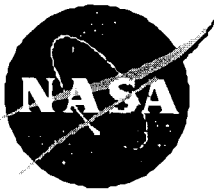


Report Recipients:
Partner, KPMG

Vice President,
Association of Universities
for Research in
Astronomy, Inc.


**KPMG LLP AUDIT OF THE ASSOCIATION OF
UNIVERSITIES FOR RESEARCH IN
ASTRONOMY, INC., FOR THE
FISCAL YEAR ENDED SEPTEMBER 30, 2002**

September 09, 2004



National Aeronautics and
Space Administration

OFFICE OF INSPECTOR GENERAL

Released by: 

David M. Cushing, Assistant Inspector General for Auditing

NASA Office of Inspector General

IG-04-026
A-04-025-00

September 09, 2004

KPMG LLP Audit of the Association of Universities for Research in Astronomy, Inc., for the Fiscal Year Ended September 30, 2002

Introduction

The Inspector General Act of 1978 (Public Law 95-452), as amended, mandates Inspectors General to ensure that work performed by non-Federal auditors complies with generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. As part of our continuing oversight of non-Federal audit work performed by independent public accountants under the Single Audit Act and the Single Audit Act Amendments of 1996, we performed a quality control review of the KPMG LLP audit of the Association of Universities for Research in Astronomy, Inc. (the Association), for the fiscal year ended September 30, 2002. The objective of our quality control review was to determine whether the audit working papers and report met the standards and requirements of GAGAS and Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," and its related Compliance Supplement (Supplement).

Executive Summary

Audit Report Quality Review. The audit report met the OMB Circular A-133 reporting requirements except for the omission of a summary schedule of prior audit findings and the data collection form did not identify that there were prior-year audit findings. The lack of a summary schedule and a properly completed data collection form meant that NASA could not assess the status of the prior-year findings.

Working Paper Quality Review. For the most part, the KPMG audit work met GAGAS and the requirements in OMB Circular A-133 and its related Supplement. However, the auditors did not properly document the working papers for the reason why the Davis Bacon Act was not material to a major research and development (R&D) program. As a result, we could not review the written documentation supporting the auditors' conclusion.

In response to our review, the Association and KPMG took sufficient corrective actions to address our concerns; therefore, we make no formal recommendations.

Findings and Recommendations

Summary Schedule of Prior Audit Findings

The Association did not prepare the required summary schedule of prior audit findings and the data collection form, which summarizes the results of audit, did not identify that there were prior-year audit findings. The data collection form should also have indicated that the National Aeronautics and Space Administration (NASA) had prior audit findings. Without the summary schedule and a properly completed data collection form, NASA could not assess the current status of the prior-year finding.

During its audit for the fiscal year ended September 30, 2001, KPMG reported a finding related to equipment that the Space Telescope Science Institute (the Institute) acquired with Federal funds. The Institute operates as a separate business unit under the Association. The Defense Contract Management Agency identified the finding during its fiscal year 2001 review of the Institute's property control system.

OMB Circular A-133, §.315, requires the auditee to prepare a summary schedule of prior audit findings that should report the status of all audit findings included in the prior audit's schedule of findings and questioned costs. Auditees are required to submit the summary schedule to the Federal Audit Clearinghouse (Clearinghouse). Further, Circular A-133, §.500(e), requires the auditor to follow up on prior audit findings and to perform procedures to assess the reasonableness of the summary schedule prepared by the auditee. When audit findings are fully corrected, the summary schedule only needs to list the audit findings and state that corrective action had been taken.

KPMG followed up on the status of the prior-year finding and determined that corrective action had been completed. Nevertheless, KPMG could not assess the reasonableness of the reported status of the prior-year finding without the completed summary schedule of prior audit findings.

We had planned to recommend that the Association prepare a summary schedule of prior audit findings and that KPMG assess the reasonableness of the status of corrective action on the summary schedule. We also planned to recommend that KPMG revise the data collection form to indicate that a summary schedule was prepared and to show that NASA should receive a copy of the reporting package. However, in response to our review, the Association prepared and KPMG assessed the summary schedule, and KPMG revised the data collection form. Both documents were submitted to the Clearinghouse. We considered the corrective action sufficient; therefore, we make no recommendation. NASA can now assess the current status of the prior-year finding.

Designation of Low-Risk Auditee

As required by OMB Circular A-133, §.530, KPMG determined that the Association qualified as a low-risk auditee, but the schedule of findings and questioned costs

erroneously stated the Association was not a low-risk auditee. The data collection form correctly stated that the Association was a low-risk auditee. Because of the inconsistent treatment, Federal users are uncertain about whether the Association qualified as a low-risk auditee.

When an auditee qualifies as low-risk, the auditor is only required to audit major programs that comprise 25 percent of total Federal expenditures. An auditee qualifies as low-risk if:

- Single audits were performed on an annual basis.
- The auditor's opinions on the financial statements and schedule of expenditures of Federal awards were unqualified.
- There were no deficiencies in internal control, which were identified as material weaknesses.
- For the preceding 2 years, none of the Federal programs had audit findings from the following:
 - Internal control deficiencies which were identified as material weaknesses,
 - Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the programs, or
 - Known or likely questioned costs that exceed 5 percent of the total Federal awards expended for the programs during the year.

According to OMB Circular A-133, §.505, the auditor's report should include a schedule of findings and questioned costs that includes a statement as to whether the auditor qualified as a low-risk auditee. The schedule should be included with the auditor's report and submitted to the Clearinghouse. OMB Circular A-133, §.320, also requires the auditee to submit a data collection form that includes a statement whether the auditee qualified as a low-risk auditee.

We had planned to recommend that KPMG revise the schedule of findings and questioned costs and resubmit it to the Clearinghouse. However, in response to our review, the auditors revised the schedule and resubmitted it to the Clearinghouse. We considered the corrective action sufficient; therefore, we make no recommendation. Federal users can now determine that the Association qualified as a low-risk auditee.

Determination of Materiality of the Davis Bacon Act

KPMG did not properly document its working papers for the reason why the Davis Bacon Act was not direct and material to the Gemini Project, which operates as a separate business unit under the Association. KPMG concluded that the Davis Bacon Act was not direct and material to Gemini based on a review of disbursements and discussions with the auditee that indicated there were no construction contracts during the year. However, construction in process increased by about \$8 million during the fiscal year. According to the Audit Manager, the increase was due to the construction of a telescope in Chile as part of the Gemini Project.

Because the working papers did not contain adequate evidence why the compliance requirement was not applicable, we could not determine from the working papers whether the auditors properly performed audit procedures and tested the Davis Bacon Act compliance requirements in making their conclusions about compliance and internal controls for the R&D major program.

OMB Circular A-133, §____.500(a), states that audits made pursuant to the Circular must be conducted in accordance with GAGAS. GAGAS §4.34 through §4.37, “Working Papers,” require auditors to retain a record of the audit in the form of working papers to demonstrate that the applicable standards of fieldwork have been met. GAGAS §4.36 states, “Working papers allow for the review of audit quality by providing the reviewer written documentation of the evidence supporting the auditors’ significant conclusions and judgments.”

We had planned to recommend that KPMG document the working papers to indicate why the Davis Bacon Act was not applicable to the R&D program. However, in response to our review, the auditors provided revised working papers to correct the deficiencies. We considered the corrective action sufficient; therefore, we make no recommendation to address the documentation deficiencies. We can now determine that the auditors properly concluded that the Davis Bacon Act was not direct and material to the R&D program.

Appendixes

Among the appendixes, note that Appendix A contains details on the Circular and Single Audit Act requirements, Appendix B provides details on the objectives and scope of our review, Appendix C provides our quality control review methodology, and Appendix D summarizes the results of the KPMG audit of the Association.

List of Appendixes

Appendix A – Single Audit Act Requirements

Appendix B – Background, Objectives, and Scope

Appendix C – Quality Control Review Methodology

Appendix D – Results of the KPMG LLP Audit of the Association of
Universities for Research in Astronomy, Inc., for the Fiscal
Year Ended September 30, 2002

Appendix E – Report Distribution

Acronyms Used in This Report

GAGAS	Generally Accepted Government Auditing Standards
OIG	Office of Inspector General
OMB	Office of Management and Budget
R&D	Research and Development

Appendix A. Single Audit Act Requirements

The Single Audit Act of 1984 (Public Law 98-502) was intended to improve the financial management of state and local governments, while OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," was intended to improve financial management for nonprofit organizations. The Act and the Circular establish uniform requirements for audits of Federal financial assistance, promote efficient and effective use of audit resources, and help ensure that Federal departments and agencies rely on and use the audit work to the maximum extent practicable.

The Single Audit Act Amendments of 1996 (Public Law 104-156) incorporate the previously excluded nonprofit organizations. Including the nonprofit organizations strengthens 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. Major changes to the Act include: (1) increasing the audit threshold from \$25,000 to \$300,000 with respect to Federal financial assistance programs before an audit is required; (2) selecting Federal programs for audit based on a risk assessment rather than the amount of funds involved; and (3) improving the contents and timeliness of single audits.

OMB issued the revised Circular A-133 on June 24, 1997, pursuant to the Single Audit Act Amendments of 1996. In general, the Circular requires that an auditee who expends \$300,000 or more annually in Federal awards obtain an audit and issue a report of its Federal award expenditures in accordance with the generally accepted government auditing standards applicable to financial audits. The audit must be performed by auditors who meet the independence standards in GAGAS and in accordance with the auditing and reporting requirements of the Circular and its related Compliance Supplement (the Supplement). The audit report submission contains the:

- financial statements and related opinion,
- schedule of expenditures of Federal awards and related opinion,
- report on the internal controls and compliance review of the financial statements,
- report on internal controls reviewed and compliance opinion on major programs, and
- schedule of findings and questioned costs.

The auditee must also submit a data collection form to the Federal Audit Clearinghouse. The form summarizes the significant information in the audit report for dissemination to the public through the Internet. Responsible officials from the audited entity and the audit organization sign the form certifying to the information presented.

The Supplement is based on the requirements of the Single Audit Act Amendments of 1996 and the June 24, 1997, revision of OMB Circular A-133, which provide for the issuance of a compliance supplement to assist auditors in performing the required audits. The National State Auditors Association study states:

The Compliance Supplement provides an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal assistance programs. This tool allows Federal agencies to effectively communicate items which they believe are important to the successful management of the program and legislative intent

Compliance with the Supplement satisfies the requirements of OMB Circular A-133. The Supplement identifies Federal programs by Federal agency. The Supplement identifies existing, important compliance requirements, which the Federal Government expects the auditors to consider as part of an audit required by the Circular and 1996 Amendments. Using the Supplement eliminates the need for the auditors to research the laws and regulations for each major program audit to determine the compliance requirements that are important to the Federal Government and that could have a direct and material effect on the major program. The Supplement is a more efficient and cost-effective approach to performing this research. The Supplement “provides a source of information for auditors to understand the Federal program’s objectives, procedures, and compliance requirements relevant to the audit as well as audit objectives and suggested audit procedures for determining compliance with the requirements.”

For single audits, the Supplement replaces agency audit guides and other audit requirement documents for individual Federal programs and specifically states which of the following 14 compliance requirements are applicable to a major program that may be audited:

1. Activities Allowed or Unallowed
2. Allowable Costs/Cost Principles
3. Cash Management
4. Davis Bacon Act
5. Eligibility
6. Equipment and Real Property Management
7. Matching, Level of Effort, Earmarking
8. Period of Availability of Federal Funds
9. Procurement and Suspension and Debarment
10. Program Income
11. Real Property Acquisition and Relocation Assistance
12. Reporting
13. Subrecipient Monitoring
14. Special Tests and Provisions

Appendix A

The Supplement also assists the auditors in determining the audit scope for the Circular's internal control requirements. For each compliance requirement, the Supplement describes the objectives of internal control and certain characteristics that, when present and operating effectively, may ensure compliance with program requirements. The Supplement gives examples of the common characteristics for the 5 components of internal controls (control environment, risk assessment, control activities, information and communication, and monitoring) for the 14 compliance requirements.

Appendix B. Background, Objectives, and Scope

Background

The Association of Universities for Research in Astronomy, Inc. (the Association) was incorporated on October 28, 1957, in Arizona. The Association constructs, operates, and maintains astronomical research centers. For the fiscal year ended September 30, 2002, the Association reported total Federal expenditures of about \$140.4 million and total NASA expenditures of about \$78.3 million. The National Science Foundation is the only other Federal agency awarding funds to the Association.

Audit Report Review

Our objectives for the audit report review were to determine whether the report submitted by the auditee met reporting standards in GAGAS and met reporting requirements in OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." As the cognizant agency for audit for the Association, the NASA Office of Inspector General (OIG) performed a review of the audit report on the Association for its fiscal year ended September 30, 2002. We reviewed the report for compliance with the requirements of the Single Audit Act, Single Audit Act Amendments of 1996, and OMB Circular A-133. We focused our review on the report's qualitative aspects of the (1) financial statement, compliance, and internal control reporting; (2) schedule of expenditures of Federal awards; and (3) schedule of findings and questioned costs.

Working Paper Review

Our objectives for the working paper review were to determine whether the audit was conducted in accordance with GAGAS and whether the audit met the requirements of OMB Circular A-133 and its related Compliance Supplement. As the cognizant agency for audit for the Association, the NASA OIG conducted a quality control review of the KPMG LLP audit working papers for the R&D major program. We focused the review on the audit's qualitative aspects of

- auditors' qualifications,
- independence,
- due professional care,
- quality control,
- planning and supervision,
- Federal receivables and payables,
- major program determination, and
- internal controls and compliance testing for major programs.

Appendix B

We also focused the review on the working paper support for the

- schedule of expenditures of Federal awards,
- schedule of findings and questioned costs, and
- data collection form.

We emphasized the areas of major concern to the Federal Government such as determining and auditing major program compliance and internal controls. We conducted the review April 20-29, 2004, at the Phoenix, Arizona, office of KPMG. The NASA OIG had previously performed quality control reviews at other KPMG locations.

Peer Review Report

To determine whether there were any issues of which we needed to be aware during our report and working paper review, we assessed the December 16, 1999, report on the most recent peer review of KPMG performed by PricewaterhouseCoopers LLP. The PricewaterhouseCoopers' review determined that KPMG met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that KPMG complied with the standards during the fiscal year ended March 31, 1999.

Appendix C. Quality Control Review Methodology

Independent Auditors' Report

The auditors are required to determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and are free of material misstatement. We reviewed the audit programs for accounts receivable and accounts payable and the evidence 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 conclusion.

Schedule of Expenditures of Federal Awards

The recipient is responsible for creating the schedule and the accompanying notes to the schedule. The auditors are required to audit the information in the schedule and review the notes to ensure that the schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. We reviewed the auditors' procedures for testing the Federal expenditures and reconciling the amounts to the financial statements.

Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards

The auditors are required to determine whether the recipient has complied with laws and regulations that may have a direct and material effect in determining financial statement amounts. The auditors are also required to obtain an understanding of internal controls that is sufficient to plan the audit and to assess control risk. We did not review programs or procedures related to the financial statement audit because we concentrated our review efforts on the audit of the research and development major program.

Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133 and Schedule of Expenditures of Federal Awards

The auditors are required to determine whether the recipient has complied with laws, regulations, and the provisions of contracts and grant agreements that may have a direct and material effect on each of its major Federal programs. The auditors are required to use the procedures in the OMB Circular A-133 Compliance Supplement to determine the compliance requirements for each major program. Further, the auditor should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant agreements that have a direct and material effect on the determination of financial statement amounts. We reviewed the audit program for the appropriate procedures and compared the audit program steps to

Appendix C

those in the Compliance Supplement to determine whether the applicable steps had been performed for the major program. We also reviewed the working paper documentation and the compliance tests performed.

The auditors must also perform procedures to obtain an understanding of internal controls over Federal programs that is sufficient to plan an audit that supports a low-assessed level of control risk for major programs. The auditors must plan and perform internal control testing over major programs to support a low level of control risk for the assertions relevant to the compliance requirements for each major program. We reviewed the audit program for the appropriate procedures, the working paper documentation, and the test of controls performed for the major program.

Schedule of Findings and Questioned Costs

The auditors are required to prepare a schedule of findings and questioned costs that summarizes the audit results. This schedule includes information about and related to the audit that is not required to be identified in other parts of the audit report including: (1) major programs audited, (2) details on findings and questioned costs (including reportable conditions and material weaknesses), (3) dollar threshold to identify major programs, and (4) whether the recipient is considered to be low risk. We reviewed the audit program for the appropriate procedures and the working paper documentation supporting the information in the schedule.

**Appendix D. Results of the KPMG LLP Audit of the
Association of Universities for Research in Astronomy, Inc., for the
Fiscal Year Ended September 30, 2002**

On December 13, 2002, KPMG LLP issued the audit report for the Association of Universities for Research in Astronomy, Inc., for the fiscal year ended September 30, 2002. The auditors issued an unqualified opinion* on the financial statements; schedule of expenditures of Federal awards; and auditee's compliance with laws, regulations, and provisions of contracts or grant agreements that could have a direct and material effect on the major program.

The auditors identified no findings and questioned costs related to the major program. The auditors also found no instances of noncompliance in the financial statement audit that must be reported under generally accepted government auditing standards. Further, the auditors identified no material weaknesses related to internal controls for the financial statements or major programs. The American Institute of Certified Public Accountants Statement on Position 98-3, Appendix D, defines a material weakness as:

. . . a condition in which the design or operation of one or more of the internal control components [control environment, risk assessment, control activities, information and communication, and monitoring] does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

*An unqualified opinion means that the financial statements are presented fairly in all material respects; expenditures of Federal funds are presented fairly in relation to the financial statements taken as a whole; and the auditee has complied with all applicable laws, regulations, and contract and grant provisions that could have a direct and material effect on each major program.

Appendix E. Report Distribution

Independent Audit Firm

Mr. Lawrence C. Bello
Partner, KPMG LLP

Audited Organization

Mr. Harry W. Feinstein, Vice President
Association of Universities for Research in Astronomy, Inc.

Other

Technical Manager, Office of Federal Financial Management
Office of Management and Budget

Federal Audit Clearinghouse

Federal Offices of Inspector General

Associate Inspector General for Audit
Office of Inspector General
National Science Foundation

National Aeronautics and Space Administration (NASA) Officials-in-Charge

Deputy Administrator
Chief of Staff
Associate Administrator for Institutions and Management
Chief Financial Officer
Deputy Chief Financial Officer for Financial Management
Deputy Chief Financial Officer for Resources (Comptroller)
Director, Financial Management Division
General Counsel
Assistant Administrator for Procurement
Assistant Administrator for Infrastructure, Management, and Headquarters Operations
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NASA Headquarters
Washington, DC 20546-0001

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To report fraud, waste, abuse, or mismanagement, contact the NASA OIG Hotline at (800) 424-9183, (800) 535-8134 (TDD), or at www.hq.nasa.gov/office/oig/hq/hotline.html#form; or write to the NASA Inspector General, P.O. Box 23089, L'Enfant Plaza Station, Washington, DC 20026. The identity of each writer and caller can be kept confidential, upon request, to the extent permitted by law.

Major Contributors to the Report

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