicable laws and regulations.

The DCAA audit report on direct costs and indirect expenses, dated September 29, 1995, questioned costs of $468,497, the majority of which relates to nonallocable educational costs; educational reimbursements that exceed Federal Acquisition Regulation limitations; and payments to universities and consortiums considered to be contributions, grants, or fellowships. MITRE agreed to all of the questioned costs, except for $10,000 related to the corporate affiliate program.

Quality Control Review Results

As the Federal cognizant agency for MITRE, we reviewed the audit report for the fiscal year ended September 30, 1994, required by OMB Circular A-133. Several nonprofit organizations, exempt from OMB Circular A-122, "Cost Principles for Nonprofit Organizations," mistakenly believed that they were also exempt from the reporting requirements of OMB Circular A-133. Because we were not aware of this problem until financial audits had been completed, we granted those organizations, including MITRE, a waiver from the specific reporting requirements of OMB Circular A-133 for the initial reporting period. We agreed in a November 8, 1993, letter to each organization, to accept copies of the most current fiscal year financial statements and the DCAA incurred cost audit reports instead of a complete OMB Circular A-133 audit for the initial reporting year. The DCAA report does not state whether the report satisfies the allowable costs/cost principles general requirement or the types of services allowed or unallowed specific requirement, or both. The report also does not express positive or negative assurance or give an opinion on compliance. However, the November 8, 1993, letter also stated that MITRE is expected to fully comply with the OMB Circular A-133 reporting requirements in subsequent years. The fiscal year 1994 financial statements and related DCAA audit report meet the agreed-to reporting requirements for fiscal year 1994 as

stated in our November 8, 1993 letter. For fiscal year 1995, we found that the requirements of OMB Circular A-133 were met by MITRE and the audit organizations.

The working papers supporting the fiscal year 1994 audit met the Government Auditing Standards, generally accepted auditing standards, and the provisions of the Federal award agreements. We suggest that the following information be included in future engagement letters to provide a written understanding that the audit will be conducted in accordance with the provisions of the Circular.

Engagement Letter. The Coopers & Lybrand L.L.P. engagement letter should state that the audit will be conducted in accordance with OMB Circular A-133 and Government Auditing Standards, issued by the Comptroller General of the United States.

Quality Control Review Objective

The objective of a quality control review is to assure that the audit was conducted in accordance with applicable standards and meets the auditing requirements of OMB Circular A-133. As the cognizant agency for MITRE, we conducted a quality control review of the audit working papers. Our review focused on the qualitative aspects of the audit: due professional care, planning, supervision, independence, quality control, internal controls, substantive testing, general compliance testing, and the Schedule of Federal Awards.

We reviewed the most recent peer review report, dated September 23, 1994, and performed by Ernst and Young LLP which found that Coopers & Lybrand L.L.P. met the objectives of the quality control review standards established by the American Institution of Certified Public Accountants and that the standards were being complied with during the fiscal year ended March 31, 1994. Ernst and Young L.L.P. commented on the need to update management representation letters, to tailor the letters to the engagement circumstances, and to comply with Coopers & Lybrand L.L.P. policies regarding the review of unaudited financial information. We continuously monitor the quality of the DCAA audit work.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) issued by the President's Council on Integrity and Efficiency as guidance for performing the quality control review procedures. The Guide is organized by the general and field work audit standards and the required

elements of a single audit. The Guide is further divided into the substantive work performed during the audit of the financial statements and the specific program compliance testing for major programs. We conducted our review on October 9 and 10, 1996.

We limited the scope of our quality control review to the Coopers & Lybrand L.L.P. working papers that covered areas related to the Department of Defense expenditures: the financial statements and the research and development program. We did not review the working papers supporting the work performed by the DCAA as part of the single audit of MITRE; however, we review DCAA audit reports and operations on an ongoing basis. The research and development program expenditures totaled about $581.3 million and accounted for 100 percent of total Federal award expenditures.

Results of Prior Quality Control Reviews

We identified minor quality control review findings and made recommendations at 3 of the 10 Coopers & Lybrand L.L.P. locations we visited from January 1, 1995, through December 31, 1996. The affected offices were notified, and no further action is necessary.

Background

The Inspector General Act of 1978, Public Law 95-452, prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspector General is required to "take appropriate steps to assure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General."

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments whose total annual expenditures are $100,000 or more with respect to Federal financial assistance programs; to establish uniform requirements for audits of Federal financial assistance; to promote efficient and effective use of audit resources; and to ensure that Federal departments and agencies rely on and use the audit work done under the Act, to the maximum extent practicable.

The Single Audit Act Amendments of 1996, based on 12 years of experience under the 1984 Act, are intended to strengthen the usefulness of single audits by increasing the audit threshold from $100,000 to $300,000. Federal financial assistance programs will be selected for audit based on risk assessment rather

than the amount of funds expended by the Federal award recipient. This process improves the content and timeliness of single audits. The Amendments also bring nonprofit organizations, previously covered by similar requirements under the OMB Circular A-133, under the Single Audit Act.

OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal awards are or exceed $100,000. The Circular provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. An agency must rely on the audit to the extent that it provides the information and assurances that an agency needs to carry out its overall responsibilities. The coordinated audit approach provides for the independent public accountant, Federal auditor, and other non-Federal auditors to consider each other's work in determining the nature, timing, and extent of their respective audit procedures. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. The revised Circular was issued June 24, 1997, to incorporate the changes in the Single Audit Act Amendments of 1996. Its provisions apply to audits of fiscal years beginning after June 30, 1996.

Discussion of Results

During our quality control review, we reviewed and took no exception to the working papers supporting the following fiscal year 1994 reports and schedules.

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

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

Schedule of Federal Awards. The recipient is responsible for creating the Schedule. The auditor is required to audit the information in the Schedule and to ensure that it identifies major programs as defined by OMB Circular A-133

and total expenditures for each program. We reviewed the audit program for the appropriate procedures, reviewed a selected number of footings/cross-footings, and traced some of the amounts to the Subsidiary Ledger and/or Trial Balance.

Independent Auditor's Report on the Internal Control Structure Based on an Audit of the Financial Statement Performed in Accordance With Government Auditing Standards. The auditor is required to obtain an understanding of the internal control structure that is sufficient to plan the audit and to assess control risk for the assertions in the financial statements. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the substantive testing performed.

Independent Auditor's Report on Internal Control Structure Used in Administering Federal Awards. The auditor is required to obtain an understanding of the internal control structure and assess control risk to determine whether the auditor intends to place reliance on the internal control structure. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance. The auditor must also review the system for monitoring subrecipients and for obtaining and acting on subrecipient audit reports. Finally, the auditor must determine whether internal controls are effective to ensure that direct and indirect costs are calculated and billed in accordance with the requirements in the compliance supplement. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the test of controls performed.

Independent Auditor's Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of the Financial Statements Performed in Accordance With Government Auditing Standards. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on the determination of financial statement amounts. We reviewed the audit program for the appropriate procedures, the working paper documentation, its support, and the compliance tests performed.

Independent Auditor's Report on Compliance With Certain General Requirements. The auditor is required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect on any of its major Federal programs. General requirements are those that could have a material effect on the recipient's financial statements including those prepared for Federal programs. The auditor's procedures were limited to those prescribed in the OMB Compliance Supplement for "Audits of Institutions of Higher Learning and Other Non-Profit Institutions." We reviewed the audit program for the appropriate procedures, compared the audit program steps to

those in the Compliance Supplement to make sure that all areas were audited, reviewed the working paper documentation and its support, and reviewed the compliance tests performed.

Independent Auditor's Schedule of Findings and Management's Responses. The auditor is required to report material findings of noncompliance in the audit report in their proper perspective: the size of the universe in number of items and dollars, the number and dollar amount of transactions tested by the auditors, and the number and corresponding dollar amount of instances of noncompliance. We traced the subrecipient monitoring and property and equipment findings in the working papers to the audit report to make sure that the report included all current year findings identified in the working papers and that the findings were properly supported. We also traced the prior year's findings in the working papers to the audit report (Enclosure 1).

Management Letter Comments and Recommendations. The auditor uses the management letter to inform top-level management about other concerns raised during the audit that do not affect the report opinions. The concerns are usually aimed at improving operational processes but have also been expanded to include immaterial findings based on an audit in accordance with OMB Circular A-133. Coopers & Lybrand L.L.P. issued a management letter, dated January 16, 1995, to MITRE's Trustee Audit Committee addressing recommendations to improve the organization, billings, reconciliations, special cash accounts, and OMB Circular A-133 requirements. We traced the recommendations in the working papers to the management letter to make sure that the management letter includes all recommendations identified in the working papers. The recommendations are presented in Enclosures 1 through 3.

Comments

Since this report contains no findings or recommendations, written comments not are required. We appreciate the courtesies extended during the review. If you have questions on this report, please contact Ms. Barbara Smolenyak, Program Director, at (703) 604-8761 or Ms. Vera Garrant at (703) 604-8743. See Enclosure 2 for the report distribution.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Enclosures

The MITRE Corporation
Fiscal Year Ended September 30, 1994

Schedule of Report Findings, Questioned Costs, and Management Letter Recommendations

Page No.		Questioned Costs	Agency
Findings-DCAA Audit Report No. 2184-95A10150001 (Direct Costs & Indirect Expenses)			
5	Education Initiative	$181,235	
	Corporate Affiliate Program	95,000	
	Advance Degree Program	162,547	
	Purchase of Company Car	7,350	
	Alcohol	506	
	Children's Christmas Party	976	
	Per Diem Overages	7,938	
	First Class Airfare	11,756	
	Other	1,189	
	Total Questioned	**$468,497**	DoD-Air Force
Coopers & Lybrand L.L.P. Findings			
IV-1	Subrecipient Monitoring[1]		DoD-DLA
IV-2	Property and Equipment[1]		DoD-DLA
Coopers & Lybrand L.L.P. Management Letter Recommendations			
1	Financial Organization		[2]
1	Unbilled Costs and Fees		DoD-DLA
2	Reconciliation of Fixed Asset Subledger to the General Ledger		DoD-DLA
2	Special Project Cash Accounts		DoD-DLA
3	Circular A-133 Audit Requirements		DoD-DLA

[1]Repeat finding from the prior year.
[2]Recommendation will be addressed by MITRE management.

Enclosure 1

The MITRE Corporation
Fiscal Year Ended September 30, 1994

Distribution List

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The MITRE Corporation
Fiscal Year Ended September 30, 1994

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The MITRE Corporation
Fiscal Year Ended September 30, 1994

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