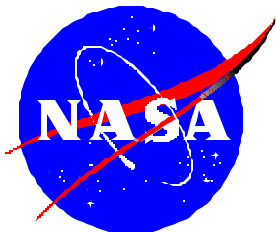


IG-00-023

**QUALITY
CONTROL
REVIEW
REPORT**

**H. LARRY JORDAN REVIEW OF STENNIS
SPACE CENTER EXCHANGE FINANCIAL
STATEMENTS FOR FISCAL YEAR ENDED
SEPTEMBER 30, 1998**

March 29, 2000



National Aeronautics and
Space Administration

OFFICE OF INSPECTOR GENERAL

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Acronyms

| | |
|-------|--|
| AICPA | American Institute of Certified Public Accountants |
| CFO | Chief Financial Officer |
| CPA | Certified Public Accountants |
| FY | Fiscal Year |
| GAAP | Generally Accepted Accounting Principles |
| GAS | Government Auditing Standards |
| NPD | NASA Policy Directive |
| OIG | Office of Inspector General |
| SSARS | Statements on Standards for Accounting and Review Services |

W

March 29, 2000

TO: A/Administrator

FROM: W/Inspector General

SUBJECT: INFORMATION: Quality Control Review of H. Larry Jordan Review of Stennis Space Center Exchange Financial Statements for Fiscal Year Ended September 30, 1998
Report Number IG-00-023

The NASA Office of Inspector General (OIG) completed a quality control review of H. Larry Jordan Review of Stennis Space Center Exchange (Stennis Exchange) fiscal year 1998 Financial Statements. We found that the Stennis Exchange inadequately managed Exchange financial reporting activities. Specifically, the Exchange (1) retained an accountant to conduct a review,¹ rather than an audit as required by NASA policy, (2) submitted the required statements and auditor reports late, (3) did not provide adequate financial statement disclosures, and (4) has not established a constitution or bylaws in accordance with NASA policy. As a result, Exchange management and other financial statement users have little assurance regarding the fair presentation of the Exchange financial statements, its internal controls, or compliance with laws and regulations.

During the quality control review, we also noted that the Stennis Exchange inappropriately used \$5,500 in appropriated funds² to pay for the fee of the financial statement review. Such expenses are the responsibility of the Exchange and should be paid with revenue generated by Exchange operations. Consequently, the Exchange was not paying for all recurring expenses, and appropriated funds used for those expenses could have been put to better use.

Background

NASA Policy Directive (NPD) 9050.6E, "NASA Exchange Activities," dated December 2, 1997, authorizes Center Directors to establish an Exchange to contribute to the efficiency,

¹ The scope of a review is substantially less than the scope of an audit and provides no opinion on the fair presentation of the financial statements, internal controls, or compliance with laws and regulations.

² Federal funds authorized (that is, appropriated) by Congress for an agency's operations. As required by the United States Code, appropriated funds may be used only for their intended purpose and for a definite period of time.

welfare, and morale of NASA personnel. Center Directors are required to appoint an Exchange Council to oversee and manage the exchange operations in a sound, business-like manner.

Exchange-operated activities are generally self-sustained, that is, supported by nonappropriated funds.³ The Directive also requires the Council to obtain annual audits of the Centers' Exchange financial statements and to submit the statements and the audit reports to the Center Chief Financial Officer by December 31 annually.

Recommendations

We recommended that the Stennis Exchange (1) require that annual audits be performed in accordance with government auditing standards by the established due date and that the engagement for the audit be competitively awarded to Certified Public Accountants (CPA) licensed to practice in the State of Mississippi, (2) follow established accounting principles in providing adequate disclosures in the notes accompanying the financial statements, and (3) establish a constitution and bylaws at the Exchange.

We also recommended that the Stennis Exchange reimburse the Agency for all appropriated funds previously spent on accounting fees and use nonappropriated funds to pay for all future operating expenses. This issue was also addressed in an OIG report on the Johnson Space Center Exchange.⁴ In part, because further audit work identified this same issue at other Centers, we redirected the recommendation in our report on the Johnson Exchange to the Associate Administrator for Management Systems and included all NASA Exchanges. Therefore, the resolution and disposition of the recommended action for all the Exchanges will be completed under Report IG-00-019.

Management Response and OIG Evaluation

Management agreed that it should provide adequate disclosures but provided no specifics on the planned corrective actions. We ask management to provide the specific actions and completion dates. We also continue to disagree with management's decision to (1) have an annual review of its financial statements performed by a NASA retiree, who is an unlicensed accountant, instead of contracting with a licensed CPA to perform an audit and (2) rely on its existing guidance as the official constitution and bylaws. We are particularly concerned that management used an unlicensed accountant for the FY 1999 financial statement examination

³ Funds received from sources other than congressional appropriations.

⁴ Report IG-00-019, "Audit of Johnson Space Center Exchange Use of Appropriated Funds for Exchange Activities," dated March 27, 2000, discusses the same issue and contains a similar recommended action regarding the use of appropriated funds to pay accounting fees.

without consulting with the Inspector General as required by NASA policy. Further, the Inspector General Act of 1978 requires that I take steps to assure that audit work performed by non-Federal auditors complies with the standards established by the Comptroller General of the United States. Stennis' use of a non-Federal auditor does not comply with audit standards promulgated by the Comptroller General.

We ask management to reconsider its position on those recommendations and to provide additional comments. A summary of the status of all the recommendations is in the Executive Summary of the report.

[original signed by]

Roberta L. Gross

Enclosure

Final Report on Quality Control Review of H. Larry Jordan Review of Stennis Space Center
Exchange Financial Statements for Fiscal Year Ended September 30, 1998

FINAL REPORT
QUALITY CONTROL REVIEW OF H. LARRY JORDAN REVIEW OF
STENNIS SPACE CENTER EXCHANGE FINANCIAL STATEMENTS
FOR FISCAL YEAR ENDED SEPTEMBER 30, 1998

W

March 29, 2000

TO: J/Associate Administrator for Management Systems
SSC/AA00/Director, Stennis Space Center
SSC/AA00/Chairman, Exchange Council

FROM: W/Assistant Inspector General for Auditing

SUBJECT: Final Report on the Quality Control Review of H. Larry Jordan Review of Stennis
Space Center Exchange Financial Statements for Fiscal Year Ended September 30,
1998
Assignment Number A9904700
Report Number IG-00-023

The subject final report is provided for your use and comments. Please refer to the Executive Summary for the overall review results. Our evaluation of your response is incorporated into the body of the report. Regarding management's partial concurrences on recommendations 1 and draft recommendation 4 (which has been renumbered as 3 for the final report), we consider the proposed actions to be nonresponsive and request that management reconsider its position and provide additional comments in response to the final report by April 28, 2000. We also request additional comments on recommendation 2 that specify the corrective planned, ongoing, or completed actions. Recommendations 1, 2, and 3 in the final report will remain open for reporting purposes. Draft report recommendation 3 is considered closed for reporting purposes. The related recommended action will be resolved and dispositioned under OIG Report IG-00-019, which contains a recommendation directed to the Associate Administrator for Management Systems that covers all the NASA Exchanges.

If you have questions concerning the report, please contact Mr. Patrick A. Iler, Director, Audit Quality, at (216) 433-5408, or Ms. Van Tran, Auditor-in-Charge, at (202) 358-0466. We appreciate the courtesies extended to the audit staff. See Appendix D for the report distribution.

[
Russell A. Rau

Enclosure

cc:

B/Chief Financial Officer

B/Comptroller

BF/Director, Financial Management Division

G/General Counsel

JL/Director, Contractor Industrial Relations

JM/Director, Management Assessment Division

SSC/AA00/Exchange Operations Manager

SSC/CA00/Chief Counsel

SSC/EA00/Chief Financial Officer

bcc:

AIGA, IG, Reading Chron

GRC/501-9/P. Iler

SSC/EA00/T. Roosevelt

W/V. Tran

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NASA Office of Inspector General

IG-00-023
A9904700

March 29, 2000

H. Larry Jordan Review of Stennis Space Center Exchange Financial Statements for Fiscal Year Ended September 30, 1998

Executive Summary

Background. The NASA Office of Inspector General (OIG) performed a quality control review of the H. Larry Jordan Review of the Stennis Space Center Exchange (Stennis Exchange) fiscal year (FY) 1998 Financial Statements. Mr. H. Larry Jordan is a retired accountant, retained by the Stennis Exchange to conduct the FY 1998 review of Exchange operations. The Exchange is Mr. Jordan's only client. The Stennis Exchange is a Government instrumentality, operating under NASA's control for the benefit of Agency employees. It operates and generates revenues from the gift shops and concessionaire agreements. For the year ended September 30, 1998, the Stennis Exchange reported a cash balance of \$938,706⁵ and a net income of \$272,222.

The Inspector General Act of 1978, as amended, mandates Inspectors General to ensure that work performed by non-Federal auditors complies with government auditing standards (GAS) issued by the Comptroller General of the United States. The GAS incorporate, by reference, the American Institute of Certified Public Accountants (AICPA) standards of field work and reporting.⁶ Compliance with GAS provides reasonable assurance that:

- Financial statements present fairly the financial condition and results of operations of the Exchange in accordance with established accounting principles.
- Internal controls are in place and operating as intended.
- The Exchange is complying with applicable laws and regulations.

Objectives. The quality control review objectives were to determine whether the independent, external auditor performed the audit in accordance with GAS and whether the Stennis Exchange had taken corrective actions on recommendations resulting from the audit. Appendix A contains additional details on our objectives, scope, and methodology.

⁵ The cash balance includes money market accounts and certificates of deposit.

⁶ GAS prescribe minimum hours of continuing education requirements and additional standards for field work and reporting.

Results of Review. The Stennis Exchange inadequately managed Exchange financial reporting activities. Specifically, the Exchange retained H. Larry Jordan to conduct a review,⁷ rather than an audit of the Exchange FY 1998 Financial Statements in accordance with GAS. The accountant neither conducted the review in accordance with standards established by the AICPA nor completed it by the December 31, 1998, due date (Finding A). In addition, Exchange management did not provide adequate financial statement disclosures in accordance with generally accepted accounting principles (Finding B). As a result, Exchange management and other financial statement users have little assurance regarding the fair presentation of the Exchange financial statements, its internal controls, or compliance with laws and regulations.

During the quality control review, we also noted two matters related to Exchange operations. Specifically, the Stennis Exchange inappropriately used \$5,500 in appropriated funds⁸ to pay for the fee of the financial statement review (Finding C). Such expenses are the responsibility of the Exchange and should be paid with revenue generated by Exchange operations. Consequently, the Exchange was not paying for all recurring expenses, and appropriated funds used for those expenses could have been put to better use. Also, the Stennis Exchange does not have a constitution or bylaws which is in noncompliance with Agency policy governing Exchange activities⁹ (Finding D).

The accountant, as part of his review, issued to Exchange management reports that contained recommendations for improvement (see Appendix B). The Stennis Exchange has resolved all the recommendations.

Recommendations. We recommend that the Stennis Exchange:

- Require that annual audits be performed in accordance with government auditing standards by the established due date and that the engagement for the audit be competitively awarded to Certified Public Accountants licensed to practice in the State of Mississippi.
- Follow established accounting principles in providing adequate disclosures in the notes accompanying the financial statements.
- Reimburse NASA for all appropriated funds previously spent on accounting fees and use its own funds (that is, nonappropriated funds¹⁰) to pay for all future operating expenses.
- Establish a constitution and bylaws at the Exchange.

Management's Response. Management agreed to provide adequate disclosures but provided no specific corrective actions or completion dates. Management partially concurred with two recommendations, stating that it would continue to (1) have an annual review of its financial statements

⁷ The scope of a review is substantially less than the scope of an audit and provides no opinion on the fair presentation of the financial statements, internal controls, or compliance with laws and regulations.

⁸ Federal funds authorized (that is, appropriated) by Congress for an agency's operations. As required by the United States Code, appropriated funds may be used only for their intended purpose and for a definite period of time.

⁹ The activities are described in NASA Policy Directive 9050.6E, "NASA Exchange Activities," dated December 2, 1997.

¹⁰ Funds received from sources other than congressional appropriations.

performed by a NASA retiree, who is an unlicensed accountant, instead of contracting with a licensed CPA to perform an audit and (2) rely on its existing guidance as the official

constitution and bylaws. Management disagreed that it should not use appropriated funds to pay for the accounting fees. The complete text of management's response is in Appendix C.

Evaluation of Response. Management's comments are generally not responsive. We ask management to provide the specifics on planned, ongoing, and completed corrective actions with regard to providing adequate disclosures including milestone dates for completing action. For management's partial concurrences, we consider the proposed actions to be nonresponsive and request that management reconsider its position and provide additional comments in response to the final report. The issue related to the use of appropriated funds to pay for the accounting fees is covered in OIG Report IG-00-019,¹¹ which contains a recommendation to the Associate Administrator for Management Systems and includes all NASA Exchanges. Therefore, we deleted the related recommendation from this report, and resolution and disposition of the recommended action will be completed under Report IG-00-019.

¹¹ Report IG-00-019, "Audit of Johnson Space Center Exchange Use of Appropriated Funds for Exchange Activities," dated March 27, 2000, discusses the same issue and contains a similar recommended action regarding the use of appropriated funds to pay accounting fees.

Introduction

NPD 9050.6E, "NASA Exchange Activities," dated December 2, 1997, authorizes Center Directors to establish an Exchange to contribute to the efficiency, welfare, and morale of NASA personnel. Center Directors are required to appoint an Exchange Council to oversee and manage the exchange operations in a sound, business-like manner. The Council (hereafter, may also be referred to as Exchange management) must consist of at least five Center employees who perform their duties without pay from the Exchange. Council members serve as Chairperson, Treasurer, Exchange Operations Manager, Secretary, or other advisory capacities. Exchange-operated activities are generally self-sustained, that is, supported by nonappropriated funds. The Directive also requires the Council to obtain annual audits of the Center's Exchange financial statements and to submit the statements and the audit reports to the Center Chief Financial Officer (CFO) by December 31 annually.

Auditors engaged to conduct the financial audits of the Exchanges have for the most part followed the generally accepted auditing standards issued by the AICPA. However, the Inspector General, together with officials from the NASA Offices of the CFO and Management Systems, determined that the audits should be conducted in accordance with GAS because the Exchanges are Government instrumentalities. The Inspector General issued a policy memorandum on March 1, 1999, to all the Exchanges regarding the change to using GAS, which their auditors must follow beginning with the FY 1999 financial statement audits.

During the last 3 years, the Stennis Exchange Council has alternated between having Stennis CFO Office staff or Mr. Jordan perform the annual review of the Exchange financial statements. Prior to his retirement, Mr. Jordan worked as an accountant in the Stennis CFO Office, and his duties included performing reviews of the Exchange.

Findings and Recommendations

Finding A. Conduct of Annual Audit

The Stennis Exchange inadequately managed Exchange financial reporting activities. Specifically, the Exchange retained Mr. Jordan to conduct a review of its FY 1998 financial statements, rather than an audit as required by NASA policy. The accountant did not conduct the review in accordance with AICPA standards or complete it in a timely manner. These conditions occurred because the Exchange Operations Manager was not clear on the audit requirement and because the accountant is not qualified to perform an audit. Also, the Exchange Operations Manager did not specify the appropriate review standards or deadline in the statement of work. As a result, the Exchange management and other financial statement users¹² do not have reasonable assurance with regard to the actual financial condition and adequacy of reporting of Exchange operations.

Requirements for the Annual Financial Statement Audit

NPD 9050.6E, paragraph 5.c.(5), requires the Exchange Council to “. . . provide for an annual audit of books and records of the Exchange and its elements by a qualified party independent of the Council.” The Directive also requires that the financial statements and audit report be submitted to the Center CFO by December 31 annually.

The Stennis Exchange completed a sole-source justification and signed a purchase order engaging Mr. Jordan’s services on November 10, 1998. Instead of contracting for an audit as required by Directive 9050.6E, Exchange management specified in the statement of work a review that was to begin on November 13 and be completed by January 31, 1999. The statement of work states:

Perform a review of NASA Exchange, Recreation Association, and Stennis Child Development Center operations to include reviews of cash management, internal control, inventory control, financial statements, potential for fraud and abuse, and operations management.

Upon completion of the review, the primary deliverable will constitute a detailed report explaining the basic procedures and methodology of the review along with a discussion on the more significant findings and recommendations, together with appropriate financial statements relating to those operations reviewed.

The Exchange Operations Manager specified a review because he believed the terms “audit” and “review” are interchangeable. The terms, however, differ significantly. For an audit, the objective is to provide a reasonable basis for expressing an opinion regarding the financial statements, the internal controls, and compliance with laws and regulations taken as a whole. A review, on the other hand, does not provide a basis for expressing such an opinion because it excludes certain procedures

¹² Other financial statement users include Headquarters CFO, Office of Management Systems, NASA employees, and the OIG.

ordinarily performed during an audit. Thus, the review would not permit an accountant to become aware of significant matters that would be disclosed in an audit.

In addition, the accountant is not qualified to perform an audit had such an engagement been specified. The accountant is not a licensed CPA and thus cannot render an opinion on the financial statements under the statutes of the Mississippi State Board of Public Accountancy.

AICPA Standards for Review Services

Because the degree of responsibility is lower for a review, the accountant should issue an appropriate report by which he indicates that responsibility. The accountant should prepare the report in accordance with AICPA Statements on Standards for Accounting and Review Services (SSARS). Sections 100.32 and 100.34 of the standards require that:

1. Each page of the financial statements reviewed by the accountant should include a reference such as "See Accountant's Review Report."
2. The review report should state:
 - a. A review was performed in accordance with Statements on Standards for Accounting and Review Services issued by the AICPA.
 - b. All information included in the financial statements is the representation of the management (owners) of the entity.
 - c. A review consists principally of inquiries of entity personnel and analytical procedures applied to financial data.
 - d. A review is substantially less in scope than an audit,¹³ the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, no such opinion is expressed.
 - e. The accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles, other than those modifications, if any, indicated in his report.

Mr. Jordan's reports, dated December 1, 1998, and January 13, 1999, did not contain any of the required elements. Also, the January 13th report was late and did not meet the specified due date in NASA policy. These conditions occurred because the Exchange Operations Manager did not specify in the statement of work that the review be done in accordance with SSARS and by the required December 31 due date.

Assurance on Exchange Operations

By not obtaining an audit in accordance with GAS or specifying appropriate standards for performing a financial statement review, the Exchange Council and other users of the financial statements do not have reasonable assurance that:

¹³ Procedures ordinarily performed in an audit include: obtaining an understanding of internal control, assessing control risk, and testing of accounting records.

- Financial statements present fairly the financial condition and results of operations of the Exchange in accordance with established accounting principles.

- Internal controls are in place and operating as intended.
- The Exchange is complying with applicable laws and regulations.

Recommendation, Management’s Response, and Evaluation of Response

- 1. The Stennis Exchange should competitively retain a Certified Public Accountant licensed to practice in the State of Mississippi to perform an annual audit in accordance with government auditing standards starting with FY 1999 and should submit the financial statements and auditor’s report by the established due date.**

Management’s Response. Partially concur. Management stated that because NASA policy does not define the terms “audit” or “qualified party,” the requirement could be taken to mean any one of the different types of engagements to be conducted by an experienced professional (for example, a non-CPA, an unlicensed accountant, or a licensed CPA). Also, based on the OIG’s March 1, 1999, policy memorandum regarding the change to using GAS, management stated that it informed NASA Headquarters of its intention to continue employing an unlicensed accountant to perform future compilations and reviews unless otherwise advised by Headquarters. NASA Offices of the CFO and Management Systems have since concurred with this Stennis Exchange practice. Additionally, management stated that the low-cost services of Mr. Jordan are preferred over the services of a local CPA firm. Also, management suggested that NASA Headquarters negotiate an Agency-wide contract with a national CPA firm to perform financial statement audits of all NASA Exchanges. A copy of management’s response is in Appendix C.

Evaluation of Response. Management’s comments are not responsive to the intent of the recommendation. The March 1 policy memorandum clearly identified which standards should be followed in an engagement (audit or review of an Exchange’s financial statements). By implication, the nature of the engagement and the accountancy laws for the state where the engagement is conducted dictate who is a qualified party. For example, the Mississippi State Board of Public Accountancy allows a non-CPA or an unlicensed accountant to perform reviews but not audits of financial statements. Therefore, the terms “audit” and “qualified party” need no definition.

When the policy memorandum was issued on March 1, 1999, all NASA Exchanges were required to comply with the newly specified requirements (that is, to request audits to be performed in accordance with GAS or to obtain waivers from NASA Headquarters in consultation with the Inspector General). Stennis Exchange, however, improperly elected to proceed with its existing practice of engaging Mr. Jordan's services and to let NASA Headquarters advise it otherwise. Further, Exchange management sought the requisite waiver after it had already engaged Mr. Jordan to perform the FY 1999 financial statement review. In accordance with our responsibility under the Inspector General Act, we consider this action to be an inappropriate use of a non-Federal auditor. In granting the waiver, the NASA Offices of the CFO and Management Systems did not consult with the OIG, as required by the policy memorandum. Had the OIG been consulted, the OIG would have raised several concerns with Stennis Exchange management’s plans to continue to obtain review services from Mr. Jordan, a NASA

retiree and an unlicensed accountant, including:

- As previously stated, by not obtaining an audit in accordance with GAS or specifying appropriate standards for performing a financial statement review the Exchange Council and other users of the financial statements do not have reasonable assurance that the financial statements present fairly the financial condition and results of operations of the Exchange in accordance with established accounting principles, internal controls are in place and operating as intended, and the Exchange is complying with applicable laws and regulations.
- Because Mr. Jordan is unlicensed, the Exchange Council has no assurance that he has continued to obtain sufficient continuing professional education to remain knowledgeable about all applicable accounting and auditing principles, practices, and standards.
- As a NASA retiree, Mr. Jordan still has access to Exchange facilities, services, and functions, which raises a question as to his independence. Mr. Jordan may believe that he is independent in his attitudes and actions, however, his status as a retiree gives the appearance of a potential conflict of interest. The GAS state:

Auditors should consider not only whether they are independent and their attitudes and beliefs permit them to be independent but also whether there is anything about their situations that might lead others to question their independence. All situations deserve consideration because it is essential not only that auditors are, in fact, independent and impartial, but also that knowledgeable third parties consider them so.

In addition, management stated that Center management remained convinced that the best option was to continue to use the services of Mr. Jordan to perform annual reviews of the Exchange financial statements. However, Center management did not state whether it required Mr. Jordan to conduct the FY 1999 or future reviews in accordance with SSARS and by the required December 31 due date. If Mr. Jordan is not required to comply with SSARS, then the reviews have even less value because they are not being performed in accordance with any recognized standards. Without an audit performed in accordance with applicable standards, the Exchange is at high risk of encouraging fraud, waste, and abuse.

Finally, Stennis management suggested that NASA Headquarters negotiate an Agency-wide contract with a national CPA firm to perform financial statement audits of all NASA Exchanges. This approach could resolve our concern about the Stennis Exchange obtaining a review by an unlicensed accountant. However, implementing this alternative approach would require NASA Headquarters to determine its practicality as well as resolution of our finding and recommendation concerning the improper use of appropriated funds to pay for Exchange audit fees. The use of appropriated funds for Exchange audit fees is discussed in Finding C.

We reaffirm our position on this issue and, therefore, request that management reconsider its position based on our evaluation and provide additional comments. The recommendation is unresolved and undispositioned pending review and evaluation of management's comments.

Finding B. Adequate Financial Statement Disclosures

The Stennis Exchange did not prepare the FY 1998 financial statements and the related notes in accordance with established accounting principles. Specifically, the financial statements provided inadequate disclosures on the reporting entity and accounting policies. The Exchange Council omitted substantially all disclosures because it prepared the financial statements for internal use rather than for a larger user group, such as NASA oversight bodies. Without adequate disclosures, the financial statements do not provide complete or meaningful information to other NASA users.

Requirements for Adequate Disclosures

An implicit and integral part of Exchange management's responsibility is to fairly present the financial statements¹⁴ in conformity with generally accepted accounting principles (GAAP) or another comprehensive basis of accounting.¹⁵ Regardless of the basis used, the financial statements and the accompanying notes should contain adequate and informative disclosures.¹⁶ The disclosures generally amplify or explain the items presented in the main body of financial statements and, at a minimum, should include a description of the reporting entity and all significant accounting policies, such as the valuation method for inventories and investments.

Presentation of Exchange FY 1998 Financial Statements

The Stennis Exchange Council provided inadequate disclosures in the FY 1998 financial statements. Except for stating that the statements were presented on a cash basis, the Council provided no other descriptions for the reporting entity (for example, the Exchange's Government instrumentality status), nature of its operations, or sources of revenues.¹⁷ Descriptions of significant accounting policies were also limited. For example, the Council disclosed no information on how the inventories or investments are valued (that is, historical cost or market value).

The Council omitted substantially all disclosures because it prepared the financial statements for internal use only. Besides the Council, users of the Exchange financial statements include the Center and Headquarters CFO's, Headquarters Office of Management Systems, NASA employees, and the OIG. Information provided in the disclosures is not only helpful but also essential to an understanding of the performance and position of the Exchange. Without adequate disclosures, the financial statements are

¹⁴ Statements on Auditing Standards, section 110.03, "Distinction Between Responsibilities of Auditor and Management," further describes the responsibilities and functions of the independent auditor.

¹⁵ GAAP are those principles that have been promulgated by authoritative accounting rule-making bodies or have been universally accepted as appropriate over time. In addition to GAAP, other basis of accounting includes a cash basis or tax basis.

¹⁶ Accounting Principles Board Opinion No. 22, "Disclosure of Accounting Policies," and Statements on Auditing Standards, sections 623.09-.10, "Evaluating the Adequacy of Disclosure in Financial Statements Prepared in Conformity With an Other Comprehensive Basis of Accounting" describe the disclosure requirements.

¹⁷ One source of revenue for the Stennis Exchange in FY 1998 was from the sale of a mock-up external tank to the Kennedy Space Center Visitor Complex for \$500,000 (payable in two installments). The external tank is NASA property. The NASA OIG is reviewing the appropriateness of this transaction under a separate assignment.

not informative or meaningful to users, especially those who have oversight responsibilities over the Exchanges.

Recommendation, Management's Response, and Evaluation of Response

- 2. The Stennis Exchange should follow established accounting principles by providing adequate disclosures in the notes accompanying the financial statements.**

Management's Response. Management concurred with the recommendation (see Appendix C).

Evaluation of Response. Although management concurred, its comments are not fully responsive because they do not describe actions planned, in process, or completed and the respective completion dates. Therefore, we request that management provide additional details on corrective actions and the completion date. The recommendation is unresolved and undispositioned pending review and evaluation of management's comments.

Finding C. Use of Appropriated Funds for Exchange Expenses

The Stennis Exchange inappropriately used appropriated funds to pay for the accounting fee incurred by the FY 1998 financial statement review. The Exchange management cited a 1990 Agency memorandum that authorized the use of appropriated funds for this purpose. Current NASA policy, however, limits the use of appropriated funds to cafeteria equipment purchases and repairs. Other expenses are the responsibility of the Exchange and should be paid with revenue generated by Exchange operations. As a result, the Exchange was not paying for all operating expenses, and appropriated funds used for those expenses could have been put to better use.

Authorization for Use of Appropriated Funds on Exchange Activities

NPD 9050.6E, paragraph 1.i., states,

Activities shall generally be supported by nonappropriated funds under the Exchange's sole jurisdiction. Center Directors may authorize use of appropriated funds to provide for cafeterias, purchase and maintenance of cafeteria equipment, other facilities, and equipment necessary for Exchange activities, with the prior concurrence of the Center Chief Counsel and Chief Financial Officer.

The accounting fee for the FY 1998 financial statement review was \$5,500. The Exchange Operations Manager, who is also the Special Assistant to the Stennis Center Director, inappropriately authorized the use of the Center Director's funds (that is, appropriated funds) to pay this fee. The Exchange Operations Manager cited a September 1990 NASA Comptroller memorandum as the basis for using appropriated funds on Exchange activities. The memorandum stated, in part, "Management and oversight of the Exchange which is an instrumentality of the government is clearly a proper use of the funds appropriated to the Agency." However, NPD 9050.6E limits the use of appropriated funds for certain capital acquisitions and repairs only. Further, the Agency has not determined that the accounting fee is a necessary expense to enhance employee morale which would be required to fully comply with the intent of 31 U.S.C. § 1301(a)¹⁸ and related Comptroller General Decisions.¹⁹

The annual expense for a financial statement audit is a cost of doing business, that is, an operating expense, and should be paid with revenue generated by the Stennis Exchange. Appropriated funds used for the Exchange's operating expenses could have been put to better use.

Redirected Recommendation, Management's Response, and Evaluation of Response

Management's Comments on Draft Recommendation. Management nonconcurred with the draft report recommendation to reimburse NASA for all appropriated funds previously spent on accounting

¹⁸ Title 31, "Money and Finance," Chapter 13, "Appropriations," explains that only necessary expenses can be paid with appropriated funds.

¹⁹ Related decisions include 18 Comptroller General Decision 147 and 27 Comptroller General Decision 679.

fees and to use appropriated funds to pay for all future operating expenses. Stennis Exchange management stated that the use of appropriated funds to pay for the annual audits of the Exchange appeared to be well supported by NPD 9050.6E; a NASA Comptroller letter dated September 25, 1990; and a NASA Associate General Counsel letter dated February 17, 2000.²⁰ Stennis Exchange also referred this issue to NASA Headquarters Offices of Chief Financial Officer and Management Systems for resolution (see Appendix C).

Evaluation of Response. Stennis management's response parallels the management response to another OIG draft report²¹ that addressed the same issue. Management's comments, supplemented by the input from the NASA Associate General Counsel, further audit work that identified this same issue at other Centers, and support provided by an OIG Attorney-Advisor resulted in our redirecting the recommended action in Report IG-00-019 to the Associate Administrator for Management Systems and including all NASA Exchanges. Therefore, draft recommendation 3 is considered closed for reporting purposes. Resolution and disposition of the related recommended action will be done under Report IG-00-019.

²⁰ The Office of the General Counsel issued a memorandum, dated February 17, 2000, supporting NASA management's position on using appropriated funds for audit fees.

²¹ The final report, IG-00-019, "Audit of Johnson Space Center Exchange Use of Appropriated Funds for Exchange Activities," issued March 27, 2000, discusses the same issue and contains a similar recommendation regarding the use of appropriated funds to pay accounting fees.

Finding D. Need for Constitution and Bylaws

The Stennis Exchange does not have a required constitution or bylaws because the Stennis Office of the Chief Counsel determined that such documents are not appropriate to the Exchange management. As a result, the Stennis Exchange does not have a framework of policies to guide its operations and is not in compliance with NASA policy for Exchange Activities.

Constitution and Bylaws Requirements

NPD 9050.6E, paragraph 5.a.(1), states that Center Directors are responsible for “establishing a constitution, bylaws, and regulations appropriate to Exchange management.” The Stennis Exchange, however, does not have the required constitution and bylaws.

The Exchange Operations Manager sought the advice of the Stennis Office of Chief Counsel (Counsel) on establishing internal regulating documents. The Counsel issued a determination in a memorandum, dated June 24, 1999, that such documents are not appropriate or necessary for the Exchange management because a constitution is “. . . generally associated with a non-profit organization,” while bylaws are “. . . traditionally associate[d] . . . with corporate information.” The Counsel stated that the determination was based on the Exchange’s status as a Government instrumentality.

The Counsel’s interpretation is contrary to the NASA Directive, which requires that Center Exchanges have a constitution and bylaws that are appropriate to the Exchange management. Johnson Exchange, for example, has its charter (that is, constitution) and bylaws. These documents address policies and operating procedures, such as Council membership, its duties and term of appointments, frequency of meetings, accountability of Exchange records, and various employee morale activities. Although the Stennis Exchange has some policies and procedures, they are loosely documented in the forms of letters and memorandum. The Exchange management stated that this was done in light of the Agency commitment to reduce directives by 50 percent. The constitution and bylaws, however, are essential to establishing accountability over Exchange operations and reporting and to ensuring that Exchange activities contribute to the efficiency, welfare, and morale of NASA personnel.

Renumbered Recommendation, Management’s Response, and Evaluation of Response

3. The Stennis Center Director should establish a constitution and bylaws that are appropriate to the Exchange management.

Management’s Response. Partially concur. Stennis Exchange Management stated that its 14-page Memorandum for Record document, “Summary of NASA/SSC Exchange Policies and Procedures,” covers similar topics as those identified in the Johnson Exchange charter and bylaws. Therefore, management opined that its document met the intent of the NPD 9050.6E. A copy of management’s response is in Appendix C.

Evaluation of Response. Management’s comments are not responsive to the intent of the recommendation. As we discussed in the finding section, although the Stennis Exchange has some policies and procedures, they are loosely documented in the forms of letters and memorandum. These policies and procedures are the same as the 14-page Memorandum for Record “Summary of NASA/SSC Exchange Policies and Procedures” that was referenced in the Stennis response. While the Memorandum for Record document covers some of the same topics found in, for example, the Johnson Exchange charter and bylaws, the Stennis Exchange document lacks key provisions such as, procedures for appointment of NASA employees to the Exchange Council, the term of appointments, and accountability of Exchange records. Stennis Exchange management should use its Memorandum for Record as a starting point toward establishing a constitution and bylaws by updating and integrating the various provisions into a seamless document. We reaffirm our position and request that management provide additional comments in response to the final report. The recommendation is unresolved and undispositioned pending review and evaluation of management's comments.

Appendix A. Objectives, Scope, and Methodology

Objectives

The quality control review objective was to determine whether the audit work for the Stennis Exchange was performed in accordance with government auditing standards. We also determined whether the Stennis Exchange had taken corrective actions in response to recommendations resulting from the audit.

Scope and Methodology

In performing the quality control review, we used the AICPA Codification of Statements on Standards for Accounting and Review Services to evaluate the accountant's work. Our review focused on the accountant's qualifications, independence, audit programs for appropriate procedures, and working paper documentation. We also reviewed NASA policies and procedures governing the Exchanges and interviewed Headquarters officials and Stennis Exchange Council members. In addition, we reviewed corrective action plans and followed up on selected recommendations to evaluate the responsiveness of corrective actions taken by the Exchange Council.

We performed the quality control review from June through December 1999 at Headquarters and the Stennis Space Center.

Appendix B. Recommendations from the Financial Statement Review

The accountant issued reports containing the following 16 recommendations. The Stennis Exchange Council has resolved all the recommendations. The OIG evaluated the implementation of selected recommendations and noted no exceptions.

| FY 1998 Recommendations | Resolved |
|--|---|
| <u>Treasurer</u> 1. Obtain quarterly bank statements that will accommodate reconciliation of certificates of deposits and savings accounts. 2. Assure that the NASA Coordinator approves all Exchange employee time sheets. 3. Reinstate a previously used form that serves to reconcile funds advanced and collected/expensed for Exchange functions. 4. Perform periodic site review of Service Station sales records. 5. Make improvements in how Paychex* accumulates and reports employee leave. | X X X X X |
| <u>Souvenir Shop - Visitor Center</u> 1. Ensure that prompt deposits are made except in extenuating circumstances. 2. Open mail promptly to ensure timely deposits of checks transferring funds to the Treasurer account. | X X |
| <u>Exchange Store</u> 1. Establish a filing system to secure financial records. 2. Establish an account payable log for each major vendor. 3. Determine reasons for the FY 1998 operating loss. | X X X |
| <u>Stennis Recreation Association</u> 1. Provide timely response to recommendations made in the prior year review. 2. Obtain liability and workers' compensation insurance coverage. 3. Establish a filing system to secure financial records. 4. Ensure that prompt deposits are made. 5. Perform quarterly inventories. 6. Provide further breakdown of major receipts and expenses in financial statements. | X X X X X X |

*A contractor that processes payroll transactions for Stennis Exchange employees.

Appendix C. Management's Response

National Aeronautics and
Space Administration
John C. Stennis Space Center
Stennis Space Center, MS 39529-6000



MAR 15 2000

Reply to Attn of: AA00

TO: NASA Headquarters
Attn: W/Assistant Inspector General for Auditing

FROM: AA00/Director

SUBJECT: Management Response to OIG's Draft Report on Stennis Space Center
(SSC) Review of FY98 Exchange Financial Statements
Assignment Number A9904700

We have reviewed the subject draft report and offer the following comments as to the findings and recommendations contained therein:

- Recommendation A – “The Stennis Exchange should competitively retain a Certified Public Accountant (CPA) licensed to practice in the State of Mississippi to perform an annual audit in accordance with government auditing standards (GAS) starting with FY 1999 and should submit the financial statements and auditors report by the established due date.”
- SSC Comment – Partially Concur - During the past ten years, the SSC Exchange has utilized three different sources for its annual review or audit of Exchange operations, i.e.:
 1. NASA/SSC CFO's Office
 2. Larry Jordan, Certified Public Accountant (unlicensed), retired NASA/SSC employee
 3. Local area CPA firm (Clifford, Harvey & Culumber (CHC), P.A., Gulfport, MS)

From this experience, “1” and “2” have proved to be the preferred sources in that they are professionally competent, are most knowledgeable of Exchange operations and thereby in a position to provide more meaningful recommendations, and are the lowest cost providers (CFO – no cost, Jordan \$5,500). “3” is the least preferred source in that while they too are professionally competent, they are not knowledgeable as to Exchange operations, thereby resulting in a marginal set of findings/recommendations, and they are the high cost provider (for FY92, \$7,625 versus a second competitive bid of \$11,000). It should be noted that the CHC effort was a “compilation and review” and not a formal audit with rendering of the attest function. At the time, an audit with attest function was priced by CHC at approximately \$12,000.

While NPD 9050.6E requires “an annual audit of books and records of the Exchange and its elements by a qualified party independent of the Council,” it does not go on to define the terms “audit” or “qualified party.” The term audit could be taken to mean per the AICPA, or per GAS, or per one of

the three or four Webster Dictionary definitions, or just relate to what is commonly referred to as a "compilation and review." As for the term qualified party, it could relate to a non-CPA experienced in reviewing financial operations and statements, a non-licensed CPA, a licensed CPA, or a licensed CPA licensed in the state where the review or audit is being performed, etc.

In correspondence dated March 1, 1999, NASA Headquarters Code W advised NASA Exchanges that all future annual reviews or audits of Exchange operations were to be performed in accordance with Government Auditing Standards (GAS), essentially requiring an attest function type audit by a licensed CPA. This correspondence requested information as to whether or not individual Exchange audits were being conducted in accordance with GAS and further advised that exceptions to the stated guidance would "require the concurrence of NASA Headquarters Codes B and J." In correspondence dated March 29, 1999, SSC advised NASA Headquarters (Codes W, B and J) that its examination of FY98 Exchange operations was more a compilation and review performed by an unlicensed CPA and that unless otherwise advised by Headquarters, would continue to follow this procedure for future year reviews. In subsequent discussions with Headquarters, Steve Varholy (BF) and Al Harding (JL) have concurred in this position or "exception," as contained in the March 1, 1999 correspondence.

Notwithstanding the above, our overall objective remains consistent with yours, i.e., to best ensure through annual review or audit of Exchange operations and financial statements, that Exchange activities contribute to the efficiency, welfare and morale of Stennis personnel, at an optimum level of effectiveness. Given our past experience, we remain convinced that this end purpose is best achieved via services of Mr. Larry Jordan, rather than those of a local area CPA firm. However, the merit of the formal audit process with the attest function performed is recognized, and as such, we recommend another option that would be applicable to all NASA Exchanges. It is suggested that NASA Headquarters take the lead in negotiating a multi-year agency-wide contract with one national-type CPA firm, to perform financial statement as well as operations audit of all NASA Exchanges. In fairly short order, one such public accounting firm performing annual audits of ten Exchange organizations, would become highly versed in overall NASA Exchange operations, having distinct advantages over our current disjointed system. At present we have as many as ten different Exchange approaches in such important areas as audit methodology, financial statement presentation, retail inventory control, cash management, merchandising, investment strategy, personnel recruitment, salaries and benefits, management reporting, insurance, property management, sourcing-out decisions, Randolph-Sheppard Act matters, etc. It would seem that many of these areas lend themselves to standardization and a decision making process that would lead to a "one best approach" way of doing business. Also, given a coordinated approach involving nine centers as well as Headquarters, and the economies to scale that would be brought to bear, a coordinated audit approach would not only accommodate a set of probable best approaches or systems put in place at all or most locations, but overall costs would probably be less.

- Recommendation B – "The Stennis Exchange should follow established accounting principles by providing adequate disclosures in the notes accompanying the financial statements."
- SSC Comment – Concur
- Recommendation C – "The Stennis Exchange should reimburse NASA for all appropriated funds previously spent on accounting fees and use nonappropriated funds to pay for all future operating expenses."

- SSC Comment – Do Not Concur – The practice of using appropriated funds for conducting annual audits or reviews of Exchange activities has a long history within the Agency and would appear to be well supported by NPD 9050.6E, a NASA Comptroller letter dated September 25, 1990, and a NASA Associate General Counsel letter dated February 17, 2000. Since the majority of NASA Exchanges use appropriated funds for this purpose, it is suggested that NASA Headquarters Codes B and J coordinate with Code W for a final resolution of this matter.

- Recommendation D – “The Stennis Center Director should establish a constitution and bylaws that are appropriate to the Exchange management.”

- SSC Comment – Partially Concur – Prior to May 22, 1995, SSC compliance with the NPD requirement for “establishing a constitution, bylaws, and regulations as appropriate to the management of the Exchange” was in the form of a Stennis Management Instruction (SMI) 9050.1, subject: NASA Exchange, - NASA/SSC Branch. However, in Headquarters Code J correspondence dated January 7, 1994, all centers were advised of Presidential Executive Order (EO) 12861 mandating “that NASA shall undertake to eliminate not less than 50 percent of its internal management regulations that are not required by law, by September 11, 1996.” As part of NASA’s Implementation Plan one rule of thumb was that if there was an existing NASA Policy Directive (NPD) on a particular subject, there would be no need for a Center Management Instruction on the same subject. Exceptions to the above could be made in four circumstances, i.e.: 1) regulations required by law; 2) regulations promoting public information access; 3) other regulations necessary for essential services or compliance with applicable law; and 4) the highest level (as determined by the Administrator) policy guidance necessary for the Agency to conduct its business. Ultimately, it was determined that the NPD on NASA Exchange Activities would be retained and that since the subject matter did not meet any of the four exceptions noted above, the SMI on SSC Exchange activities was cancelled. As such, revision to NASA policy, as coordinated by Code J, dictated elimination of our formal Exchange “guidelines for management.” However, it was recognized that cancellation of SMI 9050.1 created somewhat of a void in that the Agency NPD could not possibly cover all aspects of Exchange activity relevant to each center. As such, the SSC Exchange promulgated as of June 17, 1999, a Memorandum for Record (MFR) entitled “Summary of NASA/SSC Exchange Policies and Procedures.” This MFR is a fourteen page document similar in content to the prior SMI as well as the JSC Exchange Charter mentioned in your draft report and covers such topics as Council membership, its duties, frequency of meetings, financial statement presentation, use of appropriated funds, required reports, handling of investments, employee pay and benefits, various employee morale and recreation activities, etc. This document is attached for your reference.

Also, at the September 1998 Intercenter Exchange Conference at KSC (Codes B, G and J in attendance), section 5.a(1) of the NPD was discussed with the decision left to each center as to interpretation and implementation of the directive. In that regard SSC has determined, with the assistance of our Chief Counsel’s Office, (their MFR of 6/24/99 refers), that the promulgation of a constitution or bylaws was not “appropriate to Exchange management” and that “regulations” that serve to supplement the NPD would be issued in the form of a Stennis MFR with periodic update, summarizing Exchange policies and procedures, as attached. We are of the opinion that this document, given the total context of the matter, serves to comply with the intent of the NPD.

4

At this time, let me take the opportunity to thank you and your organization for the assistance and recommendations provided during the course of this quality control review. In particular, the efforts of Ms. Van Tran are to be commended and were in keeping with our mutual objectives to improve management controls and Agency performance.

If there are any questions regarding this response, please contact Mr. Jon Roth, Exchange Operations Manager, at (228) 688-1632.



Roy S. Estess
Director

Attachment (a/s)

cc:

AA00/M. Craig (w/o att)
AA00/J. Roth (w/o att)
CA00/K. Human (w/o att)
EA00/M. Benigno (w/o att)
LA00/T. Franklin (w/o att)
HQ/B/S. Varholý (w/att)
HQ/J/A. Harding (w/att)

Appendix D. Report Distribution

National Aeronautics and Space Administration (NASA) Headquarters

A/Administrator
B/Chief Financial Officer
B/Comptroller
BF/Director, Financial Management Division
G/General Counsel
J/Associate Administrator for Management Systems
JL/ Director, Contractor Industrial Relations
JM/Director, Management Assessment Division

NASA Centers

Director, Stennis Space Center
Chairman, Exchange Council, Stennis Space Center
Exchange Operations Manager, Stennis Space Center
Chief Counsel, Stennis Space Center
Chief Financial Officer, Stennis Space Center
Chief Counsel, Kennedy Space Center

Non-NASA Federal Organizations and Individuals

Assistant to the President for Science and Technology Policy
Deputy Associate Director, Energy and Science Division, Office of Management and Budget
Branch Chief, Science and Space Programs Branch, Energy and Science Division, Office of Management and Budget
Associate Director, National Security and International Affairs Division, Defense Acquisitions Issues, General Accounting Office
Professional Assistant, Senate Subcommittee on Science, Technology, and Space

Chairman and Ranking Minority Member – Congressional Committees and Subcommittees

Senate Committee on Appropriations

Senate Subcommittee on VA, HUD, and Independent Agencies

Senate Committee on Commerce, Science, and Transportation

Senate Subcommittee on Science, Technology, and Space

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on VA, HUD, and Independent Agencies

House Committee on Government Reform and Oversight

House Subcommittee on Government Management, Information, and Technology

House Subcommittee on National Security, Veterans Affairs, and International Relations

House Committee on Science

House Subcommittee on Space and Aeronautics, Committee on Science

Congressional Member

Honorable Pete Sessions, U.S. House of Representatives

NASA Assistant Inspector General for Auditing Reader Survey

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Report Title: H. Larry Jordan Review of Stennis Space Center Exchange Financial Statements for Fiscal Year Ended September 30, 1998

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

Circle the appropriate rating for the following statements.

| | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree | 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?

- | | |
|------------------------------------|-------------------------------|
| <input type="checkbox"/> Excellent | <input type="checkbox"/> Fair |
| <input type="checkbox"/> Very Good | <input type="checkbox"/> Poor |
| <input type="checkbox"/> 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)

- | | |
|---|--|
| <input type="checkbox"/> Congressional Staff | <input type="checkbox"/> Media |
| <input type="checkbox"/> NASA Employee | <input type="checkbox"/> Public Interest |
| <input type="checkbox"/> Private Citizen | <input type="checkbox"/> Other: _____ |
| <input type="checkbox"/> Government: _____ Federal: _____ State: _____ Local: _____ | |

May we contact you about your comments?

Yes: _____ No: _____

Name: _____

Telephone: _____

Thank you for your cooperation in completing this survey.

Major Contributors to This Report

Patrick A. Iler, Director, Audit Quality

Sandy Massey, Program Manager, Environmental and Financial Management Audits

Van Tran, Auditor-in-Charge

Nancy C. Cipolla, Report Process Manager