Policy and Oversight

Financial and Performance Audits Directorate

Quality Control Review

KPMG Peat Marwick LLP
Corporation of Mercer University
Fiscal Year Ended June 30, 1995

Report Number PO 97-023 June 11, 1997

Office of the Inspector General
Department of Defense

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Acronyms

AICPA	American Institute of Certified Public Accountants
DOD	Department of Defense
GAS	Government Auditing Standards
OMB	Office of Management and Budget
SFA	Student Financial Aid

INSPECTOR GENERAL
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400 ARMY NAVY DRIVE
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June 11, 1997

KPMG Peat Marwick LLP
345 Park Avenue
New York, New York 10154-0004

SUBJECT: Quality Control Review of KPMG Peat Marwick LLP
Corporation of Mercer University
Fiscal Year Ended June 30, 1995
Report No. PO97-023

Introduction

We are providing this report for your information and response. Your Atlanta, Georgia, office performed the single audit for the Corporation of Mercer University (Mercer), Macon, Georgia, a nonprofit educational institution. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." Mercer reported total Federal award expenditures of $13,874,010 for the fiscal year ended June 30, 1995, representing $8,356,531 for the Department of Defense (DoD) and $5,517,479 for other Federal agencies.

KPMG Peat Marwick LLP (KPMG) issued its audit report September 8, 1995. The auditors issued an unqualified opinion on the financial statements, Schedule of Federal Awards, and compliance with specific requirements applicable to major programs. They issued positive and negative assurance statements on compliance with general requirements. 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 the institution 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 report describes the auditors' scope of work in obtaining that understanding and assessing control risk. The report on 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.

Quality Control Review Results

The working papers supporting the OMB Circular A-133 audit generally met the applicable guidance and regulatory requirements in the OMB Circular A-133, its related compliance supplement, Government Auditing Standards (GAS), and Generally Accepted Auditing Standards. We found deficiencies that must be corrected for us to accept the OMB Circular A-133 audit. See Discussion of Results.

Quality Control Review Objective

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

We reviewed the most recent peer review letter dated November 8, 1996, performed by Price Waterhouse LLP that found that KPMG met the objectives of the quality control standards established by the American Institute of Certified Public Accountants (AICPA) and that the standards were being complied with during the fiscal year ended March 31, 1996.

Scope and Methodology

We used the 1991 edition of the Uniform Quality Control Guide for Single Audits (the Guide) that was approved 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. It is further divided into the substantive work performed during the audit of the financial statements and the specific program compliance testing for major programs. In addition, we supplemented the Guide to include additional review of transaction testing. Our review was conducted from October 21 through 25, 1996.

We limited the scope of our quality control review to the audit working papers covering areas related to expenditures of Department of Defense awards, the financial statements, and major programs other than student financial aid (SFA). The non-SFA program expenditures were approximately $10.2 million and accounted for 73 percent of total Federal award expenditures.

Results of Prior Quality Control Reviews

From January 1, 1995, through December 31, 1996, we conducted five quality control reviews of KPMG working papers at various locations. We identified quality control findings involving unallowable costs testing and we identified missing information from management representation letters. 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 these 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; establish uniform requirements for audits of Federal financial assistance; promote efficient and effective use of audit resources; and 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 in Federal financial assistance before an audit is required under the Act; selecting programs to be audited on the basis of risk assessment rather than the amount of dollars involved; and improving the contents 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.

The OMB Circular A-133 establishes the Federal audit and reporting requirements for nonprofit and educational institutions whose Federal awards are or exceed $100,000. It 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 implement 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. It 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 Circular

is currently being revised to incorporate the changes in the Single Audit Act Amendments of 1996.

Discussion of Findings

During our quality control review, we reviewed and took exception to the working papers supporting the following report:

Independent Auditors' Reports on Compliance With General Requirements and Compliance With Specific Requirements Applicable to Major Programs. 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. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to ensure all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and re-evaluated selected compliance items.

KPMG did not take an adequate sample of certain major Federal program award expenditures. Also, although the results of the judgmental sample of major Federal program award expenditures were documented, KPMG did not document the sampling criteria in the working papers.

Paragraph 6.28 of the AICPA Statement of Position 92-9 states that "the auditor's professional judgment should be used when selecting sample sizes. However, when exercising that professional judgment, the auditor should be aware that samples of a few items with low dollar value from a large population will probably not be sufficient to enable the auditor to express an opinion concerning compliance." Section 4.37 of GAS states that "working papers should contain the objectives, scope, and methodology, including any sampling criteria used."

Except for the SFA major program that was tested separately, KPMG did not take an adequate sample of major Federal program award expenditures, totaling $10,189,217. According to KPMG, the sample taken provided the assurance necessary to report on Mercer's compliance with general and specific requirements. For fiscal year 1995, KPMG tested 17 of the other Federal major program expenditures for compliance with general and specific requirements. The sample had a total value of $133,884. Although expenditures of DoD awards accounted for 82 percent of the non-SFA Federal major program expenditures at Mercer, only 6 of the 17 non-SFA major program transactions tested were related to expenditures of DoD awards. The DoD transactions tested totaled $50,191 and represented only 0.5 percent of the total non-SFA major program award expenditures of $10,189,217. KPMG did not explain why the sampling criteria was not documented in the working paper file.

Since an inadequate sample of non-SFA Federal major program award expenditures was taken, the risk of material misstatement is unacceptably high compared to if a more representative sample was used. Also, without the sampling criteria in the working papers, we could not determine whether the sample selection method and other criteria used to select a sample of Federal major program expenditures were adequate.

We concluded that a representative sample of DoD award expenditures was not taken; therefore, we cannot determine whether the audit position is adequately supported.

Recommendations for Corrective Action

We recommend that KPMG Peat Marwick LLP:

1. Apply audit tests to a more representative number of expenditures of non-Student Financial Aid major program award expenditures. We suggest stratifying the universe of Federal award expenditures so that higher dollar items have an increased possibility of selection and greater assurance is obtained that material misstatements will be detected.

2. Take appropriate action to ensure its audit staff uses proper sampling criteria and documents the results in all Office of Management and Budget Circular A-133 audits.

Discussion of Results

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

Independent Auditors' Report. 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 Auditors' Report on 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 the amounts in the report to the recipient's records.

Independent Auditors' Report on the Internal Control Structure Based on an Audit of Financial Statements 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 assess control risk for the assertions embodied in the financial statements. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the substantive testing performed.

Independent Auditors' Report on the 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 non-compliance, review the system for monitoring subrecipients and obtaining and acting on subrecipient audit reports, and determine whether controls are effective to ensure direct and indirect costs are computed and billed in accordance with the general 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 Auditors' Report on Compliance With Laws, Regulations, Contracts, and Grants Based on an Audit of 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 Auditors' Report on Management Assertions Applicable to Specific Compliance Requirements. This report is not required. The auditors examined assertions in management's representation letter dated October 13, 1995, that Mercer complied with the U.S. Department of Education's regulations relative to institutional eligibility for the year ended June 30, 1995. We did not perform work related to this report.

Independent Auditors' Report on Compliance With Specific Requirements Applicable to Nonmajor Program Transactions. 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 nonmajor Federal programs that were tested during the financial statement audit. We reviewed the audit program for the appropriate procedures, checked the audit program steps to those in the Compliance

Supplement to make sure all areas were audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and re-evaluated selected compliance items.

Schedule of Findings and Questioned Costs. The auditor is required to report findings and questioned costs in a separate schedule in the audit report. The recipient is responsible for forwarding the audit report to the Federal grantor agencies. All findings pertained to the Department of Education. We did not trace the findings in the working papers to the audit report. However, in a separate letter to the recipient management dated October 13, 1995, KPMG identified two immaterial findings involving the internal control structure and other operational matters (see enclosure).

Comments

Since this report contains findings and recommendations, we request your written comments within 60 days of the date of this report. We appreciate the courtesies extended during the review. If you have questions on this report, please contact Mr. Donald Steele, Project Manager, at (703) 604-8705.

Russell A. Rau
Assistant Inspector General
Policy and Oversight

Enclosure

cc: Mr. James Dykhouse
KPMG Peat Marwick LLP
Atlanta, Georgia

Board of Trustees
Corporation of Mercer University
Macon, Georgia

Resident Representative
Office of Naval Research
Atlanta Regional Office
Atlanta, Georgia

Corporation of Mercer University
Fiscal Year Ended June 30, 1995

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Finding #	Title	Agency
General		
1	Financial Aid Transcripts	DoEd
2	Refund Procedures	DoEd
Federal Perkins Loan Program		
3	Promissory Note Incomplete	DoEd
Federal Family Educational Loan Program		
4	Student Endorsement	DoEd
5	Disbursement Prior to Entrance Interview	DoEd
Higher Education Assistance Loan		
6	Entrance Counseling Documentation	DoEd
7	Federal Reporting	DoEd

MANAGEMENT LETTER FINDINGS
October 13, 1995

Finding #	Title	Agency
General		
1	Supporting Documentation	DoEd
2	Loan Action Improperly Completed	DoEd

DoEd Department of Education

Enclosure

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