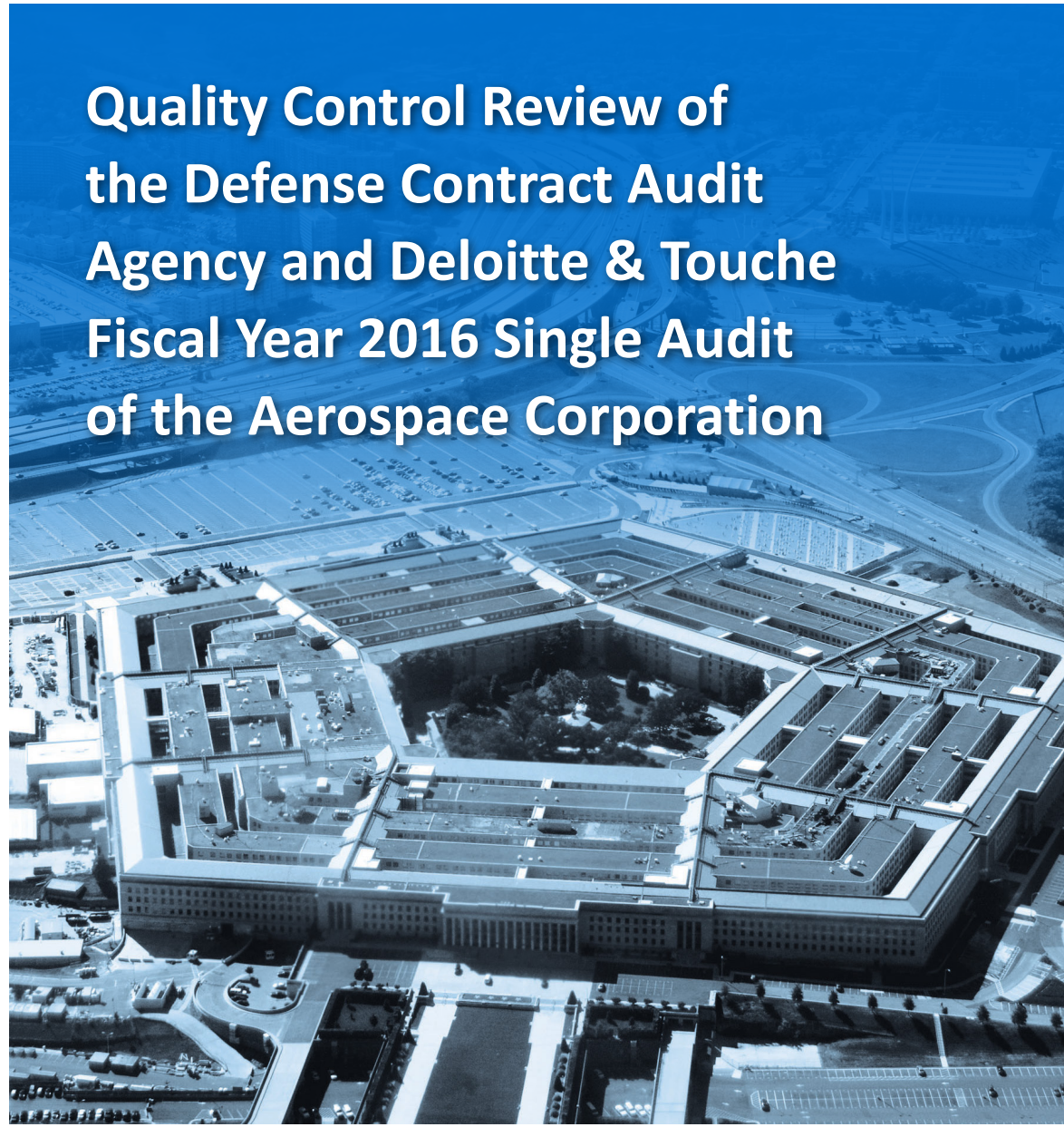




INSPECTOR GENERAL

U.S. Department of Defense

MARCH 17, 2020



Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche Fiscal Year 2016 Single Audit of the Aerospace Corporation

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





Results in Brief

Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche Fiscal Year 2016 Single Audit of the Aerospace Corporation

March 17, 2020

Objective

The objective of this quality control review was to determine whether the Defense Contract Audit Agency (DCAA) and Deloitte & Touche (D&T) LLP performed the FY 2016 single audit of the Aerospace Corporation (Aerospace) in accordance with auditing standards and Federal requirements.

Background

Public Law 104-156 (Single Audit Act) was enacted to promote sound financial management of Federal awards administered by non-Federal entities and to establish uniform requirements for audits of Federal awards. The Uniform Guidance in the Code of Federal Regulations sets forth the standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

Aerospace is a nonprofit corporation that was created to meet special long-term research and development needs in the nation's military space program. In FY 2016, Aerospace spent \$904.4 million in Federal funds on one major program referred to as the research and development cluster. The \$904.4 million included \$834.7 million in DoD awards. D&T and the DCAA performed the Aerospace FY 2016 single audit.

Findings

The DCAA did not comply with auditing standards related to audit documentation when performing the FY 2016 single audit of Aerospace because the DCAA auditors did

Findings (cont'd)

not document professional judgments they made to support the audit report opinion that they issued. As a result of DCAA's audit documentation not supporting the qualified audit report opinion, we had to obtain extensive explanations from the DCAA auditors to understand the professional judgments they made to support the opinion and to determine that the opinion was appropriate.

D&T generally complied with auditing standards and Uniform Guidance requirements when performing the Aerospace FY 2016 single audit. However, D&T auditors did not:

- consider the entire population of equipment, purchased with Federal funds, when they verified that Aerospace properly safeguarded and maintained equipment; or
- clearly document the audit procedures planned and performed when testing the operating effectiveness of Aerospace's internal controls over compliance with Federal requirements.

D&T's audit documentation was not sufficient to allow an experienced auditor with no ties to the audit to understand the work performed and reach the same conclusions. We had to obtain additional explanations from the D&T auditors and perform further analysis to determine that the audit procedures resulted in sufficient evidence to support the overall opinion on Aerospace's compliance with Federal requirements.

Recommendations

We recommend that the DCAA Branch Manager, Los Angeles South Branch Office, prepare audit documentation that provides a clear and accurate description of the professional judgments made in the FY 2016 single audit to support the audit report opinion that was issued.

For future single audits, we recommend that the D&T Managing Director:

- identify and document consideration of the population of all equipment purchased with Federal funds when designing the audit procedures to test that equipment is adequately safeguarded and maintained; and



Results in Brief

Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche Fiscal Year 2016 Single Audit of the Aerospace Corporation

Recommendations (cont'd)

- prepare audit documentation that clearly describes the planned internal control testing and the audit procedures performed to conclude on the operating effectiveness of internal controls over compliance with Federal requirements.

Management Comments and Our Response

The DCAA Assistant Director of the Integrity and Quality Assurance Directorate agreed with our recommendation and the DCAA auditors prepared supplemental audit documentation for the FY 2016 single audit. We verified that the supplemental audit documentation provided a clear and accurate description of the professional judgments the DCAA auditors made to support the qualified audit report opinion. As a result, we closed the recommendation for DCAA.

The D&T Managing Director agreed with our recommendations and stated that D&T will enhance audit procedures and documentation in accordance with our finding and recommendations. Comments from the D&T Managing Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but remain open. We will close the recommendations once we perform followup procedures to verify that D&T's corrective actions fully address our recommendations.

Please see the Recommendations Table on the next page for the status of recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Defense Contract Audit Agency Branch Manager, Los Angeles South Branch Office	None	None	A
Deloitte & Touche Managing Director	None	B.1, B.2	None

Note: The following categories are used to describe agency management’s comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.





**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE**
4800 MARK CENTER DRIVE
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March 17, 2020

Board of Trustees
Aerospace Corporation

Principal Director
Aerospace Corporation

Branch Manager
DCAA Los Angeles South Branch Office

Managing Director
Deloitte & Touche

SUBJECT: Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche
Fiscal Year 2016 Single Audit of the Aerospace Corporation
(Report No. DODIG-2020-070)

This final report provides the results of the DoD Office of Inspector General's quality control review. We previously provided copies of the draft report and requested written comments on the recommendations. We considered management's comments on the draft report when preparing the final report. These comments are included in the report.

The Defense Contract Audit Agency (DCAA) management comments and associated actions addressed the recommendation in this report and we consider the recommendation for DCAA to be closed. The Deloitte and Touche Managing Director agreed to address all the recommendations for Deloitte and Touche in this report; therefore, the recommendations are considered resolved and open. As described in the Recommendations, Management Comments, and Our Response section of this report, the recommendations may be closed when we receive adequate documentation showing that all agreed-upon actions to implement the recommendations have been completed. Therefore, upon completion of the FY 2017 single audit of the Aerospace Corporation, please provide us your response concerning specific actions in process or completed on the recommendations. Your response should be sent to [REDACTED]

If you have any questions, please contact [REDACTED]

A handwritten signature in black ink, appearing to read "Randolph R. Stone", is positioned above the printed name.

Randolph R. Stone
Assistant Inspector General for Evaluations
Space, Intelligence, Engineering, and Oversight



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Introduction

Objective

The objective of this quality control review was to determine whether the Defense Contract Audit Agency (DCAA) and Deloitte & Touche (D&T) LLP performed the FY 2016 single audit of the Aerospace Corporation (Aerospace) in accordance with auditing standards and Federal requirements.¹ Appendix A contains our scope and methodology. Appendix B lists the compliance requirements that D&T and the DCAA identified as direct and material to Aerospace's fiscal year that ended on September 30, 2016.

Background

Public Law 104-156 (Single Audit Act) was enacted to promote sound financial management of Federal awards administered by non-Federal entities and to establish uniform requirements for audits of Federal awards.² The Code of Federal Regulations (CFR), 2 CFR 200 (Uniform Guidance), sets the standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.³ The audit requirements in the Uniform Guidance became effective for non-Federal entity fiscal years beginning on or after December 26, 2014.⁴

Non-Federal entities that expend Federal funds of \$750,000 or more in a year are subject to the Single Audit Act and the Uniform Guidance requirements. Therefore, these entities must have an annual single or program-specific audit performed in accordance with Government Auditing Standards and must submit a complete reporting package to the Federal Audit Clearinghouse.⁵ The single audit includes an audit of the non-Federal entity's financial statements and Federal awards. The auditors performing the single audit determine whether the financial statements are presented fairly in all material respects in accordance with Generally Accepted Accounting Principles (financial statement audit). In addition, the auditors perform procedures on the non-Federal entity's internal controls over Federal programs and determine whether the non-Federal entity complied with Federal

¹ Auditing standards include the Government Accountability Office's, "Government Auditing Standards" and the American Institute for Certified Public Accountants, "Codification of Statements on Auditing Standards" (AU-C).

² Public Law 104-156, "Single Audit Act Amendments of 1996."

³ Office of Management and Budget, "Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards," commonly referred to as the Uniform Guidance, implemented in 2 CFR Part 200 (2019).

⁴ The effective date for the Uniform Guidance audit requirements is identified in 2 CFR sec. 200.110(b) (2019).

⁵ The reporting package includes the auditor's reports, the financial statements, the schedule of expenditures of Federal awards, the summary schedule of prior audit findings, and a corrective action plan. The Federal Audit Clearinghouse is designated by the Office of Management and Budget as the repository of record for single audit reports and maintains a database of completed audits, provides appropriate information to Federal agencies, and performs followup with auditees that have not submitted the required information.

statutes, regulations, and the terms and conditions of Federal awards that may have a direct and material effect on each of the non-Federal entity's major programs (Federal program audit).

The Aerospace Corporation Conducts Research and Development for the Military Space Program

Aerospace is a nonprofit corporation that was created to meet special long-term research and development needs in the nation's military space program. Aerospace's primary customers are the Space and Missile Systems Center of the Air Force Space Command and the National Reconnaissance Office. Aerospace also provides technical support to space-related programs managed by other agencies, international organizations, and governments. In FY 2016, Aerospace spent \$904.4 million in Federal funds on one major program, referred to as the research and development cluster.⁶ The \$904.4 million included \$834.7 million in DoD awards. Aerospace engaged D&T and the DCAA to perform the Aerospace FY 2016 single audit. The Federal Audit Clearinghouse received the FY 2016 single audit report on March 19, 2019.

Deloitte & Touche Performed Aerospace's Financial Audit and Part of Aerospace's Federal Program Audit

The D&T office in Los Angeles, California, performed Aerospace's FY 2016 financial statement audit and a portion of the Federal program audit. Specifically, for the Federal program audit, D&T was responsible for reviewing 7 of the 11 compliance requirements identified in Appendix B of this report.

D&T offers audit and assurance, consulting, regulatory, financial advisory, risk, and financial advisory services and tax services. As required by auditing standards, D&T maintains its own system of internal quality control over its accounting and auditing practice. The system of internal quality control is designed to provide D&T with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements.

Defense Contract Audit Agency Performed the Remaining Part of Aerospace's Federal Program Audit

For the Federal program audit, the DCAA Los Angeles South Branch Office in Los Angeles, California, was responsible for reviewing the remaining 4 of 11 compliance requirements identified in Appendix B and not covered by D&T. The DCAA provides audit and financial advisory services to the DoD and other

⁶ The research and development cluster is made up of a variety of research and development activities performed under different types of funding agreements, such as grants, cooperative agreements, and contracts that have similar requirements.

Federal entities responsible for acquisition and contract administration. The DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer. The DCAA primarily conducts contract audits and is organized into a Headquarters office; four corporate audit directorates organized by major contractors; three geographical regions primarily responsible for audits of other large, mid-sized, and small contractors; and a field detachment responsible for audits of classified work.

Review Results

The DCAA did not comply with auditing standards and Uniform Guidance requirements when performing the FY 2016 single audit of Aerospace because the DCAA auditors did not document professional judgments they made to support the audit report opinion that they issued (see Finding A). Additionally, D&T generally complied with auditing standards and Uniform Guidance requirements when performing the Aerospace FY 2016 single audit, except for two deficiencies that they must correct to improve future audits. First, the D&T auditors did not perform sufficient audit procedures to fully achieve the audit objective when they tested the equipment management compliance requirement. Second, the D&T auditors did not clearly document the audit procedures they planned and performed when testing the operating effectiveness of Aerospace's internal controls over compliance with Federal requirements (see Finding B).

Finding A

DCAA Audit Documentation Did Not Support the Audit Report Opinion

DCAA's audit documentation did not support the qualified audit report opinion that the DCAA issued in its Report on Compliance for the Research and Development Program (compliance report) for the Aerospace FY 2016 single audit.⁷ In the compliance report, the DCAA auditors stated that the qualified opinion was based on a material noncompliance involving Aerospace claiming expressly unallowable public relations and advertising costs.⁸ However, the DCAA audit documentation did not include evidence of the professional judgments the DCAA auditors made to support that a material noncompliance existed and a qualified audit report opinion should be issued. Instead, the audit documentation indicated that the noncompliance was not material, which would support an unmodified opinion. As a result of DCAA's audit documentation not supporting the qualified audit report opinion, we had to obtain extensive explanations from the DCAA auditors to understand the professional judgments they made to support the opinion and to determine that the opinion was appropriate.

DCAA Audit Documentation Did Not Support the Qualified Audit Report Opinion

DCAA's audit documentation did not support the qualified audit report opinion that the DCAA issued in its compliance report for the Aerospace FY 2016 single audit. Specifically, the DCAA auditors did not document the professional judgments they made as the basis for the qualified audit report opinion. Auditing standards state that the objective of the auditor is to prepare documentation that provides a sufficient and appropriate record of the basis for the auditor's report.⁹ The standards state that to meet this objective the auditors must prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation the conclusions and professional judgments they made in reaching those conclusions.¹⁰

⁷ AU-C, Section 705, "Modifications to the Opinion in the Independent Auditor's Report," paragraph .08, "Qualified opinion," requires a qualified opinion to be expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive.

⁸ Federal Acquisition Regulations (FAR), Part 2, "Definitions of Words and Terms," Subpart 2.1, "Definitions," Section 2.101, "Definitions," defines unallowable costs as any cost that, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost-reimbursements, or settlements under a Government contract.

⁹ AU-C, Section 230, "Audit Documentation," paragraph .05 "Objective."

¹⁰ AU-C, Section 230, "Audit Documentation," paragraph .08, "Form, Content, and Extent of Audit Documentation."

The DCAA auditors issued a qualified audit report opinion on Aerospace's compliance with Federal requirements based on Aerospace claiming unallowable public relations and advertising costs. However, the audit documentation states that the unallowable public relations and advertising costs represented only 0.02 percent of the total expenditures and were not material or pervasive to the audit. Without any additional explanation, the audit documentation supported the DCAA issuing an unmodified audit report opinion rather than a qualified opinion.¹¹

Additional Explanations Were Required to Understand the Basis for the Audit Report Opinion

As a result of DCAA's audit documentation not supporting the qualified audit report opinion, we had to obtain extensive explanations from the DCAA auditors to understand the professional judgments they made to support the opinion and to determine whether the opinion was appropriate. The DCAA auditors explained that their audit documentation was intended to establish that the noncompliance was considered material but not pervasive because it did not have a significant impact on the audit. The DCAA auditors further explained that, in their professional judgment, the questioned costs represented a material noncompliance because Aerospace had claimed public relations and advertising costs that were expressly unallowable in accordance with Federal regulations and subject to a level-one penalty.¹² Therefore, the DCAA ultimately determined that a qualified audit report opinion was appropriate.

After considering DCAA's explanation, which was not included in the audit documentation, we determined that the qualified audit report opinion issued by the DCAA was appropriate. Auditing standards define a material noncompliance as a failure to follow compliance requirements or a violation of prohibitions included in the applicable compliance requirements.¹³ Furthermore, auditing standards establish that, when determining whether an entity has materially complied with the applicable compliance requirements, the auditor may consider, among other factors, the nature of the noncompliance with the applicable compliance requirements.¹⁴

¹¹ AU-C, Section 700A, "Forming an Opinion and Reporting on Financial Statements," paragraph .19, "Form of Opinion," requires an unmodified opinion to be issued when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Government Auditing Standards, Chapter 2, "Standards for Use and Application of GAGAS," Section 2.07(b) and 2.08, "Financial Audits" incorporate by reference the AICPA auditing standards and identify auditing compliance relating to one or more Government programs as another type of financial audit.

¹² FAR, Part 42, "Contract Administration and Audit Services," Subpart 42.7 "Indirect Cost Rates," Section 42.709, "Penalties for Unallowable Costs," states that if the final indirect cost proposal includes costs expressly unallowable under a cost principle, the Contracting Officer is responsible to determine whether penalties should be assessed. A level-one penalty is equal to the amount of the disallowed costs, plus interest on the paid portion, if any, of the disallowance.

¹³ AU-C, Section 935, "Compliance Audits," paragraph .11, "Definitions."

¹⁴ AU-C, Section 935, "Compliance Audits," paragraph .A31, "Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion."

As a result, we take no exception to the qualified audit report opinion based on DCAA's conclusion that the noncompliance, which involved claiming expressly unallowable public relations and advertising costs, was material to the audit.¹⁵ However, the DCAA auditors did not document the professional judgments they made to support the qualified audit report opinion. Therefore, the DCAA should prepare audit documentation for the FY 2016 single audit that provides a clear and accurate description of the professional judgments made to support the qualified audit report opinion that the DCAA issued.

Recommendation, Management Comments, and Our Response

Recommendation A

We recommend that the Defense Contract Audit Agency Branch Manager, Los Angeles South Branch Office, prepare audit documentation for the FY 2016 single audit that provides a clear and accurate description of the professional judgments made to support the qualified audit report opinion that the Defense Contract Audit Agency issued.

DCAA Comments

The DCAA Assistant Director of the Integrity and Quality Assurance Directorate agreed and stated that the DCAA auditors prepared supplemental audit documentation for the FY 2016 single audit on the professional judgments made to support the qualified audit report opinion.

Our Response

Comments from the DCAA Assistant Director addressed the specifics of the recommendation. We verified that the DCAA auditors prepared supplemental audit documentation that provided a clear and accurate description of the professional judgments they made to support the qualified audit report opinion. As a result, we closed this recommendation.

¹⁵ FAR, Part 31, "Contract Cost Principles and Procedures," Subpart 31.2, "Contracts with Commercial Organizations," Section 31.205-1, "Public relations and advertising costs," states that costs for advertising and public relations designed to promote or enhance a company image are unallowable.

Finding B

D&T Audit Procedures for Testing Equipment Management Compliance and Documenting Internal Control Testing Need Improvement

The D&T auditors generally complied with auditing standards and Uniform Guidance requirements when they performed the Aerospace FY 2016 single audit, except for two deficiencies that they must correct to improve future audits. First, the D&T auditors did not perform sufficient audit procedures to fully achieve the audit objective when they tested the equipment management compliance requirement. Specifically, the D&T auditors did not consider the entire population of equipment, purchased with Federal funds, when they verified whether Aerospace properly safeguarded and maintained the equipment. Second, the D&T auditors did not clearly document the audit procedures that they planned and performed when they tested the operating effectiveness of Aerospace's internal controls over compliance with Federal requirements.

As a result, D&T's audit documentation was not sufficient to allow an experienced auditor with no ties to the audit to understand the work performed and reach the same conclusions, as required by auditing standards. We had to obtain explanations from the D&T auditors and perform additional analysis to determine that the audit procedures resulted in sufficient evidence to support the overall opinion on Aerospace's compliance with Federal requirements.

D&T Compliance Testing Did Not Include All Federally Funded Equipment

The D&T auditors did not perform sufficient audit procedures to fully achieve the audit objective for the Federal equipment management compliance requirement. Specifically, the D&T auditors did not include all federally funded equipment when they performed compliance testing to determine whether Aerospace properly safeguarded and maintained Federal equipment. Auditors are required to use the Compliance Supplement when performing a single audit in accordance with the

Uniform Guidance requirements.¹⁶ The Compliance Supplement states that the audit objective for the equipment management compliance requirement is to determine whether the non-Federal entity:

- maintains proper records for equipment, and
- adequately safeguards and maintains the equipment.¹⁷

The Compliance Supplement also advises auditors that assessing equipment purchased with Federal funds only during the year under review may not properly address requirements for the continued use of equipment on federally sponsored programs or the non-Federal entity's safeguarding of equipment maintained over multiple years.¹⁸

When the D&T auditors designed the audit procedures to test compliance, the auditors selected a sample of 10 of the 38 equipment items that Aerospace purchased in FY 2016. We determined that this sample was appropriate to perform audit procedures on equipment purchased during the year under review. These procedures include reviewing approvals and verifying that the equipment purchased was accurately included in the property records. However, when the sample is limited to equipment purchased during the year under review, the audit procedures do not adequately address whether Aerospace was properly safeguarding and maintaining equipment purchased in prior years.

D&T's compliance testing included: 1) verifying that sampled equipment items were accurately included in the property records, and 2) physically inspecting two of the sampled equipment items to verify the items were adequately safeguarded and maintained. However, because the D&T auditors excluded equipment items purchased before FY 2016 from the sample, we determined that the physical inspection of equipment items was not sufficient to fully address whether Aerospace was adequately safeguarding and maintaining equipment as required by the audit objective identified in the Compliance Supplement.

D&T Auditors Did Not Clearly Document Internal Control Testing They Planned and Performed

The D&T auditors did not clearly document the audit procedures they planned and performed when testing the operating effectiveness of Aerospace's internal controls over compliance with Federal requirements. Auditing standards require that the documentation and audit evidence include sufficient detail to enable an experienced

¹⁶ 2 CFR Part 200 (2019), Appendix XI, "Compliance Supplement." The Office of Management and Budget issues the Compliance Supplement annually. The Supplement provides guidance to assist auditors in determining compliance requirements relevant to the audit, audit objectives, and suggested audit procedures. The Supplement dated June 2016 is applicable to the Aerospace FY 2016 single audit.

¹⁷ Compliance Supplement, Part 3, "Compliance Requirements," June 2016.

¹⁸ Compliance Supplement, Part 5, "Clusters of Programs," June 2016.

auditor with no previous connection to the audit to understand the nature, timing, and extent of audit procedures performed; the results of those audit procedures; the audit evidence obtained; significant professional judgments made; and the conclusions reached.¹⁹ The Uniform Guidance states that the auditor must perform procedures to obtain an understanding of internal controls over Federal programs, plan the testing of internal controls over compliance, and perform testing of internal controls as planned.²⁰

The D&T auditors documented their understanding of Aerospace's internal controls over compliance requirements identified as direct and material to the research and development cluster. The audit documentation included a description of Aerospace's internal control procedures and references to where the D&T auditors documented the testing of internal controls. However, the D&T auditors did not identify the relevant controls that they planned to test. In addition, the audit documentation referenced by the D&T auditors did not clearly identify the procedures the D&T auditors performed to determine that Aerospace's internal controls were operating effectively.

For example, the D&T auditors referenced the internal control testing for the period of performance compliance requirement to a work paper, which states that its purpose is to document the D&T auditors' compliance testing. However, the work paper did not clearly identify the specific procedures that the D&T auditors performed to support their conclusions on Aerospace's internal controls.

D&T Audit Documentation Was Not Sufficient to Allow an Experienced Auditor to Reach the Same Conclusions Without Additional Explanations

D&T's audit documentation was not sufficient to allow an experienced auditor with no ties to the audit to understand the work performed and reach the same conclusions. We had to obtain additional explanations from the D&T auditors and perform further analysis to determine that the audit procedures resulted in sufficient evidence to support the overall opinion on Aerospace's compliance with Federal requirements.

We requested that the D&T auditors explain why the audit procedures did not include equipment purchased prior to FY 2016. The D&T auditors explained that the value of all the federally funded equipment was immaterial when compared to Aerospace's total Federal expenditures. We confirmed that the population of all equipment was not significant in relation to Aerospace's total FY 2016 Federal expenditures. Therefore, we determined D&T's overall opinion on Aerospace's

¹⁹ AU-C, Section 230, "Audit Documentation," paragraph .08, "Form, Content, and Extent of Audit Documentation."

²⁰ 2 CFR sec. 200.514 (2019).

compliance with Federal requirements would not be significantly impacted as a result of D&T not selecting a sample from all equipment. Furthermore, it would be impractical for the D&T auditors to re-perform their testing of equipment since the composition of Aerospace's inventory may have changed significantly since FY 2016. As a result, we are not recommending that D&T perform additional procedures for the FY 2016 single audit. However, in future audits, compliance testing of all federally funded equipment should be performed when the auditor determines the equipment compliance requirement is direct and material to the research and development cluster. For future single audits, D&T should identify and document its consideration of all equipment purchased with Federal funds when designing the audit procedures to test that equipment is adequately safeguarded and maintained.

We also asked the D&T auditors to explain how the audit documentation supported conclusions on the operating effectiveness of Aerospace's internal controls. In response, the D&T auditors stated that they believed that the audit documentation was sufficient to support the audit conclusions, although they acknowledged that their documentation could be improved. For the FY 2016 audit, the D&T auditors provided us with a spreadsheet that was not part of the working papers, identifying the internal control testing they performed. Based on the spreadsheet, we were able to understand the nature and extent of D&T's testing of internal controls over Federal requirements and to verify the audit procedures they performed. As a result, we concluded that D&T performed sufficient audit procedures to support conclusions that Aerospace's internal controls were operating effectively. For future single audits, D&T should prepare audit documentation that clearly describes the planned internal control testing and the audit procedures performed to conclude on the operating effectiveness of internal controls over compliance with Federal requirements.

Recommendation, Management Comments, and Our Response

Recommendation B

For future single audits, we recommend the Deloitte & Touche Managing Director:

- 1. Identify and document consideration of the population of all equipment purchased with Federal funds when designing the audit procedures to test that equipment is adequately safeguarded and maintained.**
- 2. Prepare audit documentation that clearly describes the planned internal control testing and the audit procedures performed to conclude on the operating effectiveness of internal controls over compliance with Federal requirements.**

Deloitte and Touche LLP Comments

The D&T Managing Director agreed and stated that D&T will enhance audit procedures and documentation in the areas noted in our finding and recommendations for the FY 2017 single audit of Aerospace Corporation.

Our Response

Comments from the D&T Managing Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but remain open. We will close the recommendations once we perform followup procedures on the FY 2017 single audit of the Aerospace Corporation to verify that the corrective actions were taken to improve audit documentation.

Appendix A

Scope and Methodology

We conducted our quality control review from June 2019 through January 2020 in accordance with the “Quality Standards for Inspection and Evaluation,” published in January 2012 by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). Those standards require that we adequately plan the review to ensure that objectives are met and that we perform the review to obtain sufficient, competent, and relevant evidence to support the findings, conclusions, and recommendations. We believe that the evidence we obtained was sufficient, competent, and relevant to lead a reasonable person to sustain the findings, conclusions, and recommendations.

We evaluated the FY 2016 single audit of Aerospace performed by D&T and the DCAA using the 2016 edition of the CIGIE “Guide for Quality Control Reviews of Single Audits.” The report identified one major program at Aerospace, the research and development cluster. We focused our review on the following aspects of the single audit.

- Qualification of auditors
- Auditor independence
- Due professional care
- Planning and supervision
- Audit Follow Up
- Internal control and compliance testing
- Schedule of expenditures of Federal awards
- Reporting

We visited the D&T office and the DCAA Los Angeles South Branch Office, both located in Los Angeles, California; interviewed the D&T and DCAA auditors; and reviewed the audit files that D&T and the DCAA prepared for the FY 2016 Aerospace single audit to assess whether the audit was conducted in accordance with auditing standards and Uniform Guidance requirements. Auditing standards include the Government Accountability Office’s “Government Auditing Standards” and the American Institute for Certified Public Accountants “Codification of Statements on Auditing Standards.” Uniform Guidance requirements for the single audit are identified in 2 CFR part 200.

Our review included evaluating evidence of the D&T and DCAA auditor qualifications, independence, and quality assurance. We also reviewed all audit documentation that D&T prepared to support the audit opinions on Aerospace's financial statements, the schedule of expenditures of Federal awards, and compliance with the compliance requirements applicable to the research and development cluster. For the opinion on compliance, D&T was responsible for auditing 7 of 11 applicable compliance requirements identified in Appendix B. We reviewed the documented audit procedures that D&T performed to test both Aerospace's internal controls and compliance for each of the seven compliance requirements. We discussed the audit procedures performed with the D&T auditors as necessary to understand the audit work performed and analyzed additional information they provided as support to their responses.

Additionally, we reviewed the audit documentation prepared by the DCAA to support its opinion on Aerospace's compliance with the compliance requirements applicable to the research and development cluster. For the opinion on compliance, the DCAA was responsible for auditing the remaining 4 of 11 compliance requirements identified in Appendix B and not covered by D&T. We evaluated the documented audit procedures that the DCAA performed to test both Aerospace's internal controls and compliance for each of the four compliance requirements. We discussed the audit procedures performed with the DCAA auditors as necessary to understand the audit work performed and the basis for their conclusions.

Use of Computer-Processed Data

We did not use computer-processed data to perform this quality control review.

Prior Coverage

During the last 5 years, the DoD Office of Inspector General (DoD OIG) issued one report discussing D&T single audits and two reports discussing DCAA single audits. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

DoD OIG

Report No. DODIG-2018-005, "Quality Control Review of the Deloitte & Touche LLP FY 2015 Single Audit of the Battelle Memorial Institute," October 27, 2017

The DoD OIG determined that D&T generally met auditing standards and Office of Management and Budget Circular No. A-133 requirements. However, D&T did not include an opinion paragraph in the report on Battelle Memorial Institute's compliance with requirements that are direct and material to the research and development cluster. In addition, D&T did not always properly define the population of transactions when performing audit sampling and did not always

provide a clear description of the audit procedures performed and evidence obtained to support its conclusions on compliance requirements identified as direct and material.

Report No. DODIG-2017-024, "Quality Control Review of the Ernst & Young LLP and the Defense Contract Audit Agency FY 2014 Single Audit of SRC, Inc.," November 14, 2016

The DoD OIG determined that the DCAA complied with the auditing standards and Office of Management and Budget Circular No. A-133 requirements in performing the SRC FY 2014 single audit.

Report No. DODIG-2015-112, "Quality Control Review of the PricewaterhouseCoopers LLP and the Defense Contract Audit Agency FY 2013 Single Audit of the MITRE Corporation," April 30, 2015

The DoD OIG determined that the DCAA complied with auditing standards and Office of Management and Budget Circular No. A-133 requirements in performing the MITRE Corporation FY 2013 single audit.

Appendix B

Compliance Requirements

The Compliance Supplement provides guidance to assist auditors in determining compliance requirements applicable to the audit. The Compliance Supplement summarizes Federal requirements into 12 overall compliance requirements. For the research and development cluster, the Compliance Supplement states that all compliance requirements are applicable with the exception of the eligibility compliance requirement.

Auditors must identify the applicable compliance requirements that are direct and material to the audit. D&T and the DCAA determined that 9 of the 11 applicable compliance requirements were direct and material to the research and development cluster at Aerospace. See the table below for the identification of audit responsibilities and for the compliance requirements that D&T and the DCAA identified as direct and material.

Table. Compliance Requirements That D&T and the DCAA Identified Were Direct and Material to the Research and Development Cluster.

Uniform Guidance Compliance Requirements	Auditor Responsible	Direct and Material
Activities Allowed or Unallowed	DCAA	X
Allowable Costs/Cost Principles	DCAA	X
Cash Management	DCAA	X
Equipment and Real Property Management	D&T	X
Matching, Level of Effort, Earmarking	D&T	X
Period of Performance	D&T	X
Procurement, Suspension, and Debarment	D&T	X
Program Income	D&T	
Reporting	D&T	X
Subrecipient Monitoring	D&T	
Special Tests and Provisions	DCAA	X

Source: DoD OIG, based on D&T and DCAA audit documentation.

Management Comments

Defense Contract Audit Agency



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IQA 225.4 (D2019-DEV0SO-0167.000)

February 28, 2020

MEMORANDUM FOR AUDIT OVERSIGHT DIRECTOR FOR EVALUATIONS, DEPARTMENT OF DEFENSE, OFFICE OF INSPECTOR GENERAL FOR SPACE, INTELLIGENCE, ENGINEERING, AND OVERSIGHT

ATTENTION: Mr. Mark A. Dixon [REDACTED]

SUBJECT: Response to Department of Defense Office of Inspector General (DoDIG) Draft Report, Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche FY2016 Single Audit of the Aerospace Corporation dated January 31, 2020 (Project No. D2019-DEV0SO-0167.000)

Thank you for the opportunity to respond to the subject draft report, Quality Control Review of the Defense Contract Audit Agency and Deloitte & Touche FY2016 Single Audit of the Aerospace Corporation. DCAA's response to the DoDIG finding and recommendation are as follows:

RESPONSE TO DoDIG DRAFT RECOMMENDATION:

DoDIG Recommendation A: We recommend that the Defense Contract Audit Agency Branch Manager, Los Angeles South Branch Office, prepare audit documentation for the FY 2016 single audit that provides a clear and accurate description of the professional judgments made to support the qualified audit report opinion that the Defense Contract Audit Agency issued.

DCAA Response: Concur. The FAO prepared audit documentation for the FY 2016 single audit that provides a clear and accurate description of the professional judgments made to support the qualified audit report opinion that we issued. We updated the audit opinion rationale section to include the qualitative material factor that we considered in our judgment to issue a qualified opinion. The qualitative materiality factor considered was that Aerospace was in noncompliance with FAR 31.205-1 and claimed costs that were expressly unallowable and subject to penalty. We have provided this documentation to your office in a separate email.

Please direct any questions concerning this memorandum to [REDACTED]

 Digitally signed by
BENSON CHARLES M
Date: 2020.03.03 16:00:36 -05'00'

CHARLES M. BENSON
Assistant Director, Integrity and Quality
Assurance Directorate

Copy furnished:
Felicia M. Fuller, Single Audit Technical Specialist
[REDACTED]

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FAO 4181

Deloitte & Touche LLP

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February 14, 2020

Mark A. Dixon
Audit Oversight Director for Evaluations Space, Intelligence, Engineering, and Oversight
Office of Inspector General, Department of Defense
4800 Mark Center Drive
Alexandria, Virginia 22350-1500


Re: Quality Control Review of the single audit of The Aerospace Corporation for the fiscal year ended September 30, 2016 (Project No. D2019-DEV0SO-0167.000)

Dear Mr. Dixon:

In connection with your quality control review of our single audit of The Aerospace Corporation for the year ended September 30, 2016, we have reviewed your draft report dated January 31, 2020. In response to your findings and recommendations in the report, we will enhance our procedures and documentation in the areas noted for our fiscal year 2017 audit.

We appreciate the cooperation received during this process.

Sincerely,



Venisa L. Ibarra, Managing Director
Deloitte & Touche LLP

Acronyms and Abbreviations

- CFR** Code of Federal Regulations
- CIGIE** Council of the Inspectors General on Integrity and Efficiency
- DCAA** Defense Contract Audit Agency
- D&T** Deloitte & Touche LLP
- FAR** Federal Acquisition Regulation

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For more information about DoD OIG reports or activities, please contact us:

Congressional Liaison

703.604.8324

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