

**QUALITY
CONTROL
REVIEW
REPORT**

**ARTHUR ANDERSEN LLP AUDIT OF THE NASA
FINANCIAL STATEMENTS FOR
FISCAL YEAR ENDED SEPTEMBER 30, 1999**

March 29, 2000



National Aeronautics
and
Space Administration

OFFICE OF INSPECTOR GENERAL

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Acronyms

AICPA	American Institute of Certified Public Accountants
FY	Fiscal Year
OMB	Office of Management and Budget

Office of Inspector General

March 29, 2000

Mr. Gray Smith
Partner
Arthur Andersen LLP
8000 Towers Crescent Drive
Vienna, VA 22182-2725

Re: Final Report on Quality Control Review of Arthur Andersen LLP Audit of the National Aeronautics and Space Administration Financial Statements for Fiscal Year Ended September 30, 1999
Assignment Number A9906000
Report Number IG-00-022

Dear Mr. Smith:

We are issuing the subject final report pursuant to our responsibilities under the Chief Financial Officers Act of 1990, as amended; Inspector General Act of 1978, as amended; and the Office of Management and Budget Bulletin 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998, as amended. Please refer to the Results in Brief section for the overall quality control review results.

If you have questions concerning the report, please contact Mr. Chester A. Sipsock, Program Director, Environmental and Financial Management Audits, at (216) 433-8960, or Ms. Van Tran, Auditor-in-Charge, at (202) 358-0466. We appreciate the courtesies extended to the audit staff. The final report distribution is in Appendix D.

Sincerely,

[Original signed by]

Russell A. Rau

Enclosure

cc:

B/Chief Financial Officer

B/Comptroller

BF/Director, Financial Management Division

G/General Counsel

JM/Director, Management Assessment Division

bcc:

AIGA, IG Chrons

GRC/501-9/C. Sipsock

B/L. Lauria

W/V. Tran

NASA Office of Inspector General

IG-00-022
A9906000

March 29, 2000

Arthur Andersen LLP Audit of the National Aeronautics and Space Administration Financial Statements for Fiscal Year Ended September 30, 1999

Introduction

The NASA Office of Inspector General performed a quality control review of the Arthur Andersen LLP (Arthur Andersen) audit of the NASA fiscal year (FY) 1999 Financial Statements. Our quality control review and reporting on the results thereof are required by the Office of Management and Budget (OMB) Bulletin 98-08, as amended, "Audit Requirements for Federal Financial Statements," August 24, 1998. The review objective was to determine whether Arthur Andersen conducted its audit in accordance with government auditing standards and the provisions of OMB Bulletin 98-08. Details on our objective, scope, and methodology are in Appendix A.

Results in Brief

Arthur Andersen conducted the audit in accordance with government auditing standards and the provisions of OMB Bulletin 98-08. Specifically, Arthur Andersen properly planned, executed, reported the results of its audit and issued in a timely manner the audit opinion on the financial statements and reports on internal control, compliance with laws and regulations, and application of agreed-upon procedures. A summary of Arthur Andersen's audit results is in Appendix B.

Background

The Chief Financial Officers Act of 1990 requires NASA to prepare financial statements and requires the Office of Inspector General to either audit or provide for an independent external auditor to audit the statements. Starting with FY 1996, we contracted with Arthur Andersen, an independent certified public accounting firm, to audit NASA's financial statements. Our responsibilities for audits performed by non-Federal auditors, including independent external auditors of financial statements, are identified in the Inspector General Act of 1978, as amended; the Chief Financial Officers Act of 1990, as amended; and OMB Bulletin 98-08, as amended. Generally, our responsibility is to ensure that the audit conforms to government auditing standards and applicable statutory and regulatory requirements. Further, OMB Bulletin 98-08, paragraph 10, requires the Inspector General to:

- ensure that audits are performed and that audit reports are completed in a timely manner and in accordance with the OMB Bulletin requirements,
- provide technical advice and a liaison to Agency officials and independent external auditors,

- perform quality control reviews and provide the results to interested organizations, and
- monitor and report on management's progress in resolving audit findings identified by independent external auditors.

Report of Independent Public Accountants on Financial Statements

Arthur Andersen is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. NASA's financial statements include a:

- Statement of Financial Position
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources
- Statement of Financing

We reviewed the audit program and the testing of evidence to determine whether testing was sufficient, based on an assessment of control risk, to warrant the conclusion reached and whether the working papers supported the conclusion.

Report of Independent Public Accountants on Internal Control

Arthur Andersen is required to obtain an understanding of the components¹ of internal controls sufficient to plan the audit and to assess control risk for the assertions² embodied in the financial statements. Arthur Andersen is also required to obtain an understanding of the components of internal control relating to the existence and completeness assertions relevant to the performance measures. We reviewed the audit programs for the appropriate procedures, the working paper documentation including the control risk assessment,³ and the controls testing performed. We also reviewed the working papers related to electronic data processing and performance measures for adequate documentation. Finally, we evaluated the adequacy of the auditor's effort in following up on findings and recommendations in the FY 1998 Management Letter.⁴ The

¹ The five components of internal control are control environment, risk assessment, control activities, information and communication, and monitoring.

² Assertions are implied or expressed representations by management about the financial statements. The five assertions are existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure.

³ According to American Institute of Certified Public Accountants (AICPA) Codification of Statements on Auditing Standards, Section 319, "Consideration of Internal Control in a Financial Statement," auditors are required to document the basis for concluding that control risk is below the maximum level.

⁴ A management letter describes conditions that the auditors do not include in the audit report but consider necessary to communicate to management.

status of management's progress in resolving last year's findings is in Appendix B. As required by government auditing standards, section 4.7, Arthur Andersen will follow up on all findings and recommendations in the FY 1999 Management Letter.

Report of Independent Public Accountants on Compliance with Laws and Regulations

Arthur Andersen is required to determine whether NASA has complied with laws and regulations that could have a direct and material effect in determining the financial statement amounts. Arthur Andersen is also required to assess whether NASA's financial management systems substantially comply with the Federal Financial Management Improvement Act of 1996. We reviewed the audit programs for the appropriate procedures, the working paper documentation including the fraud risk assessment,⁵ and the compliance testing performed.

Report of Independent Public Accountants on the Application of Agreed-Upon Procedures

Arthur Andersen is required to perform agreed-upon procedures⁶ related to the retirement, health, and life insurance withholdings/contributions and employee head count data. Arthur Andersen performed the procedures on behalf of the Office of Personnel Management. The auditors must apply the procedures for each Agency Payroll Office that services 30,000 or more employees per year. We reviewed the working papers to determine whether the procedures were completed as specified in draft OMB Bulletin 99-xx,⁷ Appendix I-1, and whether associated findings, if any, were supported.

As part of our oversight responsibilities, we also performed the following procedures:

- Transmitted the NASA Interim and Updated Legal Representation Letters to the General Accounting Office, OMB, and Department of the Treasury (Treasury) on December 16, 1999, and March 8, 2000.
- Completed the Federal Agencies' Centralized Trial-Balance System data verification and provided results to the General Accounting Office, OMB, and Treasury on

⁵ AICPA Codification of Statements on Auditing Standards, Section 316, "Fraud in a Financial Statement Audit," states that auditors are required to specifically assess the risk of material misstatement of the financial statements due to fraud and to document in the working papers evidence of their assessment.

⁶ The engagement to apply agreed-upon procedures is one in which the users of the report (for example, the Office of Personnel Management) specify the procedures to be performed by the auditor, and the users assume responsibility for the sufficiency of such procedures.

⁷ Draft OMB Bulletin 99-xx, "Audits of Agency Financial Statements," dated July 22, 1999, contains proposed revisions to OMB Bulletin 98-08. Certain revisions are effective for the FY 1999 audit while others are effective for FY 2000 and beyond. The draft Bulletin, however, has not yet been finalized as of the dates of Arthur Andersen's reports or this quality control review report.

March 3, 2000. The verification was to ensure agreement between amounts reported in the Agency's financial statements and those reported to the Treasury. We found no differences in amounts.

- Reviewed the Agency's draft FY 1999 Accountability Report⁸ and provided comments to NASA on January 11 and February 17, 2000. Our comments related to consistency in reporting and compliance with mandated requirements.

⁸ The annual Accountability Report links together statutorily required reports into a single document. Examples include reports required by the Chief Financial Officers Act, the Government Performance and Results Act, the Federal Managers' Financial Integrity Act, the Prompt Payment Act, and the Inspector General Act Amendments.

Appendix A. Objective, Scope, and Methodology

Objective

The review objective was to determine whether Arthur Andersen conducted its audit in accordance with government auditing standards and the provisions of OMB Bulletin 98-08.

Scope and Methodology

In performing the quality control review, we used an internal work program that incorporates the Federal financial management and audit requirements as well as government auditing standards. The government auditing standards also incorporate, by reference, the AICPA standards of field work and reporting. Based on those requirements, we developed and organized the work program according to the general, field work, and reporting audit standards. The work program also included steps covering our oversight requirements.

To satisfy the review objective and to fulfill our oversight responsibilities, we:

- reviewed Arthur Andersen's approach and planning of the audit,
- monitored the progress of the audit at key points,
- examined its working papers and audit reports, and
- performed other procedures as necessary.

We worked closely with Arthur Andersen and Agency officials to ensure the audit was done in a timely manner and according to applicable standards. Our involvement extended from the initial audit planning to execution and completion. We held periodic meetings to discuss status, reviewed Arthur Andersen's working papers as the audit progressed, and coordinated responses to mandated requirements.

We performed our quality control review from June 1999 through March 2000.

Appendix B. Summary of Arthur Andersen's Audit Results

Report of Independent Public Accountants on Financial Statements

Arthur Andersen rendered an unqualified opinion on NASA's Statement of Financial Position as of September 30, 1999. Arthur Andersen also gave the Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing for the year ended September 30, 1999, an unqualified opinion.

Report of Independent Public Accountants on Internal Control

Arthur Andersen tested NASA's controls over financial reporting and found no reportable conditions or material weaknesses.⁹ However, Arthur Andersen noted matters related to (1) financial management and accounting matters, (2) financial management systems, and (3) property management. These matters are described in the FY 1999 Management Letter (see footnote 4) and are summarized below.

Report of Independent Public Accountants on Compliance with Laws and Regulations

Arthur Andersen tested NASA compliance with certain laws and regulations that could have a direct and material effect in determining the financial statement amounts. The tests disclosed no reportable noncompliance. Arthur Andersen also concluded that NASA's financial management systems substantially comply with the Federal Financial Management Improvement Act of 1996.

The full text of the above three reports, dated February 2, 2000, are included the Agency's FY 1999 Accountability Report which can be viewed at <http://www.nasa.gov>.

Report of Independent Public Accountants on the Application of Agreed-Upon Procedures

Arthur Andersen performed the procedures as specified in Appendix I-1 of OMB Bulletin 99-xx (see footnote 7) and found differences or variances in certain procedures. Appendix I-1 listed seven detailed procedures relating to the Report of Withholdings and Contributions for Health, Benefits, Life Insurance, and Retirement and to the Supplemental Semiannual Headcount Report. The procedures generally entailed footing,¹⁰ tracing to source documents, recalculating amounts, and reconciling reports. Arthur Andersen issued its Agreed-Upon Procedures report to the Inspector General, Chief Financial Officer, and the Associate Director for Retirement and Insurance of the Office of Personnel Management on December 15, 1999.

⁹ A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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.

¹⁰ Footing is the sum of a column or row of figures.

FY 1999 Management Letter

Arthur Andersen made nine observations related to three areas: (1) Financial Management and Accounting Matters, (2) Financial Management Systems, and (3) Property Management. Overall, the recommendations for areas one and three addressed the need to strengthen the financial reporting process. For the Financial Management Systems area, the recommendations addressed the need to maintain complete and accurate documentation of security policies and procedures and to improve security-related practices and disaster recovery capabilities. In following up on the FY 1998 Management Letter recommendations, Arthur Andersen found that further activity was required on 12 of the 25 recommendations (see Appendix C).

Appendix C. Status of Prior Year Management Letter Recommendations

Fiscal Year 1998 Recommendations	Findings Not Repeated in 1999 Management Letter		Findings Repeated in 1999 Management Letter	
	Implemented	In Process*	Partially Implemented	Not Implemented
1. Continue to Improve Logical Access Controls Over Financial Management Systems	--	--	X	--
2. Strengthen Financial Reporting Process to Effectively Communicate and Monitor New and Revised Policies	--	--	--	--
a. Proper accounting for prior-period adjustments	--	--	X	--
b. Recording of transactions in the proper period	X	--	--	--
c. Inclusion of contractor fees in the recorded value of contractor-held property	X	--	--	--
d. Reclassification of expired grant advances to accounts receivable	X	--	--	--
e. Periodic analysis of significant account balance fluctuations	X	--	--	--
3. Strengthen the Consolidation Process and Preparation of Financial Statements	--	X	--	--
4. Reconcile the General Ledger to the NASA Equipment Management System on a Timely Basis	X	--	--	--
5. Reconcile the Real Property Accountability Officer's Summary Report to the General Ledger on a Timely Basis	X	--	--	--
6. Maintain Complete and Accurate Documentation of Financial Management System Security Policies and Procedures	--	--	X	--
7. Enhance Processes to Manage Financial Management System General Security Controls	--	--	X	--
8. Strengthen Financial Management System Security-Related Practices	--	--	X	--
9. Strengthen Financial Management System Disaster Recovery Capabilities	--	--	--	X
10. Complete Year 2000 Remediation Initiatives	X	--	--	--

*These recommendations will be resolved upon the implementation of NASA's Integrated Financial Management Program.

Fiscal Year 1998 Recommendations	Findings Not Repeated in 1999 Management Letter		Findings Repeated in 1999 Management Letter	
	Implemented	In Process*	Partially Implemented	Not Implemented
11. Improve Procedures Relating to Accounting for Property, Plant, and Equipment	--	--	--	--
a. Original acquisition date information for equipment transferred between contractors and NASA Centers is not always retained.	X	--	--	--
b. Depreciation expense is recorded in year of acquisition and year of disposal using mid-year convention. No procedure currently exists for accurately performing this calculation.	--	--	X	--
c. Budgetary cost data, rather than actual cost data, were used to support historical costs assigned to Assets in Space.	--	X	--	--
d. Useful lives for NASA Shuttle orbiters are estimated based on anecdotal information.	X	--	--	--
e. A formal policy for assigning specific useful lives to Assets in Space on a unit-by-unit basis does not exist.	X	--	--	--
f. Write-offs of idle, inactive property were not performed consistently at each Center.	X	--	--	--
g. NASA Centers do not consistently apply NASA's policy for tracking and reporting deferred maintenance.	--	--	--	X
12. Improve Controls Over Receipt of Equipment	--	--	--	X
13. Review of Government Property Control System Analyses for Possible Financial Statement Impact	--	--	X	--
14. Properly Account for Work-in-Progress and Completed Property	--	--	--	--
a. Monitor uniform implementation of NASA policy for transferring Work-in-Progress to Completed Property.	X	--	--	--
b. Ensure complete and proper recording of all Center projects in the Work-in-Progress account.	X	--	--	--

*These recommendations will be resolved upon the implementation of NASA's Integrated Financial Management Program.

Appendix D. Report Distribution

Independent Audit Firm

Arthur Andersen LLP
8000 Towers Crescent Drive
Vienna, VA 22182-2725

National Aeronautics and Space Administration (NASA) Headquarters

AO/Chief Information Officer
B/Chief Financial Officer
B/Comptroller
BF/ Director, Financial Management Division
G/General Counsel
J/Associate Administrator for Management Systems
JM/Director, Management Assessment Division

NASA Assistant Inspector General for Auditing Reader Survey

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Report Title: Quality Control Review of Arthur Andersen Audit of the NASA FY 1999 Financial Statement

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? _____

How could we improve our report? _____

How would you identify yourself? (Select one)

Congressional Staff

NASA Employee

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Government: _____ Federal: _____ State: _____ Local: _____

Media

Public Interest

Other: _____

May we contact you about your comments?

Yes: _____

No: _____

Name: _____

Telephone: _____

Thank you for your cooperation in completing this survey.

Major Contributors to the Report

Chester A. Sipsock, Program Director, Environmental and Financial Management Audits

Van Tran, Auditor-in-Charge

Nancy C. Cipolla, Report Process Manager

Annette Huffman, Program Assistant