



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

NOV 9 2006

TO: Administrator  
Chief Financial Officer

FROM: Inspector General

SUBJECT: Audit of the National Aeronautics and Space Administration's  
Fiscal Year 2006 Financial Statements (Report No. IG-07-004)

Under the Chief Financial Officers Act of 1990, NASA's financial statements are to be audited in accordance with generally accepted government auditing standards. The Office of Inspector General selected the independent certified public accounting firm Ernst & Young LLP (E&Y) to audit NASA's financial statements in accordance with *Government Auditing Standards* and Office of Management and Budget's Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

In the *Report of Independent Auditors* (Enclosure 1), E&Y disclaimed an opinion on NASA's financial statements for the fiscal years ended September 30, 2006 and 2005. The disclaimer resulted from NASA's inability to provide E&Y auditable financial statements and sufficient evidence to support the financial statements throughout the fiscal year and at year-end.

The E&Y *Report on Internal Control* (Enclosure 2) includes two reportable conditions, which are considered to be material weaknesses. Material weaknesses were found in NASA's controls for (1) financial systems, analyses, and oversight used to prepare the financial statements, and (2) assuring that property, plant, and equipment and materials are presented fairly in the financial statements.

The E&Y *Report on Compliance with Laws and Regulations* (Enclosure 3) identifies several instances in which NASA's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). For example, the report notes that certain subsidiary systems, including property, are not integrated with the Core Financial module and are not complemented by sufficient manual preventative and detect type controls. The report also identifies instances of noncompliance with certain provisions of the Antideficiency Act and with the Improper Payments Information Act of 2002.

NASA made significant progress in correcting two of the four deficiencies noted in FY 2005; specifically, Fund Balance with Treasury (FBWT) and estimating environmental liabilities. However, NASA's continued problems in resolving its other internal control weaknesses have contributed to its inability to produce complete and

accurate financial statements. NASA's two remaining internal control deficiencies are material weaknesses that have been reported for several years.

NASA prepared a corrective action plan in FY 2006 to address the material weaknesses and recommendations noted in the FY 2005 financial statement audit report. NASA should address the findings detailed in the enclosed reports and NASA's internally identified material weaknesses noted in the Administrator's Statement of Assurance in a new updated, corrective action plan. That plan must be detailed enough to ensure successful implementation with desired results. In addition, NASA must continue to

- ensure that the Office of the Chief Financial Officer is staffed with properly trained personnel who can address the Agency's financial management and accountability challenges;
- ensure that accounting practices are consistent with applicable standards and are consistently applied;
- establish internal controls that provide reasonable assurance that the financial statements are supported, complete, and accurate; and
- implement recommendations made in E&Y's *Report on Internal Control*, as well as those made by our office and the Government Accountability Office.

E&Y is responsible for each of the enclosed reports and the conclusions expressed therein. Accordingly, we do not express an opinion on NASA's financial statements, internal controls over financial reporting, or compliance with certain laws and regulations, including, but not limited to, FFMIA.

In fulfilling our responsibilities under the Chief Financial Officers Act of 1990, we provided oversight and technical support. We monitored the progress of E&Y's audit, reviewed reports submitted by E&Y, and ensured that E&Y met contractual requirements.



Robert W. Cobb

3 Enclosures

## Report of Independent Auditors

To the Administrator and the Office of Inspector General  
of the National Aeronautics and Space Administration

We were engaged to audit the accompanying consolidated balance sheets of the National Aeronautics and Space Administration (NASA) as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position and financing and combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of NASA's management.

During fiscal year (FY) 2003, NASA implemented an Integrated Financial Management Program (IFMP) system (now referred to as the Integrated Enterprise Management Program [IEMP] system), specifically the Core Financial Module. NASA's management identified significant errors beginning with its September 30, 2003 financial statements resulting from the implementation of IEMP. During FY 2004 through FY 2006, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control, and develop policies and procedures. In FY 2005 and FY 2006, internal control and financial reporting processes using the Core Financial Module were continuing to evolve, including the implementation and refinement of routine account analysis and reconciliation processes and the analysis of alternatives in developing effective approaches in accounting for property, plant, and equipment. As a result of these limitations, we were unable to obtain sufficient evidential support for the amounts presented in the consolidated balance sheets as of September 30, 2006 and 2005, and the related consolidated statements of net costs, changes in net position and financing and combined statements of budgetary resources for the fiscal years then ended.

Because of the matters discussed in the preceding paragraph, 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 as of September 30, 2006 and 2005, and the related consolidated statements of net cost, statements of changes in net position and financing, and combined statements of budgetary resources for the fiscal years then ended.

In its preparation and analysis of its September 30, 2006 and 2005 financial statements, NASA identified but largely did not quantify certain configuration and data integrity issues and errors in balances reported on its financial statements. The notes to the financial statements describe certain departures from accounting principles generally accepted in the United States of America in NASA's FY 2006 and FY 2005 financial statements. The notes also refer to a potential adjustment for certain mission-related assets (theme assets) that, if recorded, could have a significant impact on the financial statements.

Report of Independent Auditors  
Page 2 of 2

The information presented in the Management's Discussion and Analysis (MD&A), the Required Supplementary Stewardship Information, and the Required Supplementary Information is not a required part of the NASA's financial statements but is considered supplementary information required by Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. Such information has not been subjected to auditing procedures, and accordingly, we express no opinion on it. We were unable to apply to the information certain procedures prescribed by professional standards within the time frames established by OMB because of the limitations on the scope of our audit of the financial statements discussed above. Finally, programs identified in the FY 2005 financial statements do not directly align with the major goals and outputs described in the MD&A.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 3, 2006 on our consideration of NASA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our work.

 Ernst & Young LLP

November 3, 2006  
Washington, D.C.

## Report on Internal Control

To the Administrator and the Office of 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, 2006, and have issued our report thereon dated November 3, 2006. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheet as of September 30, 2006, and the related consolidated statements of net cost, changes in net position and financing and combined statement of budgetary resources for the fiscal year then ended.

In planning and performing our work, we considered NASA's internal control over financial reporting in order to determine our procedures for the purpose of expressing an opinion on the financial statements, which we were ultimately not able to do, and not to provide an opinion on the internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect NASA's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions we noted are described below.

A material weakness is 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described below, we consider both matters noted—Financial Systems, Analyses, and Oversight; and Enhancements Needed for Controls over Property, Plant, and Equipment and Materials—to be material weaknesses.

## MATERIAL WEAKNESSES

### Financial Systems, Analyses, and Oversight (Modified Repeat Condition)

#### Overview

In fiscal year (FY) 2002, NASA initiated a seven-year agency-wide effort to provide a single integrated suite of financial, project, contract, and human capital tools to help manage NASA's programs and prepare financial information on a timely basis consistent with evolving OMB guidance. During FY 2003, NASA implemented an Integrated Financial Management Program (IFMP) system (now referred to as the Integrated Enterprise Management Program [IEMP] system), specifically the Core Financial Module. The Core Financial Module replaced ten disparate center-level accounting systems and the NASA Headquarters accounting system, along with approximately 120 ancillary subsystems in operation for the past two decades. This conversion effort necessitated complex, extensive data cleanup, which was not always successfully completed.

Beginning with its September 30, 2003 financial statements NASA's management identified significant errors resulting from the implementation of the IEMP system. From FY 2004 through FY 2006, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control, and develop policies and procedures. We observed progress in financial management processes in FY 2006, including

- Center Periodic Monitoring Package Submissions—During August 2005, NASA issued a policy requiring each center to perform a monthly process of standardized reviews and reconciliations of financial data to identify anomalies and out of balance scenarios to provide a NASA-wide structure for reconciliation and analysis of financial data. By the 25<sup>th</sup> business day after month-end, the center's Office of the Chief Financial Officer (OCFO) is required to review and certify to the completeness of the package and forward the results to the Headquarters OCFO for further review. All supporting documentation is maintained at each center.
- Fund Balance with Treasury—NASA continued to make progress in resolving its fund balance with Treasury imbalance. Corrective actions continued into the summer of FY 2006 clearing prior reconciling items and resolving current unreconciled balances.
- Implementation of OMB A-123 Process—NASA contracted with an independent accounting firm to assist NASA in its implementation of requirements identified in OMB A-123, *Management's Responsibility for Internal Control* which requires each federal agency to establish, assess, correct, and report on internal control to improve the accountability and effectiveness of Federal programs and operations.

Report on Internal Control  
Page 3 of 22

- Improvement in Processes related to Environmental Liabilities—During FY 2006, NASA implemented updated policies, improved processes, and provided training to the Headquarters and Center technical and financial personnel who prepare the environmental liability estimates.
- Subsidiary Listing of Transactions to Support the General Ledger—Through a coordinated effort between the Competency Center and the Headquarters OCFO, a subsidiary listing of transactions for various real and nominal accounts was provided to support and analyze its general ledger.
- Theme Assets—During August 2006, NASA management met with the Accounting and Auditing Policy Committee (AAPC) of the Federal Accounting Standards Advisory Board (FASAB) to obtain guidance as to whether theme assets, totaling approximately \$12 billion, should be capitalized or expensed as research and development costs. However, a formal decision will not be issued until after November 15, 2006.
- Financial Management System Certification and Accreditation—During FY 2006, NASA had its core financial system certified and accredited.
- Guidance and Training—The Headquarters OCFO has issued updated Financial Management Requirements (FMR) for the remaining five out of 19 chapters and provided additional training to Center and Headquarters personnel.
- Contractor Reported Excess Costs Over Obligations—During FY 2006, as part of its periodic monitoring and year-end closing processes, NASA developed alternative procedures that are expected by management to ensure that excess contractor reported costs and the corresponding obligations would be researched, recorded, and resolved in a timely fashion to ensure appropriate recording of accrued costs and related obligations to its general ledger.

However, significant financial management issues continue to impair NASA's ability to accumulate, analyze, and distribute reliable financial information. Our testing of internal control continued to disclose certain weaknesses, including lack of integrated financial management systems, incomplete efforts to resolve data integrity issues, and weaknesses in entity-wide internal control which impaired NASA's ability to report accurate financial information on a timely basis. In many cases the progress noted above and related processes continued to be developed in FY 2006 and will require additional refinements in FY 2007.

#### Routine Reconciliation, Analyses and Oversight Processes

The U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* states that internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in

Report on Internal Control  
Page 4 of 22

accomplishing the organization's control objectives. Examples of control activities include top-level reviews, reviews by management at the functional or activity level, segregation of duties, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control. During FY 2005, we found that certain processes were not adequately performed to ensure differences were properly identified, researched, and resolved in a timely manner and that account balances were complete and accurate. Although we noted progress during FY 2006, continued emphasis on internal control processes is needed to provide NASA the ability to report accurate financial information in a timely fashion.

Periodic Monitoring Package Submission

At the end of FY 2005, NASA management developed an entity-wide structure for routine reconciliation, analyses, and oversight processes. Throughout FY 2006 and on-going into FY 2007, NASA management continues to identify enhancements to the process. The periodic monitoring package, a monthly process performed at the centers and forwarded to headquarters, is designed to identify issues impacting the integrity of the centers' financial management information and provide a means for communication and tracking of the issues centrally within the Headquarters OCFO. The process includes 23 separate analyses of significant financial processes within the center including, for example, fund balance with Treasury, accounts receivable and payable, budgetary, and contractor reporting. Each analysis is required to include a coversheet depicting the preparer's and reviewer's sign off, whether exceptions exist, and what the exceptions are. The coversheet submissions are due to the Headquarters' OCFO by the 25th business day after the end of each month and require a certification from the center Chief Financial Officer (CFO) indicating their review. Our review of these submissions and the related support maintained at the center identified progress at the centers in identifying issues, including system configuration concerns, continuing data integrity issues—dating back prior to the system conversion in 2003, and other issues requiring immediate attention by NASA management. However, our review of these packages also identified certain weaknesses in processes that could impair NASA's ability to correct material errors in a timely fashion. Specific concerns are as follows:

- Our review of the centers' submissions and the supporting documentation maintained at the centers identified inconsistencies in the procedures performed, the reports utilized, and the results provided among the various centers. Our review of NASA's FMR identified general guidelines as to the reconciliation to be performed, but is not specific as to the reports to be used or the specific procedures to be performed. Per discussions with Headquarters OCFO, additional training, site visits by the Headquarters submission reviewers, and improved guidance are expected during FY 2007.
- During our review of the coversheets and the related supporting documentation, we noted that although the coversheet would indicate no exceptions, the supporting documentation would identify exceptions that were not reported to Headquarters. Additionally, we noted that certain centers did not disclose certain discrepancies because they deemed them as



agency-level issues and were out of the control of the center. Per center management, formal guidance is needed to explain what is to be identified as an exception on the coversheet.

- We noted certain issues within the centers' submissions that had been identified for several months but had not been resolved in a timely fashion. Per discussions with center management, in most cases, the issues had been forwarded to headquarters either with a service request or the need for headquarters guidance but the center was awaiting guidance. Certain centers indicated that some of the delays occur due to not knowing who to contact at headquarters—primarily due to turnover in headquarters positions. Per discussions with headquarters personnel, as of October 2, 2006, there was a backlog of more than 78 service requests. Headquarters personnel indicated that procedures are still evolving and as a result certain items are still being worked. During FY 2007, headquarters OCFO personnel indicated that they are implementing procedures to resolve many of these items. Currently, other than such service requests, issues identified by the centers are not centrally tracked to determine the extent of the issue.

#### Fund Balance with Treasury

Treasury regulations require that each federal entity ensure that it reconciles, on a monthly basis, its financial records with Treasury's records and that it promptly resolves differences. If this reconciliation is not adequately performed, loss, fraud, and irregularities could occur and not be promptly detected, and/or financial reports that are inaccurate may be prepared and used in decision-making.

Throughout FY 2003, NASA implemented, in phases, a commercial off-the-shelf, agency-wide, integrated financial management system that replaced ten separate accounting systems in operation at NASA centers. This effort, which involved converting accounting data in the "legacy" accounting systems to a new accounting system, created complex accounting issues for FY 2003. Consequently, as noted in the FY 2003 audit report, as well as in our subsequent audit reports, NASA posted year-end adjustments outside its Core Financial Module, which indicated that the difference between its fund balance with Treasury balance and Treasury's balance was significantly greater than had been presented in its year-end reconciliation. In addition, these adjustments did not provide sufficient documentary evidence to explain the linkage between the adjustments and the unreconciled differences identified on headquarters' fund balance with Treasury reconciliations as of September 30, 2003.

Between FY 2003 and the third quarter of FY 2006, NASA management expended significant effort analyzing its differences related to the conversion and refining its procedures to ensure reconciliations for current activity going forward were performed properly to resolve reconciling differences in a timely fashion. On a monthly basis, these differences are now required to be reported to Headquarters' Office of the Chief Financial Officer via the periodic monitoring submission to ensure appropriate resolution. During June 2006, Headquarters' OCFO in

Report on Internal Control  
Page 6 of 22

conjunction with the centers made the decision to write-off residual pre-conversion differences of \$22 million.

Our review of current year reconciliations identified progress in the preparation and more timely identification and resolution of differences arising from current period transactions. As of June 30, 2006, budget clearing, suspense, and unreconciled differences totaled an absolute value of \$92.6 million. However, although progress was noted, we continued to identify old outstanding items greater than six months old. Additionally, one of NASA headquarters' reconciliation steps to understanding these differences includes identifying differences between amounts in the Central Resources Control System (CRCS) and the Core Financial Module. CRCS is the database used by OCFO for budget control by establishing resource plans for all levels. Each month, Resources Authority Warrants (NF 506) are issued from headquarters to centers and monthly activities are posted to CRCS. NASA personnel indicated differences between CRCS and the Core Financial Module occur because of timing differences on entering funding data and fund allocations in CRCS and the Core Financial Module between headquarters and the centers.

In preparation for the financial management system upgrade—expected to occur in October of FY 2007—NASA management took additional efforts to clear out their suspense, budget clearing, and unreconciled differences during the fourth quarter of FY 2006. At September 30, 2006, we were informed that an absolute value of differences for NASA in such accounts was \$10.7 million.

### Budgetary Analyses

Within the federal government, the budget is a primary financial planning and control tool. OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, implements the requirements of budget formulation and execution including requirements related to apportionments, accounting systems to control spending, proper recording of obligations, and closing accounts. For internal control purposes, budgetary monitoring is a key management control that, if implemented correctly, identifies cost overruns and potential material misstatements in a timely fashion.

Although we determined that reviews of the budget were being performed at the center and mission directorate level, our review of the budgetary status of funds report identified some negative balances whereby costs appeared to exceed obligations. Additionally, we noted that the centers used different reports to assess funds availability as compared to headquarters. Many of the centers indicated that the negative balances were awaiting correction or the balances in the report could not be relied upon because the amount was based on estimates. The cost over obligations edits (discussed later under “Efforts Needed to Resolve Data Integrity Concerns”), disaggregated estimation process used for certain contract accruals, and CRCS to core financial module process noted above can greatly complicate the review of status of funds reports, and could desensitize reviewers to problems normally inherent in anomalous balances.

Report on Internal Control  
Page 7 of 22

In the past few years, NASA has had more than one possible anti-deficiency act violation. The Office of Inspector General reported there were anti-deficiency violations and management agreed to report as required. To ensure these violations do not continue, enhanced budgetary monitoring processes are required.

#### Financial Statement Preparation Processes

Our review of NASA's financial statement preparation process identified certain issues impacting NASA's ability to effectively accumulate, assemble, and analyze information to timely develop its financial statements on a routine and recurring basis. Currently, although processes continue to be improved, data integrity issues, systems that are not fully integrated and evolving account reconciliation and periodic analysis processes continue to provide challenges in the development of auditable financial statements. The following represent issues identified during the financial statement preparation process:

- The requirement that each agency submit its Performance and Accountability Report (PAR) by approximately November 15 has created challenges for all agencies. The completed PAR for NASA was not available until the last week of October which did not provide sufficient time to meet deadlines for completion of the audit, review and submission processes. Many agencies have accelerated their PAR process by providing performance and other information as of an earlier date, and holding only very limited sections open for updates of information. Further, for both interim and year-end financial statements, certain analyses were not performed by OCFO until after the financial statements were submitted for audit purposes, suggesting that review processes may not be fully effective. Finally, although we were informed and documentation indicated that the PAR and supporting analyses had been through a rigorous review process prior to our audit, we noted that mistakes and errors were missed by the review process and that much of the preparation and many reviews were performed with contractor assistance. NASA personnel had limited capability to describe how balances reflected in the statements were derived, one aspect of an effective supervision and review process.
- Although NASA had indicated that it performed and upper management had reviewed its quarterly fluctuation analyses of its financial information to identify unusual balances, our review of NASA's analysis of its September 30, 2006 financial statements identified inconsistencies for which we required further explanation. Upon further inquiry, NASA indicated that due to previous data integrity issues, the balances they were comparing created variances that could not be explained. Management expected a better analysis would be available in FY 2007.
- For the third quarter financial statements, NASA had not reconciled all of its intra-governmental balances with its trading partners. Our review of the Treasury difference report identified over \$200 million for which NASA could not identify the reasons for differences with its trading partners. Further, we determined that intra-NASA transactions had not been eliminated from the initial draft of the financial statements.

Report on Internal Control  
Page 8 of 22

Many of these transactions related to services provided to the centers from the new shared service center.

- For both interim and year-end financial statements, we noted that financial statements submitted to OMB and for audit purposes were not compliant with OMB Circular A-136, *Financial Reporting Requirements*. We noted that certain disclosures, including those for net costs, undelivered orders, and intra-governmental balances had not been updated to ensure consistency with new guidance. Checklists and other tools (an annotated copy of A-136) which can help ensure that reports are appropriately prepared were not used effectively to identify the requirements of OMB Circular A-136 to ensure compliance.
- We noted that adequate documentation to support certain transactions was not readily available. Our testing of transactions identified several items where we did not receive sufficient information to determine if the transaction was valid. For example, NASA could not provide documentation to support its assertion that certain accruals were not necessary to be recorded in its financial statements as of September 30, 2006. According to OCFO management, NASA implemented processes intended to minimize the extent of required accruals, and did not record such accruals. We were unable to assess the effectiveness of this process, and whether grantees and contractors accelerated all billings for services rendered through September 30<sup>th</sup> by September 27<sup>th</sup> as the systems were not operating during conversion to the new financial management system. To the extent such processes are not consistent with Federal Acquisition Regulations (FAR) or cost principles associated with execution of grants, it is possible that grantees and contractors would not have advance billed NASA for services that they would normally not draw down funds for or invoice for until late October or November. Depending on the results seen by NASA in the beginning of FY 2007 through a review of subsequent disbursements, it may be possible to modify this approach to incorporate and estimate for any remaining necessary accrual.

#### Efforts Needed to Resolve Data Integrity Concerns

NASA's management continues to identify data integrity issues in the Core Financial Module that impairs its ability to prepare accurate and complete financial statements. Data integrity issues identified during FY 2003 and prior continue to impair FY 2006 account balances. Although much progress was seen during FY 2006, our testing continues to identify similar issues. Additionally, although the centers were able to provide subsidiary listings; the listings are frequently being generated from non-routine processes, not directly from the financial management module. Specific concerns noted include the following:

- During FY 2005, we reported that NASA designed its new Core Financial Module to include a system edit whereby, if costs (and the corresponding liabilities) are greater than the associated obligations, the difference would not be recorded in NASA's general ledger but rather maintained outside of the general ledger system. Instead, the differences were adjusted at the contract/project level by posting a liability to match the

Report on Internal Control  
Page 9 of 22

excess costs. Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, SFFAS No. 4, *Managerial Cost Accounting Concepts & Standards*, and NASA's FMRs require costs to be accrued in the period in which they are incurred and any corresponding liability to be recorded as an account payable. During FY 2006, as part of its periodic monitoring and year-end closing processes, NASA developed alternative procedures that are expected by management to ensure that excess contractor reported costs and the corresponding obligations would be researched, recorded, and resolved in a timely fashion.

As part of its periodic monitoring process, management indicated that the center OCFO is expected to work closely with the appropriate procurement official, the project manager, and the vendor to initiate the necessary contract funding modification actions to record timely increases to obligations, record excess costs, resolve mistakes in vendor reporting, obtain explanations for cost adjustments, and to validate the processes the vendor will have in place to prevent over costing in the future. Once the modification is identified, the center OCFO personnel should record the appropriate transactions to ensure amounts have been reported in the general ledger system. If amounts are not corrected by quarter-end, the center should report the status through its monthly periodic monitoring process to Headquarters' OCFO for assistance.

At year-end, Headquarters' OCFO runs a report that identifies by fund center those "costs over obligation" amounts that have not been resolved nor recorded in the general ledger. Headquarters' OCFO indicated that they then net the balances for each fund center and process top-side entries to the general ledger to either accrue the costs or obligations or process the downward cost adjustment. These entries are expected to be reversed in the first quarter of the following fiscal year so that the centers can perform the appropriate research within the normal quarterly process. It is our understanding that certain accruals of costs and obligations may be against expired funds. Management believes this process is in accordance with federal budgetary requirements.

Due to the timing of the new processes being implemented, we were unable to determine the effectiveness of these processes during FY 2006 to record accruals for costs that were in excess of recorded obligations and related obligations and downward adjustments that were necessary to record such costs in the general ledger at year-end.

- We noted numerous grants and contracts which had periods of performance prior to FY 2006 which had not officially been closed due to limited resources available for follow-up of missing or incomplete documentation from the vendor/grantee and a significant backlog of large amounts awaiting de-obligation. For several years, NASA has utilized an outside contractor to resolve the large backlog. For grants, because of the delay of close-out within the grant system, allocation of current activity costs were being posted as current expense against the expired grant obligation. As of March 31, 2006, we noted over 4,000 grants and 3,000 contracts for FY 2005 and prior which were past their period of performance still awaiting closeout and de-obligation. Further, we noted several grant

and contract sample items where requested supporting documentation was not available or not part of the official file.

- Although the centers use financial management and ad-hoc reports for management oversight purposes, such as aging analyses and collection initiatives, we noted during our testing that numerous accounts receivable were related to balances that were greater than one year old. Many of the balances relate to current and former employees, vendor amounts, conversion issues, and balances with other government agencies. The number of employee related items and their myriad causes are of note and merit rigorous follow up. As of March 31, 2006, we noted over 16% of accounts receivable or approximately \$28 million greater than one year old. Additionally, we noted inconsistencies among the centers as to the timing of when amounts are posted to the allowance for doubtful accounts.
- Although the periodic monitoring package includes a quarterly step to review unliquidated obligations and accounts payable to ensure balances that are recorded in NASA's financial system are valid and supportable, we noted that the centers do not currently age their undelivered orders or their accounts payable to identify old balances that may require follow-up or de-obligation. As of June 30, 2006, we noted numerous unliquidated obligations and accounts payable that were greater than one year old.
- We noted certain transactions were recorded utilizing budget object classes inconsistent with OMB Circular A-11 guidance. During our testing of grants and contracts, while we noted certain contracts recorded to the grant and subsidy object class, certain contracts were recorded to budget classes consistent with grants.

In some cases, individual items selected for audit testing were further researched and actions were taken by NASA management to follow-up on such items and appropriately resolve them. Similar efforts are needed for numerous other old items.

#### Processes in Estimating NASA's Environmental Liability Require Enhancement

During our review of NASA's unfunded environmental liability (UEL) totaling \$893 million as of September 30, 2006 and related disclosures to the financial statements, we noted that NASA has made progress in resolving several weaknesses that impeded its ability to generate an auditable UEL estimate. Specifically, progress has been made in documenting the UEL process and training the Remedial Project Managers (RPMs) that prepare the estimates. However, NASA has not validated the Integrated Data Evaluation and Analysis Library (IDEAL) software program that it uses to estimate a portion of its UEL estimate. Additionally, while NASA has begun to integrate the OCFO into the UEL estimation process, additional integration is required. Finally, NASA should assess its reporting and disclosure against other similarly situated federal entities and commercial enterprises as an aid in ensuring that disclosures are meaningful.



IDEAL – The IDEAL software application is a parametric cost-estimating model that estimates the cost of environmental remediation liabilities based on average cost experiences for similar conditions. NASA uses these IDEAL algorithms to estimate approximately \$190 million of its UEL. In addition, IDEAL aggregates and reports on all UEL estimates even if they were prepared externally to IDEAL. As previously identified in our prior reports, the IDEAL model has not undergone an independent software verification and validation. While the inputs to the IDEAL model can be verified, the output of the equations (e.g., the cost estimate) cannot be verified without performing a zero-cost re-estimation of the remediation scenario.

In addition, as the IDEAL data files are part of NASA’s support for its UEL estimate, we reviewed the process and noted several other control weaknesses in the application.

- Data Security – The current version of IDEAL is a host/client application. NASA’s users enter data into a desktop application that transmits the data to a third-party service contractor. This contractor then processes the data and returns it to NASA over the Internet. During our review we were notified that while the password authentication is secure, all other data transmissions are not.
- SAS 70<sup>1</sup> – NASA’s third-party service contractor manages the host IDEAL application and processes the calculation of the UEL estimate. We noted that NASA has not evaluated the controls between itself and its service providers through either a SAS 70 or other mechanism, and did not do so as part of the OMB Circular A-123 process.
- User Defined Interface (UDI) – As noted in prior years, NASA’s users have complete access to the parametric equations, cost tables, warning limits and other parameters in the model through the UDI. While a report has been developed that would highlight when the center/facility specific default parameters were modified, it would not identify if any of the global parameters/equations in any of the models were modified.
- Documentation – We noted weaknesses in the printed reports generated by IDEAL as they did not provide a complete record of the information contained in the IDEAL data files. NASA indicated that the electronic data files in IDEAL were the official record for the UEL estimates included in its financial statements. Because IDEAL is a host/client application, NASA does not maintain control over the host application, and therefore, updates and changes made to the host program will alter the processing of NASA’s client data since it is recomputed every time it is processed without any archive or electronic audit trail. Electronic IDEAL data files archived by NASA as part of the FY 2006 audit

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<sup>1</sup> A Statement of Auditing Standards No. 70, *Reports on the Processing of Transactions by Service Organizations* (SAS 70) report provides for a service organization's description of its controls that may be relevant to a client's internal control, on whether such controls had been placed in operation as of a specific date, on whether they are suitably designed to achieve specified control objectives, and on whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the related control objectives were achieved during the period specified.

might provide different results when processed by the IDEAL host application in the future.

During our online review of entries within electronic files, we noted that numerous warning and error messages were not addressed in the online documentation as to the cause or reconciliation. For example, IDEAL might provide the user with a warning or error that the limits in a parametric equation were being exceeded. While overriding these warnings might be acceptable, there was typically no documentation to support the override decision.

*OCFO Involvement* – During FY 2006 NASA made progress in implementing a quality review function that was independent of the centers/facilities that prepared the UEL estimate. It also began to integrate the OCFO into the training of the RPMs and the independent review function. In addition, during our review we noted improvement in the process that the centers/facilities used in preparation of the estimate. However, during our review we noted several accounting matters that might have been rectified earlier with additional center OCFO involvement. For example,

- Year-to-Year Changes - While NASA has begun tracking the technical reasons for changes in the year-to-year UEL estimates we noted weaknesses in tracking and analyzing changes in accordance with the accounting literature.
- Documentation – As part of the new quality review process, the center CFOs statistically sample and review IDEAL documentation. However, it was not always apparent what documentation the OCFO considered during their review. Because of software limitations, certain documentation was not attached in IDEAL as originally planned nor was a note included in IDEAL as to what was considered the official documentation. Finally, we noted discrepancies in the effective dates and versions of estimates in IDEAL.

#### Financial Management Systems Not in Substantial Compliance with FFMIA

The NASA financial management systems are not substantially compliant with the Federal Financial Management Improvement Act (FFMIA) of 1996. FFMIA requires agencies to implement and maintain financial management systems that comply with federal financial management systems requirements. More specifically, FFMIA requires federal agencies to have an integrated financial management system that provides effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. The financial management system continues to impair NASA's and the centers' abilities to adequately support and analyze account balances reported.

Although NASA implemented a commercial off-the-shelf financial module approved by the former Joint Financial Management Improvement Program (JFMIP), certain aspects of the NASA accounting system lack integration and do not conform to the requirements. NASA's



management continues to identify configuration issues in the Core Financial Module that resulted in inappropriate transactional postings. Finally, certain subsidiary systems, including systems used to account for property, plant, and equipment, the largest NASA asset, are not integrated with the Core Financial Module. Specific weaknesses noted include the following:

- Certain subsidiary systems, including all property systems (i.e., NEMS, NRPDB, and CHATS), are not integrated with the Core Financial Module and are not complemented by sufficient manual preventative and detect type controls.
- NASA's management continued to identify certain transactions that are being posted incorrectly due to improper configuration or design within the Core Financial Module. For example, during our review of the centers' periodic monitoring packages, the centers identified abnormal balances within the general ledger. The centers indicated that they believed the differences were caused by the design of the system and that system requests had been forwarded to headquarters for consideration to resolve the various issues. Additionally, during our review of the reconciliation of the financial information (FI) module to the funds management (FM) module, both residing within the IEMP, we noted that discrepancies existed due to journal entries not being properly mapped to both modules when posted.
- Although the amount is not material, the second quarter balance sheet generated from the Core Financial Module did not balance, meaning that assets did not agree to liabilities plus net position. Adjustments were made outside the system to correct this prior to submission of the quarterly statements to OMB.
- The Core Financial Module was still unable to provide a breakdown of costs by the four mission directorates which NASA has identified as significant segments for FY 2005. This is not consistent with the requirements of SFFAS No. 4, which calls for presentation of costs by responsibility segment for each fiscal year presented.
- Due to systematic limitations, NASA centers continue to use alternative approaches to ensure data and financial management information is readily available to make critical decisions. These alternative approaches are inconsistent between centers and may cause varied results in the accuracy of reporting from the centers to headquarters. For example, during our center visits, we noted that some centers use manually created spreadsheets to track invoice due dates to ensure compliance with Prompt Payment Act requirements. However, we noted that other centers rely on IEMP to track the payment due dates for compliance.

We noted that NASA is in the process of implementing a software version update which OCFO believes will address some of the systems implementation issues related to the IEMP.

Weaknesses in Information Technology General and Application Controls

Several access and segregation of duties issues were noted within the IEMP environment. The level of risk associated with these information technology issues depends in part upon the extent to which financial-related compensating controls (such as reconciliations and data integrity reviews of output) are in place and operating effectively throughout the audit period. Certain controls designed to detect errors or inappropriate processing may also not be executed in a manner which can be expected to identify errors, which, while perhaps not material to the financial statements as a whole, may subject NASA to risks regarding safeguarding of assets. Within the context of the overall weaknesses identified in the control environment referenced in the accompanying comments and although NASA has made progress in addressing and resolving prior year information technology findings, these information technology-related issues along with issues noted by NASA OIG in various engagements and their ongoing review of the SAP Version Update (SVU) project merit continued management focus.

\* \* \* \* \*

Due to the severity of these issues, an integrated financial system, a sufficient number of properly trained personnel, well-documented policies and procedures, stronger leadership from the Headquarters' Office of the Chief Financial Officer, and a strong oversight function are needed to ensure that periodic analyses and reconciliations are completed to detect and resolve errors and irregularities in a timely manner.

***Recommendation***

We recommend that NASA continue to develop and refine its financial management systems and processes to improve its accounting, analysis, and oversight of financial management activity. Specifically, we recommend that NASA:

- Continue to strengthen controls related to its entity-wide structure for account reconciliation, analyses and oversight by building consistency among centers, providing more in-depth guidance and training for financial personnel, strengthen headquarters oversight by visiting the centers, periodically requesting the supporting documentation to compare to the coversheets, and to improve communication so that issues may be resolved in a more timely manner.
- Continue to improve its current Fund Balance with Treasury procedures to ensure that all reconciling items are thoroughly researched, properly documented, timely resolved, and reviewed by appropriate center and headquarters OCFO personnel.
- Continue to build on budgetary reviews to ensure that costs incurred are within budget and the potential overruns are identified in a more timely fashion.

Report on Internal Control  
Page 15 of 22

- Continue to improve its financial reporting and internal quality review procedures to reasonably assure that information presented in the Performance and Accountability Report is accurate and is consistent with the requirements of OMB Circular A-136, Financial Reporting Requirements, including rigorous use of checklist and supervisory review processes.
- Ensure that the Core Financial Module has been configured to provide a breakdown of net costs consistent with programs identified in NASA's strategic plan and in the Management's Discussion and Analysis (MD&A) section of the financial statements for both fiscal years presented.
- Continue to enhance its procedures related to confirming intra-governmental balances with its trading partners so that differences identified through the OMB quarterly process do not exist.
- Ensure that systems used to prepare the financial statements are complete and have been sufficiently tested prior to interim and year-end reporting dates. NASA should continue to validate its data within the Core Financial Module to resolve issues with data integrity that date back prior to the system conversion in FY 2003 to ensure that data is accurate and complete.
- Develop reports from the Core Financial Module to facilitate reviews and ensure that agings of transactions and open items, unliquidated obligations, grants, and other key areas are periodically assessed, researched, and resolved. Additionally, NASA should improve its process to more timely close expired travel, grants, and contracts and develop refined guidance on accounts receivable, the allowance for doubtful accounts, and the point when accounts receivable is either referred for collection initiatives or written off.
- Continue to devise short-term and long-term resolutions to systematic and integration issues that complicate use of the IEMP.
- Continue to resolve issues identified in the general and application controls surrounding its financial management systems. Additionally, in light of the financial management system upgrade, we recommend that NASA monitor that its internal control, including periodic reconciliations and analysis, are performed to ensure that further data conversion and other issues do not lead to difficulties in processing transactions and preparing accurate reports in the months and possibly the years to come.
- Continue to focus on filling key vacancies within the financial management organization to enhance overall performance and develop a core team of highly qualified individuals with experience in NASA's financial management processes.

Report on Internal Control  
Page 16 of 22

- Continue to provide training for personnel – at Headquarters and center levels –to ensure that they understand their roles in processing transactions, performing account analyses and reconciliations, maintaining supporting documentation, and updating their knowledge of financial reporting requirements. Additionally, NASA should update guidance to ensure specific guidelines are documented as to the source of data, what comprises an exception/difference, required follow-up with timetables, and documentation retention policies.

Finally, as it relates to the estimation of environmental liabilities, we believe that estimating models and tools such as IDEAL are an accepted practice for improving the standardization of engineering estimates. Therefore, we recommend that if NASA continues to use IDEAL as part of its UEL estimation process, that it: (1) complete the verification and validation of the program; (2) encourage the IDEAL contractor to obtain a Type II SAS 70 from an independent third party service provider to demonstrate the operating effectiveness of its internal controls; (3) improve the security and controls of the application; and (4) develop a process to ensure consistent year-to-year audit trails and documentation.

We recommend continued involvement of the OCFO in the UEL process with specific focus on accounting related matters such as disclosure and documentation. We believe the center OCFO review can be enhanced with the inclusion of accounting related matters in its checklists. The OCFO review checklist should include a review of the determination that IDEAL's parametric data provides the best available estimate or that actual cost data is available that would provide a better estimate. We also recommend that NASA's OCFO continue to self-assess the UEL estimation and aggregation process to identify and correct remaining weaknesses in the UEL process.

### **Enhancements Needed for Controls Over Property, Plant, and Equipment and Materials (Modified Repeat Condition)**

Consistent with prior year audit reports, our review of property, plant, and equipment (PP&E), totaling approximately \$33.2 billion, identified serious weaknesses in internal control that, if not corrected, could prevent material misstatements from being detected and corrected in a timely manner. As stated in the prior year audit reports, NASA's current process for recognizing and accounting for fixed assets relies primarily on a retrospective review of disbursements to determine amounts which should be capitalized and continues to be heavily dependent on activities at its contractors to recognize any assets created at its contractors. Currently, NASA expenses all costs (except for certain construction of NASA-held real property) and then performs a review of the transactions to determine which costs should be capitalized. The subsequent review and dependence on contractor reporting increases the risk that related costs will not be properly captured and capitalized. Until NASA successfully implements an integrated system for reporting PP&E, and develops a methodology to identify costs that need to be capitalized starting at the budget/procurement cycle through to the processing and disbursing of funds as the transaction is processed, NASA will continue to experience difficulties in recording property-related balances and transactions. During fiscal year 2006, we were informed

that NASA has completed the first phase of its corrective action plan to flowchart and document the current business processes and procedures for each major category of PP&E. Somewhat simultaneously, NASA identified changes that needed to be made to existing policies Agency-wide and formed a cross-functional team to participate in working groups to re-engineer NASA's current processes and procedures and identify solutions to gaps in the PP&E lifecycle management. Pending implementation and acceptance of new policies and processes by all cross-functional departments within the agency of such overarching solutions, further emphasis on internal and external processes at headquarters, the centers, and the contractor locations is needed to ensure that amounts reported in its financial statements are reliable.

During our FY 2006 testing, we continued to note evidence of significant weaknesses in the property area. The weaknesses we noted during FY 2006, most of which are consistent with last year's audit report, fundamentally flow from not determining at the point of budget formulation, obligation recognition, contract development, accounts payable recognition, or disbursement the amounts of property NASA expects to buy, has contracted for, or has purchased. Rather, NASA waits until the entire transaction cycle is complete to obtain disbursement data for capitalization or, in the case of contractors, expects their contractors to do so. Insufficient internal controls surrounding contractor-held PP&E, NASA-held theme assets, NASA-held work in progress (WIP), and NASA-held real and personal property are addressed below:

#### Contractor-Held Property, Plant & Equipment

The reliance upon NASA's contractors to report property values at periodic intervals during the year without robust agency-wide detect controls to ensure the reliability and validity of those property values may increase the probability of errors and deficiencies not being detected by NASA or reported by contractors. Throughout the year, the Headquarters OCFO's property branch personnel do perform certain analytical analyses of property balances and transactions reported by NASA's largest contractors that report monthly in Contractor-Held Asset Tracking System (CHATS). This monitoring process, however, currently lacks integration of NASA's procurement and scientific community, with whom contractor accountability primarily resides, and does not include a reconciliation to the costs being incurred by these contractors via the monthly NF 533 reporting process to the property balances reported monthly in CHATS and annually via the NF 1018. Although the OCFO utilizes the Defense Contract Audit Agency (DCAA) as its primary quality assurance mechanism over NASA's contractors, the procedures that DCAA performed on the June 30, 2006 property balances and a sample of fiscal year 2006 transactions cannot alone be relied upon by NASA management to ensure the reliability and validity of contractor-held property values.

#### ***Recommendation***

- We recommend that NASA fundamentally revisit its approach to capitalizing contractor-held property by documenting, analyzing, and implementing robust control changes from end to end, including the involvement of the procurement and scientific community.

- We continue to recommend that all NASA obligation documents and expenditures be coded to identify whether they relate to a property acquisition to create a record for comparison to recorded property transactions and the CHATS subsidiary ledger. For contractor-held property, this would also include developing a method for reconciling contractor costs incurred via the monthly NF 533 reporting process to those contractor-held property balances reported monthly in CHATS and annually via the NF 1018.

#### NASA-Held Theme Assets Operational and WIP

Beginning in FY 2004 and continuing throughout FY 2006, NASA has undertaken a project to review its policies (both accounting and procedural) with respect to theme assets to identify the specific types of costs that should be capitalized and those that should be expensed.

During fiscal years 2005 and 2006, NASA revisited its process to account for theme assets and developed a number of approaches, most recently positing its current position to the AAPC of the FASAB that nearly \$12 billion of the theme asset activity is fundamentally research and development and that such costs should be expensed. The current position contrasts with earlier views that none or a small part of such activity constituted research and development, and is a significant potential change from prior approaches which led NASA to capitalize billions of dollars in such items. In any case, NASA will face challenges in addressing the question of whether certain land based assets so categorized with the theme assets that travel into space are so unique that the remaining technology and hardware are of no future use and cannot be salvaged or used in other research and development projects (a determining factor in NASA's proposed new approach on assessing whether costs should be capitalized). NASA management hopes to resolve the accounting policy-related aspects of its theme asset accounting independent of potentially longer-term needs to develop appropriate systems to capture such costs (however ultimately categorized). The specific rules for the AAPC to issue authoritative guidance which NASA management could follow in resolving the accounting issue is through a technical release approved by the FASAB, which has not yet occurred.

Management has begun to address the procedural matter, as discussed in previous years' reports, in establishing new policies by incorporating financial and engineering authoritative guidance as well as NASA program/project management policy to ensure consistent application and documentation. As one aspect of addressing the accounting issue over which costs are expensed versus capitalized for theme assets in progress and those yet to be undertaken, management implemented October 1, 2005, the revised the engineering authoritative guidance contained in NASA Procedural Requirement 7120.5C, *NASA Program and Project Management Processes and Requirements*. This requirement defined the four management requirements for formulating, approving, implementing, and evaluating NASA programs and projects and provided for an aligned budget structure and technical work breakdown structure within the Core Financial Module. These initiatives seem to be moving NASA in the right direction for identification of the component parts of theme assets throughout its life cycle. However, it is unclear as of yet how the alignment and the specificity of these pre-established work breakdown structure elements will correlate to the accounting for these costs under the authoritative literature.



Furthermore, NASA management has not yet demonstrated how these new requirements, when fully operational, will provide sufficient specificity in NASA's purchasing activity to facilitate tracking and reporting of all types of property acquisition activity, including the subset of such activity related to theme assets as projects are initiated and disbursements are made. Prior NASA efforts to obtain and retain documentation to support these assets under its existing policy created challenges.

### ***Recommendation***

- Once the process of exposing NASA's position relating to the accounting for theme assets to the authoritative standard setters has come to an end, we recommend that management act upon the final technical rulings issued by the AAPC and/or FASAB as promulgated by their charters.
- We continue to recommend that all NASA obligation documents and expenditures be coded to identify whether they relate to a theme asset property-related acquisition to create a record for comparison to recorded property transactions and the work breakdown structure (WBS) of costs incurred that result in capitalized theme assets. This would also include developing a method for reconciling costs incurred via the monthly NF 533 reporting process and recorded by WBS elements in the core financial module related to theme assets under construction (work-in-process) to the amounts reported monthly in CHATS or annually in the NF 1018, as well as the theme asset spreadsheet maintained by headquarters.

### **NASA-Held Real and Personal Property**

During our FY 2006 testing, we again noted transactions that were not recorded at the appropriate value based upon the final amount paid to the vendor/contractor (i.e., a "three-way match" between the purchase order, shipping document, and invoice was not performed by NASA personnel), transactions were not recorded in the correct month and/or fiscal year based upon the date of authorized acceptance of the property, the initiation of transactions lacked evidence of written authorization or lacked required supporting evidence (i.e. invoices, contracts), and monthly journal vouchers lacked evidence of a supervisory review. NASA management is reliant upon a monthly evaluation to determine which assets should be capitalized to record these transactions and maintains separate subsidiary ledgers which are not interfaced directly with the Core Financial Module. Management records these property, plant and equipment transactions through a manual journal voucher process, yet there is no formal policy that requires supervisory review and signoff evidencing the approval of these entries prior to their posting in the Core Financial Module. It was noted that during the fiscal year, management recorded approximately \$89 million (net) of adjustments for prior years' property transactions for such items as equipment found during routine inventory processes, components of buildings removed and no longer in use revealed during deferred maintenance reviews, and the discovery of manual input errors on key authorizing documents, such as one for \$133

million, a result of an extra digit, not found when the transaction was originally recorded. There were also adjustments recorded at the headquarters' level relating to depreciation expense totaling approximately \$24 million. All of these transactions were recorded through the current period operations. The result of these adjustments are further examples of management's need to place additional emphasis on strengthening and enforcing center-related manual prevent and detect controls that extend beyond the finance and logistics departments as these are the baseline controls upon which NASA is reliant. Furthermore, management should revisit their entity-level detect controls at the headquarters level to ensure that monthly reviews of center transactions and differences noted in subsidiary ledger reconciliations are reviewed, resolved, and communicated to center personnel in a timely manner for entry into the Core Financial Module or subsidiary ledgers.

### ***Recommendation***

We recommend that NASA management:

- Develop more robust center-related manual prevent and detect controls that extend beyond the finance and logistics departments, including a formal policy that requires supervisory review and signoff evidencing the approval of property, plant and equipment entries prior to their posting in the Core Financial Module.
- Revisit their entity-level detect controls at the headquarters level to ensure that differences and corrections are resolved and communicated timely to center personnel for entry into the Core Financial Module or subsidiary ledgers.
- Continue completing its implementation of suggested recommendations and developing detailed corrective action plans. In addition, we once again place further emphasis on recommending that NASA fundamentally revisit its approach to capitalizing property by documenting, analyzing, and implementing robust control changes from end to end to all categories of PP&E. We also recommend that all NASA obligation documents and expenditures be coded to identify whether they relate to a property acquisition to create a record for comparison to recorded property transactions and subsidiary ledgers, be they NASA activities or contractors.



**OTHER MATTERS**

Summary of FY 2005 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issue	FY 2006 Status
<b>Material Weaknesses</b>		
Financial Systems, Analyses, and Oversight	<p>Documentation regarding significant accounting events, recording of non-routine transactions, and post-closing adjustments, as well as corrections and other adjustments made in connection with data conversion issues, must be strengthened.</p> <p>Processes to prepare financial statements need improvement.</p> <p>Certain weaknesses noted relating to general and application controls.</p>	Modified Repeat Condition.
Further Research Required to Resolve Fund Balance with Treasury Differences	Supporting documentation to support application of rigorous reconciliation processes was not available. Unreconciled differences were identified in the FY 2003-2005 year-end reconciliations.	Progress made; combined with Financial Systems, Analyses, and Oversight Weakness. Corrective actions related to suspense accounts, budget clearing accounts and unreconciled differences are needed.
Enhancements Needed for Controls over Property, Plant, and Equipment and Materials	Controls relating principally to contractor-held PP&E and materials and NASA-held assets in space and WIP need improvement; headquarters oversight needs improvement.	Modified Repeat Condition.
<b>Reportable Condition:</b>		
Internal Controls in Estimating NASA's UEL Require Enhancement	Weaknesses noted in NASA's ability to generate auditable UEL estimates using IDEAL estimating methodology and to identify disclosure items; and enhancing the independent quality review.	Progress made; combined with Financial Systems, Analyses, and Oversight Weakness. Corrective actions related to the IDEAL system and the level of the Office of the CFO participation are needed.

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Report on Internal Control  
Page 22 of 22

In addition, with respect to NASA's internal control over Required Supplementary Stewardship Information and performance measures reported in the Management's Discussion and Analysis, we were unable to apply certain procedures prescribed by OMB Bulletin No. 06-03, because of the limitations on the scope of the audit of the financial statements, as discussed in our Report of Independent Auditors, dated November 3, 2006. Further, we did not audit and do not express an opinion on such controls.

We also noted certain other matters involving internal control that we will report to NASA management in a separate letter dated November 3, 2006.

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

*Ernst + Young LLP*

November 3, 2006  
Washington, D.C.

## Report on Compliance with Laws and Regulations

To the Administrator and the Office of 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, 2006, and have issued our report thereon dated November 3, 2006. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheet as of September 30, 2006, and the related consolidated statements of net cost, changes in net position and financing and combined statement of budgetary resources for the fiscal year then ended.

The management of NASA is responsible for complying with laws and regulations applicable to NASA. 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 Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to NASA.

The results of our tests disclosed two instances of potential noncompliance with the laws and regulations discussed in the preceding paragraph, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03. First, NASA's management has determined that it has violated certain provisions of the Anti-Deficiency Act (P.L. 101-508 and OMB Circular A-11). We have been advised that appropriate reporting of the violation was performed during October 2006. Additionally, NASA has potentially violated certain requirements of the Improper Payments Information Act of 2002. During FY 2006, NASA management was unable to provide sufficient documentation to support performance of an annual review of all programs and activities that it administers to identify all such programs and activities that may be susceptible to significant improper payments. NASA management indicated that an assessment was performed to estimate an error rate on research and development contracts related to payments between FY 1997 and FY 2005.

## Report on Compliance with Laws and Regulations

Page 2 of 3

Under FFMIA, we are 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 (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. However, as noted above, we were unable to complete our audit. Based upon the results of the tests we were able to complete, we noted certain instances, described below, in which NASA's financial management systems did not substantially comply with certain requirements:

- The NASA accounting system does not conform to certain Federal requirements. NASA's management continues to identify data integrity and configuration issues in the Core Financial Module, which results in inappropriate transactional postings. Additionally, certain subsidiary systems, including property, are not integrated with the Core Financial Module and are not complemented by sufficient manual preventative and detect type controls.
- Data within NASA's financial system have not been validated as reliable and may not be reliable to support NASA's financial statements. Additionally, certain data was not readily available to adequately support sufficient reconciliations and analyses of significant fluctuations in account balances, with fluctuation review processes impeded by acknowledged deficiencies in baseline information used in comparisons.
- Reviews of general and application controls over financial management systems identified certain departures from requirements specified in OMB Circular A-127, *Financial Management Systems*, and OMB Circular A-130, *Management of Federal Information Resources*. Additionally, the Office of Inspector General of NASA (OIG) identified certain issues related to systems as part of its Federal Information Security Management Act (FISMA) and other OIG projects.
- As part of its FFMIA self assessment, NASA management has identified its financial management system as a material weakness. NASA management indicated that since the completion of the roll-out of the Integrated Enterprise Management Program's (IEMP) core financial management system, challenges in system processes, configuration, and capabilities have surfaced. They believe that the current IEMP software system has certain capability limitations which require compensating controls which have not been fully implemented.

The Report on Internal Control and management letter include information related to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations related to the specific issues presented. It is our understanding that NASA's management agrees with the facts as presented and that relevant comments from NASA's management responsible for addressing the noncompliance are provided as an attachment to this report.

Report on Compliance with Laws and Regulations  
Page 3 of 3

Because we could not complete our audit, we were unable to determine whether there were other instances of noncompliance with laws and regulations that are required to be reported.

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

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

*Ernst & Young LLP*

November 3, 2006  
Washington, D.C.