U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE AND TECHNOLOGY

SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT
SUBCOMMITTEE ON SPACE AND AERONAUTICS

HEARING CHARTER

Independent Audit of the National Aeronautics and Space Administration

Thursday, December 3, 2009
2:00 - 4:00 P.M.
2318 Rayburn House Office Building

Purpose

Each year, federal agencies are required to obtain an audit of their consolidated financial statements from independent auditing firms. The National Aeronautics and Space Administration (NASA) received the report of Ernst & Young evaluating the Fiscal Year 2009 (FY09) financial statements on November 13, 2009. Ernst & Young determined that "…the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheets…." This constitutes a "disclaimed opinion" - one in which the auditing firm finds a material weakness in the accounting processes of the agency so severe that they cannot reliably verify the agency's financial accounts. The Subcommittees on Investigations and Oversight and Space and Aeronautics will hold a hearing to determine what NASA needs to do to continue improving its financial control and accounting system.

Witnesses

Hon. Paul Martin
Inspector General
National Aeronautics and Space Administration (NASA)

accompanied by Hon. Tom Howard, Deputy Inspector General

Confirmed by the Senate as NASA Inspector General on November20, 2009, Mr. Martin served as the Deputy Inspector General at the Department of Justice (DOJ) for six years. From 2001 to 2003, he served as the Counselor to the Inspector General, and previously as Special Counsel to the Inspector General from 1998 to 2001. Earlier Martin spent 13 years at the U.S. Sentencing Commission, and began his career as a reporter with The Greenville News in Greenville, South Carolina.

Mr. Dan Murrin
Partner, Assurance and Advisory Business Services
Ernst & Young LLP

Mr. Murrin has been the primary Ernst & Young partner managing the NASA audit team since the company won the independent audit contract in 2004. Murrin served as a Professional Accounting Fellow for two years at the Government Accountability Office (GAO) during passage and initial startup of the Chief Financial Officers Act of 1990. He then resumed his career at Ernst & Young in October 1992. He has 30 years total experience relating to public sector auditing issues.

Hon. Elizabeth Robinson
Chief Financial Officer
National Aeronautics and Space Administration

Dr. Robinson assumed her job as NASA's Chief Financial Officer on November 9, 2009, following her confirmation by the Senate. In her previous position, she served as Assistant Director for Budget at the Office of Management and Budget. She had also held the post of Deputy Director at the Congressional Budget Office. In her early career, Dr. Robinson served on the Science and Technology Committee evaluating Department of Energy programs and policies.

Findings in the FY09 Audit: Material Weakness

Ernst & Young, NASA's auditors, cited the continuing problem of valuing NASA's older property, plant and equipment (PP&E) - the Space Shuttle and the International Space Station - as a material weakness.[1] This situation has existed for a number of years and is a result of misinterpreting guidance on property management accounting during the past decade. The auditors credit NASA with a concerted multi-year effort to properly classify these assets and describe the agency's progress in establishing proper valuations. However, the valuation of property in the International Space Station and Space Shuttle programs still failed to meet the requirements of the Federal Accounting Standards Advisory Board (FASAB) during the period of the audit, leading to Ernst & Young's disclaimer of opinion on the financial statements.

Until October, the Federal accounting standard for PP&E[2] required agencies to use actual cost data for these items listed on its balance sheets. NASA, like the Department of Defense (DOD), lacked the documentation needed to satisfy this requirement to the satisfaction of auditors. In such cases, the standard did provide for agency estimates of asset values, but this was to be based on actual cost data. Agencies with significant legacy assets attempting to comply with the strict interpretation of the standard were spending significant funds to locate available documentation and reconstruct the needed data, and in the end were not producing measurably better results.

Responding to DOD’s concerns about its inability to meet the standard, FASAB developed and issued “Statement of Federal Financial Accounting Standards 35 (SFFAS

[1] "…[A] reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis."
[2] Statements of Federal Financial Accounting Standards 6.

35)." The Board amended the previous guidance on PP&E to allow "reasonable" estimates of historical costs as a means of valuing assets. The standard also offered more detailed guidance on the basis for estimates. In doing so, the Board indicated that actual data was still preferred and should underlie an agency's estimates where possible. Further, agencies using estimates were encouraged to develop financial systems that would capture necessary information on transactions going forward. Ernst & Young's report notes that NASA is working with other agencies to determine appropriate methods for implementing SFFAS 35, and that it has updated its internal controls on property beginning with contracts effective in Fiscal Year 2008 (October 1, 2007).

The auditors made two recommendations relating to this material weakness. First, NASA needs to continue evaluating how it develops estimates allowed by SFFAS 35, especially when actual data is missing or questionable. NASA should also seek to avoid depending on contractor-provided estimates, trying instead to match outlays to particular property, plant or equipment if possible. The auditors encourage additional effort for older contracts lacking newer requirements for tracking property, plant and equipment. The second recommendation calls for "robust and rigorous review" as NASA continues to develop estimation techniques and seeks to assure completeness of documentation. Special attention to Center internal control processes for property is also suggested to insure that necessary information on property, plant and equipment is now captured.

Findings in the FY09 Audit: Significant Deficiencies

The audit report also cited two significant deficiencies[3]: 1) the agency's method for estimating its liabilities for environmental cleanup and 2) the financial management system is not in substantial compliance with the Federal Financial Managers Integrity Act (FFMIA).

According to the audit report, NASA has an estimated $922 million in environmental liabilities as of the end of Fiscal Year 2009. While the auditors note efforts by the agency to improve these estimates and implement recommendations in last year's audit, there were still "…weaknesses in NASA's ability to generate an auditable estimate on a timely basis of its UEL [unfunded environmental liability] environmental cleanup costs and its environmental liabilities associated with PP&E ." These estimates were prepared quickly and NASA told Ernst & Young that more training and greater control over the development of estimates is needed. Examining the software used for estimates of some twenty percent of environmental liabilities, the audit questioned whether it was generating reliable outputs.

The audit also noted that NASA developed an estimation process that assumed that NASA would face a particular environmental liability during a 30-year window, unless there was available data to demonstrate that the agency was responsible for cleanups over a longer period of time. By making this assumption, the total environmental liability was reduced by about 25 per cent in Fiscal Year 2009. Ernst & Young questioned the process by which this outcome was reached, and specifically raised concern that "[t]he estimate was compiled and aggregated by EMD [the Environmental Management

[3] "[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."

Division] with little support from the individual project managers, and OCFO [the Office of the Chief Financial Officer] was not aware of the process."

Relating to the system weaknesses, the auditors state that integration between the core financial module and the real property module is lacking. They also question whether the tracking of changes within the system may be inadequate and that compensating external reviews to reconcile transactions and review integrity of data are not in place. While the auditors do not believe these control weaknesses would result in serious problems with the financial statements, NASA might be exposed to "…risks regarding safeguarding of assets." These items led the auditors to declare that the system falls short of FFMIA requirements. The auditors recommend correcting these issues.

Agency response

NASA's response declared that the agency "is committed" to resolving the issues relating to legacy PP&E valuation using the guidance provided by SFFAS 35. It also stated that the significant deficiencies would also be addressed.

Background

In 1988, NASA made its first attempt to develop an integrated financial management system; the NASA Accounting and Financial Information System (NAFIS). The program ran into trouble, as GAO noted in a report to then-Administrator Richard Truly: the cost estimate had jumped from $25.9 million to $45.7 million in just over two years.[4] In May 1992, the Subcommittee on Investigations and Oversight held a hearing at which GAO detailed a number of major weaknesses in NASA financial management, including cases where budgetary obligations were made without assuring sufficient resources were available - violations of the Anti-Deficiency Act. GAO also noted that noted that NASA's systems were "…nonintegrated, nonstandard, not fully automated, requiring multiple data entry and lengthy reconciliations…."[5]

NASA then signed a fixed-price agreement in September 1997 with KPMG to use a commercial product to develop a new accounting system. In this case the number of changes needed to conform to government accounting requirements rapidly brought the program to a halt. Three years and $131 million into the contract NASA terminated the effort.[6]

During this time, as GAO testified before the Government Reform Committee in March 2002, NASA was receiving unqualified – or "clean" - opinions from Arthur Andersen, then the independent auditor. It was therefore somewhat of a shock to the incoming Administrator, Sean O'Keefe, when the agency's newly-hired audit team from PriceWaterhouseCoopers submitted a disclaimer on the Fiscal Year 2001 audit for major internal control weaknesses and declared that the financial management systems were not in compliance with FFMIA.[7] This episode badly affected relations between Mr.

[4] GAO/AFMD-91-74, August 21, 1991; p. 1.
[5] *Window on Waste: Atrophy in NASA Management*, Serial 142, 102nd Congress; May 7, 1992; p. 31.
[6] GAO-01-258, January 2001; p. 12.
[7] GAO-02-551T, March 20, 2002; pp 1-2.

O'Keefe and Roberta Gross, then the NASA Inspector General.[8] It also led to early termination of the PriceWaterhouseCoopers auditing contract.[9]

Since April 2000, NASA had been working to finish its third attempt at a financial management system, the Integrated Enterprise Management Program. In this case NASA adopted the R/3 enterprise management program developed for U.S. government agencies by the SAP Corporation. The core financial module was implemented at the agency field centers between October 2002 and June 2003. It was not a smooth transition; as noted in the agency's the Fiscal Year 2003 audit, auditors from PriceWaterhouseCoopers found in their last report that:

> "…NASA management identified significant errors in its June 30, 2003, financial statements resulting from the implementation of the IFMP [Integrated Financial Management Program] system. NASA management communicated that it would correct these errors in the September 30, 2003, financial statements. When NASA first prepared its September 30, 2003, financial statements, NASA concluded that these financial statements also contained significant errors. NASA's efforts to correct these errors led to significant delays in its completion of the September 30, 2003, financial statements and its compilation of documentation in support of amounts and disclosures in these financial statements, including support for resolution of the June 30, 2003, financial statement errors. The documentation NASA provided in support of its September 30, 2003, financial statements was not adequate to support $565 billion in adjustments to various financial statement accounts, which it identified as being related to the conversion of data to the IFMP system; $2 billion in net adjustments to its Fund Balance with Treasury account, which had the effect of reducing NASA's recorded balance so it equaled Treasury's reported balance; and its corrections of the financial data errors that affected its June 30, 2003, and September 30, 2003, financial statements. Because of the delays in preparation of the September 30, 2003, financial statements, it was not possible to pursue further evidence in support of these transactions and amounts, nor was it possible to complete other planned auditing procedures within the reporting deadline established by Office of Management and Budget (OMB). Thus, we could not complete

---

[8] Ms. Gross was removed at the behest of Administrator O'Keefe on February 14, 2002. Contemporaneous articles made it clear Ms. Gross did not go voluntarily and not for cause [Edward Walsh, "Inspectors General Ousted at 2 Agencies: Moves Raise Concerns for Watchdogs' Role," Washington Post, April 3, 2002; p. A21; Paul C. Light, "The Last Word: Off With Their Heads," Government Executive, May 2002, p. 66]. The importance of NASA's audit lapse was highlighted by Mr. O'Keefe's statement in his first appearance before the Senate Appropriation Committee Subcommittee on VA, HUD and Independent Agencies that, "The idea of ... a disclaimed opinion from independent auditors because they couldn't get the data is unacceptable. So in my judgment, this will not be a topic of discussion next year." [Jefferson Morris, "O'Keefe to Congress," Aerospace Daily, May 2, 2002; p. 1.] Ms. Gross described the connection between her dismissal and the disclaimer of opinion by PriceWaterhouseCoopers in a 2007 interview with staff.

[9] Competing claims about the PriceWaterhouse Coopers contract's end came in allegations against former Inspector General Robert Cobb investigated by the Integrity Committee of the the President's Council on Integrity and Efficiency; in statements by Cobb when interviewed by committee staff in 2007, and in a Reuters article reporting that "…the audit firm opted out of the contract because it was unhappy with the relationship." [Arindam Nag and Deborah Zabarenko, "NASA's finances in disarry – auditor departs," Reuters May 14, 2004 17:40 GMT]

> our audit and were unable to determine whether there were other matters that are required to be reported…."

In the reports it has issued since becoming the agency's independent auditor, Ernst & Young has traced the changes NASA has made to correct the four material weaknesses they first identified in their Fiscal Year 2004 report.[10] The Fiscal Year 2005 audit declared the improvements in the IFMP control environment "substantially complete." In the Fiscal Year 2006 audit, the Fund Balance With Treasury material weakness was combined with the broader Financial Systems, Analyses and Oversight issue. This year's audit left only the Property material weakness discussed earlier. As a small measure of NASA's progress it only took Ernst and Young 12 pages in this year's audit report compared to the 24 needed for its first report in Fiscal Year 2004. The bottom line is that while NASA received a disclaimed opinion, the agency has come a long way towards getting out of the woods on their accounting. With a solid implementation of SFFAS 35, NASA may get a qualified or clean opinion for the FY2010 audit.

Attached for information are the Inspector General's letter to the Administrator, the Ernst & Young audit, and NASA's response.

[10] Financial Systems, Analyses and Oversight; Fund Balance with Treasury; Property; and Integrated Financial Management Program (IFMP) Systems Control Environment.