FEBRUARY 23, 2006

QUALITY CONTROL REVIEW REPORT

OFFICE OF AUDITS

IG-06-005

# QUALITY CONTROL REVIEW OF PRICEWATERHOUSECOOPERS LLP AND THE DEFENSE CONTRACT AUDIT AGENCY OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 AUDITS OF THE JET PROPULSION LABORATORY FOR FISCAL YEAR ENDED SEPTEMBER 30, 2001

OFFICE OF INSPECTOR GENERAL

National Aeronautics and
Space Administration

REPORT NO. IG-06-005 (ASSIGNMENT NO. A-05-023-00)

## Acronyms

| | |
|---|---|
| AICPA | American Institute of Certified Public Accountants |
| DCAA | Defense Contract Audit Agency |
| DoD | Department of Defense |
| FY | Fiscal Year |
| GAGAS | Generally Accepted Government Auditing Standards |
| JPL | Jet Propulsion Laboratory |
| NASA | National Aeronautics and Space Administration |
| OIG | Office of Inspector General |
| OMB | Office of Management and Budget |
| PwC | PricewaterhouseCoopers LLP |
| R&D | Research and Development |

National Aeronautics and
Space Administration

**Office of Inspector General**
Washington, DC 20546-0001

February 23, 2006

Mr. Ronald L. Bartlett, Partner
PricewaterhouseCoopers LLP

Ms. Patricia Artusi, Branch Manager
Defense Contract Audit Agency

Ms. Sharon Patterson, Associate Vice President for Finance and Controller
California Institute of Technology

Mr. Albert V. Battistelli, Audit Liaison Office Coordinator
Jet Propulsion Laboratory

SUBJECT: Quality Control Review of PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audits of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001 (Assignment No. A-05-023-00)

We are providing this report for your information and use. The audit firm of PricewaterhouseCoopers LLP (PwC) and the Defense Contract Audit Agency (DCAA) performed single audits of the Jet Propulsion Laboratory (JPL) for the fiscal year (FY) ended September 30, 2001 (FY 2001).[1] Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations," requires these audits.

**Background.** JPL, located in Pasadena, California, is a federally funded research and development (R&D) center operated under contract by the California Institute of Technology (Caltech). Caltech has operated JPL since 1959 to meet specific Government R&D needs. The contract in effect to operate JPL at the time of the audits was National Aeronautics and Space Administration (NASA) Contract NAS7-1407. This contract commenced on September 21, 1998, and continued through September 28, 2003. The contract value was $5 billion, or an average of $1 billion per year. The activities of JPL include robotics exploration of the solar system, astrophysics, earth sciences, and space

[1] The specific audit responsibilities were determined through discussions between PwC and DCAA. Those responsibilities are listed in Enclosures 2 and 3.

physics. JPL reported total Federal expenditures for FY 2001 of $1.36 billion. The Schedule of Expenditures of Federal Awards[2] identifies NASA as the funding agency for all the expenditures.

**Quality Control Review Objectives.** As the cognizant audit agency for JPL, the NASA Office of Inspector General (OIG) performed a quality control review of the PwC and DCAA audits of JPL for FY 2001.[3] The objectives of our quality control review were to determine whether PwC and DCAA conducted audits 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. Enclosure 1 contains details of the scope and methodology of our review, requirements for single audits, prior quality control reviews, and the latest peer reviews of PwC and DCAA. Enclosures 2 and 3 contain the results of the PwC and DCAA audits of JPL for FY 2001, respectively.

**National Single Audit Sampling Project.** In addition to our quality control review, we performed work for the National Single Audit Sampling Project (the Project). The Project is a collaborative effort of the OIGs of Federal departments and agencies that rely on audits performed under the Single Audit Act (the Act). The Project is being conducted to evaluate the quality of audits performed under the Act, Public Law 98-502, as amended, and OMB Circular A-133. 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 GAGAS and the auditing and reporting requirements of OMB Circular A-133 and the Supplement. The FY 2001 audits of JPL were selected for review as part of the Project.

**Review Results.** PwC and DCAA's audit work generally met the applicable GAGAS standards and OMB Circular A-133 reporting requirements with the following exceptions:

- PwC and DCAA auditors incorrectly calculated and reported the threshold to determine what Federal programs were major and should have been audited (Finding A).[4]

- DCAA auditors did not adequately document the computation of questioned costs for sales and use taxes (Finding B).

---

[2] The Schedule of Expenditures of Federal Awards shows the amount of annual Federal award expenditures by Federal agency for each program, grant, or contract.

[3] The PwC office in Los Angeles, California, and the DCAA suboffice in Pasadena, California, performed the single audits of JPL for FY 2001.

[4] OMB Circular A-133 requires the use of a risk-based approach to determine which Federal programs are major programs. The auditor must identify larger Federal programs as Type A programs using the percentages and threshold outlined in §__.520 of the Circular.

- PwC auditors did not test internal controls over special tests and provisions (Finding C).

**Management Comments.** Our draft report made four recommendations to improve audit documentation and corrective action plans for future audits of JPL: one to PwC and DCAA; one to PwC; one to DCAA; and one to JPL. PwC concurred with both recommendations; DCAA concurred with one and nonconcurred with the other; and JPL nonconcurred with its recommendation. However, PwC, DCAA, and JPL took corrective actions that met the intent of our recommendations, and we consider them closed. In addition, we deleted one of the findings and its recommendation in response to management comments. See Enclosure 4 for the full text of the comments.

**Other Matters of Interest.** Our review also noted matters of interest involving the PwC auditors. Specifically, PwC did not complete the low-risk auditee determination, sign independence confirmations in two instances, or adequately document its testing universes in the working papers. These other matters of interest are for informational purposes and required no written response by PwC management.

## Finding A

**Incorrect Audit Threshold Reported.** The PwC and DCAA auditors incorrectly calculated and reported the audit threshold. OMB Circular A-133, §__.520 requires the auditor to use a risk-based approach to determine what Federal programs are major and should be audited. The auditors must first identify the larger Federal programs and label them as Type A programs. OMB Circular A-133, §__.520(b)1(ii), defines Type A programs as programs that exceed the larger of $3 million or three-tenths of 1 percent (0.003 percent) of total Federal awards expended exceeding $100 million but are less than or equal to $10 billion. Both PwC and DCAA reported JPL's Type A threshold as $3 million; however, 0.003 percent of JPL's total Federal awards expended of $1,365,579,000 was $4,096,737. Although the incorrect Type A threshold had no impact on identifying Type A programs, since JPL consists of only one R&D major program, the Type A threshold was still reported incorrectly in both audit reports and the data collection forms. PwC and DCAA management both agreed that the Type A threshold was incorrect and, although the Type A threshold did not affect what programs were tested, PwC and DCAA management stated that subsequent thresholds were correctly calculated.

**Recommendation 1.** For future audits of JPL, we recommend that PwC and DCAA calculate and report the Type A threshold using the total Federal expenditures as reported on the data collection form.

**Management's Response.** PwC and DCAA concurred, stating that the Type A threshold was incorrectly calculated for the 2001 audit but was corrected in subsequent years' audits.

## Finding B

**Insufficient Documentation of Questioned Costs.** DCAA auditors did not adequately document the computation of questioned costs for sales and use taxes[5] for 9 out of 16 reported findings. According to OMB Circular A-133, §__.510(b)(4), the identification of questioned costs and how they are computed should be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for Federal agencies and pass-through entities[6] to arrive at a management decision. DCAA management stated there was no computation necessary because it questioned 100 percent of the costs. However, DCAA auditors did not document that they questioned 100 percent of the dollars submitted for sales and use taxes.

**Recommendation 2.** We recommend that the DCAA auditors include sufficient detail to explain the computation of questioned costs for each finding containing questioned costs on the major program in future audits of JPL.

**Management's Response.** DCAA nonconcurred, stating that a computation of questioned costs was not needed because JPL and NASA personnel knew that DCAA was questioning 100 percent of the claimed sales and use tax. DCAA stated that, in future audit reports, it will include sufficient detail in the condition note to explain any applicable computation of questioned costs, which may include a table of claimed and questioned costs.

**Evaluation of Management's Response.** We stand by our conclusion that DCAA did not meet the requirements of OMB Circular A-133, §__.510(b)(4), for the identification of questioned costs and how the costs were computed. Although DCAA did not concur, its planned action of including sufficient detail in the condition note to explain any applicable computation of questioned costs, such as a table of claimed and questioned

[5] California sales tax is imposed on all California retailers. It applies to all retail sales of tangible personal property in the state. California use tax is imposed on consumers of tangible personal property that is used, consumed, or stored in the state. Use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales. Use tax also applies to most leases of tangible personal property. The sales and use tax are "mutually exclusive," which means either sales or use tax applies to a single transaction, but not both.

[6] A pass-through entity is a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

costs, meets the intent of our recommendation, and we consider the recommendation closed.

## Finding C

**Incomplete Internal Control Testing.** The PwC auditors did not test internal controls over the special tests and provisions compliance requirement. OMB Circular A-133, §__.500(c)(2), requires that the auditor "[p]lan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program." The Circular also requires that the auditor perform testing of internal controls as planned. Per an agreement between PwC and DCAA, both organizations had audit responsibility for the special tests and provisions requirement. The DCAA auditors did an adequate job. PwC management stated that DCAA covered the most significant special tests and provisions; therefore, the PwC auditors limited their coverage of the special tests and provisions requirement. Although, the PwC auditors performed some compliance testing, there was insufficient support that the PwC auditors tested the effectiveness of internal controls for preventing and detecting noncompliance relevant to special test and provisions.

**Recommendation 3.** We recommend that PwC plan and perform internal control testing, as required by OMB Circular A-133, for special tests and provisions that have a direct and material effect on the major program in future audits of JPL.

**Management's Response.** PwC partially concurred with the recommendation, stating that although adequate audit coverage was obtained through the combination of PwC and DCAA work, the working papers could have more clearly documented the conclusion. PwC stated that it will more clearly document conclusions in future audits.

**Evaluation of Management's Response.** PwC's actions are responsive to the recommendation, and we consider the recommendation closed.

## Other Matters of Interest

Our review also noted matters of interest involving the PwC auditors. These other matters of interest are for informational purposes and required no written response by PwC management.

**Low-Risk Auditee Determination Not Documented.** PwC auditors did not follow OMB Circular A-133, §__.530, criteria conditions for declaring JPL a low-risk auditee. If the auditee meets all of the criteria in §__.530 for a low-risk auditee, it is eligible for

reduced audit coverage and the auditor need only audit major Federal programs that, in aggregate, encompass at least 25 percent of total Federal awards expended. PwC's working papers did not contain sufficient evidence to support the low-risk auditee designation in the audit report or the data collection form, as required. PwC management stated that the low-risk auditee determination had no relevance to the audit and it would not have changed the audit in any way because JPL consisted of only one R&D major program.

**Signed Independence Confirmations Not Obtained.** Two out of 28 members of the PwC audit organization did not complete an independence confirmation with respect to the specific client prior to an individual serving that client. GAGAS 3.11 states that in all matters relating to the audit work, the audit organization and the individual auditors, whether government or public, should be free from personal and external impairments to independence, should be organizationally independent, and should maintain an independent attitude and appearance. PwC management documented independence confirmations for the two individuals serving the client via oral communication, but did not obtain the signed confirmation. Both individuals left the firm without signing a confirmation.

**Audit Universes Not Documented.** PwC auditors did not adequately document their audit universes (Total Dollars, Total Number of Cases, etc.) in the working papers. GAGAS 4.35 states that working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to obtain, from the working papers, the evidence that supports the auditor's significant conclusions and judgments. PwC auditors did not document in the working papers the relationship between the transactions tested and the total number of transactions in the universe for internal audit and compliance approaches. There is uncertainty as to the adequacy of the PwC auditors' sample sizes, given the lack of documented audit universes. PwC management stated that the 2004 database now documents universes.

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 Mr. Mark A. Lemke, National Single Audit Coordinator, at 202-358-7071. See Enclosure 5 for the report distribution. The review team members are listed inside the back cover of this report.

Evelyn R. Klemstine

Evelyn R. Klemstine
Assistant Inspector General for Auditing

5 Enclosures

# QUALITY CONTROL REVIEW PROCESS

## Scope and Methodology

We conducted a quality control review of the PwC and DCAA audits of JPL for FY 2001 and of the resulting reporting package submitted to the Federal Audit Clearinghouse (the Clearinghouse). We performed our review July 18–29, 2005, at the Los Angeles, California, office of PwC and August 8–19, 2005, at the Pasadena, California, suboffice of DCAA. Our review covered areas related primarily to the audit of JPL's R&D major program. For FY 2001, JPL reported total Federal expenditures of $1.36 billion, all of which was attributable to NASA.

In addition to our quality control review, we performed work to support the National Single Audit Sampling Project. The audit of JPL 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 conducted most of the reviews; state audit agencies conducted some of the 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 cognizant audit 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

In conducting our review, we assessed the audit documentation prepared by PwC and DCAA. We also discussed the audit with PwC and DCAA audit personnel. We emphasized the areas that are of major concern to the Federal Government, such as determining and auditing major program compliance and internal controls.

## 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[7] 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 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

[7] 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.

5. Eligibility
6. Equipment and Real Property Management
7. Matching, Level of Effort, Earmarking
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 American Institute of Certified Public Accountants (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

On March 21, 2001, we issued a "Quality Control Review of PricewaterhouseCoopers LLP and Defense Contract Audit Agency Audit of the Jet Propulsion Laboratory Managed by the California Institute of Technology, Fiscal Years Ended

September 20, 1998, and September 26, 1999" (IG-01-016). Our review of the 1998 audit found that the PwC and DCAA audit work and reports met the applicable auditing and reporting guidance and regulatory requirements contained in OMB Circular A-133 and its related Compliance Supplement, GAGAS, and generally accepted auditing standards. However, we found that the 1999 audit by DCAA did not meet GAGAS for internal control working paper documentation in two areas: the cash management and the period of availability of Federal funds compliance requirements. We also could not determine the adequacy of internal control testing performed by DCAA for the period of availability of Federal funds compliance requirements because of the inadequate documentation. As a result, we recommended that DCAA ensure that working papers adequately describe the auditor's understanding of internal controls and the planned and completed internal control testing for the period of availability of Federal funds compliance requirement. We also recommended that DCAA document the internal controls, the criteria to test internal controls, and the cash management compliance requirement.

DCAA responded that it would improve its 1999 and future internal control working paper documentation for the period of availability of Federal funds compliance requirements to identify the five components of internal control, summarize the DCAA auditors' understanding of the system of internal controls, and summarize the attributes and criteria tested. DCAA also agreed to document in its 1999 and future working papers the specific cash management internal controls relied upon and the criteria used to test those controls.

On September 20, 1999, we issued a "Quality Control Review of PricewaterhouseCoopers LLP and Defense Contract Audit Agency Audit of the Jet Propulsion Laboratory at the California Institute of Technology for the Fiscal Year Ended September 21, 1997" (IG-99-045). We determined that the PwC and DCAA audit work and reports met the applicable auditing and reporting guidance and regulatory requirements contained in OMB Circular A-133 and its related Compliance Supplement, GAGAS, and generally accepted auditing standards.

## Deloitte & Touche Peer Review of PwC

We reviewed the November 21, 2003, peer review report on PwC by Deloitte & Touche to determine whether we needed to be aware of any issues during our working paper and report review. Deloitte & Touche determined that PwC met the requirements of the quality control review standards established by the AICPA and that PwC complied with the standards during the fiscal year ended June 30, 2003.

As is customary in a peer review, Deloitte & Touche issued a letter on November 21, 2003, that sets forth comments relating to certain policies and procedures or compliance with them. According to this letter, Deloitte & Touche noted that full compliance was

not achieved in ensuring that appropriate documentation exists and is included in the working papers relating to the procedures conducted and conclusions reached on each engagement. In response to the November 21, 2003, letter, PwC stated that it would enhance targeted training in the specific areas cited, highlighting the documentation requirements at the same time as, and in the context of, training around the related basic accounting and auditing concepts.

Deloitte & Touche also noted that compliance should be improved in the reporting of transactions in the investment tracking system database, primarily by managers and senior managers, and completion of individual audit engagement team independence confirmations with respect to the specific client prior to an individual serving that client. In response, PwC stated that it would continue to emphasize the importance of the individual's responsibility to report required transactions in the investment tracking system in a timely manner and to complete individual audit engagement team independence confirmations. PwC also stated that it had already begun to use data from the tracking system to monitor individual transaction reporting compliance and was considering increasing sanctions for noncompliance.

In its 2003 letter, Deloitte & Touche commented that additional improvements should be made regarding the appropriate nature and extent of substantive testing of noncompliance with policies in performing employee benefit plan engagements in prior periods. In response to that letter, PwC stated that it had instituted broad policies focused on ensuring the quality of its employee benefit plan engagements. PwC stated that it would continue this increased emphasis on employee benefit plans through internal communications, the ongoing development of the specialist network, and training for personnel involved in employee benefit plan engagements. In our opinion, the issues raised by Deloitte & Touche were not of sufficient significance to affect our review of the PwC working papers and report.

## Department of Defense OIG Peer Review of DCAA

We reviewed the December 15, 2003, peer review report on DCAA, performed by the Department of Defense (DoD) OIG. The DoD OIG reviewed the DCAA audit operation's system of quality control for the 3-year period ending September 30, 2002, and issued an unqualified opinion.

We also found that a separate Memorandum of Comments and Observations was issued on December 15, 2003, by the DoD OIG. The DoD OIG noted that DCAA did not adequately plan and perform the review of internal controls over compliance requirements for major Federal programs for single audits. The DCAA agreed that continued diligence in the area of single audits was necessary. The DoD OIG also noted that DCAA did not perform any independent testing to determine whether it was complying with various requirements specified in the qualification and independence

standards. In response, DCAA stated that the DoD OIG did not convey that the quality assurance organization's efforts included documenting the monitoring and testing of other DCAA oversight organizations, which are also key elements of DCAA's overall quality control system. DCAA stated that its system of quality control is designed to make the most effective use of existing agency resources by relying on oversight performed by other headquarters elements, not duplicating it. DCAA agreed that monitoring and testing by other headquarters elements, as well as DCAA's quality assurance organization, should be expanded to better cover selected areas pointed out by the DoD OIG. However, DCAA did not agree that DCAA's quality assurance organization needed to substantially re-test all monitoring and initial testing, stating that such work is more appropriately done by other DCAA oversight elements.

During its initial review, the DoD OIG determined that DCAA did not track the requirement that 24 hours of the required 80 continuing professional education hours be in a subject directly related to Government environment and to Government auditing. DCAA stated that the 24-hour continuing professional education has always been part of DCAA's audit and personnel policies, but took the added step of incorporating this requirement into the DCAA Contract Audit Manual.

The DoD OIG also determined that the DCAA ethics program needed greater emphasis and visibility to ensure that all employees understood the requirements of the various laws and regulations related to ethical behavior. In December 2003, the DoD OIG reported that DCAA had acted to correct these ethics program deficiencies.

In our opinion, the issues disclosed by the DoD OIG were not of sufficient significance to affect our review of the DCAA working papers and report.

# RESULTS OF THE PWC AUDIT OF JPL FOR FY 2001

## PwC Audit Report

On November 15, 2001, PwC issued its audit report on JPL for FY 2001. The PwC auditors are responsible for auditing JPL financial statements and the following compliance requirements for the R&D major program: 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; and Special Tests and Provisions.

The PwC auditors (1) identified one internal control finding; (2) questioned no costs, and (3) issued an unqualified opinion[8] on the financial statements, Schedule of Expenditures of Federal Awards, and major program compliance. The auditors also found no instances of noncompliance in the financial statement audit that is required to be reported under GAGAS. In addition, the auditors noted no matters involving internal controls relating to the financial statements or the major program that are considered material weaknesses.[9]

The PwC auditors also noted that in February 1997, the NASA OIG issued a subpoena for a large number of financial records relating to the operation of JPL. Caltech provided the requested financial records and Caltech representatives had ongoing discussions with appropriate Government officials. The Government officials made no claims against *Caltech.* In August 2005, a Caltech official stated that although the matter is not yet fully resolved, Caltech believes that its potential liability for any Government claims is no longer material and, therefore, is no longer disclosing the liability in its financial statements.

[8] An unqualified opinion means that the financial statements present fairly, in all material respects, financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

[9] The AICPA Audit Guide, May 1, 2003, Appendix D, defines a material weakness as a condition in which the design or operation of one or more of the internal control components 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.

## PwC Management Letter

PwC's November 15, 2001, management letter to Caltech's Audit Committee of the Board of Trustees sets forth comments relating to certain policies and procedures over cash management and access controls. In our opinion, the issues identified in the management letter were not significant enough to affect the opinion expressed in the PwC report.

# RESULTS OF THE DCAA AUDIT OF JPL FOR FY 2001

## DCAA Audit Report

On June 25, 2002, DCAA issued its report on internal controls and compliance for JPL for FY 2001. The DCAA auditors are responsible for auditing the following compliance requirements for the R&D major program: Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Cash Management, and Special Tests and Provisions.

The DCAA auditors (1) identified internal control and compliance findings, (2) questioned costs, and (3) issued a qualified opinion[10] on major program compliance. The auditors also noted no matters involving internal controls related to the major program that were considered material weaknesses.

The DCAA qualification was for environmental and superfund costs. The DCAA qualification cited a NASA OIG draft report of April 10, 1997,[11] that reported on NASA's efforts for sharing environmental cleanup costs with other responsible parties. The report concluded that NASA paid the full costs of contamination cleanup activities at JPL without the assistance of other potentially responsible parties (including Caltech). If the NASA OIG is successful in its efforts to have NASA share the costs associated with environmental and superfund activities with other responsible parties, allowable costs under contract NAS7-1407 could be affected. According to DCAA management, a civil lawsuit involving JPL is still ongoing and remains in the notes to the financial statements.

[10] A qualified opinion means that except for the effects of the matter to which a qualification relates the financial statements fairly present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

[11] "Cost Sharing for Cleanup Activities at Jet Propulsion Laboratory" (IG-97-024, June 6, 1997).

## MANAGEMENT COMMENTS

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
350 South Grand Avenue
Los Angeles CA 90071
Telephone (213) 356 6000
Facsimile (813) 637 4444

February 6, 2006

Ms. Evelyn R. Klemstine
Assistant Inspector General for Auditing
National Aeronautics and Space Administration Headquarters

Mr. Karl M. Allen
Project Manager
National Aeronautics and Space Administration Headquarters

Mr. Mark A. Lemke
National Aeronautics and Space Administration Headquarters
Office of Inspector General
300 E Street, SW
Code W, Mail Drop 8V79
Washington, DC 20546

SUBJECT: Quality Control Review of PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management Budget Circular A-133 Audits of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001 (Assignment No. A-05-023-00)

Dear Mr. Lemke:

This letter is in response to the correspondence sent to us dated January 13, 2006. Following are comments and actions related to the findings specific to PricewaterhouseCoopers LLP.

**Finding A**
Incorrect Audit Threshold Reported

**Response**
We agree the Type A/Type B threshold was incorrectly calculated; however there was no impact on the determination of major programs as there was only one award. This was an oversight on the part of the engagement team, and was correctly addressed in subsequent years.

**Finding B**
Insufficient Documentation of Questioned Costs – response to be provided by DCAA

Deleted

**Finding C**
No Corrective Action Plan – response to be provided by California Institute of Technology

PRICEWATERHOUSECOOPERS

**Finding D**
Incomplete Internal Control Testing (over special tests and provisions)

Finding C in this final report.

**Response**
As noted in the PwC Major Program report included on page 19 of the JPL A-133 Report on Federal Awards, the Defense Contract Audit Agency (DCAA) was responsible for auditing both internal control over compliance and compliance for special tests and provisions related to activities allowed or unallowed, and allowable costs/cost principles. The DCAA audit work therefore included internal control and compliance testing over the most significant areas of special tests and provisions. However, PwC also selected five additional items to test special compliance provisions over and above those special provisions DCAA tested. These provisions tested by PwC included assignment of key personnel, provision of medical benefits, adequate space and facilities, and safety standards. Although we believe adequate audit coverage was obtained through the combination of PwC and DCAA work the working papers could have more clearly documented that conclusion and it will be more clearly documented in future audits.

If you have any questions, please contact me at 213-217-3011.

Sincerely,

Ronald L. Bartlett

2

DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PQA 225.4 (A-05-023-00)

February 13, 2006

Ms. Evelyn R. Klemstine
Assistant Inspector General for Auditing
Attention: Ms. Catherine Schneiter, Director, Financial and Institutional Management
NASA Headquarters, Office of Inspector General,
300 E Street, SW
Code W, Mail Drop 8V79,
Washington, D.C. 20546

SUBJECT: DCAA Comments on the Draft NASA IG Report on the Quality Control Review of PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency Office of Management and Budget Circular (OMB) A-133 Report of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001 (Assignment No A-05-023-00.)

Dear Ms. Klemstine:

Thank you for the opportunity to respond to the draft report. The subject report provides the results of your office's quality control review of the OMB Circular A-133 audit performed at Jet Propulsion Laboratory (JPL) for fiscal year 2001. PricewaterhouseCoopers, LLP, and DCAA performed the audit on a coordinated basis. Our response to the individual report recommendations is contained in the attached memorandum from the DCAA San Gabriel Branch Office.

As discussed in the Branch Office's response, DCAA does not concur with the IG's finding relating to the insufficient documentation of questioned costs. In our opinion, the audit findings related to sales and use tax were presented in sufficient detail in the DCAA audit report for the auditee to take corrective action as required by OMB Circular A-133.

DCAA does concur with the IG's finding relating to the incorrect dollar threshold used to distinguish between Type A and Type B programs. Corrective action had already been taken in June 2005 to insure the threshold was correctly calculated in the FY 2004 audit report and future audits. As the IG noted, JPL had only one program valued at $1.4 billion; therefore, the threshold computation had no impact on which programs would be audited.

PQA 225.4 (A-05-023-00) February 13, 2006

SUBJECT: DCAA Comments on the Draft NASA IG Report on the Quality Control Review of PricewaterhouseCoopers, LLP, and the Defense Contract Audit Agency Office of Management and Budget Circular (OMB) A-133 Report of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001 (Assignment No A-05-023-00.)

If you have any questions, please contact Mr. Douglas Sexton, Program Manager, Policy Quality Assurance Division, at (703) 767-2298, or Mr. Dave Fleming, Program Manager, Policy Programs Division, at (703) 767-2273.

Sincerely,

Earl J. Newman

Earl J. Newman
Assistant Director
Policy and Plans

Enclosures:
Western Region Response Dated February 3, 2006

DCAA Response to NASA OIG Draft.doc

Copy furnished:
Mr. Hugh Monaghan (U.S. Department of Education)

2

WESTERN REGION
**DEFENSE CONTRACT AUDIT AGENCY**
16700 VALLEY VIEW AVENUE, SUITE 300
LA MIRADA, CALIFORNIA 90638-5833

IN REPLY REFER TO

RD-4/720.4

FEB - 3 2006

MEMORANDUM FOR DIRECTOR, DCAA

ATTENTION: PQA

SUBJECT: DCAA Comments on Draft NASA IG Quality Control Review of PricewaterhouseCoopers LLP (PwC) and the Defense Contract Audit Agency (DCAA) Office of Management and Budget (OMB) Circular A-133 Audit of the Jet Propulsion Laboratory (JPL) for Fiscal Year Ended September 30, 2001 (Assignment No. A-05-023-00)

Enclosed is our response to the subject draft report prepared by the San Gabriel Valley Branch Office.

Should you have any questions, please contact Ms. Patricia Artusi, Branch Manager, San Gabriel Valley Branch Office, at (626) 918-5922 or Ms. Susan Barajas, Regional Audit Manager, at (714) 228-7004.

CHRISTOPHER M. ANDREZZETTI
Regional Director

Enclosure: a/s

4901 Response to QCR JPL 2001.doc

Copy furnished:
Ms. Patricia Artusi, Branch Manager, SGVBO
Ms. Ellen Hoffer, RQA-4

SAN GABRIEL VALLEY BRANCH OFFICE
WESTERN REGION
**DEFENSE CONTRACT AUDIT AGENCY**
1000 EAST LAKES DRIVE, SUITE 400
WEST COVINA, CALIFORNIA 91790-2900

720.4/4901 (2006-128) February 3, 2006

MEMORANDUM FOR REGIONAL DIRECTOR, WESTERN REGION

THRU: RQA-4

SUBJECT: DCAA Comments on Draft NASA IG Quality Control Review of PricewaterhouseCoopers LLP (PwC) and the Defense Contract Audit Agency (DCAA) Office of Management and Budget (OMB) Circular A-133 Audit of the Jet Propulsion Laboratory (JPL) for Fiscal Year Ended September 30, 2001 (Assignment No. A-05-023-00)

The subject report provides the results of the NASA IG's quality control review of the OMB Circular A-133 audit performed at JPL for fiscal year 2001. Our response to the individual report recommendations follow:

**IG Finding A – Incorrect Audit Threshold Reported**

**Deficiency No. 1-041-1.** The schedule of findings and questioned costs incorrectly listed the dollar threshold used to distinguish between Type A and Type B programs, as described in §_.520(b). (NASA Research and Development - Jet Propulsion Laboratory — CFDA No. 43.001).

**Recommendation.** For future audits of JPL, we recommend that PwC and DCAA calculate and report the Type A threshold using the total Federal expenditures as reported on the data collection form.

**DCAA.** Concur. The error in the Type A threshold was due to inadvertent use of the $3,000,000 amount in lieu of calculating a threshold. This error was also noted during an internal review of the 2002 and 2003 audits and corrective action was taken in June 2005 to insure the threshold was correctly calculated in the FY 2004 audit report and future audits. As the IG noted, JPL had only one program, valued at $1.4 billion; clearly the threshold computation had no impact on which programs would be audited.

**IG Finding B – Insufficient Documentation of Questioned Costs**

**Deficiency No. 1-041-2.** Nine findings involving sales and use taxes (DJ01-1, DJ01-2, DJ01-3, DJ01-4, DJ01-5, DJ01-6, DJ01-7, DJ01-8, and DJ01-13) out of the 16 findings in DCAA report did not contain sufficient detail to show how the questioned costs were computed. (NASA Research and Development - Jet Propulsion Laboratory — CFDA No. 43.001).

**Recommendation.** We recommend that the DCAA auditors include sufficient detail to explain the computation of questioned costs for each finding containing questioned costs on the major program in future audits of JPL.

720.4/4901 (2006-128)
SUBJECT: DCAA Comments on Draft NASA IG Quality Control Review of PricewaterhouseCoopers LLP (PwC) and the Defense Contract Audit Agency (DCAA) Office of Management and Budget (OMB) Circular A-133 Audit of the Jet Propulsion Laboratory (JPL) for Fiscal Year Ended September 30, 2001 (Assignment No. A-05-023-00)

**DCAA.** Nonconcur. We disagree with the deficiency as we believe the FY 2001 audit report was fully compliant with OMB Circular A-133 §_.510(b)(4). In our opinion, a computation of questioned costs was not needed as both JPL and NASA personnel knew we were questioning 100 percent of the claimed sales and use tax. Although we did not specifically state in the condition note of the report that we were questioning 100 percent of the sales and use tax, we stated on page 16 in note DJ01-1 in the Auditor's Response section of the report: "...we will continue to consider these costs unallowable and question them in their entirety". This statement is synonymous with saying we questioned 100 percent of the cost. Therefore, in our opinion, the audit findings related to sales and use tax were presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action as required by OMB Circular A-133 §_.510(b). However, in its response to our draft audit report, JPL did not concur with the finding. Future audit reports will include sufficient detail in the condition note to explain any applicable computation of questioned costs; such detail may include a table of claimed and questioned costs.

If you have any questions related to this memorandum, please contact the undersigned at (626) 918-5922.

PATRICIA B. ARTUSI
Branch Manager

Copy furnished:
RAMB-4

# *CALIFORNIA INSTITUTE OF TECHNOLOGY*

**Pasadena, California 91125**

**Office of the Associate Vice President for Finance and Controller**
**Financial Services Administration Building, Mail Code 229-15**
**626-395-3937**

February 13, 2006

Refer to JPL ARO:200670001/AVBI:bjj

Ms. Evelyn R. Klemstine
Assistant Inspector General for Auditing
NASA Office of Inspector General
Washington, DC 20546-0001

Dear Ms. Klemstine:

Subject: Response to the NASA Office of Inspector General Draft Audit Report on the Quality Control Review of PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audits of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001

Reference: Office of Inspector General Draft Audit Report on the Quality Control Review of PricewaterhouseCoopers LLP and the Defense Contract Audit Agency Office of Management and Budget Circular A-133 Audits of the Jet Propulsion Laboratory for Fiscal Year Ended September 30, 2001, Assignment no. A-05-023-00, received January 19, 2006.

The California Institute of Technology (CIT) and the Jet Propulsion Laboratory (JPL) are pleased to provide comments in response to the subject draft report. For ease of reference, listed are the recommendations applicable to JPL, followed by CIT/JPL comments.

**Finding C – No Corrective Action Plan**

Draft Finding C was deleted; draft Finding D is Finding C in this final report.

Finding:

JPL personnel did not develop a corrective action plan for 5 out of 16 findings. OMB Circular A-133, §_.315(c), requires the auditee, at the completion of the audit, to prepare a corrective action plan to address each audit finding included in the current year's reports. The Circular states that "[t]he corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons." JPL personnel stated that they wanted to withhold their comments on the five findings until a review of the facts and circumstances as presented was completed. JPL's June 25, 2002, response stated

that it would provide a corrective action plan and report on any outstanding issues no later than July 26, 2002. According to DCAA management, there is no record in the DCAA files of any further written response by JPL to include a corrective action plan. Without a corrective action plan, NASA cannot track the status of DCAA recommendations.

Recommendation:

We recommend that JPL prepare a corrective action plan to address the audit findings that includes the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If JPL does not agree with the audit findings or believes that corrective action is not required, then JPL's response should include an explanation and specific reasons.

JPL Comments:

JPL received the subject DCAA draft audit findings and recommendations on June 18, 2002. Insufficient time was provided for JPL to review the facts and circumstances and develop a corrective action plan for 5 of the 16 findings by June 25, 2002, for incorporation into the DCAA's final report. As such, JPL states in its June 25, 2002 response, addressed to the resident NASA Management Office (NMO), that JPL withheld comment on these 5 recommendations but would provide a follow-up corrective action plan for all outstanding issues, no later than July 26, 2002.

JPL provided the follow-up response addressing all outstanding DCAA recommendations, including a corrective action plan for each of the 5 findings for which comment was previously withheld, to the NMO on July 26, 2002. A copy of the July 26, 2002 response to the NMO is available upon request.

Caltech and JPL believe that its actions were in compliance with the requirements of OMB Circular A-133, §_.315(c) and that the facts do not support this finding. As such, this finding should not be included in your final report.

If you have any questions, please direct them to Mr. Albert Battistelli, JPL Audit Liaison Office, at (818) 354-2425.

Cordially,

Sharon Patterson

Sharon Patterson
Associate Vice President for Finance and
Controller, California Institute of Technology

cc: J. M. Lupis
J. B. McKelvie
E. Trinh

# REPORT DISTRIBUTION

## Independent Audit Firm

PricewaterhouseCoopers LLP
Mr. Ronald L. Bartlett, Partner

## Defense Contract Audit Agency

Ms. Patricia Artusi, San Gabriel Branch Manager
Mr. Kenneth Saccoccia, Chief, Quality Assurance Division

## Audited Organization

California Institute of Technology
Ms. Sharon Patterson, Associate Vice President for Finance and Controller
Jet Propulsion Laboratory
Mr. Albert Battistelli, Coordinator, Jet Propulsion Laboratory Audit Liaison Office

## 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 Government 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, Financial and Institutional Management Director
Karl M. Allen, Project Manager
Mark A. Lemke, National Single Audit Coordinator

FEBRUARY 23, 2006

REPORT NO.IG-06-005

OFFICE OF AUDITS

OFFICE OF INSPECTOR GENERAL

## ADDITIONAL COPIES

Visit www.hq.nasa.gov/office/oig/hq/audits/reports/FY06/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.