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QUALITY CONTROL REVIEW OF
PRICEWATERHOUSECOOPERS L.L.P
CALIFORNIA INSTITUTE OF TECHNOLOGY
FISCAL YEAR ENDED SEPTEMBER 30, 1997

Report Number D-2000-6-002

November 19, 1999

Office of the Inspector General
Department of Defense

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Acronyms

DCAA	Defense Contract Audit Agency
NASA	National Aeronautics and Space Administration
OIG	Office of Inspector General
OMB	Office of Management and Budget
PwC	PricewaterhouseCoopers LLP



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November 19, 1999

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SUBJECT: Quality Control Review of PricewaterhouseCoopers LLP
And the Defense Contract Audit Agency
California Institute of Technology
Fiscal Year Ended September 30, 1997
Report No. D-2000-6-002 (Project No. 90A-1002.1)

Introduction

We are providing this report for your information. The California Institute of Technology (Caltech) is a private, not-for-profit institution of higher education based in Pasadena, California. As the cognizant audit agency for Caltech, the Office of Inspector General, Department of Defense (OIG, DoD) performed a joint review with the Office of Inspector General, National Aeronautics and Space Administration (OIG, NASA), of the Circular A-133 Audit of Caltech for the fiscal year (FY) ended September 30, 1997. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The offices of PricewaterhouseCoopers LLP (PwC), Los Angeles, California and the Defense Contract Audit Agency (DCAA), West Covina, California, performed the single audit for Caltech. For the fiscal year ended September 30, 1997, Caltech reported total Federal expenditures of \$209,451,263, representing \$32,729,941 for DoD, \$18,863,796 for NASA, and \$157,857,526 for other Federal agencies.

PwC and DCAA performed the FY 1997 audit using a coordinated audit approach. DCAA's audit work was limited to the Research and Development program. DCAA

performed the internal control and compliance testing relating to activities allowed or unallowed, allowable costs/cost principles, cash management, matching (related to allowable costs/cost principles), and special tests and provisions (related to activities allowed or unallowed and allowable costs/cost principle).

Quality Control Review Results

The PwC audit report on Caltech was dated February 10, 1998 and June 30, 1999. The auditors identified reportable conditions pertaining to internal control over financial reporting and compliance. PwC issued an unqualified opinion of the financial statements, Schedule of Federal Awards, and compliance with requirements applicable to each major program. The auditors found no instances of noncompliance in the financial statement audit that required reporting under generally accepted government auditing standards. Finally, the auditors identified no material weaknesses related to internal control for the financial statements or major programs.

The DCAA audit report on Caltech was dated June 29, 1999. The auditors identified reportable conditions for internal controls and questioned costs related to the findings on compliance requirements. DCAA issued an unqualified opinion on compliance for the research and development major program. Finally, the auditors identified no material weaknesses related to internal controls for the major program.

The PwC and DCAA audit work generally meets the applicable guidance and regulatory requirements of OMB Circular A-133 and its related Compliance Supplement, which incorporate generally accepted auditing standards and generally accepted government auditing standards. A summary of findings and questioned costs is provided in Enclosure 1.

Quality Control Review Objective

The objective of our quality control review was to ensure that the audit was conducted according to applicable standards and meets the auditing requirements of OMB Circular A-133. We focused our review on the following qualitative aspects of the audit: auditor qualifications, independence, due professional care, quality control, planning, supervision, major program determinations, and the Schedule of Federal Awards.

In 1998 Coopers & Lybrand LLP and Price Waterhouse LLP merged to form PwC. We reviewed the most recent peer review letters, issued November 6, 1996 and October 28, 1997, by Deloitte & Touche LLP and Ernst & Young LLP, for Price Waterhouse LLP and Coopers & Lybrand LLP, respectively. The peer review letters stated that the firms met the objectives of the quality control review standards

established by the American Institute of Certified Public Accountants and complied with the standards during the fiscal years ended June 30, 1996 (Price Waterhouse LLP) and March 31, 1997 (Coopers & Lybrand LLP).

Scope and Methodology

We used a draft of the upcoming 1999 edition of the Uniform Quality Control Guide for A-133 Audits (the Guide) to perform our review. The Guide is the President's Council on Integrity and Efficiency's approved guidance for performing the quality control review procedures. The Guide is organized by the general and fieldwork audit standards and the required elements of a single audit. Our review was conducted from July 19 through 30, 1999, and covered areas related to the financial statements and the research and development program. We did not review compliance with requirements related to the other major programs, as defined by OMB Circular A-133. The other major program at Caltech FY 1997 was the Student Financial Aid program for the Department of Education.

Results of Prior Quality Control Reviews

Since July 1996, we have performed nine quality control reviews of Coopers & Lybrand LLP, one quality review of Pricewaterhouse LLP, and one quality review of PricewaterhouseCoopers LLP. We identified conditions resulting in quality control review findings and made recommendations at several locations. We notified the affected offices, and no further action is necessary.

Background

The Inspector General Act of 1978 prescribes the duties and responsibilities of that office. In implementing those responsibilities, the Inspectors General are 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 (the Act) was intended to improve the financial management of state and local governments, while OMB Circular A-133 (the Circular) was intended to improve financial management for nonprofit organizations. The Act and the Circular established uniform requirements for audits of Federal awards, promoted efficient and effective use of audit resources, and helped 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 incorporate the previously excluded nonprofit organizations. Including the nonprofit organizations strengthened the

usefulness of the audits by establishing one uniform set of auditing and reporting requirements for all Federal award recipients that are required to obtain a single audit. The Act Amendments increased the threshold to trigger an audit requirement from \$25,000 to \$300,000; prescribed a risk-based approach to determine major programs; and, shortened and streamlined the report submission process.

The OMB Circular A-133 was revised on 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. The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal award expenditures are, or exceed, \$300,000 annually. It provides that an audit made in accordance with the Circular shall be in lieu of any financial audit required under individual Federal awards. Federal agencies must rely on the audit to the extent that it provides the information and assurances needed to perform overall agency responsibilities. 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.

Discussion of Results

During our quality control review, we reviewed and took no exception to the working papers supporting the following reports prepared by PwC and DCAA.

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

Report of Independent Accountants on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards. The auditor is required to obtain a sufficient understanding of internal controls to plan the audit and to assess control risk for the assertions embodied in the financial statements. The auditor is also required to determine whether the recipient has complied with laws, regulations, contracts and grants that may have a direct and material effect in determining financial statement amounts. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the results of the testing of controls.

Report of Independent Accountants on Compliance with Requirements Applicable to each Major Program and on Internal Control over Compliance in Accordance with Selected Components of OMB Circular A-133. The auditor is required to determine whether the recipient has complied with laws, regulations, contracts and grants that may have a direct and material effect on each of its major Federal programs. The auditor is also required to obtain a sufficient understanding of the internal control over compliance for Federal programs to plan the audit to support a low assessed level of control risk for major programs. They must plan and perform testing of internal controls over compliance to support a low assessed level of control risk for assertions relevant to the compliance requirements for each major program. PwC was not responsible for auditing Caltech's compliance with the following requirements applicable to the research and development program: Activities allowed or unallowed; allowable costs/cost principles; cash management; matching (related to allowable costs/cost principles); and special tests and provisions (related to activities allowed or unallowed and allowable costs/cost principles.) We reviewed the audit programs for appropriate procedures, the working paper documentation and related support, and the compliance and internal control testing performed.

DCAA Report on California Institute of Technology's Compliance with Requirements Applicable to Major Programs and on Internal Control Over Compliance in Accordance with OMB Circular A-133, Fiscal Year 1997. 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 research and development program. DCAA was responsible for auditing compliance with the following general and specific requirements: cash management; allowable costs and cost principles; types of services allowed or unallowed; and special tests and provisions related to allowable costs and cost principles. We reviewed the audit program for the appropriate procedures, reviewed the working paper documentation and related support, and reviewed the compliance tests performed.

The auditor is required to obtain an understanding of the internal control over compliance, assess control risk and perform tests of controls on the policies and procedures designed to provide reasonable assurance that Federal awards are managed in compliance with applicable laws, regulations, and contract terms. The auditor must also test the controls in effect to ensure that direct and indirect costs are properly computed and billed. DCAA was responsible for evaluating the internal controls related to the following general and specific requirements: cash management; allowable costs and cost principles; types of services allowed or unallowed; and special tests and provisions related to allowable costs and cost principles. We reviewed the audit programs for appropriate procedures, the working paper documentation and related support, and the results of the testing of controls.

Comments

If you have questions on this report, please contact Ms. Barbara Smolenyak at (703) 604-8761 or by e-mail at bsmolenyak@dodig.osd.mil. The report distribution is included as Enclosure 2.

A handwritten signature in cursive script that reads "Donald E. Davis".

Donald E. Davis
Deputy Assistant Inspector General
for Audit Policy and Oversight

Enclosures

**Fiscal Year Ended September 30, 1997
Findings and Questioned Cost**

PricewaterhouseCoopers LLP

<u>Finding Reference</u>	<u>Report Page</u>	<u>Finding Description</u>	<u>Costs Questioned</u>	<u>Resolution Agency</u>
97-1	27-30	Reportable Conditions-Financial Reporting	None	DoD
97-2	31	Matching	None	DoD
97-3	32	Close-out Procedures	None	DoD
97-4	34	Property Management	None	DoD
97-5	35	Procurement Policy	None	DoD
97-6	36	Subrecipient Monitoring	None	DoD
97-7	37	Federal Reporting	None	DoD
97-8	38	Davis Bacon	None	DoD
97-9	39	Suspension and Debarment	None	DoD
97-10	40	Program Income	None	DoD

Defense Contract Audit Agency - Caltech Compliance and Internal Control, Report 4901-98P10150001

<u>Finding Reference</u>	<u>Report Page</u>	<u>Finding Description</u>	<u>Costs Questioned</u>	<u>Resolution Agency</u>
97-1 thru 97-5 97-19 thru 97-22	15,64	Indirect Cost Finding Depreciation & Use Allowance	\$ 806,446	DoD
97-6 thru 97-12 97-19 thru 97-22	15,64	Indirect Cost Finding Operations & Maintenance	6,560,435	DoD
97-13 97-19 thru 97-22	15,64	Indirect Cost Finding General Administration	209,221	DoD
97-14 97-19 thru 97-22	15,64	Indirect Cost Finding Departmental Administration	5,210,316	DoD
97-16 97-19 thru 97-22	15,64	Indirect Cost Finding Sponsored Projects Administration	1,189,128	DoD
97-15 97-19 thru 97-22	15,64	Indirect Cost Finding Student Services	1,260,470	DoD
97-17 thru 97-18 97-19 thru 97-22	15,64	Indirect Cost Finding Library	276,151	DoD
97-23 thru 97-25	78	Indirect Cost Finding - Staff Benefits	1,745,000	DoD
97-26	82	Reportable Condition-Activities Allowed or Unallowed and Allowable Costs/Cost Principles	None	DoD
97-27	82	Reportable Condition-Allowable Costs/Cost Principles	None	DoD
97-28	83	Reportable Condition-Allowable Costs/Cost Principles	None	DoD

California Institute of Technology
Fiscal Year Ended September 30, 1997

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California Institute of Technology
Fiscal Year Ended September 30, 1997

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