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The Inspector General
National Archives and Records Administration

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying Consolidated Balance Sheets of the National Archives and Records Administration (NARA) as of September 30, 2011 and 2010, and the related Statements of Net Cost, Changes in Net Position, and Budgetary Resources (the last statement as restated for 2010) for the years then ended. These financial statements are the responsibility of NARA management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial statement audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) audit guidance. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NARA as of September 30, 2011 and 2010, and its net cost, changes in net position, and budgetary resources (the last as restated for 2010) for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21 to the financial statements, the fiscal year (FY) 2010 Statement of Budgetary Resources has been restated to correct a material misstatement related to the year-end revenue accrual for unfilled customer orders. We previously issued our auditor's report dated November 12, 2010, on the FY 2010 financial statements. The section of our FY 2010 auditor's report dealing with the FY 2010 Statement of Budgetary Resources should no longer be relied upon, as that statement was materially misstated. Our FY 2010 auditor's report is replaced by this report, which provides our opinion on the FY 2010 restated financial statements.

We also issued our report dated November 12, 2010, on internal control over financial reporting and compliance with laws and regulations as of September 30, 2010. In that report, we stated that we did not find any material weaknesses. In our FY 2011 audit, we determined that there was a material weakness as of September 30, 2010. Our report on internal control for FY 2011 describes this material weakness.

The information in *Management's Discussion and Analysis* and *Required Supplementary Information* sections is not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We did not audit this information and, accordingly, we express no opinion on it. We did, however, compare

this information for consistency with the financial statements and discussed methods of measurement and presentation with NARA officials. On the basis of this limited work, we found no material inconsistencies between the financial statements and U.S. generally accepted accounting principles or OMB financial reporting requirements.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The information in the Message from the Chief Financial Officer, Performance Section, and Other Accompanying Information is presented for purposes of additional analysis and is not required as part of the consolidated financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we also issued two other reports dated November 14, 2011. The first report is on our consideration of NARA's internal control over financial reporting and compliance with laws and regulations. The second report is on our tests of NARA's compliance with certain provisions of laws and regulations and other matters. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

COTTON & COMPANY LLP

A handwritten signature in blue ink, appearing to read "Colette Y. Wilson".

Colette Y. Wilson
Partner

Alexandria, Virginia
November 14, 2011



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The Inspector General
National Archives and Records Administration

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

We have audited the financial statements of the National Archives and Records Administration (NARA) as of September 30, 2011 and 2010 (as restated), and have issued our report thereon dated November 14, 2011. That report contained our unqualified opinion on the financial statements for fiscal year (FY) 2011 and on the restated financial statements for FY 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) audit guidance.

NARA management is responsible for establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met. The objectives of internal control are as follows:

- **Financial reporting:** Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- **Compliance with laws and regulations:** Transactions are executed in accordance with (1) laws governing the use of budget authority, (2) other laws and regulations that could have a direct and material effect on the financial statements, and (3) any other laws, regulations, and government-wide policies identified by OMB audit guidance.

In planning and performing our audits, we considered NARA's internal control over financial reporting and over compliance with laws and regulations. We did this as a basis for designing our procedures for auditing the financial statements and not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and over compliance with laws and regulations.

Our consideration of internal control was for the limited purpose described in the previous paragraph. Thus, it was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses; therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. As discussed below, however, we identified a deficiency in internal control that we consider to be a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination

of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of an entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiency in NARA's internal control to be a material weakness.

We issued our report dated November 12, 2010, on internal control over financial reporting and compliance with laws and regulations as of September 30, 2010. In that report, we stated that we did not identify any material weaknesses. In our FY 2011 audit, we determined that there was a material weakness as of September 30, 2010. As a result of this material weakness, management failed to detect an \$11.3 million misstatement affecting the Statement of Budgetary Resources (SBR). The FY 2010 SBR was restated, and the misstatement is described in Note 21 to the financial statements.

This material weakness as of September 30, 2010 is described below. This material weakness still exists as of September 30, 2011.

Review of Manual Journal Entries

Management does not have an effective process for the analysis and review of manual, non-routine journal entries, especially those made after the normal adjustment and review process. As a result, misstatements to the financial statements might not be detected and corrected.

At the end of FY 2010, NARA's Revolving Fund (BCR) made an error in recording a year-end accrual. An incorrect methodology and posting logic was used and the BCR director did not detect or prevent the error during the review and approval of the journal entry. Additional controls were not in place to detect and prevent the error from being reported in the financial statements, as the Financial Reports Staff (BCF), the organization responsible for preparing the financial statements, was not required to approve the journal entry from BCR and did not review it as it was prepared and submitted after the normal adjustment and review period. This journal entry contained erroneous postings that resulted in an overstatement of Budgetary Resources and an understatement of Obligated Balances on the Statement of Budgetary Resources in the amount of \$11.3 million.

BCF discovered the FY 2010 error during the normal year-end closing and financial statement preparation process for FY 2011. However, as of September 30, 2011, management had not developed adequate control procedures regarding the review of manual journal entries prepared and submitted subsequent to the normal adjustment period. Accordingly, we consider this weakness to be a material weakness for FY 2011 as well.

Government Accountability Office's (GAO) Internal Control Standards, GAO/AIMD-00-21.3.1 (11/99) page 11 states:

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation.

We recommend that:

1. BCF develop, document, and implement procedures that require the review and approval of all manual journal entries prepared and submitted during and after the normal adjustment period. In addition, management should communicate these procedures to all involved in the process.

2. BCR, as well as other offices, thoroughly review the methodologies and supporting documentation for all journal entries approved and submitted for financial reporting throughout the year (as required by current procedures).

NARA's management response to the material weakness identified in our report is included as Appendix A to this report. We did not audit NARA's response and, accordingly, we express no opinion on it.

STATUS OF PRIOR-YEAR RECOMMENDATIONS

We reviewed the status of NARA's corrective actions with respect to the significant deficiency from the prior-year report on internal control. Appendix B to this report provides details of the status of recommendations.

In addition to the above, we noted certain matters involving internal control and its operation that will be reported to NARA management in a separate letter. These include the remaining open items in Appendix B.

Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

This report is intended solely for the information and use of NARA management, NARA Office of Inspector General, the Government Accountability Office, OMB, the Congress of the United States, and those who have read NARA's financial statements, our report on those financial statements, and our report on compliance with laws and regulations. This report is not intended to be and should not be used by anyone other than those parties.

COTTON & COMPANY LLP



Colette Y. Wilson, CPA
Partner

Alexandria, Virginia
November 14, 2011

APPENDIX A
MANAGEMENT COMMENT



NATIONAL
ARCHIVES

ARCHIVIST *of the*
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10 November 2011

To: Paul Brachfeld, Inspector General
From: David S. Ferriero, Archivist of the United States
Subject: Management response to FY 2011 Audit Report

Thank you for the opportunity to respond to your reports, *Independent Auditor's Report on Internal Control* and *Independent Auditor's Report on Compliance with Laws and Regulations*.

NARA acknowledges the challenges identified in these reports and concurs in all recommendations of the independent auditor. We are disappointed with the new material weakness over financial reporting. NARA is instituting a broad range of measures which will strengthen internal controls over financial reporting. In particular, NARA is developing formal policies governing the review and approval of manual journal entries and assuring accountability for these adjustments, as recommended by the independent auditor.

NARA will continue to work diligently to address the challenges identified in FY 2011, improve agency financial management, and ensure the accuracy and reliability of agency financial statements. I would like to thank the Office of Inspector General and Cotton & Company, LLP for their efforts and cooperation through the audit process.

APPENDIX B
NATIONAL ARCHIVES AND RECORDS ADMINISTRATION
STATUS OF PRIOR-YEAR RECOMMENDATIONS
SEPTEMBER 30, 2011

APPENDIX B
NATIONAL ARCHIVES AND RECORDS ADMINISTRATION
STATUS OF PRIOR-YEAR RECOMMENDATIONS
SEPTEMBER 30, 2011

We present below the status of recommendations from our prior-year reports on internal control over financial reporting and compliance with laws and regulations. In our FY 2010 report, we found a significant deficiency related to various components of NARA's information technology. NARA has made progress in this area, and some of our recommendations have been closed. Recommendations that remain open are considered deficiencies and will be reported in a separate letter to management.

Condition/Audit Area and Recommendations	Status as of September 30, 2011
<u>Access Controls</u>	
1. Implement a process for managing NARANet accounts that:	Open
a) Ensures all accounts are tied to a specific individual who has the responsibility for managing the account and determining the ongoing need for non-login accounts.	
b) Ensures all access and privileges of terminated employees are promptly removed.	
2. Implement a process for managing RCPBS accounts that:	
a) Requires a recertification of all system accounts at least annually.	Closed
b) Implements a more restrictive password age control that is consistent with requirements for federal information systems.	Open
3. Ensure that supervisors receive training in their exit clearance process responsibilities, including alerting applicable personnel when employees and contractors under their supervision no longer require access.	Open
4. Develop and implement policies and procedures that prohibit RCPBS users from having multiple accounts as well as the ability to enter and approve their own transactions.	Open
5. Require a record of logged-in users creating account requests to show that requests are being generated by a supervisor, not the user.	Open
6. Implement the following recommendations related to NARANet logging and monitoring:	Open
a) Reconfigure audit settings within the NARANet Novell environment to log group membership add and delete activities.	
b) Continue with the implementation of Netforensic and, once in place, ensure that procedures exist for identifying key events that will be alerted to	

Condition/Audit Area and Recommendations	Status as of September 30, 2011
and reviewed by management on a periodic basis.	
c) Continue with efforts to audit account creations, deletions, and modifications within OFAS and develop standard procedures for regularly reviewing and monitoring application audit logs.	
d) Enable logging of all events within RCPBS, required by NARA IT Security Methodology for Audit and Accountability, and develop standard procedures for regularly reviewing and monitoring application activity logs.	
7. Assign one individual to the shared OFAS account, or split responsibilities of the shared account to additional administrator accounts, to allow accountability of administrator activities to be established.	Closed
<u>Contingency Planning</u>	
8. Update the contingency and disaster recovery plans for RCPBS to reflect current operating conditions.	Closed
<u>Configuration Management</u>	
9. Improve upon NARA's current router and firewall build process by updating their standard configuration file to be based on NIST-approved security checklists for router and firewall platforms and devices in use by NARA. We also recommend that the final standard configuration be documented and compared against devices to monitor for configuration compliance on a periodic basis.	Closed
<u>Security Management</u>	
10. Complete risk assessments for all NARANet components.	Closed
11. Finalize and approve security plans for all NARANet components.	Closed
12. Certify each NARANet component, then certify and accredit the entire NARANet general support system.	Open
13. Implement policies and procedures which require the completion of security and awareness training before being granted access to NARA information systems.	Closed



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The Inspector General
National Archives and Records Administration

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND OTHER MATTERS

We have audited the financial statements of the National Archives and Records Administration (NARA) as of September 30, 2011 and 2010 (as restated), and have issued our report thereon dated November 14, 2011. That report contained our unqualified opinion on the financial statements for fiscal year (FY) 2011 and on the restated financial statements for FY 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) audit guidance.

NARA management is responsible for complying with laws and regulations applicable to NARA. As part of obtaining reasonable assurance about whether NARA's financial statements are free of material misstatements, we performed tests of NARA's compliance with certain provisions of laws and regulations that have a direct and material effect on the financial statements. We did not test compliance with all laws and regulations applicable to NARA. We limited our tests of compliance to those provisions of laws and regulations that OMB audit guidance requires we test if deemed applicable to the financial statements for the fiscal year ended September 30, 2011. We caution that noncompliance may have occurred and may not have been detected by these tests, and that such testing may not be sufficient for other purposes.

Our tests of compliance with laws and regulations described in the preceding paragraph disclosed no instances of material noncompliance that are required to be reported under *Government Auditing Standards* and OMB audit guidance. Providing an opinion on compliance with certain provisions of laws and regulations was not, however, an objective of our audit: accordingly we do not express such an opinion.

This report is intended solely for the information and use of NARA management, NARA Office of Inspector General, the Government Accountability Office, OMB, the Congress of the United States, and those who have read NARA's financial statements, our report on those financial statements, and our report on internal control. This report is not intended to be and should not be used by anyone other than those parties.

COTTON & COMPANY LLP

Colette Y. Wilson
Partner

Alexandria, Virginia
November 14, 2011