

**QUALITY  
CONTROL  
REVIEW  
REPORT**

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**KPMG LLP AUDIT OF  
NEW MEXICO STATE UNIVERSITY FOR  
THE FISCAL YEAR ENDED JUNE 30, 2001**

**August 12, 2002**

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National Aeronautics and  
Space Administration

**OFFICE OF INSPECTOR GENERAL**

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## **Acronyms**

FY	Fiscal Year
GAGAS	Generally Accepted Government Auditing Standards
NASA	National Aeronautics and Space Administration
OIG	Office of Inspector General
OMB	Office of Management and Budget
R&D	Research and Development

August 12, 2002

Office of Inspector General

Mr. Carl D. Gilbert, Partner  
KPMG LLP  
221 N. Kansas Street, Suite 1300  
El Paso, TX 79901-0010

Re: Final Report on the Quality Control Review of the KPMG LLP Audit of New  
Mexico State University for the Fiscal Year Ended June 30, 2001  
Assignment Number A-02-019-00  
Report Number IG-02-023

Dear Mr. Gilbert:

Enclosed please find the subject final report. Please refer to the Results of Review for the overall results. Our evaluation of your response has been incorporated into the body of the report. We consider the corrective actions taken sufficient to close the recommendations. The final report distribution is in Appendix F.

We appreciate the courtesies extended to the audit staff. If you have questions concerning the report, please contact Mr. Chester A. Sipsoc, Program Director, Financial Management Audits, Quality and Oversight, at (216) 433-8960; Ms. Vera J. Garrant, Program Manager, Audit Quality and Reporting Group, at (202) 358-2596; or Ms. Sandra L. Laccheo, Auditor-in-Charge, at (757) 864-3458.

Cordially,

[Original Signed By]  
Alan J. Lamoreaux  
Assistant Inspector General for Audits

Enclosure

cc:

HQ/AI/Associate Deputy Administrator

HQ/B/Deputy Chief Financial Officer

HQ/B/Comptroller

HQ/BF/Director, Financial Management Division

HQ/G/General Counsel

HQ/JM/Director, Management Assessment Division

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# NASA Office of Inspector General

IG-02-023  
A-02-019-00

August 12, 2002

## KPMG LLP Audit of New Mexico State University for the Fiscal Year Ended June 30, 2001

### Executive Summary

**Background.** New Mexico State University (the University) at Las Cruces, New Mexico, is a tax-exempt, land-grant institution that provides education, research, extension education, and public service with special emphasis on preserving the state's multi-cultural heritage, protecting its environment, and fostering its economic development in an interdependent world. For the fiscal year ended June 30, 2001, the University reported total Federal expenditures of about \$111.0 million and total direct National Aeronautics and Space Administration (NASA) expenditures of about \$15.9 million.

As the cognizant agency for audit,<sup>1</sup> the NASA Office of Inspector General (OIG) performed a quality control review of the KPMG LLP (KPMG) audit of the University for the fiscal year ended June 30, 2001.<sup>2</sup> The Single Audit Act and the Single Audit Act Amendments of 1996<sup>3</sup> required the audit. Appendix A provides details on the Single Audit Act requirements.

**Objectives.** The objectives of our quality control review were to ensure that the audit report and related working papers met applicable standards and requirements.

- **Audit Report Review.** The objectives of our report review were to determine whether the fiscal year (FY) 2001 audit report the University submitted to the Federal Audit Clearinghouse<sup>4</sup> met reporting standards in generally accepted government auditing standards<sup>5</sup> and met reporting requirements in Office of Management and Budget (OMB) Circular A-133.

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<sup>1</sup> The cognizant agency for audit is the Federal awarding agency that provides the predominant amount of direct funding to the non-Federal entity.

<sup>2</sup> The El Paso, Texas, office of KPMG performed the single audit for the University for the fiscal year ended June 30, 2001. Appendix D discusses the results of the KPMG audit.

<sup>3</sup> Office 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 of 1996. Appendix A contains details on the Circular and Single Audit Act requirements.

<sup>4</sup> The Single Audit Act Amendments of 1996, §7504(c), required the Office of Management and Budget to establish the Federal Audit Clearinghouse to receive the Circular A-133 audit reports.

<sup>5</sup> These standards, promulgated by the Comptroller General of the United States, are broad statements of the independent auditors' responsibilities and incorporate the standards promulgated by the American Institute of Certified Public Accountants. The standards deal with the quality of the audit and are divided into three groups: (1) general standards, (2) field work standards, and (3) reporting standards.

- **Working Paper Review.** The objectives of our working paper review were to determine whether KPMG conducted the FY 2001 audit of the financial statements and major programs<sup>6</sup> in accordance with generally accepted government auditing standards and whether the audit met the requirements in OMB Circular A-133 and its related Compliance Supplement.
- **Quality Control Review Scope Limitation.** For FY 2001, KPMG identified three major programs at the University:

<u>Major Program</u>	<u>Federal Expenditures</u>
Research and Development	\$63,919,410
Student Financial Aid	18,389,354
Title IV-E Foster Care	<u>910,655</u>
Total	\$83,219,419*

\* Of the total Federal expenditures of about \$111.0 million, KPMG identified major and nonmajor program expenditures of about \$83.2 million and \$27.8 million, respectively.

We reviewed KPMG’s audit of the research and development (R&D) major program. The Department of Education is responsible for student financial aid, and the Department of Health and Human Services is responsible for the Title IV-E foster care program. We invited both agencies to participate in the review, but they declined. Therefore, we excluded from our scope the KPMG audit working papers for those two major programs.

Appendix B provides details on the objectives and scope. Appendix C provides our quality control review methodology.

**Results of Review.** We concluded the following based on our review of the reporting package the University submitted to the Federal Audit Clearinghouse for the fiscal year ended June 30, 2001, and KPMG’s working papers for the FY 2001 audit.

- **Audit Report Quality Review.** The audit report met the applicable reporting standards and the OMB Circular A-133 reporting requirements.
- **Working Paper Quality Review.** The KPMG audit did not meet the applicable auditing standards or the requirements in OMB Circular A-133 and its related Compliance Supplement because the auditors’ working papers did not document the reconciliation of the Schedule of Expenditures of Federal Awards<sup>7</sup> to the financial

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<sup>6</sup> A major program is a Federal program that the auditors determine through a risk analysis is subject to audit for the organization’s current fiscal year.

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

statements. As a result, Federal agencies and other report users cannot rely on the auditors' opinion that the Schedule was fairly presented in all material respects to the financial statements taken as a whole (Finding A).

Additionally, the KPMG auditors' working papers did not document the applicability and materiality for 4 of the 14 compliance requirements<sup>8</sup> for the R&D major program (Finding B) and the sampling methodologies for the internal control and compliance tests for 5 compliance requirements for the R&D major program (Finding C). However, after we discussed our review results with KPMG, the firm provided revised working papers to support their conclusions on the applicability of the compliance requirements and their sampling methodologies. With the revised working papers, Federal agencies can rely on KPMG's reported opinions and internal control assurances related to the Federal awards.

**Recommendations.** For the FY 2001 audit, we recommended that the KPMG auditors document the working papers to support the audit procedures performed to opine on the Schedule of Expenditures of Federal Awards. For future-year audits, we recommended that KPMG strengthen its review procedures to ensure that working papers document the audit procedures KPMG auditors performed to determine that the Schedule is presented fairly, the reasons a compliance requirement is not applicable to the major program, and the sampling methodologies for all material compliance requirements.

**Management's Response.** Management concurred in principle with each recommendation. The complete text of the response is in Appendix E.

**Evaluation of Management's Response.** We consider management's comments responsive. Federal agencies and other report users can now rely on the audit report opinion that the Schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. Therefore, the recommendations are closed for reporting purposes.

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<sup>8</sup> The Federal Government requires the auditors to consider 14 compliance requirements as part of an audit required by the Single Audit Act and OMB Circular A-133. The 14 compliance requirements are: Activities Allowed or Unallowed; Allowable Costs/Cost Principles; Cash Management; Davis-Bacon Act; Eligibility; Equipment and Real Property Management; Matching, Level of Effort, Earmarking; Period of Availability of Federal Funds; Procurement and Suspension and Debarment; Program Income; Real Property Acquisition and Relocation Assistance; Reporting; Subrecipient Monitoring; Special Tests and Provisions.



## **Introduction**

The Single Audit Act Amendments of 1996 (Public Law 104-156) and the June 24, 1997, revision to OMB Circular A-133 require that a non-Federal entity obtain an annual audit of its fiscal year Federal expenditures. The audit must be performed by independent auditors and must be in accordance with the Single Audit Act Amendments of 1996, OMB Circular A-133 and its related Compliance Supplement, and the generally accepted government auditing standards applicable to financial audits.

A complete reporting submission in accordance with OMB Circular A-133 includes the following: (1) financial statements and related opinion, (2) Schedule of Expenditures of Federal Awards and related opinion, (3) report on internal controls and compliance review on the financial statements, (4) report on internal control review and compliance opinion on major programs, and a (5) Schedule of Findings and Questioned Costs.<sup>9</sup>

Appendix A provides additional details on the Single Audit Act requirements.

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<sup>9</sup>Appendix C describes the information in the Schedule of Findings and Questioned Costs.

## **Findings and Recommendations**

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### **Finding A. Documentation to Support the Opinion on the Schedule of Expenditures of Federal Awards**

The KPMG auditors' working papers did not contain a reconciliation of the Schedule of Expenditures of Federal Awards to the financial statements needed to support the auditors' opinion that the Schedule was presented fairly in all material respects to the financial statements taken as a whole. Because this document was not in the working papers, we could not determine whether KPMG performed the reconciliation. Further, the supervisory review of the working papers did not detect that the reconciliation was omitted. Without the documented support, Federal agencies and other report users cannot rely on KPMG's opinion that the Schedule of Expenditures of Federal Awards was presented fairly.

#### ***Schedule Requirements***

OMB Circular A-133, §\_\_\_.300(d), requires the auditee to prepare a Schedule of Expenditures of Federal Awards. OMB Circular A-133, §\_\_\_.505(a), and the American Institute of Certified Public Accountants Statement of Position 98-3, §5.1, require the auditor to determine and opine on whether the Schedule, prepared by the University, is presented fairly in all material respects to the financial statements taken as a whole. To reach an opinion on the Schedule, auditors must perform procedures to determine whether the Schedule includes all Federal awards expended during the period. Auditors generally will perform a reconciliation of the Schedule to the financial statements to make that determination.

#### ***Documentation Requirements***

Generally accepted government auditing standards (GAGAS), sections 4.34 through 4.37, "Working Papers," require auditors to retain a record of the audit in the form of working papers to demonstrate that the applicable standards of field work have been met. GAGAS further state that the form and content of the working papers should allow an experienced auditor to understand the auditor's significant conclusions and judgments.

#### ***Adequacy of Working Paper Review***

Although the KPMG manager and partner reviewed the working papers, the review did not ensure that the working papers contained evidence of the audit procedures performed to opine on the Schedule. After our quality control review, the KPMG manager provided a working paper showing that the auditors verified about 10 percent of the total Federal expenditures to the University's financial reporting system. However, the auditors' working paper did not contain a reconciliation of total Federal

expenditures to the financial statements and, therefore, did not include the evidence to support their opinion that the Schedule was presented fairly in all material respects in relation to the financial statements taken as a whole.

### ***Reliability of Report Opinion***

Because the reconciliation was not in the working papers, we could not determine whether the KPMG auditors performed the necessary audit procedures to meet the A-133 requirement to opine on the Schedule of Expenditures of Federal Awards. Further, without the documented reconciliation, Federal agencies and other report users cannot rely on the audit report opinion that the Schedule is presented fairly in all material respects in relation to the financial statements taken as a whole.

## **Recommendations, Management's Response, and Evaluation of Response**

### **1. KPMG should document the FY 2001 working papers for the audit procedures performed to conclude that the Schedule was presented fairly in all material respects to the financial statements taken as a whole.**

**Management's Response.** Concur in principle. The KPMG partner stated that the working papers contained sufficient evidence that KPMG reconciled the Schedule of Expenditures of Federal Awards to the financial statements. KPMG provided the documentation to the NASA OIG and added an explanation to clarify how the auditor reconciled \$305,484 of Federal expenditures to the general ledger.<sup>10</sup> The complete text of management's comments is in Appendix E.

**Evaluation of Response.** During our site visit, we could not locate evidence in the working papers of audit procedures performed to opine on the Schedule. We inquired about a reconciliation of the Schedule to the University's financial statements, but the KPMG manager was unable to produce the documentation at that time. On June 21, 2002, KPMG provided us the reconciliation of the Schedule to the financial statements. According to KPMG's reconciliation, Federal expenditures totaling \$305,484 were included in the University's current unrestricted fund account balance of about \$238 million. The auditors reconciled the total fund account balance to the financial statements, but the working paper did not indicate that the auditors reconciled the Federal expenditures to the general ledger. Therefore, we could not verify the accuracy of the \$305,484 in Federal expenditures. During a telephone conversation on July 3, 2002, the KPMG manager and partner explained the procedures they performed to verify the accuracy of the \$305,484 in Federal expenditures, and they subsequently modified their working paper to include a statement on the audit procedures performed.

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<sup>10</sup> KPMG provided a reconciliation of the Federal expenditures totaling about \$111 million. The University recorded the Federal expenditures in four financial statement fund accounts — current unrestricted funds, current restricted funds, loan funds, and unexpended plant funds. The current unrestricted fund balance of about \$238 million contained \$305,484 of Federal expenditures.

As a result, management's completed actions are responsive to the recommendation. Federal agencies and other report users can now rely on the audit report opinion that the Schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. Management's actions are sufficient to close the recommendation for reporting purposes.

**2. KPMG should strengthen review procedures for future-year audits to ensure that working papers document the audit procedures performed to determine that the Schedule is presented fairly in all material respects to the financial statements taken as a whole.**

**Management's Response.** Concur in principle. The KPMG partner stated that established review procedures are adequate but that for future audits, KPMG auditors will more clearly document the agreement of Federal expenditures to the general ledger. The complete text of management's comments is in Appendix E.

**Evaluation of Response.** Management's planned actions satisfy the intent of the recommendation. We consider management's actions sufficient to close the recommendation for reporting purposes.

## **Finding B. Documentation of Applicable Compliance Requirements**

The KPMG auditors' conclusions that the following four compliance requirements were not applicable to the R&D major program were not documented in accordance with GAGAS:

- equipment and real property management,
- program income,
- real property acquisition and relocation assistance, and
- special tests and provisions.

The working papers did not properly document the conclusions regarding the inapplicability of the four compliance requirements to the R&D major program. In addition, the supervisory review did not recognize that the working papers did not contain the bases for the auditors' conclusions. Because the working papers did not contain adequate evidence that the compliance requirements were not applicable, we could not determine whether the auditors properly performed audit procedures and tested material compliance requirements to make conclusions on compliance and internal controls for the R&D major program. Further, without the documented support for the conclusions, report users could not rely on the stated compliance opinion and internal control assurances in the report. After our quality control review, the KPMG auditors revised the FY 2001 working papers to document their conclusions that the four compliance requirements were not applicable to the R&D major program. As a result, report users can now rely on the compliance opinion and internal control assurances for FY 2001.

### ***Requirement to Determine Compliance***

OMB Circular A-133, § \_\_\_\_.500(a), states that audits made pursuant to the Circular must be conducted in accordance with GAGAS. OMB issued the Compliance Supplement to assist auditors in meeting the requirements of Circular A-133. An audit performed following the guidance in the Supplement meets the requirements of Circular § \_\_\_\_.500(d), which requires the auditors to determine compliance with laws, regulations, and the provisions of contracts or grant agreements that have a direct and material effect on the major program. Part 3 of the Supplement requires the auditors to test all material compliance requirements and provides suggested audit procedures.

The Supplement, Part 2, identifies the types of compliance requirements that are generally applicable to each Federal program and states that all 14 compliance requirements may apply to an R&D cluster of programs.<sup>11</sup> A compliance requirement may not apply because the auditee has no activity subject to that type of compliance requirement or the

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<sup>11</sup> A cluster of programs is a group of closely related programs that share common compliance requirements. A cluster is considered as one program for determining major programs. R&D is considered a cluster.

activity does not have a material effect on the major program. Therefore, auditors must determine every year whether each of the 14 compliance requirements applies to the R&D program at each organization audited.

### ***Documentation Requirements***

GAGAS §4.34 through §4.37, “Working Papers,” require auditors to retain a record of the audit in the form of working papers to demonstrate that the applicable standards of field work have been met. GAGAS §4.36 states, “Working papers allow for the review of audit quality by providing the reviewer written documentation of the evidence supporting the auditors’ significant conclusions and judgments.”

### ***Quality of Documentation***

Although the KPMG auditors determined that the equipment and real property management, program income, real property acquisition and relocation assistance, and special tests and provisions compliance requirements were not applicable to the University, the working papers did not properly document the bases for the auditors’ conclusions, as discussed below:

- **Equipment and Real Property Management.** This compliance requirement is applicable when the auditee acquires or disposes of equipment or real property acquired with Federal funds. The working papers properly documented the auditors’ tests related to the acquisition and disposal of equipment acquired with Federal R&D funds. However, the working papers did not document tests related to the disposal of real property acquired with Federal funds and did not document the reasons the requirement was not applicable. The KPMG manager stated that the University had not disposed of any real property that had been acquired with Federal funds. Nevertheless, the working papers did not document the auditors’ basis for the conclusion that real property management was not applicable to the R&D major program.
- **Program Income.** This compliance requirement is applicable when the auditee receives income directly generated by the federally funded project. Program income includes fees for services performed, the use or rental of real or personal property acquired with grant funds, and the sale of items fabricated under a grant agreement. The auditors’ working papers stated that program income was not applicable because the University earned no interest on funds reimbursed by Federal-awarding agencies. The auditors’ conclusion that program income did not apply was not valid because interest income is explicitly excluded from the Supplement’s definition of program income. The KPMG manager stated that the University did not receive any program income. However, the working papers did not document the proper basis for the auditors’ determination that the University received no program income and that program income was not applicable to the R&D program.

- **Real Property Acquisition and Relocation Assistance.** This compliance requirement is applicable when real property has been acquired using Federal funds. The KPMG manager stated that the University did not use any Federal funds to purchase real property in FY 2001. However, the auditors' working papers stated only that the compliance requirement did not apply to the R&D cluster and did not contain any support for the determination.
- **Special Tests and Provisions.** The specific requirements for special tests and provisions are unique to each Federal program. The Supplement does not contain suggested audit procedures for the compliance requirement. Therefore, auditors must identify special tests and provisions through inquiry of auditee management and review of contract and grant agreements. The KPMG auditors' working papers contained no documentation on whether the special tests and provisions requirement was applicable to the R&D program. The KPMG manager stated that the KPMG auditors reviewed contract and grant terms and identified no special tests and provisions; therefore, the requirement was not applicable to the R&D major program. Nevertheless, the auditors did not document their rationale and conclusion in the working papers.

#### ***Adequacy of Working Paper Review***

The KPMG manager and partner could not explain why the auditors did not properly document in their working papers that the four compliance requirements did not apply to the R&D major program. We determined that the KPMG manager and partner had performed a supervisory review of the working papers. However, their review did not ascertain that the auditors did not document the correct conclusions regarding the applicability of the four compliance requirements. The KPMG manager and partner stated that the compliance requirements were not applicable at the University. Notwithstanding, the working papers should support the auditors' conclusions, as required by GAGAS.

#### ***Reliability of Internal Control Assurances and Opinion***

Because the KPMG working papers were incomplete, we could not use them to determine whether the auditors' conclusions were proper that the equipment and real property management, program income, real property acquisition and relocation assistance, and special tests and provisions compliance requirements did not apply to the R&D major program. Consequently, we could not determine from the working papers whether the auditors properly performed audit procedures and tested material compliance requirements in making their conclusions about compliance and internal controls for the R&D major program. More important, without the documented support for the auditors' conclusions, Federal agencies and other report users could not rely on the opinion on compliance and the audit report's assurance that internal controls are in place and operating effectively.

We had planned to recommend that KPMG use guidance in the Compliance Supplement to document the reasons the equipment and real property management, program income, real property acquisition and relocation assistance, and special tests and provisions compliance requirements were not applicable or material to the R&D major program for the FY 2001 audit. However, in response to our discussions with the KPMG manager regarding the documentation deficiencies, the auditors provided revised working papers that corrected the deficiencies. Therefore, we consider the corrective action sufficient, and we make no recommendation to address documentation on the inapplicability of the four compliance requirements to the R&D major program.

## **Recommendations, Management's Response, and Evaluation of Response**

**3. KPMG should strengthen review procedures for future-year audits to ensure that working papers document the reasons a compliance requirement does not apply to a major program.**

**Management's Response.** Concur in principle. The KPMG partner stated that established review procedures are adequate, but that for future audits, KPMG auditors will more fully document their reasons for determining that a compliance requirement does not apply (see Appendix E).

**Evaluation of Response.** Management's planned actions satisfy the intent of the recommendation. We consider management's actions sufficient to close the recommendation for reporting purposes.



## **Finding C. Sampling Methodology Documentation**

The KPMG auditors' working papers did not document the sampling methodologies for the internal control and compliance tests for the following five compliance requirements:

- activities allowed or unallowed,
- allowable costs/cost principles,
- cash management,
- equipment and real property management, and
- procurement and suspension and debarment.

The supervisory review did not ascertain that the working papers did not contain the sampling methodologies. Because the sampling methodologies were not documented, we could not determine whether the auditors had appropriately tested transactions within the R&D major program to support their conclusions on internal control and compliance. Additionally, without the documentation, report users cannot rely on the overall reported internal control assurances and opinion on compliance. After we completed our quality control review, the KPMG auditors provided the working paper that documented the sampling methodologies for the five compliance requirements. Therefore, report users can now rely on the reported internal control assurances and compliance opinion.

### ***Documentation Requirements***

GAGAS, §4.34 through §4.37, "Working Papers," require auditors to retain a record of the audit in the form of working papers to demonstrate that the applicable standards of field work have been met. GAGAS §4.36 states, "Working papers allow for the review of audit quality by providing the reviewer written documentation of the evidence supporting the auditors' significant conclusions and judgments." GAGAS §4.37 states that working papers should contain the sampling criteria the auditors used.

The auditors' evidence to support an opinion on compliance may be obtained by sampling transactions. The American Institute of Certified Public Accountants Codification of Statements on Auditing Standards §350, "Audit Sampling," provides guidance when sampling is used to obtain audit evidence. The standard states that the auditor should consider the specific objective<sup>12</sup> to be achieved and the characteristics of the population or universe<sup>13</sup> and determine how the sample items will be selected. GAGAS §4.37 requires this information to be documented in the working papers.

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<sup>12</sup> Audit objectives for compliance testing are in the OMB Circular A-133 Compliance Supplement.

<sup>13</sup> The population or universe consists of the total number of items constituting the account balance; class of transactions; or other transactions, documents, or events.

### *Adequacy of Working Paper Review*

The planning document referenced a working paper for the auditors' sample selection methodology, but the audit manager could not locate the referenced working paper. During our site visit, the KPMG manager explained that the University provided the auditors a microfiche that contained monthly R&D expenditures by contract. The auditors used the microfiche listing to select sample transactions but did not prepare working papers with the sampling methodologies for the five compliance requirements. KPMG working papers for other compliance requirements contained evidence of supervisory reviews through the partner level. However, the supervisory reviews for the five compliance requirements did not ensure that the sampling methodologies were documented in accordance with GAGAS.

The KPMG auditors' working papers adequately described the sampling methodologies for the other audited requirements. For example, in relation to testing the disposition of equipment acquired with Federal funds, the working papers explained how the auditors obtained a list of disposed equipment that had been acquired with R&D funds and used the list to select items to test.

### *Reliability of Internal Control Assurances and Opinion*

Because the KPMG auditors did not document the sampling methodologies for the five compliance requirements, we could not determine from the working papers whether the auditors had appropriately tested transactions to support their conclusions on internal control and compliance for the R&D major program. In addition, without the documented methodologies, report users could not rely on the overall reported internal control assurances and opinion on compliance.

We had planned to recommend that KPMG document the sampling methodologies for the activities allowed or unallowed, allowable costs/cost principles, cash management, equipment and real property management, and procurement and suspension and debarment compliance requirements for the FY 2001 audit. In response to our discussions with the KPMG manager regarding the sampling methodologies, the auditors provided revised working papers that corrected the deficiencies. Therefore, we considered the corrective action sufficient, and we make no recommendation to address documentation of the sampling methodologies.

## **Recommendations, Management's Response, and Evaluation of Response**

**4. KPMG should strengthen review procedures for future-year audits to ensure that working papers document the sampling methodologies for all compliance requirements tested.**

**Management's Response.** Concur in principle. The KPMG partner stated that established review procedures are adequate, but that for future audits, KPMG auditors will more fully document their sampling methodologies (see **Appendix E**).

**Evaluation of Response.** Management's planned actions satisfy the intent of the recommendation. We consider management's actions sufficient to close the recommendation for reporting purposes.

## **Appendix A. Single Audit Act Requirements**

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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 Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," was intended to improve financial management for nonprofit organizations. The Act and the Circular 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 independence 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 Federal Audit Clearinghouse. The form summarizes the significant information in the audit report for dissemination to the public through the Internet. Responsible officials from the audited entity and the audit organization sign the form certifying to the information presented.

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

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

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

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

1. Activities Allowed or Unallowed
2. Allowable Costs/Cost Principles
3. Cash Management
4. Davis-Bacon Act
5. Eligibility
6. Equipment and Real Property Management
7. Matching, Level of Effort, Earmarking
8. Period of Availability of Federal Funds

## **Appendix A**

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9. Procurement and Suspension and Debarment
10. Program Income
11. Real Property Acquisition and Relocation Assistance
12. Reporting
13. Subrecipient Monitoring
14. Special Tests and Provisions

The Compliance Supplement also assists the auditors in determining the audit scope for the Circular's internal control requirements. For each compliance requirement, the Supplement describes the objectives of internal control and certain characteristics that, when present and operating effectively, may ensure compliance with program requirements. The Supplement gives examples of the common characteristics for the five 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**

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### **Audit Report Review**

Our objectives for the audit report review were to determine whether the report submitted by the auditee met reporting standards in generally accepted government auditing standards<sup>14</sup> and met reporting requirements in Office of Management and Budget (OMB) Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations.” As the cognizant agency for audit<sup>15</sup> for the New Mexico State University (the University), the NASA Office of Inspector General (OIG) performed a review of the audit report on the University for its fiscal year ended June 30, 2001. We reviewed the report for compliance with the requirements of the Single Audit Act, Single Audit Act Amendments of 1996, and OMB Circular A-133. We focused our review on the report’s qualitative aspects of the (1) financial statement, compliance, and internal control reporting; (2) Schedule of Expenditures of Federal Awards; and (3) Schedule of Findings and Questioned Costs.<sup>16</sup>

### **Working Paper Review**

Our objectives for the working paper review were to determine whether the audit was conducted in accordance with generally accepted government auditing standards and whether the audit met the requirements of OMB Circular A-133 and its related Compliance Supplement. As the cognizant agency for audit for the University, the NASA OIG conducted a quality control review of the KPMG LLP (KPMG) audit working papers for the research and development program. We did not review the audit working papers for the student financial aid and Title IV-E foster care programs, which KPMG also identified as major programs for the FY 2001 audit. We focused the review on the audit’s qualitative aspects of:

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

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<sup>14</sup> See footnote number 5.

<sup>15</sup> See footnote number 1.

<sup>16</sup> Appendix C describes the information in the Schedule of Findings and Questioned Costs.

## **Appendix B**

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

- Schedule of Expenditures of Federal Awards,
- Schedule of Findings and Questioned Costs, and
- data collection form.

We emphasized the areas of major concern to the Federal Government such as determining and auditing major program compliance and internal controls. We conducted the review February 25-28, 2002, at the El Paso, Texas, office of KPMG. The NASA OIG had previously performed quality control reviews at other KPMG locations, including a quality control review of the KPMG Peat Marwick LLP audit of the New Mexico State University for the fiscal year ended June 30, 1998.<sup>17</sup>

### **Peer Review Report**

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

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<sup>17</sup> On March 24, 1999, we issued audit report IG-99-014, "Quality Control Review of KPMG Peat Marwick LLP Audit of New Mexico State University for Fiscal Year Ended June 30, 1998."



## **Appendix C. Quality Control Review Methodology**

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### **Independent Auditors' Report 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 accounting principles and are free of material misstatement. The auditors are also required to subject the Schedule of Expenditures of Federal Awards (Schedule) 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 KPMG LLP (KPMG) audit program and working papers related to the Schedule and for accounts receivable and accounts payable and the evidence to determine whether testing was sufficient based on an assessment of control risk to warrant the conclusion reached.

### **Schedule of Expenditures of Federal Awards**

The recipient is responsible for creating the Schedule and the accompanying notes to the Schedule. The auditors are required to audit the information in the Schedule and review the notes to ensure that the Schedule is presented fairly in all material respects in relation to the financial statements taken as a whole. We reviewed KPMG's procedures for reconciling the Federal expenditures to the general ledger and 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 KPMG audit program for the appropriate procedures, working paper documentation, and compliance and substantive testing performed.

### **Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and on 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 Office of Management and Budget Circular A-133 Compliance Supplement to determine the compliance requirements for each major program. Further, the auditor should design the audit to provide reasonable assurance of detecting material misstatements resulting from noncompliance with provisions of contracts or grant

## **Appendix C**

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agreements that have a direct and material effect on the determination of financial statement amounts. We reviewed the audit program for the appropriate procedures and compared the audit program steps to those in the Compliance Supplement to determine whether the applicable steps had been performed for the R&D major program. We also reviewed the working paper documentation and the compliance tests performed.

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

### **Schedule of Findings and Questioned Costs**

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

### **Summary of Prior Year Audit Findings**

The New Mexico State University is required to prepare a Summary Schedule of Prior Audit Findings (Summary) that reports the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The Summary must state whether corrective action is completed, in process, or significantly different from the planned corrective action previously reported. If applicable, the Summary must also state the reasons the auditee believes the audit findings are no longer valid or do not require further corrective action.

The auditor is required to follow up on prior audit findings and perform procedures to assess the reasonableness of the University's Summary Schedule of Prior Audit Findings. If the auditor concludes that the Summary materially misrepresents the status of any prior audit finding, the auditor must report the misrepresentation as a current-year audit finding. The auditor must perform audit follow-up procedures regardless of

whether a prior audit finding relates to a major program in the current year. We reviewed the auditors' working papers that supported the determination that the Summary of Prior Year Audit Findings materially represents the status of the prior-year finding.

## **Appendix D. Results of the KPMG LLP Audit of New Mexico State University for the Fiscal Year Ended June 30, 2001**

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On October 29, 2001, KPMG LLP issued the audit report for the New Mexico State University for the fiscal year ended June 30, 2001. The auditors issued an unqualified opinion<sup>18</sup> on the financial statements; Schedule of Expenditures of Federal Awards;<sup>19</sup> and 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. The auditors identified no findings and questioned costs related to the three major programs — research and development, student financial aid, and Title IV-E foster care. The auditors also found no instances of noncompliance in the financial statement audit that must be reported under generally accepted government auditing standards.<sup>20</sup> Further, the auditors identified no material weaknesses<sup>21</sup> related to internal controls for the financial statements or major programs.<sup>22</sup>

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<sup>18</sup> An unqualified opinion means that the financial statements are presented fairly in all material respects; expenditures of Federal funds are presented fairly in relation to the financial statements taken as a whole; and the auditee has complied with all applicable laws, regulations, and contract and grant provisions that could have a direct and material effect on each major program.

<sup>19</sup> See footnote number 7.

<sup>20</sup> See footnote number 5.

<sup>21</sup> The American Institute of Certified Public Accountants Statement of Position 98-3, Appendix D, defines a material weakness as:

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

<sup>22</sup> See footnote number 6.

## Appendix E. KPMG Response



221 N. Kansas Street, Suite 1300  
P.O. Box 522551  
El Paso, TX 79999-0010

Telephone 915 532 3665  
Fax 915 532 0254

July 24, 2002

Mr. Alan Lamoreaux  
Assistant Inspector General for Audits  
Code W  
NASA Headquarters  
Washington, DC 20546-0001

Dear Mr. Lamoreaux:

We have reviewed the Draft Report on the Quality Control Review of the KPMG LLP Audit of New Mexico State University (the University) for the Fiscal Year ended June 30, 2001, Assignment Number A-02-019-00. Our responses to the findings and recommendations in the Draft Report are as follows:

**Finding A. Documentation to Support the Opinion on the Schedule of Expenditures of Federal Awards**

***Recommendation 1:***

The original work papers include a reconciliation of total Federal expenditures, as reported in the Schedule of Expenditures of Federal Awards, to the University's audited financial statements. The work papers also document the procedures performed by KPMG to agree the Federal expenditures to the University's general ledger. We provided the NASA auditor a copy of these work papers. After providing a copy of these work papers, the NASA auditor indicated that it was unclear how \$305,484 of the total reported Federal expenditures of \$110,954,713 were agreed by KPMG to the University's general ledger. A supplemental explanation has been added to the work papers to clarify how this amount was agreed to the general ledger, and a copy of the revised work paper was provided to the NASA auditor for review.

The KPMG audit work papers contain sufficient evidence that we reconciled the Schedule of Expenditures of Federal Awards to the University's financial statements and that the reported Federal expenditures agree to the University's general ledger. Accordingly, we believe that users are able to rely on our audit opinion that the University's Schedule of Expenditure of Federal Awards is presented fairly in all material respects in relation to the financial statements taken as a whole.



KPMG LLP, KPMG LLP, a U.S. limited liability partnership, is  
a member of KPMG International, a Swiss association.



***Recommendation 2***

We believe that the established review procedures in place at KPMG are adequate. We welcome your feedback and in future audits we will endeavor to more clearly document the agreement of the Federal expenditures to the general ledger.

**Finding B. Documentation of Applicable Compliance Requirements**

***Recommendation 3***

We concur with the account of corrective action taken by KPMG. We believe that the established work paper review procedures in place at KPMG are adequate, however, we welcome your feedback and in future audits we will endeavor to more fully document our reasons for determining that compliance requirements do not apply.

**Finding C. Sampling Methodology Documentation**

***Recommendation 4***

We concur with the account of corrective action taken by KPMG. We believe that the established work paper review procedures in place at KPMG are adequate, however, we welcome more fully document our sampling methodologies.

Thank you for your prompt attention to our response. Please contact me at 915-351-4146 with any questions or comments you may have.

Sincerely,  
KPMG LLP

A handwritten signature in cursive script that reads 'Carl D. Gilbert'.

Carl D. Gilbert  
Partner

## **Appendix F. Report Distribution**

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### **Audit Firm**

Mr. Carl D. Gilbert, Partner  
KPMG LLP

### **Audited Organization**

Mr. James L. McDonough  
Vice President for Business and Finance  
New Mexico State University

### **Other**

Branch Manager, Arizona Branch Office, Defense Contract Audit Agency  
Office of Management and Budget, Office of Federal Financial Management,  
Executive Office of the President

### **Federal Offices of Inspector General**

Department of Agriculture  
Department of Commerce  
Department of Defense  
Department of Education  
Department of Energy  
Department of Health and Human Services  
Department of Housing and Urban Development  
Department of the Interior  
Department of Justice  
Department of Labor  
Department of State  
Department of Transportation  
Department of Veterans Affairs  
Environmental Protection Agency  
Federal Emergency Management Agency  
National Endowment for the Humanities  
National Science Foundation

## **Appendix F**

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

HQ/A/Administrator  
HQ/AI/Associate Deputy Administrator  
HQ/B/Deputy Chief Financial Officer  
HQ/B/Comptroller  
HQ/BF/Director, Financial Management Division  
HQ/F/Assistant Administrator for Human Resources and Education  
HQ/G/General Counsel  
HQ/H/Assistant Administrator for Procurement  
HQ/J/Assistant Administrator for Management Systems  
HQ/JM/Director, Management Assessment Division  
HQ/L/Assistant Administrator for Legislative Affairs

### **NASA Centers**

ARC/D/Director, Ames Research Center  
GSFC/100/Director, Goddard Space Flight Center  
LaRC/106/Director, Langley Research Center  
JPL/1000/Director, Jet Propulsion Laboratory  
JSC/AA/Director, Lyndon B. Johnson Space Center  
MSFC/DA01/Director, George C. Marshall Space Flight Center



## NASA Assistant Inspector General for Audits Reader Survey

The NASA Office of Inspector General has a continuing interest in improving the usefulness of our reports. We wish to make our reports responsive to our customers' interests, consistent with our statutory responsibility. Could you help us by completing our reader survey? For your convenience, the questionnaire can be completed electronically through our homepage at <http://www.hq.nasa.gov/office/oig/hq/audits.html> or can be mailed to the Assistant Inspector General for Auditing; NASA Headquarters, Code W, Washington, DC 20546-0001.

**Report Title:** Quality Control Review of the KPMG LLP Audit of New Mexico State University for the Fiscal Year Ended June 30, 2001 (Assignment No. A-02-019-00)

**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?*

- 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.* \_\_\_\_\_

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**How did you use the report?** \_\_\_\_\_  
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**How could we improve our report?** \_\_\_\_\_  
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**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 the Report**

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

Vera J. Garrant, Program Manager, Financial Audits

Sandra L. Laccheo, Auditor-in-Charge

Nancy C. Cipolla, Report Process Manager

Annette Huffman, Program Assistant