NOVEMBER 21, 2005

QUALITY CONTROL REVIEW REPORT

OFFICE OF AUDITS

IG-06-002

QUALITY CONTROL REVIEW OF R. J. RICCIARDI, CERTIFIED PUBLIC ACCOUNTANT, OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 AUDIT OF THE MOLECULAR RESEARCH INSTITUTE FOR FISCAL YEAR ENDED JUNE 30, 2003

OFFICE OF INSPECTOR GENERAL

National Aeronautics and
Space Administration

REPORT NO. IG-06-002 (ASSIGNMENT NO. A-05-005-00)

Acronyms

AICPA	American Institute of Certified Public Accountants
CFDA	Catalog of Federal Domestic Assistance
FY	Fiscal Year
GAGAS	Generally Accepted Government Auditing Standards
NASA	National Aeronautics and Space Administration
OMB	Office of Management and Budget
R&D	Research and Development

National Aeronautics and
Space Administration

Office of Inspector General
Washington, DC 20546-0001

November 21, 2005

Mr. Ralph J. Ricciardi
Certified Public Accountant

SUBJECT: Quality Control Review of the R. J. Ricciardi, Certified Public Accountant, Office of Management and Budget Circular A-133 Audit of the Molecular Research Institute, Fiscal Year Ended June 30, 2003 (Report No. IG-06-002)

We are providing this report for your information and use. The audit firm of R. J. Ricciardi, Certified Public Accountant (R. J. Ricciardi), performed a single audit of the Molecular Research Institute (the Institute) for the fiscal year (FY) ended June 30, 2003 (FY 2003). Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," requires the audit.

Background. The Institute is a scientific, nonprofit corporation that conducts basic research in the physical, chemical, and biological sciences with the goal of understanding specified systems and processes on a molecular level. For FY 2003, the Institute reported total Federal expenditures of $795,227, of which $160,261 were National Aeronautics and Space Administration (NASA) expenditures.

Quality Control Review Objectives. The NASA Office of Inspector General performed the quality control review of the report and supporting working papers for the Institute's FY 2003 single audit. Because of an error on the Data Collection form, NASA was incorrectly identified as the oversight agency for audit and thus responsible for performing the quality control review. The Department of Health and Human Services should have been identified as the oversight agency.

In addition to our quality control review, we performed work for the National Single Audit Sampling Project (the Project), which is being conducted to evaluate the quality of audits performed under the Single Audit Act (the Act), Public Law 98-502, as amended, and OMB Circular A-133. The Project is a collaborative effort of the Offices of Inspectors General of Federal departments and agencies that rely on audits performed under the Act. The FY 2003 audit of the Institute was selected for review as part of the Project.

The objectives of the Project are to evaluate the quality of single audits by providing a statistically reliable estimate of the extent to which the audits were conducted in

accordance with generally accepted government auditing standards (GAGAS) and the auditing and reporting requirements of OMB Circular A-133 and its related Compliance Supplement (the Supplement). OMB issued the Supplement to assist auditors in meeting the requirements of OMB Circular A-133. See Enclosure 1 for details of our review, requirements for single audits, prior quality control reviews, and the latest peer review of R. J. Ricciardi. See Enclosure 2 for the results of the R. J. Ricciardi audit of the Institute for FY 2003.

Review Results. R. J. Ricciardi's audit work did not meet GAGAS or the requirements in OMB Circular A-133 and its related Supplement. In addition, the audit report did not meet OMB Circular A-133 reporting requirements. Based on discussions during our site visit, the R. J. Ricciardi auditors commenced corrective actions for the FY 2003 audit. As a result of the auditors' corrective actions, Federal agencies can now rely on the audit report to manage their programs. The auditors' corrective actions are discussed with each of the following findings:

- R. J. Ricciardi did not correctly report the major program in the audit report and did not properly identify direct awards on the Data Collection form (Finding A).
- R. J. Ricciardi did not document the determination of major programs (Finding B).
- R. J. Ricciardi did not document the conclusion about the materiality of the reporting compliance requirement (Finding C).
- The Schedule of Expenditures of Federal Awards[1] did not label research and development (R&D) awards as required (Finding D).

Finding A

Incorrect Reporting. R. J. Ricciardi did not identify the correct major program on the Schedule of Findings and Questioned Costs or on the Data Collection form. OMB Circular A-133, §__.105, defines a cluster of programs as a group of closely related programs that share common compliance requirements. The Circular specifically identifies R&D as a single cluster of programs. All of the Federal programs at the Institute were in the R&D cluster of programs. However, Pharmacochemical Studies of Opiate Narcotics and Molecular Modeling, Design, and Evaluation of BDZ Ligands (Catalog of Federal Domestic Assistance [CFDA] 93.279) was incorrectly shown as the major program on the Schedule of Findings and Questioned Costs. The major program should have been identified as the R&D cluster of programs, which had been audited as the major program.

[1] The Schedule of Expenditures of Federal Awards is prepared by the auditee and reports the total expenditures for each Federal program.

In addition, the Data Collection form incorrectly classified some Federal programs as indirect awards. OMB Circular A-133, §___.320, requires the auditee to submit to the Federal Audit Clearinghouse (Clearinghouse) a Data Collection form that provides the results of the audit. The form summarizes the significant information in the audit report for dissemination to the public through the Internet. The information in the form, in its entirety, should be accurate and complete; however, the form contained the following errors:

- Theory of Physical Properties and Reactivity in P450 (CFDA 93.859), Theoretical Studies of Heme Proteins (CFDA 47.074), and Quantum Chemical Studies in Titan's Atmosphere (CFDA 43.001) were not shown as major programs on the Data Collection form. These programs are within the R&D cluster and should have been identified as major programs on the Data Collection form.

- Pharmacochemical Studies of Opiate Narcotics and Molecular Modeling, Design, and Evaluation of BDZ Ligands (CFDA 93.279) and Theory of Physical Properties and Reactivity in P450 (CFDA 93.859) were incorrectly shown as indirect awards, but the Department of Health and Human Services awarded the programs directly to the Institute. As a result of these awards being incorrectly shown as indirect, the Clearinghouse determined that NASA rather than the Department of Health and Human Services was the oversight agency for audit.

Corrective Action Taken. On January 31, 2005, R. J. Ricciardi revised the Schedule of Findings and Questioned Costs and the Data Collection form and resubmitted them to the Clearinghouse. Based on our review of the revised schedule and form, we consider the corrective actions sufficient.

Finding B

Documentation of Auditor Conclusions. R. J. Ricciardi auditors did not document their determination of the major program in their working papers. GAGAS 4.34 through 4.37 require specific documentation of auditor conclusions, stating that auditors should retain a record of the audit in the form of working papers to demonstrate that the applicable standards of fieldwork were met. GAGAS further states that the form and content of the working papers should allow an experienced auditor to understand significant conclusions and judgments. R. J. Ricciardi's audit documentation incorrectly stated that CFDA 93.279 was the major program—the R&D cluster of programs was the major program. All Federal expenditures at the Institute were for R&D; however, the audit documentation incorrectly indicated that CFDA 93.279 was the major and only Type A program and that other programs in the R&D cluster were Type B programs. OMB Circular A-133, §___.520, requires the auditor to use a risk-based approach to determine which Federal programs are major and should be audited. The auditors must first identify the larger Federal programs and label them as Type A programs. All other programs are Type B.

The R&D cluster of programs should have been the only Type A and major program, with no Type B programs. Although R. J. Ricciardi's audit documentation did not indicate that the R&D cluster of programs was the major program, the auditor performed the audit on the R&D cluster.

Corrective Action Taken. R. J. Ricciardi revised the working papers to reflect the conclusion that the R&D cluster of programs was the major program. Based on our review of the revised working papers, we consider the corrective actions sufficient.

Finding C

Reporting Compliance Requirement. R. J. Ricciardi incorrectly documented a conclusion that the reporting compliance requirement was not direct and material to the R&D program, stating it was not applicable because "the funding source will not reimburse Molecular Research Institute unless the reports are filed in a timely manner." Although auditors generally test whether reports are filed in a timely manner, it is not an audit objective in the Supplement. The Supplement provides auditors guidance on auditing compliance with and reviewing internal controls for the reporting requirement. The auditors must satisfy the objectives in the Supplement to determine compliance. The Supplement states that auditors must determine whether the required reports for Federal awards include all activity of the reporting period, are supported by applicable accounting records, and are fairly presented in accordance with program requirements. The auditors must also determine whether the organization's internal control system provides reasonable assurance that the compliance objectives for the reporting requirement are met. Reporting was required for the Federal programs; therefore, the auditor's conclusion was not valid that the compliance requirement was not applicable to the Federal programs.

Corrective Action Taken. R. J. Ricciardi revised the working papers to document the tests of internal controls and compliance for the reporting requirement. Based on our review of the revised working papers, we consider the corrective actions sufficient.

Finding D

R&D Award Not Identified on Schedule of Expenditures of Federal Awards. All Federal expenditures at the Institute were for R&D; however, the Schedule of Expenditures of Federal Awards did not state the expenditures were included in the R&D cluster of programs. As a result, the schedule did not agree with the Data Collection form that had correctly identified the expenditures as R&D. OMB Circular A-133, §__.310(b), states that the auditee must prepare a Schedule of Expenditures of Federal Awards for the

period covered by the auditee's financial statements. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. The American Institute of Certified Public Accountants (AICPA) Audit Guide, "Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards," May 2003, states the schedule should state whether the award is for R&D.

Corrective Action Taken. R. J. Ricciardi revised the Schedule of Expenditures of Federal Awards to state that all expenditures were within the R&D cluster of programs. On January 31, 2005, the auditee submitted the revised schedule to the Clearinghouse. Based on our review of the revised schedule, we consider the corrective action sufficient.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Karl M. Allen, Project Manager, at 202-358-2595 or Ms. Sandra L. Laccheo, National Single Audit Coordinator, at 757-864-3458. See Enclosure 3 for the report distribution. The review team members are listed inside the back cover of this report.

Evelyn R. Klemstine
Assistant Inspector General for Auditing

3 Enclosures

QUALITY CONTROL REVIEW PROCESS

Scope and Methodology

We conducted a quality control review of the R. J. Ricciardi audit of the Institute for fiscal year ended June 30, 2003 (FY 2003) and of the resulting reporting package submitted to the Clearinghouse. We performed our review January 10–14, 2005, at the San Rafael, California, office of R. J. Ricciardi and covered areas related to the audit of the Institute's R&D major program. For FY 2003, the Institute reported total Federal expenditures of $795,227, of which $160,261 (20.2 percent) was attributable to NASA.

In addition to our quality control review, we performed work to support the National Single Audit Sampling Project (the Project). The audit of the Institute was one of 208 single audits the Project selected for quality control reviews in order to evaluate the extent to which the audits were conducted in accordance with GAGAS and OMB Circular A-133 requirements. The 208 audits were randomly selected from all single audits accepted by the Clearinghouse during the 1-year period ended March 31, 2004. Federal staff and contracted certified public accountants will conduct 204 reviews; State audit agencies will conduct 4 reviews. We performed the review using questionnaires developed by the Project, which were based on the 1999 edition of the "Uniform Quality Control Review Guide for A-133 Audits" (the Guide), issued by the President's Council on Integrity and Efficiency. The Project modified the Guide to obtain information relevant for a statistically reliable estimate of the quality of the audits.

As the agency responsible for performing the review as part of the Project, we focused the review on six areas:

- Reporting
- Auditor qualifications
- Planning
- Conduct of the audit work
- Audit work relating to the Schedule of Federal Awards
- Supervision

Single Audit Requirements

The Act and OMB Circular A-133 are designed to improve the financial management of State and local governments and nonprofit organizations. The Act and OMB Circular A-133 establish uniform auditing and reporting requirements for all Federal

award recipients who are required to obtain a single audit. OMB Circular A-133 establishes policies that guide implementation of the Act and provide an administrative foundation for uniform requirements of non-Federal entities administering Federal awards. OMB Circular A-133 requires that Federal departments and agencies rely on and use the single audit work to the maximum extent practicable. Entities that expend $300,000[2] or more of Federal awards in a fiscal year are subject to the Act and the audit requirements in OMB Circular A-133 and, therefore, must have an annual single or program-specific audit performed in accordance with GAGAS. To meet the requirements of the Act and OMB Circular A-133, the auditee (non-Federal entity) submits to the Clearinghouse a complete reporting package on each single audit. The submission includes the following:

- a Data Collection form certified by the auditee and auditor that the audit was completed in accordance with the Circular;
- financial statements and related opinions;
- a Schedule of Expenditures of Federal Awards and related opinion;
- a report on compliance and internal controls over financial reporting;
- a report on internal controls over compliance for major programs;
- a report on compliance with requirements for major programs and related opinions;
- a Schedule of Findings and Questioned Costs;
- a summary schedule of prior audit findings, when appropriate; and
- a corrective action plan, when appropriate.

The Supplement assists auditors in identifying the compliance requirements that the Federal Government expects to be considered as part of the single audit. For each compliance requirement, the Supplement describes the related audit objectives for the auditor to consider in each audit conducted in compliance with OMB Circular A-133 as well as suggested audit procedures. The Supplement also describes the objectives of internal controls and characteristics that, when present and operating effectively, help ensure compliance with requirements. The following 14 compliance requirements identified in the Supplement may be material to a major program that is 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

[2] On June 27, 2003, OMB Circular A-133 was revised to increase the threshold for a required audit to $500,000 or more annually. The revision is effective for fiscal years ending after December 31, 2003.

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

The AICPA Audit Guide provides guidance on auditor responsibilities for conducting audits according to the Act and OMB Circular A-133. In general, the Audit Guide provides auditors with an understanding of the unique planning, performance, and reporting considerations for single audits performed in compliance with GAGAS. In addition, the Audit Guide uses summary tables and detailed discussions to provide the auditor with an understanding of the additional GAGAS general, fieldwork, and reporting requirements, including the additional standards relating to quality control systems, continuing professional education, working papers, audit follow-up, and reporting.

The AICPA Audit Guide emphasizes that when planning an audit to meet the requirements of OMB Circular A-133, several factors should be considered in addition to those ordinarily associated with an audit of financial statements in accordance with generally accepted auditing standards and GAGAS. The factors include but are not limited to the following:

- Determining that the Schedule of Expenditures of Federal Awards is presented fairly in relation to the financial statements taken as a whole.
- Determining major programs for audit using a risk-based approach.
- Determining compliance requirements.
- Gaining an understanding of internal controls over Federal programs.
- Testing internal controls over major programs.
- Determining compliance with laws, regulations, and the provisions of contract or grant agreements that have a direct and material effect on each major program.
- Satisfying the additional requirements of the Act and OMB Circular A-133 for working papers, audit follow-up, and reporting.

Prior Quality Control Reviews

The NASA Office of Inspector General performed two prior quality control reviews of R. J. Ricciardi:

- On December 6, 2001, we issued "R. J. Ricciardi, CPA, Audit of the Search for Extraterrestrial Intelligence Institute, Fiscal Year Ended September 30, 1999" (IG-02-005). We determined that the R. J. Ricciardi audit work met the President's Council on Integrity and Efficiency definition of a referable action under the Council's Position Statement 4, "IG [Inspector General] Quality Control Referral Procedures." The NASA Office of Inspector General sent a letter of referral to the AICPA Professional Ethics Division on January 28, 2002. On February 19, 2004, the AICPA Professional Ethics Division issued a letter of required corrective action to R. J. Ricciardi. R. J. Ricciardi agreed to the required corrective actions, which are in process. As of September 27, 2005, the case has not been closed.

- On June 8, 2005, we issued "Quality Control Review of R. J. Ricciardi, Inc., Certified Public Accountant, Office of Management and Budget Circular A-133 Audit of the American Technology Alliances Fiscal Year Ended December 31, 2002" (IG-05-019). We determined that R. J. Ricciardi's report on compliance with requirements applicable to the major program was written incorrectly and that the Data Collection form was completed incorrectly because direct awards were not properly identified. R. J. Ricciardi agreed with the findings and took corrective action by revising its report on compliance and internal controls and its Schedule of Findings and Questioned Costs. In addition, R. J. Ricciardi revised the Data Collection form and provided it to the auditee to sign and resubmit to the Clearinghouse.

Peer Review Report

We reviewed the January 19, 2001, peer review report on R. J. Ricciardi by Carl M. Arntzen, CPA, to determine whether we needed to be aware of any issues during our report and working paper review. Mr. Arntzen's review determined that R. J. Ricciardi met the objectives of the quality control review standards established by the AICPA and that R. J. Ricciardi complied with the standards during the fiscal year ended May 31, 2000.

R. J. RICCIARDI'S AUDIT RESULTS

Single Audit Report

On October 22, 2003, R. J. Ricciardi issued the audit report for the Institute for FY 2003. The auditors issued an unqualified opinion[3] on the financial statements; the Schedule of Expenditures of Federal Awards; and the auditee's compliance with laws, regulations, and provisions of contracts or grant agreements that could have a direct and material effect on the Institute's major program. During the audit, the auditors found no instances of noncompliance in the financial statements that, under GAGAS, would have to be reported.

The auditors identified no reportable conditions or material weaknesses related to internal controls for the financial statements or the major program. The AICPA Audit Guide 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 noncompliance with applicable requirements of law, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Management Letter

R. J. Ricciardi's management letter to the board of directors of the Institute, dated October 22, 2003, contained two observations involving the internal control structure and other operational matters.

Capitalization Policy. The capitalization amount for property and equipment is $500; however, most organizations use a capitalization amount of $1,000 or $5,000. The auditor recommended revisiting the capitalization policy for record keeping for property and equipment.

[3] 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.

Updating the Fixed Assets List. The Institute was not maintaining its fixed assets list. The auditor recommended that the Institute annually update its fixed assets list to reveal any acquisitions, dispositions, or losses during the year.

REPORT DISTRIBUTION

Independent Audit Firm

Mr. Ralph J. Ricciardi
Certified Public Accountant

Audited Organization

Mr. Jacob Arrington
Administrator
Molecular Research Institute

Federal Offices of Inspector General

Corporation for National and Community Service
Department of Agriculture
Department of Commerce
Department of Defense
Department of Education
Department of Energy
Department of Health and Human Services
Department of Homeland Security
Department of Interior
Department of Justice
Department of Labor
Department of State
Department of Transportation
National Science Foundation
Environmental Protection Agency
Small Business Administration

NASA Headquarters

Deputy Administrator
Chief of Staff
Chief Financial Officer
- Deputy Chief Financial Officer for Financial Management
- Deputy Chief Financial Officer for Resources (Comptroller)
- Director, Financial Management Division

Director for Procurement
Director, Management Systems Division

Non-NASA Federal Organizations

Office of Management and Budget
- Deputy Associate Director, Energy and Science Division
  - Branch Chief, Science and Space Programs Branch
- Technical Manager, Office of Federal Financial Management

Government Accountability Office
- Director, NASA Issues, Office of Acquisition and Sourcing Management

Federal Audit Clearinghouse

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
- Senate Subcommittee on Commerce, Justice, and Science

Senate Committee on Commerce, Science, and Transportation
- Senate Subcommittee on Science and Space

Senate Committee on Homeland Security and Governmental Affairs

House Committee on Appropriations
- House Subcommittee on Science, State, Justice, and Commerce

House Committee on Government Reform
- House Subcommittee on Government Management, Finance, and Accountability

House Committee on Science
- House Subcommittee on Space and Aeronautics

Major Contributors to the Report:

Catherine M. Schneiter, Director, Financial and Institutional Management
Karl M. Allen, Project Manager
Sandra L. Laccheo, National Single Audit Coordinator

NOVEMBER 21, 2005

REPORT NO. IG-06-002

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

ADDITIONAL COPIES

Visit www.hq.nasa.gov/office/oig/hq/audits/reports/FY05/index.html to obtain additional copies of this report, or contact the Assistant Inspector General for Auditing at 202-358-1232.

COMMENTS ON THIS REPORT

In order to help us improve the quality of our products, if you wish to comment on the quality or usefulness of this report, please send your comments to Ms. Jacqueline White, Director of the Quality Control Division, at Jacqueline.White@nasa.gov or call 202-358-0203.

SUGGESTIONS FOR FUTURE AUDITS

To suggest ideas for or to request future audits, contact the Assistant Inspector General for Auditing. Ideas and requests can also be mailed to:

Assistant Inspector General for Auditing
NASA Headquarters
Washington, DC 20546-0001

NASA HOTLINE

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