Policy and Oversight

Financial and Performance Audits Directorate

Evaluation Report on the Procurement of Single Audits by Recipients of Federal Awards

Report Number PO 97-020

May 22, 1997

Office of the Inspector General
Department of Defense

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Acronyms

CEO	Creating Economic Opportunity Council, Inc.
CPSR	Contractor Procurement System Review
DLA	Defense Logistics Agency
FAR	Federal Acquisition Regulation
OMB	Office of Management and Budget
ONR	Office of Naval Research

INSPECTOR GENERAL
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May 22, 1997

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
DIRECTOR, DEFENSE PROCUREMENT
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Evaluation Report on the Procurement of Single Audits by Recipients of Federal Awards (Report No. PO 97-020)

We are providing this evaluation report for review and comment. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. As a result of management comments, we revised draft Recommendation C.2 to clarify our intention. The Director, Defense Logistics Agency, did not provide dates or a timetable for implementation of Recommendations A, C.1, C.2, and C.3. The Director, Defense Procurement, did not provide a date for implementation of Recommendation B and the Navy did not provide a date for implementation of Recommendation C.2. Therefore, we request that the Director, Defense Procurement; the Navy; and the Director, Defense Logistics Agency, provide comments by July 22, 1997. We also ask that the Director, Defense Logistics Agency, and the Navy comment on the potential monetary benefits.

We appreciate the courtesies extended the Policy and Oversight staff. Questions on the audit should be directed to Mrs. Barbara E. Smolenyak, Program Director, at (703) 604-8760 (DSN 664-8760) or Mr. Donald D. Steele, Project Manager, at (703) 604-8705 (DSN 664-8705). See Appendix G for the report distribution. The evaluation team members are listed inside the back cover of this report.

Russell A. Rau
Assistant Inspector General
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Office of the Inspector General, DoD

Report No. PO 97-020 **May 22, 1997**
(Project No. 6OA-0096)

The Procurement of Single Audits by Recipients of Federal Awards

Executive Summary

Introduction. The Single Audit Act of 1984 and the Amendments of 1996 and Office of Management and Budget Circulars require institutions of higher education and other nonprofit organizations to procure audit services from independent public accountants to examine financial statements, internal controls, and compliance with laws and regulations. The institutions and organizations, in turn, pass these costs to the Government as an expense charged to individual Federal grants and contracts. Federal reviewers and auditors from the Federal Agencies also do some independent and/or coordinated examination of these institutions and organizations.

Evaluation Objectives. Our objectives were to determine whether educational and nonprofit organizations procured their single audits from public accounting firms in accordance with Federal requirements and whether Federal reviewers and non-Federal auditors duplicated each others' work when conducting purchasing system reviews. We selected 43 of 177 recipients for review.

Evaluation Results. Generally, the 43 recipients reviewed complied with Federal requirements for procurement of single audits. However, three conditions warranting management action were identified during the evaluation.

o Thirteen recipients did not properly procure their single audits. The recipients were satisfied with the past performance of their audit firm and auditor selection was made outside the purview of the purchasing department. Therefore, assurance of a fair and reasonable price was lacking, auditor independence was questionable, and the entity was not in compliance with the Federal requirements for auditor selection (Finding A).

o Federal reviewers and non-Federal auditors failed to coordinate their efforts in conducting procurement system reviews. As a result, the economies gained through mutual reliance were not achieved and tests and procedures were duplicated (Finding B).

o Two nonprofit organizations did not credit approximately $144,000 to Federal awards for amounts received back from the public accounting firm that performed their audits. Failure to properly credit Federal awards occurred because the monies received were identified as contributions in the audit contracts. As a result, Federal awards were overcharged and the Federal award funds were used for the general purposes of the nonprofit organization (Finding C).

Recommendations in this report, if implemented, will assure that reasonable and fair prices are paid for audit services and will result in efficiencies and economies in procurement system reviews. Also, proper accounting for rebates and credits received

as a result of awarding contracts for audit services will result in additional savings to the Government. Appendix F summarizes the potential benefits resulting from the evaluation.

Summary of Recommendations. We recommend notifying institutions of the importance of compliance with requirements for audit procurement. Also, we recommend issuing policy guidance to re-emphasize the need for coordination before initiating purchasing system review procedures at institutions of higher education and non-profit organizations. We also recommend recovery of the monies due from the institutions with uncredited rebates and determination of the extent of the practice of treating rebates as contributions.

Management Comments. We received comments on a draft of this report from the Director, Defense Procurement; the Navy; and the Director, Defense Logistics Agency (DLA). The Navy and the Director, Defense Logistics Agency, concurred with our recommendation to notify their cognizant educational and nonprofit institutions of the importance of procuring their Office of Management and Budget Circular A-133 audits in accordance with regulatory requirements. However, the Director, Defense Logistics Agency, did not comment on how and when its cognizant institutions would be notified.

The Director, Defense Procurement, concurred with our recommendation to issue policy guidance reminding contracting officers of the requirement to avoid duplicative purchasing system review procedures; however, the Director, Defense Procurement did not provide a date for issuance of the policy guidance.

The Navy concurred and the Director, Defense Logistics Agency, partially concurred with our recommendation to determine the amount of overcharging of Federal awards and issue a demand for payment to Focus: HOPE and Creating Economic Opportunity Council, Inc., respectively. Before taking recovery action, the Director, Defense Logistics Agency, wants to investigate whether Creating Economic Opportunity Council, Inc., selected its independent auditors based on adequate competition and whether the contribution was consistent with past practices; however, a timetable for completion of the investigation was not provided.

The Navy and the Director, Defense Logistics Agency, concurred with our recommendation to query grantees under their cognizance to determine whether rebates have been received from accounting firms and not properly credited; however, the Director, Defense Logistics Agency did not provide a date for querying its grantees.

The Director, Defense Logistics Agency, partially concurred and the Navy concurred with our recommendation to issue guidance requiring that all rebates by accounting firms be credited to the Government; however, the Director, Defense Logistics Agency, did not provide a date for issuance of the policy guidance. The Director, Defense Logistics Agency, commented that all contributions vendors made to recipients are not rebates. Although not required to comment, the Navy concurred that duplicative purchasing system procedures should be avoided and will issue appropriate guidance based on policy guidance from the Director, Defense Procurement. See Part I for a complete discussion of management comments and Part III for the complete text of these comments.

Evaluation Response. The Director, Defense Procurement; the Navy; and the Director, Defense Logistics Agency, generally concurred with our findings and recommendations. As a result of management comments, we revised Recommendation C.2 to clarify our intent.

We do not agree that collection of the amount of overpayment to Creating Economic Opportunity Council, Inc., is contingent on an investigation into whether Creating Economic Opportunity Council, Inc., selected its accounting firm based on adequate competition and whether the contribution was consistent with past practices. The term contribution was directly incorporated into the agreement to provide audit services and relates that contribution directly to the work to be performed. As previously stated, it is a contribution in name only and, in fact, is a discount or rebate and must be credited to the Federal award. Therefore, the outcome of the Defense Logistics Agency investigation does not change the fact that Federal awards were overcharged and the monies must be reimbursed to the Government.

We request that final comments from the Director, Defense Procurement; the Navy; and the Director, Defense Logistics Agency, provide dates for implementation of the unresolved recommendations by July 22, 1997.

Part I - Evaluation Results

Evaluation Background

The DoD policy for single audits is in DoD Directive 7600.10, "Audits of State and Local Governments, Institutions of Higher Education, and Other Nonprofit Institutions." The Directive emphasizes the policy that DoD Components should rely on and use for financial and performance audits performed by non-Federal auditors in the oversight of Federal awards provided to state and local governments, institutions of higher education, and other nonprofit institutions. The Inspector General, DoD, serves as the senior DoD official for policy guidance, direction, and coordination with DoD Components and other Federal Agencies on audit matters related to the single audit concept. The DoD Components have overall management responsibility for matters dealing with audits of awards that they provide. This responsibility includes ensuring accurate input of award data to the appropriate DoD management information system.

Public Law 98-502, "Single Audit Act of 1984," resulted in significant improvement over the prior approach of auditing Federal programs on a grant-by-grant basis. The Directive implemented the "Single Audit Act of 1984"; Office of Management and Budget (OMB) Circular A-128; "Audits of State and Local Governments"; and OMB Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions." These OMB Circulars provide policy guidance to Federal Agencies on implementing the single-audit concept. The Single Audit Act itself does not apply to nonprofit organizations; rather, the single-audit concept is described in OMB Circular A-133 as an "organization-wide audit." The single audit provides reports on the financial statements, internal controls, compliance with laws and regulations, and a Schedule of Federal Awards. The Schedule of Federal Awards shows total expenditures for each Federal program and is used by Federal Agencies to administer their awards. OMB Circular A-110 establishes the standards for obtaining consistent and uniform administration of grants to and agreements with institutions of higher education, hospitals, and other non-profit organizations among Federal Agencies.

The recently enacted Single Audit Act Amendments of 1996 should improve oversight of Federal award programs that as of June 30, 1996, total more than $250 billion annually. The amendments place greater emphasis on program risks to ensure that Federal awards are being properly used, while also ensuring the most effective use of Federal audit resources.

Evaluation Objectives

Our overall objective was to determine whether the procurement of single audits was in compliance with OMB Circular A-133 and OMB Circular A-110, "Uniform Requirements for Grants and Agreements With Institutions of Higher

Education, Hospitals, and Other Non-Profit Organizations." Specifically, we determined whether procurement of single audits was competed, auditor independence existed, adequate procurement files and documentation were maintained, procurement policies and procedures were followed, and duplication existed in purchasing system reviews. We also evaluated whether the amounts given back to two recipients should have been classified as rebates or credits versus contributions. See Appendix A for our scope and methodology.

Finding A. Procurement of Single Audits

Thirteen of the 43 recipients surveyed did not procure their OMB Circular A-133 single audit in accordance with OMB Circular A-110. Specifically, the 13 recipients, with expenditures of $2.7 billion in FY 1993, did not compete the procurement of their OMB Circular A-133 single audit. Eleven of the 13 recipients did not document and justify their basis for auditor selection. While all recipients had written procurement policies and procedures, auditor selection was made outside the purview of the purchasing department. As a result, assurance of a fair and reasonable price for the audit was lacking, auditor independence was questionable, and there was a lack of compliance with Federal requirements for procurement of single audits.

Procurement of OMB Circular A-133 Audits

The OMB Circular A-133 requires that the recipient procure its single audit in accordance with the requirements of OMB Circular A-110, "Uniform Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations." Recipient is defined in OMB Circular A-133, April 1996, as "a nonprofit organization that expends Federal awards received directly from a Federal awarding agency to carry out a Federal Program." The OMB Circular A-110 requires the recipient to provide open and free competition, to the extent practicable, on all procurement transactions.

Thirteen of the 43 recipients surveyed did not compete the award of their OMB Circular A-133 audit as required by OMB Circular A-110. See Appendix B for a list of the 13 recipients. Specifically, 12 recipients continued with the same audit firm and one recipient noncompetitively changed audit firms. The 12 recipients had been doing business with the same audit firms for 10 to 67 years. These 12 recipients continued with the same audit firms primarily because they were satisfied with the level of work received and believed that the auditors were knowledgeable of their accounting systems.

The cost of procuring a single audit is an allowable cost chargeable to Federal awards; therefore, failure to compete the selection of the audit firm may result in higher costs to the Government. Also, failure to compete the selection of the audit firm results in a lack of assurance that competitive review and selection procedures were applied and does not provide small and minority audit firms the maximum opportunity to submit proposals for auditing services. In addition, failure to compete the selection of the audit firm and consistent use of the same audit firm for long periods may compromise auditor independence. For example, a long association between an audit firm and a client could be perceived as effecting auditor independence. Others could perceive the auditor as lacking impartiality, limiting the extent of inquiry and disclosure, and slanting or weakening the findings.

Procurement Documentation Requirements

While the general intent of OMB Circular A-110 is to procure services through competition, the Circular recognizes that under certain conditions some procurements can be awarded without competition. However, the Circular requires documentation consisting of the basis for selection, a justification for the lack of competition, a cost or price analysis, and the basis for the award cost or price. This documentation is necessary to show that the procurement did not conflict with the requirements of the Circular or with the recipient's procurement policy and procedures. It also explains the reason(s) the particular public accounting firm was selected, especially when factors other than lowest bid were used. In addition, the Circular also requires all recipients to establish written procurement policies and procedures.

Eleven recipients selected for on-site evaluations did not maintain a file on the procurement of their OMB Circular A-133 audits or did not document the file in accordance with the requirements of OMB Circular A-110. Some recipients had minutes of meetings that included presentations from their current outside auditors and some analytical information. However, none of the 11 recipients had adequate files justifying the award of the audit that met the requirements of OMB Circular A-110. The recipient that noncompetitively changed audit firms followed its state bid laws regarding auditor selection.

The 11 recipients had written procurement policies for the purchase of services and had procedures related to procurement file maintenance and documentation. All 11 recipients maintained an informal policy that auditor selection is outside the responsibilities of the Procurement Department. For example, the audit firm was selected by the Audit Committee, Financial Director, or through recommendations by other management personnel. However, none of the 11 recipients had written policies and procedures governing auditor selection outside the Procurement Department, such as who was responsible for auditor selection or how the selection should be accomplished. While auditor selection may be performed outside the purview of the Purchasing Department, at a minimum, adequate policies and procedures should be established for auditor selection that meet the OMB Circulars A-133 and A-110 requirements. At a minimum, these procedures should reference procedures already established by the Procurement Department and state that adherence to the procedures is mandatory for auditor selection. Due to a lack of policies and procedures on auditor selection, Federal requirements for the purchase of audit services were not followed and the recipient had no assurance that the best qualified audit firm was selected to do the audit.

As a result of our findings, the DoD expanded the scope of quality control reviews to closely monitor the procurement of single audits. We will share our findings with other cognizant Federal Agencies for whatever action is deemed appropriate.

Management Comments on the Finding and Evaluation Response

Navy Comments. The Navy requested that our report identify the 13 Federal award recipients that did not procure their OMB Circular A-133 single audits in accordance with OMB Circular A-110. The Navy stated that, for those recipients under Navy cognizance, corrective action would be taken.

Evaluation Response. We added Appendix B to the final report to identify the 13 Federal award recipients that did not procure their single audits in accordance with OMB Circular A-110 and to identify their cognizant agency.

Recommendation, Management Comments, and Evaluation Response

A. We recommend that the Chief of Naval Research and the Director, Defense Logistics Agency, notify all DoD cognizant institutions of the importance of conducting procurement of Office of Management and Budget Circular A-133 audits in accordance with regulatory requirements in Office of Management and Budget Circular A-110, especially when auditor selection is made outside the purview of the Purchasing Department.

Navy Comments. The Navy concurred, stating that within 30 days of the issuance of the final report, the Navy would notify those educational or nonprofit institutions where the Navy has cognizance of the importance of procuring OMB Circular A-133 audits in accordance with regulatory requirements of OMB Circular A-110.

Defense Logistics Agency (DLA) Comments. DLA concurred, stating that it will issue policy directing contract administration personnel to advise recipients of assistance agreements under its cognizance that independent audits performed in accordance with OMB Circular A-133 be procured in accordance with the requirements in OMB Circular A-110, especially when auditor selection is made outside the purview of the purchasing department.

Evaluation Response. The DLA comments were responsive; however, we request that the DLA provide comments in its response to the final report on the effective date it will implement the recommendation.

Finding B. Purchasing System Reviews

Federal reviewers and independent auditors reviewed the procurement system at the same 18 recipients during the same year, but did not consider each other's work in determining the nature, timing, and extent of their review procedures. Failure to consider each other's work was caused by a lack of coordination between the Federal reviewers and the independent auditors. Therefore, in these 18 instances, the potential economies gained through mutual reliance and the intent of OMB Circular A-133 were not achieved. As a result, tests and procedures were duplicated, the recipients were unnecessarily disrupted, and the DoD incurred additional costs.

Overlapping Regulatory Requirements and Similar Objectives

The Federal Acquisition Regulation (FAR), Subpart 44.3, "Contractors' Procurement Systems Reviews," requires the administrative contracting agency to conduct a Contractor Procurement System Review (CPSR) every 3 years at contractors whose sales to the Government, using other than sealed bid procedures, are expected to exceed $10 million within the next 12 months. The OMB Circular A-133 requires institutions of higher education and other nonprofit institutions that receive $100,000 or more a year in Federal awards to have an audit that meets OMB Circular A-133 requirements. The Circular A-133 audit includes a review of the procurement system. Institutions of higher education and nonprofit institutions that have Federal contracts and Federal financial assistance are subject to the FAR and OMB Circular A-133 requirements.

The objectives of these two procurement system reviews are essentially the same. The CPSRs, performed by Federal reviewers, are intended to assist contracting officers in determining whether the purchasing systems and practices used by selected contractors provide maximum protection to the Government; comply with Public Law, the FAR, and contract clauses; and promote efficient and effective purchasing practices. The procurement system reviews, performed by the independent auditors, are intended to ensure that materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal law and executive orders.

Because of the overlapping coverage and similar objectives, the Federal reviewers and the independent auditors must consider each other's work in determining the nature, timing, and extent of audit or review of procurement procedures. The objective of this "coordinated audit approach" is to minimize duplication of audit effort but not to limit the scope of the audit work so as to preclude the independent auditor from meeting the objectives in OMB Circular A-133. A coordinated audit must be conducted in accordance with Government Auditing Standards and meet the reporting requirements in Circular A-133. In accordance with the American Institute of Certified Public Accountants' Statement on Auditing Standards 11, "Using the Work of a Specialist," the

auditors could use the work of the procurement system reviewers. Therefore, the independent auditor would only be required to satisfy himself or herself concerning the reviewer's professional qualifications and obtain and understand the purpose and nature of the work performed. However, at the 18 recipients, the Federal reviewers and the independent auditors did not consider each other's work in planning and conducting their respective procurement system reviews. For example, some areas covered that would be covered by both Federal reviewers and non-Federal auditors include purchasing policies and procedures, source selection, awards to small and disadvantaged firms, and cost and price analyses. As a result, the objective of the single audit required by OMB Circular A-133 was not achieved: coordinating audit work and reporting among auditors to achieve the most cost-effective audit and avoid duplication.

At Harvard University, management estimated that 200 hours of labor were unnecessarily expended to support two purchasing system reviews. Because the Federal reviewer and the independent auditor did not coordinate, each requested supporting documentation for a sample of purchases to review and transactions to test to satisfy the same objectives. For the three fiscal years ended September 1996, the Office of Naval Research (ONR) conducted 53 CPSRs, resulting in salary, travel, and other associated expenses that exceeded $450,000. The ONR CPSRs reported findings and recommendations on the lack of a cost and/or price analyses in the procurement file, missing contract provisions in the award document, and inadequate or outdated policies and procedures. However, based on the review of ONR CPSR reports submitted to our office, we did not note findings related to procurement of Circular A-133 audits.

The recipients' cost of the single audit by the independent auditor is an allowable cost to Government awards and the DoD bears its allocable share. However, OMB Circular A-133 requires that when a Federal Agency makes or contracts for audits in addition to audits made by recipients pursuant to the Circular, that Agency must arrange for the funding of that additional audit. Therefore, when DoD reviewers perform a CPSR review in accordance with the provisions of the Federal Acquisition Regulations, only the DoD and its contract administration customers bear the cost of the review. When a lack of coordination results in duplicative work, DoD has unnecessary costs. However, we were unable to quantify the cost impact. Regardless, coordination among reviewers and auditors would result in better use of funds. We are looking at the overall issue of duplicative and overlapping reviews DoD-wide. We plan to recommend that the Director, Defense Procurement, initiate a revision to the FAR 44.302 and revise the Defense Federal Acquisition Regulation Supplement 244.303 to eliminate the requirement to conduct special reviews of contractor purchasing systems.

Management Comments on the Finding and Evaluation Response

Director, Defense Procurement, Comments. The Director, Defense Procurement, stated that the Civilian Agency Acquisition Council and the Defense Acquisition Regulation Council agreed on a final rule amending the FAR to revise the requirement relating to CPSRs. The final rule deletes the requirement for a CPSR every 3 years; instead, the cognizant contract administration agency determines the need for a CPSR based on, but not limited to, the past performance of the contractor and the volume, complexity, and dollar value of the subcontracting effort.

Navy Comments. Although not required to comment, the Navy recommended that the report identify the 18 recipient locations and the cognizant agency where Federal reviewers and independent auditors did not consider each other's work in conducting purchasing system reviews.

The Navy also requested that the final report identify the recipient that estimated 200 hours of labor unnecessarily expended to support the two duplicative reviews. The Navy pointed out that the statement, "when DoD reviewers perform a CPSR review, the DoD bears 100 percent of the unnecessary costs" was inaccurate because DoD customers of contract administrative services (such as the Department of Energy) share all CPSR costs. The Navy did not agree that a revision to the FAR 44.302 and a revision to the Defense Acquisition Regulation Supplement 244.303 were necessary because of the recent FAR changes. The Navy is drafting a new policy and procedures manual.

Evaluation Response. As the Navy requested, we added Appendix C to identify the 18 recipients where Federal and non-Federal auditors did not consider each other's work relative to performing purchasing system reviews.

We identified the institution where the estimated 200 hours of labor were unnecessarily expended to support two purchasing system reviews. We revised the final report to reflect that DoD does not always bear 100 percent of the costs when DoD reviewers perform a CPSR. We also changed the number of CPSRs performed by ONR from 25 to 53 and the associated costs from $225,000 to $450,000.

Recommendation, Management Comments, and Evaluation Response

B. We recommend that the Director, Defense Procurement, issue policy guidance reminding contracting officers of the requirement to avoid duplicative purchasing system review procedures. The guidance should emphasize that when Federal auditors or reviewers are planning to perform audits or reviews at educational institutions and nonprofit organizations

that are subject to the audit requirements of Office of Management and Budget Circular A-133, a coordinated audit approach is required to avoid duplication.

Defense Procurement Comments. The Director, Defense Procurement, concurred with the finding and will issue a policy guidance memorandum.

Evaluation Response. The Director, Defense Procurement, comments were responsive; however, we request she provide the effective date of the planned action in her response to the final report.

Navy Comments. Although not required to comment, the Navy said it will issue implementing instructions to the appropriate Navy personnel based on policy guidance from the Director, Defense Procurement.

Finding C. Rebates Classified as Contributions

Two nonprofit organizations we reviewed, Creating Economic Opportunity (CEO) Council, Inc. and Focus: HOPE, did not credit approximately $144,000 to Federal awards for amounts received back from the public accounting firms that performed their OMB Circular A-133 audits. The monies received were identified as contributions to the nonprofit organizations based on the wording in their audit contracts. As a result, Federal awards were overcharged and Federal award funds were used for the general purposes of the nonprofit organization.

Audit Agreements Provide for Contributions

The OMB Circular A-122, "Cost Principles for Nonprofit Organizations," Attachment A, (Section A.1.), states that "The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits." Attachment A, (Section A.5), defines applicable credits as "those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. . . . In addition, to the extent that such credits accruing or received by the organization relate to allowable cost, they shall be credited to the Government either as a cost reduction or cash refund as appropriate." OMB Circular A-133 provides that the costs of audits made in accordance with the provisions of the Circular are allowable charges against the Federal awards, either as direct or indirect costs.

The audit contracts for performance of the OMB Circular A-133 audits entered into by Ernst and Young and Plante and Moran with Focus: HOPE and CEO Council, Inc., respectively, provided for refunding a portion of the audit fee to the nonprofit organizations. In one instance, the letter of understanding (contract) stated, "Upon payment of our invoices by (recipient), (public accounting firm) will make a cash contribution to (recipient) in an amount equal to 35 percent of our fees." In the other instance, the confirmation letter stated, "As our contribution to the continued services of the (recipient), we will contribute $2,500 at the completion of our engagement." Generally, making contributions to universities or other nonprofit institutions are presently allowable by their independent public accountants. However, the practice raises independence concerns that we will address in a separate review. Also, incorporation of the term "contribution" directly into the agreement to provide audit services relates that contribution directly to the audit to be performed. It also becomes a cost that should be defrayed from award funds. The contribution is in name only and is, in fact, a discount or rebate. In accordance with OMB Circular A-122, the monies should be credited to the Federal awards.

The two nonprofit organizations did not credit approximately $144,000 received back against the cost of the audit to the Federal assistance program involved.

Instead, the nonprofit organizations credited the monies to the general revenues of their organizations. The practice of receiving rebates, in the form of contributions, from their public accountants has continued at the one nonprofit institution since 1990. This practice resulted in diversion of Federal award funds to the general purposes of the organization and overcharging of the Federal award program involved.

We estimated that the overcharging of Federal awards for Focus: HOPE at $143,000 for audits of the 5 fiscal years ended September 30, 1994. We estimated the amount of overcharging of Federal awards by the CEO, Council, Inc., at $1,000 for audits of the 5 fiscal years ended December 31, 1993.

Perception of Lack of Independence

The Government Auditing Standards addresses auditor independence issues. The standards require that the audit organization and the individual audited be free from personal impairments to independence in all matters related to the audit work. Personal impairments may include personal or financial relationships, whether direct or indirect in the audited entity or program, that others might perceive to effect the independence of the auditor. Financial or personal impairments could effect the auditor's independence by causing him or her to not be impartial, limit the extent of inquiry, or slant or weaken the findings. The provision of rebates can raise independence concerns because the U.S. Government bears the ultimate cost.

We were unable to determine the extent by which public accounting firms use rebates, improperly called contributions, to benefit nonprofit organizations at the Government's expense. This practice may be taking place in other nonprofit and educational institution communities and not identified and properly accounted for. We have expanded the scope of quality control reviews to evaluate audit contractual documents to determine whether other recipients are also receiving credits or rebates classified as contributions from their public accounting firms. We are also recommending that the Chief, ONR, and the Director, DLA, query the grantees and contractors under their cognizance to determine the extent of this practice and take appropriate action.

Management Comments on the Finding and Evaluation Response

DLA Comments. The Director, Defense Logistics Agency, does not agree conclusive evidence warrants a demand for repayment of an amount equal to the contribution. The DLA will instruct the Defense Contract Management Command to perform an investigation to answer questions regarding the contribution identified in the report, past contribution practices, and the adequacy of competition for audit services. The DLA stated that if there was

adequate competition, it would be difficult to prove that the contribution was a rebate. The DLA also stated that if the past practice of contributions to CEO Council, Inc., by Plante and Moran was consistent with other firms making contributions and with prior Plante and Moran contributions, DLA would accept that the contribution was unrelated to the audit agreement and would not pursue a refund.

Evaluation Response. Although the DLA will review the past contribution practices and the adequacy of competition, our finding that the contributions represent a reduction in audit fees is not based on these factors. The initial audit service agreement with Plante and Moran was awarded based on a proposal that reduced the total audit fees by the contribution amount. The CEO Council, Inc.'s schedule of bidder's proposed audit fees compared total costs reduced by the amount of contributions. The review of past practices would not change the OMB Circular A-122 requirement that allowable costs exclude applicable credits that operate to reduce costs.

Navy Comments. The Navy requested clarification as to whether CEO Council, Inc., and Focus: HOPE were the only two recipients that had a problem with rebates as contributions relative to audit services or whether the problem exists at the other 41 recipients.

Evaluation Response. The two recipients were the only entities that identified contributions as part of the fees for audit services in their audit contracts. Although other accounting firms may have made contributions to their auditees, we obtained no evidence of the contributions being in their audit service contracts for the other 41 recipients.

Recommendations, Management Comments, and Evaluation Response

As a result of management comments, we revised Recommendation C.2 to delete the word "grantee" and replace it with "Federal award recipients."

C.1. We recommend that Director, Defense Logistics Agency, and the Chief of Naval Research instruct the contracting officers to determine the amount of overcharging of Federal awards and then issue a demand for payment to Creating Economic Opportunity Council, Inc., and Focus: HOPE that overcharged Federal awards.

DLA Comments. The DLA partially concurred and will instruct the Defense Contract Management Command to investigate whether CEO Council, Inc., selected Plante and Moran based on adequate competition and whether the contribution was consistent with past practices. If either condition was not met, the administrative contracting officer will be instructed to take the appropriate action to recover the amount due.

Evaluation Response. The DLA comments are partially responsive. While the DLA can investigate the circumstances surrounding the alleged overcharging of Federal awards, past practices and the adequacy of competition have no bearing on this finding.

Navy Comments. As the agency with oversight responsibility for Focus: HOPE, the Navy concurred and will implement the recommendation within 30 days after issuance of the final report.

C.2. We recommend that Director, Defense Logistics Agency, and the Chief of Naval Research query all Federal award recipients under their cognizance to determine whether rebates have been received from accounting firms and not properly credited to grants and contracts. Action should be taken, as appropriate, to recoup the monies due to the Government.

DLA Comments. The DLA concurred but stated that the recommendation addresses nonprofit organizations and state and local governments that are Federal award recipients under the cognizance of the Defense Contract Management Command. The DLA did not concur that this finding represents all grantees, because a grantee could be a profit-oriented corporation.

Evaluation Response. We concur with the DLA definition of grantee and have revised the recommendation to clarify; however, the DLA comments do not address the recommendation. We request that the DLA provide the date by which it will query Federal award recipients to determine whether rebates have been received from accounting firms and not properly credited to grants and contracts.

Navy Comments. The Navy concurred and will implement the recommendation for those educational and nonprofit organizations under the cognizance or oversight of Navy and for which Navy has the responsibility to establish indirect cost rates.

Evaluation Response. The Navy evaluation response did not indicate a timetable or plan for implementing the recommendation. We request the Navy provide a timetable for the planned actions in its response to the final report.

C.3. We recommend that Director, Defense Logistics Agency, and the Chief of Naval Research issue guidance to contracting officers requiring that all rebates by auditing firms be credited to the Government.

DLA Comments. The DLA partially concurred and will issue guidance to the administrative contracting officers that nonprofit organizations and state and local government Federal award recipients, under the cognizance or oversight of the Defense Contract Management Command, should credit rebates by auditing firms to the Government, as appropriate. The DLA does not consider all contributions vendors made to recipients to be rebates.

Evaluation Response. We concur with the DLA that not all contributions vendors made to recipients are rebates. Our recommendation addresses that

rebates auditing firms made to recipients be credited to the Government. The DLA did not indicate the date by which actions will be complete. We ask the DLA to provide the date in its response to the final report.

Navy Comments. The Navy concurred with the recommendation and will issue guidance within 30 days after issuance of our evaluation report to contracting officers of educational and nonprofit organizations for which Navy is the cognizant or oversight agency.

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Part II - Additional Information

Appendix A. Scope and Methodology

The Financial Management and Performance Directorate maintains statistical information on all OMB Circular A-133 audit reports received from Federal award recipients. These audit reports are due 13 months after the recipient's fiscal year ends. We sorted information in our data base for the fiscal year ended 1993 by total direct expenditures.

We judgmentally selected 43 of 177 nonprofit institutions (includes educational institutions) for our evaluation that represented a cross-section of institutions based on a high, medium, and low dollar stratification of total direct expenditures. The 177 nonprofit institutions collectively represent $9.9 billion in direct award expenditures with DoD institutions accounting for $1.8 billion of this amount. The 43 nonprofit institutions selected for evaluation represent $5.3 billion in direct award expenditures with DoD institutions accounting for $1.0 billion of this amount.

We sent questionnaires to the 43 nonprofit institutions selected. We requested the following information on the most recent procurement of audit services to perform the OMB Circular A-133 audit:

- the most recent year a request for bid was made for audit services,
- the number of entities solicited for bids,
- the number of responses received, and
- the basis for audit firm selection.

The following information was requested on procurement systems reviews:

- whether the independent auditor reviewed the procurement system;
- whether the independent auditors' review of the procurement system included the policies and procedures;
- whether a Federal Agency reviewed the procurement system within the last 3 years; and
- the name of the Federal Agency that performed the review and the date of the review, if applicable.

See Appendix D for institutions selected for evaluation and Appendix E for institutions selected for on-site visits.

Appendix B. Federal Award Recipients in Noncompliance With Office of Management and Budget Circular A-110

Name of Institution	State	Cognizant Agency[1]
Cornell University	NY	DOD[2]
Duke University	NC	HHS
Focus: HOPE	MI	DOD
Harvard University	MA	HHS
Institute of Electrical & Electronics Engineers, Inc.	NJ	DOD
John Hopkins University	MD	HHS
Lehigh University	PA	HHS
Massachusetts Institute of Technology	MA	DOD
Medical College of Pennsylvania	PA	HHS
Princeton University	NJ	DOE
University of Pennsylvania	PA	HHS
University of Southern California	CA	HHS
Washington University	MO	HHS

[1]Federal agency responsible for negotiating indirect cost rates under OMB Circular A-21 or A-122.

[2]Cognizance changes to the Department of Health and Human Services as of June 30, 1997.

Appendix C. Federal Award Recipients Receiving Duplicative Purchasing System Reviews

Name of Institution	State	Cognizant Agency[1]
Arizona Procurement Technical Assistance Network, Inc.	AZ	DOD
Creating Economic Opportunity Council, Inc.	MI	DOD
Cold Spring Harbor Laboratory	NY	HHS
Columbia University in the City of New York	NY	DOD[2]
County of Union New Jersey (Union County Economic Development Corporation)	NJ	HHS
Duke University	NC	HHS
GreatLakes Composites Consortium	SC	DoD
Harvard University	MA	HHS
International Computer Science Institute	CA	DOD
Lawrence Economic Development Corporation	OH	DOC
Princeton University	NJ	DOE
Saginaw Future, Inc.	MI	DOD
Shreveport Chamber of Commerce	LA	HHS
University of California System	CA	HHS
University of Maryland System	MD	HHS
University of Minnesota	MH	HHS
University of Pennsylvania	PA	HHS
University of Southern California	CA	HHS

[1]Federal agency responsible for negotiating indirect cost rates under OMB Circular A-21 or A-122.

[2]Cognizance changes to the Department of Health and Human Services as of June 30, 1997.

DOC Department of Commerce
DOE Department of Energy
HHS Department of Health and Human Services

Appendix D. Institutions Selected for Evaluation

Name of Institution	State	Cognizant Agency[1]	Total FY 93 Expenditures in Thousands of Dollars[2]
Alabama A&M University	AL	HHS	16,500
Arizona Procurement Tech Assistance	AZ	DoD	163
Central State University	OH	DEd	18,424
Cold Spring Harbor Laboratories	NY	HHS	19,941
Columbia University	NY	DoD	209,860
Cornell University	NY	DoD	247,220
County of Union New Jersey	NJ	HHS	83
Creating Economic Opportunity Council, Inc.[3]	MI	DoD	56
Duke University	NC	HHS	176,287
Focus: HOPE	MI	DoD	18,679
GreatLakes Composite Consortium	SC	DoD	16,000
Harvard University	MA	HHS	189,513
Institute of Electrical & Electronics Engineers, Inc.	NJ	DoD	61
International Computer Science Institute	CA	DoD	264
John Hopkins University	MD	HHS	745,979
Johnstown Area Regional Industry	PA	DoD	164
Lawrence Economic Development Corp.	OH	DOC	80
Lehigh University	PA	HHS	20,000

Appendix D. Institutions Selected for Evaluation

Name of Institution	State	Cognizant Agency[1]	Total FY 93 Expenditures in Thousands of Dollars[2]
Long Island Development Corp.	NY	DoD	119
Loyola University of Chicago	IL	HHS	17,000
Mahoning Valley Economic Development Corp.	OH	DOC	65
Massachusetts Institute of Technology	MA	DoD	634,389
Medical College of Pennsylvania	PA	HHS	18,900
Michigan Technological University	MI	HHS	14,532
Minnesota Project Innovation	MN	DoD	143
Morehouse School Of Medicine	GA	HHS	17,200
Northeast Michigan Consortium	MI	DoD	50
Ohio State University	OH	DED	20,900
Princeton University	NJ	DOE	165,010
Research Foundation of The State University of New York	NY	HHS	378,620
Saginaw Future, Inc.	MI	DoD	56
Shreveport Chamber of Commerce	LA	DoD	67
Tulane University	LA	HHS	131
University of California System	CA	HHS	1,039,000
University of Louisville	KY	HHS	23,600
University of Maryland System	MD	HHS	217,966
University of Michigan	MI	HHS	300,553

Name of Institution	State	Cognizant Agency[1]	Total FY 93 Expenditures in Thousands of Dollars[2]
University of Minnesota	MN	HHS	204,151
University of Pennsylvania	PA	HHS	204,000
University of Southern California	CA	HHS	170,000
University of Toledo	OH	HHS	17,000
Washington University	MO	HHS	153,957
Wright State University	OH	DoD	18,100

[1]Based on Navy comments, we clarified the definition of cognizant agency. Federal Agency responsible for negotiating indirect cost rates under OMB Circular A-21 or A-122.

[2]Represents total direct Federal expenditures in fiscal year 1993.

[3]The name has been changed to Business Development Bureau.

DOC Department of Commerce
DED Department of Education
DOE Department of Energy
HHS Department of Health and Human Services

Appendix E. Institutions Selected for On-site Visits

Alabama A&M University, Normal, AL

Cornell University, Ithaca, NY

Duke University, Durham, NC

Focus: HOPE, Detroit, MI[1]

Harvard University, Cambridge, MA

Institute of Electrical & Electronics Engineers, Inc., Piscataway, NJ

Lehigh University, Bethlehem, PA

Loyola University of Chicago, Chicago, IL

Massachusetts Institute of Technology, Cambridge, MA

Medical College of Pennsylvania, Bala Cynwyd, PA

Princeton University, Princeton, NJ[2]

[1]Field visit not performed.
[2]Field visit performed by on-site Department of Energy auditors.

Appendix F. Summary of Potential Benefits Resulting From Evaluation

Recipient Name Reference	Description of Benefit	Type of Benefit
A.	Compliance With Laws and Regulations. Assures a reasonable price is paid for audits.	Nonmonetary.
B.	Economy and Efficiency. Maximizes cost avoidance by avoiding duplication.	Nonmonetary.
C.1.	Compliance with Regulations or Laws. Government will receive refunds due to improper treatment of rebates or credits on costs charged to Federal awards.	$144,000.
C.2.	Compliance with Regulations or Laws.	Undetermined. Amount is subject to management review.
C.3.	Compliance with Regulations or Laws	Nonmonetary.

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Deputy Under Secretary of Defense (Acquisition Reform)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Director, Defense Procurement
Director, Defense Research and Engineering

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy
Chief of Naval Research

Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Executive Director of Procurement, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General Accounting Office
Chairman and ranking minority member of each of the following congressional committees and subcommittees:
- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Federal Government Departments

Action Agency
Agency for International Development
Appalachian Regional Commission
Department of Veteran Affairs
Federal Emergency Management Agency
General Services Administration
National Aeronautics and Space Administration
National Archives and Records Administration
National Endowment for the Arts
National Endowment for the Humanities
National Science Foundation
Nuclear Regulatory Commission
Small Business Administration
Tennessee Valley Authority
U.S. Department of Agriculture
U.S. Department of Commerce
U.S. Department of Education
U.S. Department of Energy
U.S. Department of Health & Human Services
U.S. Department of Interior
U.S. Department of Justice
U.S. Department of Labor
U.S. Department of State

Federal Government Departments (cont'd)

U.S. Department of Transportation
U.S. Environmental Protection Agency
U.S. Information Agency

Nonprofit Institutions Evaluated

Alabama A&M University
Arizona Procurement Technical Assistance Network, Inc.
Creating Economic Opportunity Council, Inc.
Central State University
Cold Spring Harbor Laboratory
Columbia University in the City of New York
Cornell University
Duke University
Focus: HOPE
GreatLakes Composites Consortium
Harvard University
Institute of Electrical & Electronic Engineers, Inc.
International Computer Science Institute
Johns Hopkins University
Johnstown Area Regional Industries
Lawrence Economic Development Corporation
Lehigh University
Long Island Development Corporation
Loyola University of Chicago
Mahoning Valley Economic Development Corporation
Massachusetts Institute of Technology
Medical College of Pennsylvania*
Michigan Technological University
Minnesota Project Innovations, Inc.
Morehouse School of Medicine
Northeast Michigan Consortium
Ohio State University
Princeton University
Research Foundation of the State University of New York
Saginaw Future, Inc.
Shreveport Chamber of Commerce
Tulane University
Union County Economic Development Corporation
University of California System
University of Louisville
University of Maryland System

*Based on Navy comments, we deleted Allegheny Health Education and Research Foundation and the University of California Medical College of Pennsylvania and added the Medical College of Pennsylvania.

Nonprofit Institutions Evaluated (cont'd)

University of Michigan
University of Minnesota
University of Pennsylvania
University of Southern California
University of Toledo
Washington University in St. Louis
Wright State University

DoD Cognizant/Oversight Nonprofit Institutions

Advertising Council, Inc.
Aerospace Corporation
Alameda Reuse and Redevelopment Corporation
American Association of State Colleges & Universities
American Council on Education
American Foundation for Biological Research
American Institute of Biological Sciences, Inc.
American Institute of Research Behavioral Sciences
American Registry of Pathology
American Society for Engineering Education
American Society of Mechanical Engineering
American Welding Institute
Analytical Services, Inc.
Archibold Expeditions
Base Redevelopment Corporation
Battelle Memorial Institute
Ben Franklin Technology Center
Brown University
California Institute of Technology
Carnegie Mellon University
Castle Joint Powers Authority
Charles Stark Draper Laboratory
Civil Engineering Research Foundation
CNA Corporation
College of William & Mary
Columbia University
Concurrent Technology Corporation
Consortium of Universities of the Washington Metro Area
Corporation for Open System Intern

DoD Cognizant/Oversight Non-Profit Institutions (cont'd)

Crater Planning District Commission
Downriver Community Conference
Edison Welding Institute
England Economic & Industrial Development District
Environmental Research Institute of Michigan
Ft. Harrison Transportation Task Force
Genesee County Metropolitan Planning Commission
Georgetown University Medical Center
Georgia Technology Research Corporation
Grissom Redevelopment Authority
Henry M. Jackson Foundation for the Advancement of Military Medicine, Inc.
High Plains Development Authority
Hubbs Sea World Research Institute
Hudson Institute
Human Resources Research Organization
Indiana Small Business Development Corporation
Inland Valley Development Agency
Institute for Technology Development
Jackson Alliance for Business Development
Kestrel Institute
Linfield Research Institute
Loring Development Authority
Lowell Observatory
Lowry Redevelopment Authority
March Joint Powers Authority
Materials Research Society
Midwest Research Institute
Mississippi Contract Procurement Center, Inc.
Montana Tradeport Authority
Mote Marine Laboratory
National Academy of Sciences
National Biomedical Research Foundation
National Center for Manufacturing Sciences
Nebraska Military Department
New Mexico Institute of Mining & Technology
New Mexico State University
New River Valley Planning District Commission
Northeast Consortium for Engineering Education, Inc.
Optical Society of America
Oregon Graduate Institute of Science & Technology
Pease Development Authority

DoD Cognizant/Oversight Non-Profit Institutions (cont'd)

Pennsylvania State University
Police Department of Kansas City
Polytechnic University
Procurement Technical Assistance Center
Pueblo Area Council of Governments
Pueblo Depot Activity Development Authority
Rand Corporation
Regional Contracting Assistance Center, Inc.
Riverside Research Institute
San Bernardino International Airport
Satellite Communications for Learning
Sematech
Smithsonian Institution
South Carolina Research Authority
Southeast Center for Electrical Engineering Education, Inc.
Southeast Indiana Regional Planning Commission
Southern Alleghenies Planning & Development Commission
Southwest Research Institute
Stanford University
Stevens Institute of Technology
Syracuse Research Corporation
Syracuse University
The Massachusetts Government Land Bank
The Mitre Corporation
Thumb Area Employment & Training Consortium
Tri-County Council Waste
Tribal Government Institute
University of Alaska
University of Dayton
University of Denver
University of Hawaii
University of Illinois
University of Notre Dame du Lac
University of Rhode Island
University of Rochester
Virginia Institute of Marine Sciences
Virginia Military Institute Research Laboratories
West Virginia High Technology Consortium Foundation
Williams Gateway Airport
Woods Hole Oceanographic Institute

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Part III - Management Comments

Director, Defense Procurement, Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

APRIL 2, 1997

DP/CPA

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: The Procurement of Single Audits by Recipients of Federal Awards (Project No. 6OA-0096.00)

This is in response to your request for comments on the subject report. I am attaching for your consideration specific comments on those recommendations pertaining to the Director of Defense Procurement. Thank you for the opportunity to comment.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Attachment

The Procurement of Single Audits by Recipients of Federal Awards (Project No. 6OA-0096.00) Recommendations and Director of Defense Procurement (DDP) Comments

Finding B. Purchasing System Reviews

DoDIG Comment: We plan to recommend that the Director, Defense Procurement, initiate a revision to the FAR 44.302 and revise the Defense Federal Acquisition Regulation Supplement 244.303 to eliminate the requirement to conduct special reviews of contractor purchasing systems.

DDP Position: The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council have agreed on a final rule amending the Federal Acquisition Regulation (FAR) to revise the requirements relating to Contractors' Purchasing Systems Reviews (CPSRs). I am attaching a copy of the recent Federal Register notice. The final rule deletes the requirement for a CPSR every three years and instead the cognizant contract administration agency determines a need for a CPSR based on, but not limited to, the past performance of the contractor and the volume, complexity, and dollar value of the subcontracting effort. The final rule should have a positive affect on the "duplication and overlapping reviews" issue.

Recommendation B. We recommend that the Director, Defense Procurement, issue policy guidance reminding contracting officers of the requirement to avoid duplicative purchasing system review procedures. The guidance should emphasize that when Federal auditors or reviewers are planning to perform audits or reviews at educational institutions and nonprofit organizations that are subject to the audit requirements of Office of Management and Budget Circular A-133, a coordinated audit approach is required to avoid duplication.

DDP Position: Concur. I will issue a policy guidance memorandum.

Assistant Secretary of the Navy Comments

THE ASSISTANT SECRETARY OF THE NAVY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

APR 17 1997

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

Subj: DRAFT PROPOSED EVALUATION REPORT ON THE PROCUREMENT OF SINGLE AUDITS BY RECIPIENTS OF FEDERAL AWARDS (PROJECT NO.6OA-0096.00)

Ref: (a) DODIG memo of 30 Jan 97

Encl: (1) Navy response to DODIG draft evaluation report of 30 Jan 97

The Department of the Navy (DON) has reviewed the subject proposed evaluation report, forwarded by reference (a), and is in general agreement with the findings and recommendations in the draft report. Comments to the findings and recommendations are provided in enclosure (1).

John W. Douglass

Copy to:
ASN(FM&C) (FMO-31)
NAVINSGEN
CNR

Department of the Navy Response

to

DODIG Draft Report of January 30, 1997

The Procurement of Single Audits by Recipients of Federal Awards
(Project No. 6OA-0096.00)

Part I - Evaluation Results

Finding A. Procurement of Single Audits

Page 4. Finding A. Procurement of Single Audits:

"Thirteen of the 43 recipients surveyed did not procure their OMB Circular A-133 single audit in accordance with OMB Circular A-110...."

DON Comment: Recommend the DODIG evaluation report identify the DOD recipients that did not procure their OMB Circular A-133 single audit in accordance with OMB Circular A-110. In addition, the report should contain an appendix which lists the 13 recipients and the respective cognizant agency. This information is needed so that DON can determine if any of the 13 recipients are under the cognizance of the Office of Naval Research, and to ensure that follow-up corrective action is taken.

Recommendation for Corrective Action

Page 6. Recommendation A:

"We recommend that the Chief of Naval Research, and the Director, Defense Logistics Agency, notify all DOD cognizant institutions of the importance of conducting procurement of Office of Management and Budget Circular A-133 audits in accordance with regulatory requirements contained in OMB Circular A-110, especially when auditor selection is made outside the purview of the Purchasing Department."

DON Comment: Concur. The Office of Naval Research will implement this recommendation within thirty days after issuance of the DODIG report, notifying those educational or nonprofit institutions where the Office of Naval Research has audit resolution responsibility for A-133 issues.

1

FINDING B. PURCHASING SYSTEM REVIEWS

Page 7, Finding B:

"Federal reviewers and independent auditors reviewed the procurement system at the same 18 recipients during the same year, but did not consider each other's work in determining the nature, timing, and extent of their review procedures...."

DON Comment: Recommend the DODIG evaluation report identify the 18 recipient locations and cognizant agency where the Federal reviewers and independent auditors did not consider each other's work relative to purchasing system reviews. This information is needed for the Office of Naval Research to look into the specific circumstances at its cognizant institutions.

Page 8. First Full Paragraph, Line One:

"At one institution visited, the recipient estimated that 200 hours of labor were unnecessarily expended to support the two purchasing system reviews."

DON Comment: Recommend the DODIG evaluation report identify the institution visited where 200 hours of labor effort were spent to support two purchasing system reviews.

Page 8. Second Full Paragraph, Line Six:

"Therefore, when DOD reviewers perform a CPSR review, the DOD bears 100 percent of the unnecessary costs."

DON Comment: This statement is not accurate. DOD customers of contract administration services (e.g., National Aeronautics and Space Administration and Department of Energy) share all CPSR costs.

Pages 8 and 9 :

"We are looking at the overall issue of duplicative and overlapping reviews DOD-wide. We plan to recommend that the Director, Defense Procurement, initiate a revision to the FAR 44.302 and revise the Defense Federal Acquisition Regulation Supplement 244.303 to eliminate the requirement to conduct special reviews of contractor purchasing systems."

DON Comment: The Navy's position is that the proposed action is not necessary. In response to the DOD Acquisition Reform Initiative, the DOD Acquisition Steering Committee

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empowered an Interagency Process Action Team (PAT), led by the Defense Logistics Agency, to review the CPSR process. Based on recommendations of this PAT, Federal Acquisition Circular (FAC) 90-37 raised the threshold for performance of CPSRs from $10 million to $25 million, and Defense Acquisition Circular (DAC) 91-11 deleted DFARS 244.303, " Extent of Review," and Appendix C, "Contractor Purchasing System Reviews" (detailed procedures for performing a CPSR). In addition, the FAR Secretariat is reviewing Case 94-605 which will require cognizant administrative agencies to perform a risk analysis to determine if a CPSR is necessary. This FAR change is scheduled for publication under FAC 90-46.

The Office of Naval Research (ONR) is drafting a new policy and procedures manual for appropriate ONR personnel to implement these changes. As a result of these changes, CPSRs will only be performed at those institutions with substantial expenditures under DOD and NASA awards (ONR's primary customers), for contractors with identified risk factors. Accordingly, fewer CPSRs will be performed, at less cost to our customers, and the reviews will be focused on high risk areas. The nature, timing and extent of these reviews will be coordinated with the institution's independent auditor.

RECOMMENDATION FOR CORRECTIVE ACTION

Page 9. Recommendation B:

"We recommend that the Director, Defense Procurement, issue policy guidance reminding contracting officers of the requirement to avoid duplicative purchasing system review procedures. The guidance should emphasize that when Federal auditors or reviewers are planning to perform audits or reviews at educational institutions and nonprofit organizations that are subject to the audit requirements of Office of Management and Budget Circular A-133, a coordinated audit approach is required to avoid duplication."

DON Comment: Concur. The Chief of Naval Research concurs with the policy of avoiding duplicative purchasing system review procedures to the extent practicable, and will issue appropriate implementing instructions to appropriate Office of Naval Research personnel based on policy guidance from the Director, Defense Procurement.

FINDING C. REBATES CLASSIFIED AS CONTRIBUTIONS

Page 10. Finding C:

"Two nonprofit organizations we reviewed...did not credit approximately $144,000 to Federal awards for amounts received

3

back from the public accounting firms that performed their OMB Circular A-133 audits...."

DON Comment: The DODIG draft report needs to clarify whether the nonprofit institutions, Creating Economic Opportunity Council, Inc. and Focus: HOPE, were the only two recipients reviewed that had a problem with rebates (contributions) relative to audit services provided by the public accounting firms, or did the problem also exist at the other 41 recipients.

RECOMMENDATION FOR CORRECTIVE ACTION

Page 12. Recommendation C:

We recommend that Director, Defense Logistics Agency, and the Chief of Naval Research:

1. Instruct the contracting officers to determine the amount of overcharging of Federal awards and then issue a demand for payment to Creating Economic Opportunity Council, Inc., and Focus: HOPE that overcharged Federal awards.

2. Query all grantees under their cognizance to determine if rebates have been received from accounting firms and not properly credited to grants and contracts. Action should be taken, as appropriate, to recoup the monies due to the Government.

3. Issue guidance to contracting officers requiring that all rebates by auditing firms be credited to the Government.

DON Comment: Concur. The Office of Naval Research (ONR) will implement these recommendations within thirty days after issuance of the DODIG report for those educational or nonprofit institutions under the cognizance of ONR and for which ONR has the responsibility to establish indirect cost rates under Office of Management and Budget Circulars A-21 and A-122.

PART II - ADDITIONAL INFORMATION

Pages 16, 17 and 18, Appendix C. Institutions Selected for Evaluation:

Appendix C is a listing of educational and nonprofit institutions selected for evaluation.

DON Comment: Appendix C, listing 43 recipients, does not reconcile with Appendix F (pages 23 and 24), the Nonprofit Institutions Evaluated. Appendix C lists 43 recipients and includes the Medical College of Pennsylvania. However, Appendix F, which lists 44 institutions, does not include the Medical

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College of Pennsylvania, but does include the Allegheny Health, Education and Research Foundation, and the University of California.

Pages 16, 17 and 18, Appendix C:

"Cognizant Agency" in header.

DON Comment: Recommend the DODIG report clarify that "Cognizant Agency" is that agency having negotiation responsibility for the establishment of indirect cost rates under OMB Circular A-21 or A-122.

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Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

IN REPLY REFER TO DDAI

4 APR 1997

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

SUBJECT: Draft Report on the Procurement of Single Audits by Recipients of Federal Awards, 6OA-0096.00

Enclosed is our response to your request of 30 January 1997. The DLA action officer is Dave Stumpf, 767-6266.

Encl

OLIVER E. COLEMAN
Acting Chief
Internal Review Office

cc:
AQCBA
AQOC

Federal Recycling Program Printed on Recycled Paper

SUBJECT: Procurement of Single Audits by Recipients of Federal Awards, 6OA-0096.00

FINDING A: PROCUREMENT OF SINGLE AUDITS.

Thirteen of the 43 recipients surveyed did not procure their OMB Circular A-133 single audit in accordance with OMB Circular A-110. Specifically the 13 recipients, with expenditures of $2.7 billion in FY 1993, did not compete the procurement of their OMB Circular A-133 single audit. Eleven of the 13 recipients did not document and justify their basis for auditor selection. While all recipients had written procurement policies and procedures, auditor selection was made outside the purview of the purchasing department. As a result, assurance of a fair and reasonable price for the audit was lacking, auditor independence was questionable, and there was a lack of compliance with Federal requirements for procurement of single audits.

DLA COMMENTS: Concur. The OMB circular A-133 is clear in stating that "In arranging for audit services institutions shall follow the procurement standards prescribed by Circular A-110, "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and other Nonprofit Organizations." Written procedures established in accordance with OMB Circular A-110 must be consistently applied in the course of performance under Federal assistance awards.

ACTION OFFICER: Timothy J. Frank, AQOC, (703) 767-3431
APPROVAL: Gary S. Thurber, Deputy, DCMC
COORDINATION: Dave Stumpf, DDAI, 767-6266

DLA APPROVAL:

4 APR 1997

SUBJECT: Evaluation Report on the Procurement of Single Audits by Recipients of Federal Awards, 6OA-0096.00

FINDING C: Rebates Classified as Contributions. Two nonprofit organizations we reviewed, Creating Economic Opportunity Council, Inc. (CEO) and Focus: HOPE, did not credit approximately $144,000 to Federal awards for amounts received back from the public accounting firms that performed their OMB Circular A-133 audits. The monies received were identified as contributions to the nonprofit organizations based on the wording in their audit contracts. As a result, Federal awards were overcharged and Federal award funds were used for the general purposes of the nonprofit organization.

DLA COMMENTS: Partially concur. Our specific comments are provided with respect to Creating Economic Opportunity Council, Inc. (CEO), which is administered by DCMC. The finding regarding CEO is based upon a letter of agreement for audit services from Plante and Moran (P&M), an accounting firm, to CEO, which describes the services to be provided and sets the price of the audit. The letter also states that P&M will make a contribution in the amount of $2,500 to CEO, "upon completion of our engagement."

Although we agree that provision for a contribution in the same letter which provides for audit services gives the appearance of a refund, we do not believe that there is conclusive evidence at this time to support issuing a demand for repayment based on overcharging for Federal awards. We believe that there are two questions impacting on this issue, past practice regarding contributions, and the adequacy of competition.

CEO, Inc. stated in a November 25, 1996 letter to the DoD IG, that P&M was selected through a competitive bidding process. If this is the case, the basis for concluding that the contribution is in fact a rebate would be difficult to support, particularly in consideration of the relatively small amount of money involved. To resolve this question we will instruct DCMC Grand Rapids to review the circumstances of the selection of P&M as auditor for CEO in 1992 and for subsequent years.

We will also instruct DCMC Grand Rapids to review the past practice of contributions to CEO, Inc. to determine whether the P&M contribution was in a manner consistent with the contributions of other firms and consistent with prior contribution by P & M.

If these two reviews determine that the competition was adequate, and that the P&M contribution was made in a manner consistent with past practice, we would accept their position that the $2,500 contribution was in fact unrelated to the audit transaction and does not constitute a rebate. Otherwise, the Administrative Contracting Officer will be instructed to treat the amount as a rebate and pursue appropriate credits to Federal awards.

We do not consider that it is necessarily improper for a vendor of a nonprofit organization to make a contribution to support the activities of that nonprofit organization, however. in such cases, the transactions should be clearly separate, and the file documented sufficiently to satisfy that no impropriety occurred.

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