

IG-01-011

**QUALITY
CONTROL
REVIEW
REPORT**

**ARTHUR ANDERSEN LLP AUDIT OF WILLIAM MARSH
RICE UNIVERSITY, FISCAL YEAR ENDED JUNE 30, 1999**

March 14, 2001



National Aeronautics and
Space Administration

OFFICE OF INSPECTOR GENERAL

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Acronyms

HHS	Department of Health and Human Services
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget

Office of Inspector General

March 14, 2001

Ms. Vicki H. Hitzhusen, Partner
Arthur Andersen LLP
711 Louisiana Street
Houston, TX 77002

Re: Quality Control Review of the Arthur Andersen LLP Audit of William Marsh Rice
University for the Fiscal Year Ended June 30, 1999
Assignment Number A0101200
Report No. IG-01-011

Dear Ms. Hitzhusen:

The subject final report is provided for your use. Please refer to the Results of Review section for the overall review results.

If you have any questions concerning the report, please contact Mr. Patrick A. Iler, Director, Audit Quality, at (216) 433-5408, or Ms. Vera Garrant, A-133 Audit Manager, at (202) 358-2596. We appreciate the courtesies extended to the audit staff. The report distribution is in Appendix D.

Sincerely,

[original signed by]

Russell A. Rau
Assistant Inspector General for Auditing

Enclosure

cc:

A/Administrator

AA/Chief of Staff

AI/Associate Deputy Administrator

AO/Chief Information Officer

B/Acting Chief Financial Officer

B/Comptroller

BF/Director, Financial Management Division

G/General Counsel

H/Associate Administrator for Procurement

JM/Director, Management Assessment Division

Mr. John Fisher, Manager, National External Review Center, Office of Inspector General,
Department of Health and Human Services

bcc:

AIGA chron

W/ P. Iler

V. Garrant

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NASA Office of Inspector General

IG-01-011
A0101200

March 14, 2001

Quality Control Review of Arthur Andersen LLP Audit of William Marsh Rice University Fiscal Year Ended June 30, 1999

Introduction

William Marsh Rice University (University) of Houston, Texas, is a private, not-for-profit corporation that operates a private research university. The Department of Health and Human Services (HHS) is the cognizant audit agency for the University. HHS granted the National Aeronautics and Space Administration (NASA), a Federal funding agency to the University, permission to perform a quality control review of the Arthur Andersen LLP audit of the University's fiscal year ended June 30, 1999.¹ The Single Audit Act and the Single Audit Act Amendments² require the audits. For the fiscal year, the University reported total direct Federal expenditures of about \$4 million for NASA and total direct expenditures of about \$38 million.

Appendix A provides details on the single audit requirements.

Objectives

The objective of our report review was to determine whether the report the University submitted to the Federal Audit Clearinghouse³ meets the applicable reporting standards and Office of Management and Budget (OMB) Circular A-133⁴ reporting requirements.

The objectives of our quality control review were to determine whether Arthur Andersen LLP conducted the audit of the financial statements and the research and development major program⁵ in accordance with applicable standards and whether the audit met the auditing and reporting requirements of OMB Circular A-133. Appendixes B and C provide details on the objectives, scope, and methodology.

¹The Houston, Texas, office of Arthur Andersen LLP, performed the single audit for the University for the fiscal year ended June 30, 1999.

²Office of Management and Budget Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," implements the requirements of the Single Audit Act and the Single Audit Act Amendments. Appendix A contains details on the requirements of the Circular.

³The Single Audit Act Amendments of 1996, §7504(c), require the Office of Management and Budget to establish the Federal Audit Clearinghouse to receive the Circular A-133 audit reports.

⁴See footnote number 2.

⁵A major program is a Federal program that the auditors determined through a risk analysis is subject to audit for the organization's current fiscal year.

Results of Review

We reviewed the Arthur Andersen LLP audit results, audit report format, and related working papers and concluded the following:

- **Reported A-133 Results.** On October 1, 1999, Arthur Andersen LLP issued the audit report for the University's fiscal year ended June 30, 1999. The auditors identified no findings or questioned costs related to the major programs. Arthur Andersen LLP issued an unqualified opinion⁶ on the financial statements, Schedule of Expenditures of Federal Awards,⁷ and major program compliance.⁸ The auditors also found no instances of noncompliance in the financial statement audit that must be reported under generally accepted government auditing standards.⁹ Finally, the auditors identified no material weaknesses¹⁰ related to internal controls for the financial statement or major programs.
- **Report Quality Review Results.** The audit report meets the applicable auditing and reporting guidance and regulatory requirements in (1) OMB Circular A-133 and its related Compliance Supplement, (2) generally accepted government auditing standards, and (3) generally accepted auditing standards.
- **Audit Quality Review Results.** The Arthur Andersen LLP audit work meets the applicable auditing guidance and requirements in (1) OMB Circular A-133 and its related Compliance Supplement, (2) generally accepted government auditing standards, and (3) generally accepted auditing standards.

⁶An 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 provisions that could have a direct and material effect on each major program.

⁷The Schedule of Expenditures of Federal Awards shows the amount of annual Federal award expenditures by Federal agency for each program, grant, or contract.

⁸Major program compliance refers to an assessment of the auditee's compliance with laws, regulations, and provisions of contracts or grant agreements that could have a direct and material effect on each major program.

⁹These standards, promulgated by the Comptroller General of the United States, are broad statements of the auditors' responsibilities.

¹⁰The American Institute of Certified Public Accountants (AICPA) Statement of Position 98-3, Appendix D, defines a material weakness as:

... the 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.

Appendix A. Single Audit Requirements

The Inspector General Act of 1978, as amended (Public Law 95-452), requires an agency's Inspector General 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, while OMB Circular A-133 was intended to improve financial management for nonprofit organizations. The Act and the Circular established uniform requirements for audits of Federal financial assistance, promoted efficient and effective use of audit resources, and helped to 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 independent standards in generally accepted government auditing standards and in accordance with the auditing and reporting requirements of the Circular and its related Compliance 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 Department of Commerce 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.

Appendix A

The Compliance Supplement is based on the requirements of the Single Audit Act Amendments of 1996 and the final 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 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. It "... 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/Relocation Assistance
12. Reporting
13. Subrecipient Monitoring
14. Special Tests and Provisions

The Compliance Supplement 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. Objectives and Scope

Audit Report Review

The objective of an audit report review is to determine whether the report submitted by the auditee meets the applicable reporting standards and the OMB Circular A-133 reporting requirements. As a Federal funding agency to William Marsh Rice University, we performed a review of the audit report on the University for its fiscal year ended June 30, 1999. 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 (1) due professional care; (2) auditor's qualifications and independence; (3) financial statements, compliance, and internal control reporting; (4) Schedule of Expenditures of Federal Awards; and (5) Schedule of Findings and Questioned Costs.¹¹

Quality Control Review

The objectives of a quality control review are to ensure that an audit was conducted in accordance with generally accepted government auditing standards¹² and generally accepted auditing standards and whether the audit meets the auditing and reporting requirements of OMB Circular A-133. As a Federal funding agency to the University, we conducted a quality control review of the Arthur Andersen audit working papers. We focused the review on the audit's qualitative aspects of:

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

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.

¹¹Appendix C describes the information in the Schedule of Findings and Questioned Costs.

¹²These standards, promulgated by the Comptroller General of the United States, are broad statements of the auditors' responsibilities.

We organized our review by the general and field work audit standards and the required elements of a single audit. 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 February 7-14, 2001, at the Houston, Texas, office of Arthur Andersen LLP. The NASA Office of Inspector General has not previously performed a quality control review at other Arthur Andersen LLP locations.

Peer Review Report

We reviewed the October 14, 1998, report on the most recent peer review of Arthur Andersen LLP performed by Deloitte & Touche LLP. The Deloitte & Touche LLP review determined that Arthur Andersen LLP met the objectives of the quality control review standards established by the American Institute of Certified Public Accountants and that Arthur Andersen complied with the standards during the fiscal year ended August 31, 1998.

Appendix C. Quality Control Review Methodology

Independent Auditors' Report on Financial Statements and Supplementary Schedule of Expenditures of Federal Awards

The auditors are required to determine whether the financial statements are presented fairly in all material respects in conformity with generally accepted auditing principles and are free of material misstatement. The auditors are also required to subject the Schedule of Expenditures of Federal Awards to the procedures applicable to the audit of the financial statements and to ensure that the amounts are fairly stated in relation to the basic financial statements. We reviewed the audit programs and the testing of 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 of Expenditures of Federal Awards and the accompanying notes to the Schedule. The auditors are required to audit the information in the Schedule and review the notes to ensure it is fairly presented in all material respects in relation to the financial statements taken as a whole. We reviewed the audit programs for the appropriate procedures and traced some of the amounts to the Subsidiary Ledger and/or Trial Balance.

Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of 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 reviewed the audit programs for the appropriate procedures, the working paper documentation, and the compliance and substantive testing performed.

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

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 (April 1999) to determine the compliance requirements for each major program. We reviewed the audit program for the appropriate procedures and compared the audit program steps to those in the Compliance Supplement to determine whether the applicable steps had been performed. We also reviewed the working paper documentation and its support and the compliance tests performed.

The auditors must perform procedures to obtain an understanding of internal controls over Federal programs that is sufficient to plan an audit to support a low-assessed level of control risk for major programs. The auditors must plan and perform internal controls 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 programs for the appropriate procedures, the working paper documentation, and the test of controls performed.

Summary of Auditors' Results

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 programs for the appropriate procedures and the working paper documentation supporting the information in the schedule.

Appendix D. Report Distribution

Audit Firm

Ms. Vicki H. Hitzhusen, Partner
Arthur Andersen LLP
711 Louisiana Street
Houston, TX 77002

Audited Organization

Mr. Tom Iezzi
Assistant Controller
William Marsh Rice University
MS 70, 6100 Main Street
Houston, TX 77005-6001

Federal Offices of Inspector General

Department of Agriculture
Department of Defense
Department of Education
Department of Energy
Department of Health and Human Services
Department of the Interior
Environmental Protection Agency
General Services Administration
National Archives and Records Administration
National Foundation for the Humanities
National Science Foundation

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

A/Administrator
AA/Chief of Staff
AI/Associate Deputy Administrator
AO/Chief Information Officer
B/Acting Chief Financial Officer
B/Comptroller
BF/Director, Financial Management Division
G/General Counsel
H/Associate Administrator for Procurement

JM/Director, Management Assessment Division

NASA Centers

Director, Ames Research Center

Director, John H. Glenn Research Center at Lewis Field

Director, Goddard Space Flight Center

Acting Director, Lyndon B. Johnson Space Center

Director, Langley Research Center

Director, George C. Marshall Space Flight Center

NASA Assistant Inspector General for Auditing Reader Survey

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Report Title: Final Report on Quality Control Review of Arthur Andersen L.L.P. Audit of William Marsh Rice University for Fiscal Year Ended June 30, 1999 (Assignment No. A0101200)

Report Number: _____ **Report Date:** _____

Circle the appropriate rating for the following statements.

	Strongly Agree	Agree	Neutra l	Disagre e	Strongl y Disagre e	N/A
1. The report was clear, readable, and logically organized.	5	4	3	2	1	N/A
2. The report was concise and to the point.	5	4	3	2	1	N/A
3. We effectively communicated the audit objectives, scope, and methodology.	5	4	3	2	1	N/A
4. The report contained sufficient information to support the finding(s) in a balanced and objective manner.	5	4	3	2	1	N/A

Overall, how would you rate the report?

Excellent Fair Very Good Poor Good

If you have any additional comments or wish to elaborate on any of the above responses, please write them here. Use additional paper if necessary. _____

How did you use the report? _____

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Public Interest

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May we contact you about your comments?

___ Yes Name: _____

Telephone #: _____

___ No

Thank you for your cooperation in completing this survey.

Major Contributors to the Report

Patrick A. Iler, Director, Audit Quality

Vera J. Garrant, A-133 Audit Manager

Sandra L. Laccheo, Auditor

Nancy C. Cipolla, Report Process Manager