

Office of Inspector General

March 29, 1999

Mr. Larry W. Albert  
Partner  
Arthur Andersen LLP  
1666 K Street, NW  
Washington, DC 20006-2873

Re: Final Report on Quality Control Review of Arthur Andersen LLP Audit of the  
National Aeronautics and Space Administration Financial Statements  
for Fiscal Year Ended September 30, 1998  
Assignment Number A-HA-98-035  
Report Number IG-99-018

Dear Mr. Albert:

We are issuing the subject final report pursuant to our responsibilities under the Chief Financial Officers Act of 1990, as amended, Inspector General Act of 1978, as amended, and the Office of Management and Budget Bulletin 98-08, "Audit Requirements for Federal Financial Statements," August 24, 1998. Please refer to the Results in Brief section for the overall quality control review results. We provided Arthur Andersen LLP an opportunity for written comments and none were provided.

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

Sincerely,

**[Original signed by]**

Russell A. Rau  
Assistant Inspector General for Auditing

Enclosure

**IG-99-018**

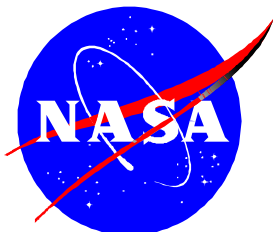
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**QUALITY  
CONTROL  
REVIEW  
REPORT**

**QUALITY CONTROL REVIEW OF  
ARTHUR ANDERSEN LLP AUDIT OF THE  
NATIONAL AERONAUTICS AND SPACE  
ADMINISTRATION FINANCIAL  
STATEMENTS FOR FISCAL YEAR ENDED  
SEPTEMBER 30, 1998**

**MARCH 29, 1999**

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National Aeronautics and  
Space Administration

**OFFICE OF INSPECTOR GENERAL**

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Assistant Inspector General for Auditing  
NASA Headquarters  
Code W, Room 8V69  
300 E Street, SW  
Washington, DC 20546-1000

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## **Acronyms**

AICPA	American Institute of Certified Public Accountants
FY	Fiscal Year
OMB	Office of Management and Budget
SFFAS	Statement of Federal Financial Accounting Standards

## NASA Office of Inspector General

IG-99-018  
A-HA-98-035

March 29, 1999

### ARTHUR ANDERSEN LLP AUDIT OF THE NATIONAL AERONAUTICS AND SPACE ADMINISTRATION FINANCIAL STATEMENTS FOR FISCAL YEAR ENDED SEPTEMBER 30, 1998

#### *Introduction*

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

#### *Results in Brief*

Arthur Andersen conducted the audit in accordance with government auditing standards and provisions of OMB Bulletin 98-08. Specifically, Arthur Andersen planned, executed, and reported the results of its audit according to applicable standards, and issued the reports in a timely manner. A summary of Arthur Andersen's audit results is in Appendix A.

#### *Background*

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

- ensure that audits are performed and audit reports completed in a timely manner and in accordance with the Bulletin requirements,
- provide technical advice and a liaison to Agency officials and independent external auditors,
- perform quality control reviews and provide the results to interested organizations, and
- monitor and report on management's progress in resolving audit findings identified by independent external auditors.

## *Scope and Methodology*

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

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

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

We coordinated with the OMB, General Accounting Office, and other Federal entities, as needed, during the course of the audit performed by Arthur Andersen and provided liaison to Agency officials to facilitate audit accomplishments.

Arthur Andersen issued its reports on February 3, 1999. We performed our quality control review from May 1998 to March 1999.

## *Review Results*

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

We reviewed and took no exception to the audit work performed supporting the following reports:

**Report of Independent Public Accountants on Financial Statements.** Arthur Andersen is required to obtain reasonable assurance about whether the financial statements are free of material misstatement. NASA's financial statements include:

- Statement of Financial Position
- Statement of Net Cost

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

We reviewed the audit program and the testing of evidence to determine whether testing was sufficient, based on assessment of control risk, to warrant the conclusion reached and whether the working papers supported the conclusion. We also evaluated the extent of audit coverage on NASA implementation of the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, “Managerial Cost Accounting Standards”; SFFAS No. 6, “Accounting for Property, Plant, and Equipment”; SFFAS No. 7, “Accounting for Revenue and Other Financing Sources”; and SFFAS No. 8, “Supplementary Stewardship Reporting.”

**Report of Independent Public Accountants on Internal Control.** Arthur Andersen is required to obtain an understanding of the components<sup>1</sup> of internal controls that is sufficient to plan the audit and to assess control risk for the assertions<sup>2</sup> embodied in the financial statements. Arthur Andersen is also required to obtain an understanding of the components of internal control relating to the existence and completeness assertions relevant to the performance measures. We reviewed the audit programs for the appropriate procedures, the working paper documentation including the control risk assessment,<sup>3</sup> and the controls testing performed. We also reviewed the working papers related to electronic data processing and performance measures for adequate documentation. Finally, we evaluated the adequacy of the auditors’ effort in following up on findings and recommendations in the FY 1997 Management Letter.<sup>4</sup> The status of management’s progress in resolving last year’s findings is in Appendix B. As required by government auditing standards, section 4.7, Arthur Andersen will follow up on all reportable conditions and findings and recommendations in the FY 1998 Management Letter.

**Report of Independent Public Accountants on Compliance with Laws and Regulations.** Arthur Andersen is required to determine whether NASA has complied with laws and regulations that could have a direct and material effect in determining the financial statement amounts. Arthur Andersen is also required to assess whether NASA’s financial management systems substantially comply with the Federal Financial

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

<sup>2</sup> The five assertions are existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure.

<sup>3</sup> According to AICPA Codification of Statements on Auditing Standards, Section 319, *Consideration of Internal Control in a Financial Statement*, auditors are required to document the basis for concluding that control risk is below the maximum level.

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

Management Improvement Act of 1996. We reviewed the audit programs for the appropriate procedures, the working paper documentation including the fraud risk assessment,<sup>5</sup> and the compliance testing performed.

**Report of Independent Public Accountants on the Application of Agreed-Upon Procedures.** Arthur Andersen is required to perform payroll agreed-upon procedures related to the retirement, health, and life insurance withholdings/contributions and employee headcount data. The procedures were performed on behalf of the Office of Personnel Management. The auditors must apply the procedures for each Agency Payroll Office that services 30,000 or more employees per year. We reviewed the working papers to determine whether the procedures were completed as specified in OMB Bulletin 98-08, Appendix H, and whether associated findings, if any, were supported.

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

- Transmitted the required letters/report to external agencies as follows:
  - NASA Interim and Updated Legal Representation Letters to OMB, Department of the Treasury (Treasury), and the General Accounting Office on January 21, and February 23, 1999.
  - NASA Management Representation Letter to OMB, Treasury, and the General Accounting Office on February 23, 1999.
  - Arthur Andersen’s report on its application of agreed-upon procedures to the Office of Personnel Management’s Inspector General, Chief Financial Officer, and Associate Director for Retirement and Insurance on February 23, 1999.
- Completed the Federal Agencies’ Centralized Trial-Balance System data verification and provided results to Treasury and the General Accounting Office on March 3, 1999. The verification was to ensure agreement between amounts reported in the Agency’s financial statements and those reported to Treasury. We found no differences in amounts.

At the Agency’s request, we reviewed the draft FY 1998 Accountability Report<sup>6</sup> and provided comments on January 5, and February 5, 1999. Our comments involved consistency in reporting and compliance with mandated requirements, such as the Year 2000 issues disclosure.

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

<sup>6</sup> The annual Accountability Report links together statutorily required reports into a single document. Examples include reports required by the Chief Financial Officers Act, the Government Performance and Results Act, the Federal Managers’ Financial Integrity Act, the Prompt Payment Act, and the Inspector General Act Amendments.

## **APPENDIX A. SUMMARY OF ARTHUR ANDERSEN'S AUDIT RESULTS**

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### **Report of Independent Public Accountants on Financial Statements**

Arthur Andersen rendered an unqualified opinion on NASA's Statement of Financial Position as of September 30, 1998. The Statements of Net Cost, Changes in Net Position, Budgetary Resources, and Financing for the year ended September 30, 1998, also received an unqualified opinion.

### **Report of Independent Public Accountants on Internal Control**

Arthur Andersen tested NASA's controls over financial reporting and found no material weaknesses.<sup>7</sup> However, the auditors noted a reportable condition related to information technology policies and procedures which require improvement to prevent unauthorized access to NASA financial management systems. The reportable condition is a repeat deficiency from last year's audit. Other findings are described in the Management Letter (see footnote 4) and are summarized below.

### **Report of Independent Public Accountants on Compliance with Laws and Regulations**

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

The full text of the above three reports are included the Agency's FY 1998 Accountability Report which can be viewed at <http://www.nasa.gov>.

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

Arthur Andersen performed the procedures as specified in Appendix H of OMB Bulletin 98-08 and found no differences or variances above the stated limit. Appendix H listed seven detailed procedures relating to the Report of Withholdings and Contributions for Health, Benefits, Life Insurance, and Retirement and to the Supplemental Semiannual Headcount Report. The procedures generally entailed footing,<sup>8</sup> tracing to source documents, recalculating amounts, and reconciling reports.

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<sup>7</sup> A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

<sup>8</sup> Footing is the sum of a column or row of figures.



## **Appendix A**

### **FY 1998 Management Letter**

In addition to the reportable condition involving information technology, Arthur Andersen made 14 additional observations related to three areas: (1) Financial Management and Accounting Matters, (2) Financial Management Systems, and (3) Property Management. Overall, the recommendations for areas one and three addressed the need to strengthen the financial reporting process or procedures and to perform reconciliation in a timely manner. For the Financial Management Systems area, the recommendations addressed the need to strengthen general security controls, to maintain complete and accurate documentation of security policies and procedures, to improve security-related practices and disaster recovery capabilities, and to complete Year 2000 remediation initiatives. In following up on the FY 1997 Management Letter recommendations, Arthur Andersen found that of 23 recommendations that warranted action, further activity was required on 19 recommendations. In particular, two recommendations were not implemented pertaining to developing and tracking financial management performance measures and reclassification of expired grant advances to accounts receivable (see Appendix B).

**APPENDIX B. STATUS OF PRIOR YEAR MANAGEMENT LETTER  
RECOMMENDATIONS**

Fiscal Year 1997 Recommendations	Findings Not Repeated In 1998 Management Letter		Findings Repeated in 1998 Management Letter	
	Implemented	In Process	Partially Implemented	Not Implemented
1. Strengthen financial Reporting Process to Effectively Communicate and Monitor New and Changing Policies				
a. Proper accounting for prior-period adjustments			X	
b. Recording of transactions in the proper period			X	
c. Prompt liquidation of non-governmental deposit liabilities	X			
d. Uniform implementation of NASA policy for transferring work in progress to completed property			X	
e. Inclusion of contractor fees in the recorded value of contractor-held property			X	
f. Periodic analysis of significant account balances fluctuations			X	
g. Reclassification of expired grant advances to accounts receivable				X
h. Endorsement of checks immediately upon receipt		X		
2. Improve Logical Access Controls over Security of Financial Management Systems			X	
3. Establish Process to Obtain All Audit Reports of Grant Recipients		X		
4. Continue to Strengthen Performance Measurement Process		X		

## Appendix B

Fiscal Year 1997 Recommendations	Findings Not Repeated in 1998 Management Letter		Findings Repeated in 1998 Management Letter	
	Implemented	In Process	Partially Implemented	Not Implemented
5. Develop and Track Financial Management Performance Measures				X
6. Ensure Timely Submission of NASA's Prompt Payment Report	N/A*			
7. Strengthen Process for Accruing Legal Contingencies	X			
8. Reconcile Advances Detail with Control Account at Headquarters Accounting Division	X			
9. Clear Suspense Accounts on a Timely Basis	X			
10. Develop Formal, Written Documentation of Financial Management System Security Policies and Procedures			X	
11. Enhance Processes to Manage Financial Management System General Security Controls			X	
12. Strengthen Financial Management System Security - Related Practices			X	
13. Strengthen Financial Management System Disaster Recovery Documentation and Capabilities			X	
14. Complete Year 2000 Application and Operating System Conversion Initiative			X	
15. Review Government Property Control System Analyses for Possible Financial Statement Impact			X	
16. Reconcile the General Ledger to Property Records on a Timely Basis			X	
17. Improve Monitoring controls over Recording of Property Transactions			X	

\*The requirement for the submission of NASA's Prompt Payment Report was eliminated and thus not tested by Arthur Andersen.

## APPENDIX C. REPORT DISTRIBUTION

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### **National Aeronautics and Space Administration (NASA) Headquarters**

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## **MAJOR CONTRIBUTORS TO THIS REPORT**

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