

**Testimony before the Subcommittee on Investigations and Oversight and  
Subcommittee on Space and Aeronautics, House Committee on  
Science and Technology**

**U.S. House of Representatives**

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**Independent Audit of the National  
Aeronautics and Space Administration**

**Statement of**

**The Honorable Paul K. Martin**

**Inspector General**

**National Aeronautics and Space Administration**



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Chairman Miller and Chairwoman Giffords, Ranking Members, and Members of the Subcommittees:

Thank you for the opportunity to discuss the fiscal year (FY) 2009 audit of the National Aeronautics and Space Administration's (NASA) financial statements. The independent public accounting firm Ernst & Young LLP (E&Y) conducted the audit under a contract with the Office of Inspector General (OIG).

As requested, this statement describes the OIG's views of the issues identified by E&Y, NASA's progress in remediating its financial management problems, and E&Y's recommendations to address continuing issues.

The OIG has identified the need to improve financial management at NASA as one of the most serious performance and management challenges facing Agency leadership for most of this decade. Over the years, NASA implemented a variety of corrective actions to address long-standing weaknesses in its financial management processes and systems. While the Agency has made significant improvements, several challenges remain to be addressed.

For example, in its most recent report, E&Y disclaimed an opinion on NASA's financial statements for FY 2009. The disclaimer indicates that E&Y was unable to obtain sufficient evidentiary support for the amounts presented in the Agency's financial statements and resulted primarily because of continued weaknesses in NASA's internal controls over accounting for legacy assets—specifically, the Space Shuttle and International Space Station (ISS). Although the auditor's report recognizes that the Agency has made significant progress in improving its financial processes and systems, the report identified three significant deficiencies<sup>1</sup> in internal controls with one considered a material weakness.

Specifically, E&Y reported a material weakness in NASA's controls for assuring that the value of legacy property, plant, and equipment (PP&E) and materials presented in the financial statements is fairly stated. E&Y's identification of internal controls over legacy assets as a material weakness means there was a reasonable possibility that the controls were not sufficient to prevent a material misstatement in the financial statements. The other two internal control deficiencies cited by E&Y involved NASA's processes for estimating environmental liabilities and its compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA).

E&Y's report contains specific recommendations to assist the Agency in remediating existing weaknesses during FY 2010. For example, E&Y identified areas for particular focus in improving the Agency's implementation of recent guidance permitting the use of estimates in establishing the value of legacy assets.

Through its own initiatives and as a result of discussions with our office and E&Y, NASA's Office of the Chief Financial Officer is pursuing actions intended to improve financial management and address specific weaknesses in internal controls. Most notably, the Agency made improvements to and revised its Continuous Monitoring Program, which assesses financial management processes and internal controls for compliance with generally accepted accounting principles (GAAP) and ensures that balances and activities reported in the financial statements

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<sup>1</sup> During the reporting period of the FY 2009 audit, the American Institute of Certified Public Accountants standards defined a "significant deficiency" as a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

are accurate and complete. The Agency is also conducting specific remediation efforts to address the valuation of legacy assets, improve the process for estimating environmental liabilities, and ensure compliance with FFMIA.

Through effective implementation of E&Y's most recent recommendations and a continued focus on its ongoing monitoring and remediation efforts, the Agency should be able to correct existing weaknesses in financial management during FY 2010.

### **NASA's Weaknesses in Financial Management Are Longstanding**

In FY 2002, NASA initiated a 7-year, Agency-wide effort to provide a single, integrated suite of financial, project, contract, and human capital tools. This new integrated financial management system was envisioned to help NASA manage its programs and prepare financial information on a timely basis.

During FY 2003, NASA implemented the Core Financial module as part of its single, integrated financial management system. The Core Financial module replaced 10 disparate Center-level accounting systems and the NASA Headquarters accounting system, along with approximately 120 ancillary subsystems in operation for the past 2 decades. The conversion of legacy accounting data into the Core Financial module posed a greater-than-expected challenge for the Agency because of the volume of data and the cumbersome techniques utilized to convert it from the legacy systems to the new system. The conversion had a significant impact on the quality and timeliness of the Agency's financial information and necessitated complex, time-consuming data cleanup efforts that were not well defined or easily accomplished.

In January 2004, the independent auditor at the time—PricewaterhouseCoopers—determined that it could not render an opinion on NASA's financial statements for FY 2003 because of the data integrity issues resulting from the conversion. During its audit testing and review of the year-end financial statements, the auditor noted significant adjustments and discrepancies that the Agency could not explain. For example, the auditor found that in preparing the financial statements, NASA posted numerous manual adjustments outside of the Core Financial module.

In its review of these adjustments and discrepancies, PricewaterhouseCoopers noted that the value of 87 adjustments was approximately \$582 billion. Of the \$582 billion in adjustments, nearly \$565 billion related to data conversion errors and nearly \$2 billion related to net adjustments to the Agency's Fund Balance with Treasury account. NASA could not provide documentary evidence to support the purpose and the validity of the adjustments.

Also in its report on the FY 2003 financial statement audit, PricewaterhouseCoopers cited five reportable conditions,<sup>2</sup> including four that it considered material weaknesses:<sup>3</sup>

- Property, Plant, and Equipment (Material Weakness)

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<sup>2</sup> During the reporting period of the FY 2003 audit, the American Institute of Certified Public Accountants (AICPA) standards defined "reportable condition" as significant deficiencies in the design or operation of internal control that in the auditor's judgment could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

<sup>3</sup> During the reporting period of the FY 2003 audit, AICPA standards defined "material weakness" as a reportable 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 caused by error or fraud 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.

- Financial Statement Preparation Process (Material Weakness)
- Audit Trail and Documentation to Support the Financial Statements (Material Weakness)
- Fund Balance with Treasury (Material Weakness)
- General Information Technology (IT) Controls (Reportable Condition)

From FY 2003 through FY 2009, unresolved data integrity problems, material weaknesses in internal controls over assets, and ineffective report development processes continued to impair the Agency’s ability to prepare financial statements that were accurate and complete.

### NASA Has Made Significant Progress in Remediating Financial Management Weaknesses

In the years that followed the conversion to the Core Financial module, NASA focused significant efforts on identifying and resolving long-standing systemic and financial management issues. As part of these efforts, NASA reorganized its financial management structure, reorganized its business processes to align with the financial management system, upgraded its system, developed new guidance, and provided training to its personnel to address these issues.

As shown in the following table, NASA has made significant progress in remediating the majority of its material weaknesses in internal controls.

National Aeronautics and Space Administration Office of Inspector General Analysis of NASA's Financial Statement Audit Opinion and Reported Findings							
	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Independent Auditor	PwC	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y
Audit Opinion	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer	Disclaimer
1	General Controls Environment	RC	MW				
2	Property, Plant, and Equipment	MW	MW	MW	MW	MW	MW
3	Financial Statement Preparation Process and Oversight	MW	MW	MW	MW	MW	
4	Fund Balance with Treasury	MW	MW	MW			
5	Audit Trail and Documentation to Support Financial Statements	MW					
6	Environmental Liability Estimation		RC	RC			SD
7	Financial Management Systems Not in Substantial Compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA)						SD

PwC, PricewaterhouseCoopers, LLP; E&Y, Ernst & Young, LLP; RC, Reportable Condition; SD, Significant Deficiency; MW, Material Weakness

### General IT Controls

In FY 2005, NASA completed corrective actions to substantially remediate weaknesses noted in the control environment of the integrated financial management system. NASA improved upon its entity-wide security program controls, its application software development and program change controls, and its system software controls that limit and monitor access to powerful programs and sensitive files that control computer hardware and secure applications supported by the system.

## Fund Balance with Treasury

In FY 2006, NASA substantially remediated its material weakness concerning Fund Balance with Treasury reconciliations. An agency's Fund Balance with Treasury represents monies an agency can spend for authorized transactions; these monies are based on budget spending authorizations and are made available through Treasury warrants. In the FY 2003 audit report, PricewaterhouseCoopers noted that to correct cash imbalances between NASA and Treasury, NASA made adjustments of nearly \$2 billion, net, to its Fund Balance with Treasury account to agree with Treasury's reported balance on September 30, 2003, but could not provide sufficient documentary evidence to explain the adjustments.

Over the next few years, NASA expended significant effort in analyzing discrepancies related to the conversion and refining its procedures to ensure it was performing reconciliations properly to allow differences to be resolved in a timely manner. E&Y's review of the FY 2006 reconciliations identified progress in the preparation and more timely identification and resolution of differences arising from current-period transactions, thus eliminating the issue as a stand-alone material weakness for FY 2006 reporting.

## Financial Systems, Analyses, and Oversight

The material weakness in financial systems, analyses, and oversight identified by E&Y in FY 2004 encompassed the underlying findings noted by PricewaterhouseCoopers in FY 2003 relating to NASA's financial statement preparation process and its audit trail supporting the financial statements. In FY 2008, NASA developed the Comprehensive Compliance Strategy to help focus the Agency on ensuring compliance with GAAP and other financial reporting requirements. NASA also further developed its Continuous Monitoring Program (CMP) by requiring the Centers to perform a set of control activities to assess internal controls and compliance with GAAP to ensure that the evidence to support the balances and activity reported in NASA's financial statements are accurate and complete.

Throughout FY 2009, NASA continued to improve its internal controls over financial reporting by implementing and improving CMP. Ultimately, CMP operated as designed—by identifying exceptions through the execution of the control activities and then tracking the resolution of the exceptions in a timely manner. Successful implementation of the CMP was the major contributing factor in resolving the long-standing material weakness over financial systems, analyses, and oversight.

## Property, Plant, and Equipment

To help address the material weakness in property, plant, and equipment (PP&E), NASA implemented new PP&E capitalization policy and procedures for assets procured on or after October 1, 2007. Successful implementation of the policy and procedures were intended to ensure that the value and completeness of capitalized assets procured after that date, whether Government-held or contractor-held, will be accurate.

For contracts with effective dates on or after October 1, 2007, contractors are required to report the cost of each capitalized asset as a separate item on required contractor cost reports. NASA also designed a process to reconcile the monthly contractor cost reports and the capitalized PP&E amounts recorded in NASA's Contractor-Held Asset Tracking System and the Core Financial module. Although E&Y recognized that NASA's new policy and procedures represent

significant progress in improving its internal controls over PP&E, the independent public accountant could not test the effectiveness of the controls because the Agency did not have any new contracts that fell into this category during FY 2008 or FY 2009.

### **E&Y's Recommendations Can Help NASA Remediate Remaining Weaknesses in FY 2010**

As noted, NASA has made significant progress in developing policies, procedures, and controls to improve its financial processes and systems; nevertheless, challenges remain. Specifically, during FY 2009 both NASA and E&Y continued to identify deficiencies in the Agency's system of internal control that impair its ability to timely report accurate and complete financial information. However, E&Y's Report on Internal Control contains specific recommendations to assist the Agency in remediating the three identified deficiencies during FY 2010.

Through its own initiatives and as a result of discussions with our office and E&Y, NASA's Office of the Chief Financial Officer is pursuing actions intended to improve financial management and address specific weaknesses in internal controls. As noted, the Agency's Continuous Monitoring Program was the major contributing factor in resolving the long-standing material weakness over financial systems, analyses, and oversight. Moving forward, continuing specific remediation efforts need to address the valuation of legacy assets, improve the process for estimating environmental liabilities, and ensure FFMIA compliance.

#### Legacy PP&E

The weakness in controls over PP&E discussed in E&Y's FY 2009 report focuses primarily on controls over legacy assets that flow from contracts executed prior to October 1, 2007. For several years, audits of these legacy assets have identified serious weaknesses in internal controls over the completeness and accuracy of the value of the assets.

In early FY 2010, the Federal Accounting Standards Advisory Board issued the Statement of Federal Financial Accounting Standards (SFFAS) No. 35, *Estimating the Historical Cost of G-PP&E*. The standard reaffirms that Federal entities should report their general PP&E based on historical cost in accordance with the asset recognition and measurement provisions of the earlier property accounting standards. However, the standard clarifies that it is acceptable to use reasonable estimates of historical costs to value general PP&E assets. The proper and effective implementation of this accounting standard will be an important step for NASA in remediating the material weakness in internal controls over legacy assets in FY 2010.

During FY 2009, in preparation for the issuance of SFFAS No. 35, NASA performed an analysis of costs that were capitalized for major components of the International Space Station (ISS) and the Space Shuttle. During this analysis, NASA changed its capitalization policy for Integration and Operations costs associated with the ISS, which was placed into service on September 30, 2001, and also changed its policy for capitalizing Shuttle launch service costs associated with the ISS. Because these policy changes affected costs that had been capitalized since 2001, they resulted in the reclassification of approximately \$11 billion of ISS costs; and because many of the adjustments affected prior periods, they represent a correction of an error in the financial statements.

The Agency's ongoing efforts to develop a robust and rigorous review process that both validates and challenges the adequacy of estimation techniques and the sufficiency of supporting

documentation will serve the Agency well in preparing for the audit of these estimates in FY 2010 and future years.

### Environmental Liability Estimation

Over the years, NASA has addressed challenges associated with estimating its unfunded environmental liability (UEL). The current challenge identified in the FY 2009 audit focuses on establishing and implementing an Agency-wide policy to capture cleanup costs for removing, containing, and/or disposing of hazardous waste from property or material associated with the permanent or temporary shutdown of a program.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, requires agencies to capture this information when placing applicable property into service. The standard has been in effect since FY 1998; however, NASA made its first attempt to implement the standard in September 2009. Because the timing of this effort came so late in the fiscal year, it placed the Agency under severe time constraints, which compromised the effectiveness of the process for estimating and disclosing the costs in the financial statements. As a result, NASA needs to take additional steps to enhance and formalize the process for estimating environmental cleanup costs under SFFAS No. 6.

In addition, during FY 2009 NASA changed the timeframe it uses to estimate its environmental liability to clean up contaminated sites. NASA now limits the length of the remediation period included in the UEL accrual estimates to 30 years as of the Balance Sheet date. According to NASA, beyond a 30-year horizon UEL estimates have not proven to be reliable for presentation in the financial statements. While NASA's guidance regarding UEL estimates is under continued revision, NASA has articulated that it will consider reliable engineering estimates beyond the 30-year period while developing the accrual estimates.

To overcome the challenges associated with estimating its UEL, NASA needs to implement controls that are designed to coordinate changes in accounting policy related to environmental liabilities so as to ensure these policies comply with GAAP and are implemented appropriately.

### Compliance with the Federal Financial Management Improvement Act of 1996

Substantial compliance with FFMIA has been elusive for the Agency. Under FFMIA, E&Y is required to report whether NASA's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Standard General Ledger at the transaction level. E&Y noted certain instances, described below, in which NASA's financial management systems did not substantially comply with Federal system and Federal accounting standard requirements:

- The real property system is not integrated with the Core Financial module.
- IT audits note issues related to access and change management.
- NASA was unable to meet certain requirements to ensure compliance with Federal accounting standards for legacy assets.

NASA should move forward with its plans in FY 2010 to integrate Government-held real property transactions into the Asset Accounting module of its integrated financial management

system and to improve implementation of SFFAS No. 35, *Estimating the Historical Cost of G-PP&E*.

**Closing**

That concludes our prepared remarks. We would be happy to answer any questions you might have.