

Report of Independent Accountants on Compliance with Laws and Regulations

To the Inspector General of the
National Aeronautics and Space Administration:

We were engaged to audit the financial statements of the National Aeronautics and Space Administration (NASA) as of and for the year ended September 30, 2001, and have issued our report thereon dated February 22, 2002, in which we disclaimed an opinion on those financial statements.

The management of NASA is responsible for complying with laws and regulations applicable to the agency. We performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to NASA.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements. The results of our tests disclosed instances, described below, which indicated that NASA's financial management systems did not substantially comply with Federal financial management systems requirements and applicable Federal accounting standards.

We found that NASA lacked adequate controls to provide reasonable assurance that materials and property, plant, and equipment are presented fairly in the financial statements as of September 30, 2001. In addition, NASA did not provide sufficient documentary evidence in support of amounts reported as obligations incurred and operating expenses in fiscal year 2001. We also noted weaknesses over the security surrounding NASA's financial management systems and the mainframe located at the NASA Automated Data Processing Consolidation Center. We believe that these matters, taken together, represent substantial noncompliance with the Federal financial management systems requirements under FFMIA. Further details on these findings, together with our recommendations for corrective action have been reported separately to NASA in our report on internal control dated February 22, 2002.

Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires federal agencies to report

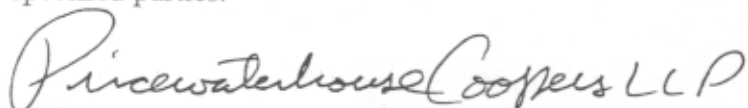
within the financial statements the full cost of their programs. Office of Management and Budget (OMB) Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, requires that costs incurred during a fiscal year that are capitalized on the balance sheet be reported in the statement of financing and notes that such costs do not result in expenses in the statement of net cost in that period. NASA reported \$8.5 billion of capitalized costs as operating expenses of the programs, while depreciation expense of \$2.5 billion was not reported as an operating expense of the programs. We believe the elimination of capitalized costs from each program's operating expenses and the allocation of depreciation expense to each program are necessary for the fair presentation of the fiscal year 2001 consolidated statement of net cost in conformity with generally accepted accounting principles. Thus, we believe that NASA's treatment of depreciation expense and capital expenditures in its fiscal 2001 statement of net cost represents substantial noncompliance with the Federal accounting standards requirements under FFMIA.

We believe that NASA should assign priority to corrective actions for these FFMIA related matters consistent with the requirements of OMB Circular No. A-50, Revised, on audit follow-up.

The results of our tests of compliance disclosed no other instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our work; accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the management of NASA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.



Washington, D.C.
February 22, 2002