

*O*versight

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QUALITY CONTROL REVIEW OF GRANT THORNTON LLP  
AND THE DEFENSE CONTRACT AUDIT AGENCY  
THE CNA CORPORATION  
FISCAL YEAR ENDED SEPTEMBER 30, 1996

Report Number PO 98-6-015

July 30, 1998

Office of the Inspector General  
Department of Defense

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### **Acronyms**

CNA	The CNA Corporation
DCAA	Defense Contract Audit Agency
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	General Accounting Office
OMB	Office of Management and Budget



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July 30, 1998

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**SUBJECT:** Quality Control Review of Grant Thornton LLP  
and the Defense Contract Audit Agency  
The CNA Corporation  
Fiscal Year Ended September 30, 1996  
Report No. PO98-6-015 (Project No. 8OA-9-008.08)

## **Introduction**

We are providing this report for your information. The Vienna, Virginia, office of Grant Thornton LLP (Grant Thornton), and the Defense Contract Audit Agency (DCAA), performed the single audit for The CNA Corporation (CNA), Alexandria, Virginia, a nonprofit organization. The audit is required by Office of Management and Budget (OMB) Circular A-133, "Audits of Institutions of Higher Education and Other Nonprofit Institutions." For the fiscal year ended September 30, 1996, the CNA reported total Federal expenditures of \$46,896,000 representing \$44,021,000 for the Department of Defense (DoD), and \$2,875,000 for other Federal agencies.

The Grant Thornton audit report is dated November 20, 1996. Grant Thornton issued an unqualified opinion on the financial statements, Schedule of Federal Awards, internal controls and compliance requirements. The DCAA audit report on incurred costs is dated October 31, 1997. The audit report was issued to determine allowability of direct and indirect cost rates for the period from September 23, 1995, through September 22, 1996. CNA submitted its indirect cost proposal and its Certificate of Indirect Costs on December 31, 1996. The DCAA questioned \$265,743 related to general and administrative expenses and \$117,818 related to other direct costs. Specifically, the questioned costs were due to noncompliance with cost principles and standards and inadequately supported and/or unallowable costs claimed by CNA.

Grant Thornton issued positive and negative assurance statements on compliance with general requirements. Positive assurance means that, with respect to the items tested, the results of auditors' procedures disclosed no material instances of noncompliance. Negative assurance means that, with respect to the items not tested, nothing came to the auditors' attention that caused them to believe that CNA has not complied in all material respects.

Grant Thornton 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 in assessing control risk. The report on internal controls further describes the significant internal controls and control structure, including reportable conditions, material weaknesses, and controls that provide reasonable assurance that Federal awards are being managed in accordance with applicable laws and regulations.

## **Quality Control Review Results**

The working papers supporting the OMB Circular A-133 audit, performed by Grant Thornton and DCAA meet the applicable guidance and regulatory requirements in the Circular, its related Compliance Supplement, Generally Accepted Government Auditing Standards, Generally Accepted Auditing Standards and the provisions of the Federal award agreements.

## **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 OMB Circular A-133. As the Federal oversight agency for the CNA, we conducted a quality control review of Grant Thornton and DCAA working papers for their audit of the CNA. 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 issued by BDO Seidman, LLP, and dated October 3, 1995. The peer review found that Grant Thornton met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that the standards were being complied with during the fiscal year ended June 30, 1996. However, the peer review letter contained a recommendation to improve the comprehensiveness of documentation supporting significant matters.

## **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. The Guide is further divided into the substantive work performed during the audit of the financial statements and the specific program compliance testing for major programs. In addition, we supplemented the Guide to include additional review of transaction testing. Our review was conducted from March 30 through April 4, 1998.

Our quality control review of the audit working papers covered areas related to the financial statements and the research and development program. The research and development program expenditures totaled approximately \$46.9 million and accounted for 100 percent of total Federal award expenditures at the CNA.

## **Results of Prior Quality Control Reviews**

Since January 1, 1996, we performed one quality control review of Grant Thornton and reported no material findings. The DCAA reports and operations are reviewed by this office on an ongoing basis.

## **Background**

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

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

The Single Audit Act Amendments of 1996 (the Amendments), 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; by selecting programs to be audited on the basis of risk assessment rather than the amount of funds involved; and

by improving the contents and timeliness of single audits. The Amendments also bring nonprofit organizations, previously covered by similar requirements in the OMB Circular A-133, under the Single Audit Act provisions.

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 perform its overall responsibilities. The coordinated audit approach provides for the independent public accountant, Federal auditor, and other non-Federal auditors to consider each other's work in determining the nature, timing, and extent of their respective audit procedures. The Circular also requires that the cognizant agency obtain or conduct quality control reviews of selected audits made by non-Federal auditors and provide the results, when appropriate, to other interested organizations. The revised OMB Circular A-133 was issued 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.

## **Discussion of Results**

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

**Report of Independent Certified Public Accountants.** The auditor is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. We reviewed the audit program and the testing of evidence 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.

**Report of Independent Certified Public Accountants 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 Independent Auditors' Report.

**Schedule of Federal Awards.** The recipient is responsible for creating the Schedule of Federal Awards. The auditor is required to audit the information in the Schedule and to ensure that it identifies major programs, as defined by OMB Circular A-133, and total expenditures for each program. We reviewed the audit program for the appropriate procedures, reviewed a selected number of footings/cross footings, and traced some of the amounts to the subsidiary Ledger and/or Trial Balance.

**Report of Independent Certified Public Accountants on the Internal Control Structure in Accordance with Government Auditing Standards.** The auditor is required to obtain an understanding of the internal controls that is sufficient to plan the audit and to 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.

**Report of Independent Certified Public Accountants on the Internal Control Structure Required by OMB Circular A-133.** The auditor is required to obtain an understanding of the internal controls to assess control risk to determine whether the auditor intends to rely on the internal controls. The auditor must perform tests of controls to evaluate the effectiveness of the design and operation of the policies and procedures in preventing or detecting material noncompliance, to review the system for monitoring subrecipients and obtaining and acting on subrecipient audit reports, and to determine whether controls are effective to ensure that direct and indirect costs are calculated 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.

**Report of Independent Certified Public Accountants 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.

**Report of Independent Certified Public Accountants on Compliance With General 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. The auditors' procedures were limited to those prescribed in the OMB Circular A-133 Compliance Supplement. We reviewed the audit program for the appropriate procedures, compared the audit program steps to those in the Compliance Supplement to make sure that all areas are audited, reviewed the working paper documentation and its support, reviewed the compliance tests performed, and reevaluated selected compliance items.

**Report of Independent Certified Public Accountants on 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 its major Federal programs, including Types of Services Allowed or Unallowed; Eligibility; Matching, Level of Effort, and/or Earmarking Requirements; Special Reporting Requirements; and Special Tests and Provisions. We reviewed the

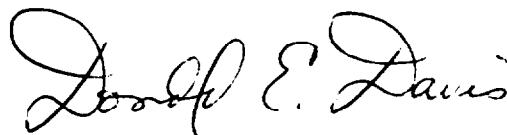
material effect on its major Federal programs, including Types of Services Allowed or Unallowed; Eligibility; Matching, Level of Effort, and/or Earmarking Requirements; Special Reporting Requirements; and Special Tests and Provisions. We reviewed the audit program for the appropriate procedures, checked 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 reevaluated selected compliance items.

**Report of Independent Certified Public Accountants on Compliance with Specific Requirements Applicable to Nonmajor Program Transactions.** The auditor is required to issue a report on nonmajor programs that provides a statement of positive assurance on those items that were tested for compliance and negative assurance on those items not tested. If the auditor has not selected any nonmajor program transactions or if the entity has no nonmajor programs, no report is required. We ensured that, when the auditor had selected such transactions, they were tested for compliance with the specific requirements that apply to the individual transactions.

**Schedule of Findings and Questioned Costs.** CNA reported no material findings in fiscal year ended September 30, 1996. The DCAA questioned \$265,743 of claimed general and administrative costs and \$117,818 of direct costs.

## Comments

Because this report contains no findings or recommendations, written comments are not required. We appreciate the courtesies extended during our review. If you have questions on this report, please contact Ms. Barbara Smolenyak, at (703) 604-8760. The report distribution is in the Enclosure.



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

Enclosure



**The CNA Corporation  
Fiscal Year Ended September 30, 1996**

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