



Part 3

Financials

Letter from the Chief Financial Officer



This section of the National Aeronautics and Space Administration's (NASA) *Fiscal Year 2004 Performance and Accountability Report* contains the annual financial statements and associated audit reports. NASA received a disclaimer of audit opinion for the FY 2004 financial statements.

While NASA achieved measurable improvements in its financial management practices during FY 2004, much work remains to achieve an unqualified audit opinion. We anticipated the ongoing challenges of implementing an organization-wide integrated financial management system and adopting full cost business practices at the Agency, and we carefully mapped an ambitious but doable plan to remedy residual system conversion data problems, achieve full and compliant accountability of property, plant, and equipment, and prepare for future integrated system functionality.

Transformation of NASA Headquarters, including the Office of the Chief Financial Officer, solidified much-needed organizational stability and improved accountability. Chief financial officers at NASA's

Centers now report directly to me. In addition, we have integrated the Office of Procurement and the Office of Small and Disadvantaged Business Utilization into the Office of the Chief Financial Officer to ensure that financial policies, processes, and practices are consistent and connected through NASA's entire life cycle of financial transactions and events. We are clearly positioning ourselves to become the "best in government" for financial management.

My staff and I look forward to working with the entire NASA community and our auditors during the coming year to improve significantly our future financial management within the Agency.


Dawn D. Cycles
Chief Financial Officer and Chief Procurement Officer

FINANCIAL OVERVIEW

SUMMARY OF FINANCIAL RESULTS, POSITION, AND CONDITION

NASA's financial statements were prepared to report the financial position and results of operations of the Agency. The principal financial statements include 1) the Consolidated Balance Sheet, 2) Consolidated Statement of Net Cost, 3) Consolidated Statement of Changes in Net Position, 4) Combined Statement of Budgetary Resources, and 5) Consolidated Statement of Financing. Additional financial information is also presented in the notes and required supplementary schedules.

The *Chief Financial Officers Act of 1990* requires that agencies prepare financial statements to be audited in accordance with Government Auditing Standards. The financial statements were prepared from the NASA Integrated Financial Management system (SAP) and other Treasury reports, in accordance with Generally Accepted Accounting Principles and accounting policies and practices summarized in this note. The statements should be read with the realization that NASA is a component of the U.S. Government, a sovereign entity. The following paragraphs briefly describe the nature of each required financial statement and its relevance. Significant account balances and financial trends are discussed to help clarify their impact upon operations.

CONSOLIDATED BALANCE SHEET

The Consolidated Balance Sheet on page 191 is presented in a comparative format providing financial information for fiscal years 2004 and 2003. It presents assets owned by NASA, amounts owed (liabilities), and amounts that constitute NASA's equity (net position). Net position is presented on both the Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position.

CONSOLIDATED STATEMENT OF NET COST

The Consolidated Statement of Net Cost on page 192 presents the "income statement" (the annual cost of programs) and distributes fiscal year expenses by appropriation symbol. The Net Cost of Operations is reported on the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, and also on the Combined Statement of Financing.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

The Consolidated Statement of Changes in Net Position displayed

on page 194 identifies appropriated funds used as a financing source for goods, services, or capital acquisitions. This Statement presents the accounting events that caused changes in the net position section of the Consolidated Balance Sheet from the beginning to the end of the reporting period. Cumulative Results of Operations represents the public's investment in NASA, akin to stockholder's equity in private industry.

COMBINED STATEMENT OF BUDGETARY RESOURCES

The Combined Statement of Budgetary Resources on page 195 highlights budget authority for the Agency and provides information on budgetary resources available to NASA for the year and the status of those resources at the end of the year.

Funding was received and allocated through the following appropriations:

- **Space Flight Capabilities**—This appropriation provided for the International Space Station and Space Shuttle programs, including the development of research facilities for the International Space Station; continuing safe, reliable access to space through augmented investments to improve Space Shuttle safety; support of payload and expendable launch vehicle operations; and other investments including innovative technology development, commercialization, research technology development for future exploration, and initial studies for a future crew exploration vehicle.
- **Science, Aeronautics, and Exploration**—This appropriation provided for NASA's research and development activities, including all science activities, global change research, aeronautics, technology investments, education programs, space operations, and direct program support.
- **Inspector General**—This appropriation provided for the workforce and support required to perform audits, evaluations, and investigations of programs and operations.

CONSOLIDATED STATEMENT OF FINANCING

The Consolidated Statement of Financing on page 196 provides the reconciliation between the obligations incurred to finance operations and the net costs of operating programs.

National Aeronautics and Space Administration
Consolidated Balance Sheet
As of September 30, 2004 and September 30, 2003
(In Thousands of Dollars)

	2004	2003
Assets		
Intragovernmental Assets		
Fund Balance with Treasury (Note 2)	\$ 7,629,298	\$ 7,492,506
Investments (Note 3)	17,077	17,138
Accounts Receivable, Net (Note 4)	116,365	61,144
Advances and Prepaid Expenses	—	7,399
Total Intragovernmental Assets	\$ 7,762,740	\$ 7,578,187
Accounts Receivable, Net (Note 4)	49,793	3,607
Materials and Supplies (Note 5)	2,952,031	2,679,477
Property, Plant and Equipment, Net (Note 6)	34,609,217	36,624,536
Advances and Prepaid Expenses	97	5,270
Total Assets	\$ 45,373,878	\$ 46,891,077
Liabilities		
Intragovernmental Liabilities		
Accounts Payable	\$ 73,972	\$ 96,931
Other Liabilities (Note 7)	110,872	74,022
Total Intragovernmental Liabilities	\$ 184,844	\$ 170,953
Accounts Payable	2,029,570	2,144,112
Federal Employee and Veterans' Benefits	68,876	—
Environmental Cleanup (Notes 1 and 8)	986,891	1,096,109
Other Liabilities (Note 7)	397,834	458,625
Total Liabilities	\$ 3,668,015	\$ 3,869,799
Net Position		
Unexpended Appropriations	\$ 4,771,482	\$ 4,291,001
Cumulative Results of Operations	36,934,381	38,730,277
Total Net Position	\$ 41,705,863	\$ 43,021,278
Total Liabilities and Net Position	\$ 45,373,878	\$ 46,891,077

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Net Cost
For the Fiscal Year Ending September 30, 2004
(In Thousands of Dollars)

	<u>2004</u>
Program Cost	
Science, Aeronautics, and Exploration	
Intragovernmental Costs	\$ 708,041
Less: Intragovernmental Earned Revenue	<u>383,396</u>
Intragovernmental Net Costs	<u>324,645</u>
Gross costs with the Public	8,271,087
Less: Earned Revenue from the Public	<u>36,969</u>
Net Costs with the Public	<u>8,234,118</u>
Total Net Cost	\$ 8,558,763
Space Flight Capabilities	
Intragovernmental Costs	381,764
Less: Intragovernmental Earned Revenue	<u>233,600</u>
Intragovernmental Net Costs	<u>148,164</u>
Gross costs with the Public	6,281,011
Less: Earned Revenue from the Public	<u>33,314</u>
Net Costs with the Public	<u>6,247,697</u>
Total Net Cost	\$ 6,395,861
Total SAE and SFC	\$ 14,954,624
Cost Not Assigned	
Intragovernmental Costs	(33,330)
Less: Intragovernmental Earned Revenue	<u>(11)</u>
Intragovernmental Net Costs	<u>(33,319)</u>
Gross costs with the Public (Note 12)	1,499,495
Less: Earned Revenue from the Public	<u>(8,752)</u>
Net Costs with the Public	<u>1,508,247</u>
Total Net Cost	\$ 1,474,928
Net Cost of Operations (Notes 1 and 11)	\$ 16,429,552

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Net Cost
For the Fiscal Year Ending September 30, 2003
(In Thousands of Dollars)

	<u>2003</u>
Program Costs by Enterprise	
Human Exploration and Development of Space	
Intragovernmental Costs	\$ 343,440
Less: Intragovernmental Earned Revenue	221,191
Intragovernmental Net Costs	<u>122,249</u>
Gross costs with the Public	5,103,285
Less: Earned Revenue from the Public	26,050
Net Costs with the Public	<u>5,077,235</u>
Total Net Cost	\$ 5,199,484
Space Science	
Intragovernmental Costs	153,162
Less: Intragovernmental Earned Revenue	49,023
Intragovernmental Net Costs	<u>104,139</u>
Gross costs with the Public	2,655,656
Less: Earned Revenue from the Public	2,771
Net Costs with the Public	<u>2,652,885</u>
Total Net Cost	\$ 2,757,024
Earth Science	
Intragovernmental Costs	432,973
Less: Intragovernmental Earned Revenue	337,854
Intragovernmental Net Costs	<u>95,119</u>
Gross costs with the Public	1,185,104
Less: Earned Revenue from the Public	11,386
Net Costs with the Public	<u>1,173,718</u>
Total Net Cost	\$ 1,268,837
Biological and Physical Research	
Intragovernmental Costs	63,512
Less: Intragovernmental Earned Revenue	18,554
Intragovernmental Net Costs	<u>44,958</u>
Gross costs with the Public	1,308,828
Less: Earned Revenue from the Public	23,749
Net Costs with the Public	<u>1,285,079</u>
Total Net Cost	\$ 1,330,037
Aerospace Technology	
Intragovernmental Costs	97,132
Less: Intragovernmental Earned Revenue	30,627
Intragovernmental Net Costs	<u>66,505</u>
Gross costs with the Public	1,140,563
Less: Earned Revenue from the Public	9,699
Net Costs with the Public	<u>1,130,864</u>
Total Net Cost	\$ 1,197,369
Education Programs (formerly Academic Programs)	
Gross costs with the Public	169,562
Less: Earned Revenue from the Public	606
Net Costs with the Public	<u>168,956</u>
Total Net Cost	\$ 168,956
Other Programs	
Intragovernmental Costs	54,251
Less: Intragovernmental Earned Revenue	311
Intragovernmental Net Costs	<u>53,940</u>
Total Net Cost	\$ 53,940
Net cost of operations (Notes 11 and 14)	\$ 11,975,647

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Changes in Net Position
For the Fiscal Years Ending September 30, 2004 and September 30, 2003
(In Thousands of Dollars)

	2004 Cumulative Results of Operations	2004 Unexpended Appropriations	2003 Cumulative Results of Operations	2003 Unexpended Appropriations
Beginning Balances	\$ 38,730,277	\$ 4,291,001	\$ 35,759,338	\$ 3,903,145
Budgetary Financing Sources				
Appropriations Received	—	15,380,228	—	15,464,165
Appropriations Used	14,815,775	(14,815,775)	14,707,384	(14,707,384)
Appropriations Transferred In/Out	—	—	—	(125)
Unexpended Appropriations—Adjustments	—	(83,972)	—	(368,800)
Nonexchange Revenue	15,619	—	1,049	—
Donations	1	—	6	—
Other Financing Sources				
Donations of Property	—	—	3,231	—
Transfers In/(Out) Without Reimbursement	(347,480)	—	104,620	—
Imputed Financing	149,741	—	130,296	—
Total Financing Sources	\$ 14,633,656	\$ 480,481	\$ 14,946,586	\$ 387,856
Net Cost of Operations	\$ (16,429,552)	\$ —	\$ (11,975,647)	\$ —
Ending Balances	\$ 36,934,381	\$ 4,771,482	\$ 38,730,277	\$ 4,291,001

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Combined Statement of Budgetary Resources
For the Fiscal Years Ending September 30, 2004 and September 30, 2003
(In Thousands of Dollars)

Budgetary Resources	2004	2003
Budgetary authority		
Appropriation Received	\$ 15,457,160	\$ 15,451,354
Net Transfers, Current Year Authority	—	(125)
Opening Balance Adjustment (Note 16)	13,141	—
Total Adjusted Appropriations Received	15,470,301	15,451,229
Unobligated balance		
Unobligated Balance, Brought Forward, October 1 (Note 16)	1,763,930	1,127,920
Spending from Offsetting Collections		
Earned		
Collected	632,069	720,031
Receivable from Federal Sources	57,700	2,617
Change in Unfilled Orders		
Advance Received	(18,904)	(32,167)
Without Advance from Federal Sources	124,582	(64,203)
Recoveries of prior year obligations, Actual	1,332,239	181,530
Permanently Not Available		
Cancellations of Expired/No-Year Accounts	(83,963)	(45,733)
Authority Unavailable Pursuant to Public Law	(91,269)	(75,258)
Total Budgetary Resources	\$ 19,186,685	\$ 17,265,966
Opening Balance Adjustment (Note 16)	43,184	—
Total Adjusted Budgetary Resources	\$ 19,229,869	\$ 17,265,966
Status of Budgetary Resources		
Obligations Incurred (Note 13)		
Direct	15,313,397	14,859,449
Reimbursable	679,067	778,297
Total Obligations Incurred	\$ 15,992,464	\$ 15,637,746
Unobligated Balance (Note 16)		
Apportioned, Currently Available	2,353,659	1,550,693
Trust Funds	3,590	3,616
Not Available, Other	822,691	73,911
Total Unobligated Balances	3,179,940	1,628,220
Status Budgetary Resources	\$ 19,172,404	\$ 17,265,966
Opening Balance Adjustment (Note 16)	57,465	—
Total Adjusted Status Budgetary Resources	\$ 19,229,869	\$ 17,265,966
Obligated Balance, Net as of October 1 (Note 16)	5,798,062	5,633,407
Obligated Balance, End of Period		
Accounts Receivable	(118,833)	(61,100)
Unfilled Customer Orders	(294,103)	9,580
Undelivered Orders	2,757,050	3,608,790
Accounts Payable	2,124,642	2,354,273
Outlays		
Disbursements	15,807,247	15,239,665
Collections	(613,164)	(687,864)
Subtotal	\$ 15,194,083	\$ 14,551,801
Less: Offsetting Receipts	1	6
Net Outlays	\$ 15,194,082	\$ 14,551,795
Opening Balance Adjustment (Note 16)	(8,011)	—
Total Adjusted Net Outlays	\$ 15,186,071	\$ 14,551,795

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Financing
For the Fiscal Years Ending September 30, 2004 and September 30, 2003
(In Thousands of Dollars)

	2004	2003
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	\$ 15,992,464	\$ 15,637,746
Less: Spending authority from offsetting collections and recoveries	2,127,686	807,808
Obligations net of offsetting collections and recoveries	13,864,778	14,829,938
Less: Offsetting receipts	1	6
Net obligations	\$ 13,864,777	\$ 14,829,932
Other Resources:		
Donations of Property	—	3,231
Transfers In/Out Without Reimbursements	(347,480)	104,620
Imputed financing from costs absorbed by others	149,741	130,296
Net Other Resources Used to Finance Activities	\$ (197,739)	\$ 238,147
Total Resources Used to Finance Activities	\$ 13,667,038	\$ 15,068,079
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	(955,583)	(881,272)
Resources That Fund Expenses Recognized in Prior Periods	(293,686)	(192,455)
Budgetary Offsetting Collections and Receipts that Do Not Affect the Net Costs of Operations—Other	(13,623)	(6,631)
Opening Balance Adjustment (Note 16)	91,933	
Resources that Finance the Acquisition of Assets	(1,741,671)	(5,530,972)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operation	(347,480)	(104,745)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	\$ (3,260,110)	\$ (6,716,075)
Total Resources Used to Finance the Net Cost of Operations	\$ 10,406,928	\$ 8,352,004
Components of Net Cost that Will Not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Periods		
Increases in Annual Leave Liability	7,821	12,989
Increase in Exchange Revenue Receivable from the Public	(100,653)	2,254
Other	106,424	51,018
Total Components of Net Cost that will Require or Generate Resources in Future Periods	\$ 13,592	\$ 66,261
Components Not Requiring or Generating Resources		
Depreciation	5,814,834	3,348,775
Revaluation of Assets or Liabilities	(14,663)	211,574
Other	208,861	(2,967)
Total Components of Net Cost of Operations that will not Require or Generate Resources	\$ 6,009,032	\$ 3,557,382
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	\$ 6,022,624	\$ 3,623,643
Net Cost of Operations (Note 1)	\$ 16,429,552	\$ 11,975,647

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Notes to Financial Statements

1. Summary of Accounting Policies and Operations

Reporting Entity

The National Aeronautics and Space Administration (NASA) is an independent Agency established to serve as the fulcrum for initiatives by the United States in civil space and aviation. With this responsibility, NASA is entrusted with ensuring that our programs and projects are fiscally managed and properly accounted for. In August 2004, NASA restructured from six Strategic Enterprises—Human Exploration and Development of Space, Space Science, Earth Science, Biological and Physical Research, Aerospace Technology, and Education Programs—to four Mission Directorates: Exploration Systems, Space Operations, Science, and Aeronautics Research. The transformation of NASA's organizational structure is designed to streamline the agency and position it to better implement the Vision for Space Exploration.

Additionally, the transformation also consisted of restructuring the NASA functional offices to Mission Support Offices, which includes the Office of the Chief Financial Officer (OCFO). The OCFO is responsible for all NASA financial matters, including procurement and small and disadvantaged business activities. As part of the OCFO transformation, the NASA Centers' Chief Financial Offices have been realigned to report directly to the Headquarters CFO to better address critical financial issues. The financial management of operations is the responsibility of officials at all organizational levels.

The nine NASA Centers, NASA Headquarters, and the Jet Propulsion Laboratory carry out the activities of the Mission Directorates. The Jet Propulsion Laboratory is a Federally funded Research and Development Center owned by NASA but managed by an independent contractor.

Basis of Presentation

These financial statements include the Consolidated Balance Sheet as of September 30, 2004 and September 30, 2003, the related Consolidated Statement of Net Cost, Consolidated Statement of Changes in Net Position, Combined Statement of Budgetary Resources, and the Consolidated Statement of Financing for the fiscal years ended September 30, 2004 and September 30, 2003, respectively, as required by the *Chief Financial Officers Act of 1990* and the *Government Management Reform Act of 1994*.

The financial statements were prepared from the NASA Integrated Financial Management system (SAP) and other Treasury reports, in accordance with Generally Accepted Accounting Principles and accounting policies and practices summarized in this note. These financial statements were prepared under the accrual basis of accounting, where expenses and revenues are recorded in the period in which they are incurred or earned, respectively except as related to corrections of prior year data.

The Statement of Net Cost is presented on a non-comparative appropriation basis due to the organizational transformation that occurred in August 2004 of six Strategic Enterprises to four Mission Directorates. The related notes require a detailed breakdown by mission directorates, which was not available due to the late year transformation. The statement of net cost presents the Space Flight Capabilities, and Science, Aeronautics, and Exploration separately, with all remaining items reported as costs not assigned.

Budgets and Budgetary Accounting

NASA is funded by three appropriations, which require individual treatment for accounting and control purposes. The financial management system, SAP, does not prevent cross-appropriation financial postings. NASA has identified instances of cross-appropriation postings that created out-of-balance appropriations. Some cross-appropriations and out-of-balance conditions were still being researched at year-end.

Reimbursements to appropriations total approximately \$678 and \$732 million for fiscal years 2004 and 2003, respectively. As part of its reimbursable program, NASA launches devices into space and provides tracking and data relay services for the U.S. Department of Defense, the National Oceanic and Atmosphere Administration, and the National Weather Service.

On the Statement of Budgetary Resources, Unobligated Balances—Available should represent the amount remaining in accounts that are available for obligation in future fiscal years. Unobligated Balances—Not Available should represent the amount remaining in appropriation accounts that can only be used for adjustments to previously recorded obligations. The amount reported for Recovery of Prior Year Obligations, approximately \$1.3 billion for FY 2004, is overstated. The financial system has limited functionality that could not be configured before year-end to capture the proper data for Recovery of Prior Year Obligations. The functionality also created misstatements in other budgetary accounts including Unobligated Balances—Available.

National Aeronautics and Space Administration
Notes to Financial Statements**Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Fund Balance with Treasury

Treasury processes cash receipts and disbursements for NASA. Fund Balance with Treasury includes appropriated funds, trust funds, deposit funds, and budget clearing accounts.

Investments in U.S. Government Securities

Intragovernmental non-marketable securities includes the following investments:

- The National Aeronautics and Space Administration Endeavor Teacher Fellowship Trust Fund established from public donations in tribute to the crew of the Space Shuttle Challenger, and
- The Science Space and Technology Education Trust Fund established for programs to improve science and technology education.

Accounts Receivable

Most receivables are for reimbursement of research and development costs related to satellites and launch services. The allowance for uncollectible accounts is based upon evaluation of public accounts receivable, considering the probability of failure to collect based upon current status, financial and other relevant characteristics of debtors, and the relationship with the debtor. Under a cross-servicing arrangement, public accounts receivables over 180 days delinquent are turned over to Treasury for collection. The receivable remains on NASA's books until Treasury determines the receivable is uncollectible.

Prepaid Expenses

Payments in advance of receipt of goods or services are recorded as prepaid expenses at the time of payment and recognized as expenses when related goods or services are received.

Materials and Supplies

Materials held by Centers and contractors that are repetitively procured, stored and issued on the basis of demand are considered Materials and Supplies. Certain NASA contractors' inventory management systems do not distinguish between items that should be classified as materials and those that should be classified as depreciable property. NASA reclassifies as property, all materials valued at \$100,000 or greater that support large-scale assets such as the Space Shuttle and the International Space Station.

Property, Plant and Equipment

The Agency and its contractors and grantees hold NASA-owned property, plant, and equipment. Property with a unit cost of \$100,000 or more and a useful life of two years or more is capitalized; all other property is expensed when purchased. Capitalized costs include all costs incurred by NASA to bring the property to a form and location suitable for its intended use. Under provisions of the Federal Acquisition Regulation (FAR), contractors are responsible for control over accountability for government-owned property in their possession. NASA's contractors and grantees report on NASA property in their custody annually and its top contractors monthly.

In FY 2003, the accounting treatment for capitalization of Theme Assets was expanded to include all costs. In previous years, NASA expensed certain components of these types of assets that did not meet the capitalization criteria (useful life less than two years). In order to properly match outputs to inputs, NASA's policy was changed to capture certain components of these assets as Work in Progress (WIP) and then expense the costs in their year of operation.

Capitalized costs for internally developed software included the full costs (direct and indirect) incurred during the software development stage only. For purchased software, capitalized costs include amounts paid to vendors for the software and material internal costs incurred by the Agency to implement and make the software ready for use through acceptance testing. When NASA purchases software as part of a package of products and services (for example: training, maintenance, data conversion, reengineering, site licenses, and rights to future upgrades and enhancements), capitalized and non-capitalized costs of the package are allocated among individual elements on the basis of a reasonable

**National Aeronautics and Space Administration
Notes to Financial Statements**

estimate of their relative fair market values. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements are expensed. NASA capitalizes costs for internal use software when the total projected cost is \$1,000,000 or more and the expected useful life of the software is two years or more.

These financial statements report depreciation expense using the straight-line method. Useful lives are 40 years for buildings; 15 years for other structures and facilities; 15 years for leasehold improvements, 15 years for space hardware; seven years for special test equipment and tooling; and five to 20 years for other equipment depending on its nature. Useful lives for the Shuttle fleet range from 28 to 39 years. Useful lives for theme assets are their mission lives, ranging from two to 20 years.

International Space Station

NASA began depreciating the Station in FY 2001 when occupied by the first permanent crew. Only the Station's major elements in space are depreciated; any on-ground elements are reported as work in process until launched and incorporated into the existing Station structure. In FY 2003, NASA management changed the Station's operational life from 10 years to 15 years. The depreciation expense for FY 2004 was \$965 million and the depreciation expense for FY 2003 was \$929 million.

On January 14, 2004, President Bush announced a new vision for the Nation's space exploration program. Implementation of this initiative has required NASA to prioritize and restructure existing programs and missions, and to phase out sooner than originally planned, or eliminate all together over the next several years, some programs and missions. These programs and missions include the Shuttle, which was originally planned to continue to the year 2020 but now will retire as soon as assembly of the International Space Station is completed (planned for the end of this decade), and the possible cancellation of planned servicing missions to the Hubble Space Telescope.

Barter Transactions

NASA utilizes non-monetary transactions in the form of barter agreements with International Partners that govern the reciprocal exchange of goods and services. The Station international agreements are committed to minimize the exchange of funds among partners, by utilizing non-monetary transactions in the form of barter agreements with International Partners. NASA's policy is to record barter transactions based upon the fair value of the non-monetary assets transferred to or from an enterprise, whichever is more readily determinable. Fair value is determined by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair value market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence. If fair value is not readily determinable within reasonable limits, no value is ascribed to the non-monetary transactions in accordance with Accounting Principles Bulletin No. 29, Accounting for Non-monetary Transactions. When fair value is readily determinable, barter transactions are recorded as an asset to Government-Held/Government-Owned Equipment with a corresponding liability to Liability for Assets Obtained Under Barter Agreements.

Advances from Others

Advances from Others represents amounts advanced by other Federal and non-Federal entities for goods or services to be provided and are included in other liabilities in the Financial Statements.

Liabilities Covered by Budgetary Resources

Liabilities covered by budgetary resources are liabilities that are covered by realized budgetary resources as of the balance sheet date. Realized budgetary resources include new budget authority, unobligated balances of budgetary resources at the beginning of the year, and spending authority from offsetting collections. Examples include accounts payable, and salaries.

Accounts Payable includes amounts recorded for the receipt of goods or services furnished. Additionally, NASA accrues costs and recognizes liabilities based on information provided monthly by contractors on Contractor Financial Management Reports (NASA Forms 533M and 533Q). DCAA performs independent audits to ensure reliability of reported costs and estimates. To provide further assurance, financial managers are required to test the accuracy of NF 533 generated cost accruals each month, and NASA Headquarters independently analyzes the validity of Centers' data.

Liabilities and Contingencies Not Covered by Budgetary Resources

Generally liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided. Examples include the *Federal Employees' Compensation Act* (FECA) actuarial liability and contingencies.

Liabilities not covered by budgetary resources include certain environmental matters, legal claims, pensions and other retirement benefits (ORB), workers' compensation, annual leave, and closed appropriations.

National Aeronautics and Space Administration
Notes to Financial Statements

Liabilities not covered by budgetary resources consist primarily of environmental cleanup costs as required by Federal, state, and local statutes and regulations. Where up-to-date, site-specific engineering estimates for cleanup are not available, NASA employs commercially available parametric modeling software to estimate the total cost of cleaning up known contamination at these sites over future years. NASA estimates the total cost of environmental cleanup to be \$986 million and \$1,097 million for the fiscal years ended September 30, 2004 and September 30, 2003, respectively, and recorded an unfunded liability in its financial statements for this amount. This estimate could change in the future due to identification of additional contamination, inflation, deflation, and changes in technology or applicable laws and regulations. NASA believes the estimated environmental liability could range from \$656 million to \$1.5 billion because of potential future changes to the engineering assumptions underlying the estimates. The estimate represents an amount that will be spent to remediate currently known contamination, subject to the availability of appropriated funds. Other responsible parties that may be required to contribute to the remediation funding could share this liability. NASA was appropriated \$84 million and \$92 million for the fiscal years ended September 30, 2004 and September 30, 2003, respectively, for environmental compliance and restoration.

NASA is a party in various administrative proceedings, court actions (including tort suits), and claims brought by or against it. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions and claims will not materially affect the financial position, net cost, changes in net position, budgetary resources, or financing of NASA. Liabilities have been recorded for \$36 million and \$1 million for these matters as of September 30, 2004 and September 30, 2003, respectively.

No balances have been recorded in the financial statements for contingencies related to proceedings, actions, and claims where management and legal counsel believes that it is possible but not probable that some costs will be incurred. These contingencies range from zero to \$127 million and from zero to \$50 million, as of September 30, 2004 and September 30, 2003.

A liability for \$85 million and \$84 million was recorded, as of September 30, 2004 and September 30, 2003, respectively, for workers' compensation claims related to FECA, administered by the U.S. Department of Labor. FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. The FECA program initially pays valid claims and subsequently seeks reimbursement from the Federal agencies employing the claimants. The FECA liability includes the actuarial liability of \$69 million for estimated future costs of death benefits, workers' compensation, and medical and miscellaneous costs for approved compensation cases. The present value of these estimates at the end of FY 2004 was calculated by the Department of Labor using a discount rate of 4.883 percent for FY 2004. This liability does not include the estimated future costs for claims incurred but not reported or approved as of September 30, 2004.

NASA has recorded approximately \$83 million in Accounts Payable related to closed appropriations for which there are contractual commitments to pay. These payables will be funded from appropriations available for obligation at the time a bill is processed, in accordance with Public Law 101-510.

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned; the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Employee Benefits

Agency employees participate in the Civil Service Retirement System (CSRS), a defined benefit plan, or the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, NASA makes contributions of 8.51 percent of pay. For FERS employees, NASA makes contributions of 10.7 percent to the defined benefit plan, contributes 1 percent of pay to a retirement saving plan (contribution plan), and matches employee contributions up to an additional four percent of pay. For FERS employees, NASA also contributes to employer's matching share for Social Security.

Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," require government agencies to report the full cost of employee benefits (FEHB), and the Federal Employees Group Life Insurance (FEGLI) Programs. NASA used the applicable cost factors and imputed financing sources from the Office of Personnel and Management Letter For Chief Financial Officers, dated August 16, 2004, in these financial statements.

National Aeronautics and Space Administration
Notes to Financial Statements

2. Fund Balance with Treasury

(In Thousands of Dollars)

	September 30, 2004		
	Entity	Non-Entity	Total
Fund Balances			
Appropriated Funds	\$ 7,645,106	\$ —	\$ 7,645,106
Trust Funds	—	3,592	3,592
Other Fund Types	(19,400)	—	(19,400)
Total	\$ 7,625,706	\$ 3,592	\$ 7,629,298

NASA reformatted the display of note 2 for FY 2004 to better align with the Office of Management and Budget, Bulletin 01-09, Form and Content of Agency Financial Statements. The second part of the note related to opening balances could not be prepared as discussed in Note 16.

	September 30, 2003			
	Obligated	Unobligated— Available	Unobligated— Not Available	Total
Fund Balances				
Appropriated Funds	\$ 5,911,543	\$ 1,550,693	\$ 73,911	\$ 7,536,147
Trust Funds	—	—	3,616	3,616
Total	\$ 5,911,543	\$ 1,550,693	\$ 77,527	\$ 7,539,763
Clearing and Deposit Accounts				(47,257)
Total Fund Balance with Treasury				\$ 7,492,506

Obligated balances represent the cumulative amount of obligations incurred, including accounts payable and advances from reimbursable customers, for which outlays have not yet been made. Unobligated available balances represent the amount remaining in appropriation accounts that are available for obligation in the next fiscal year. Unobligated balances not available represent the amount remaining in appropriation accounts that can be used for adjustments to previously recorded obligations. Unobligated balances not available are the result of settling obligated balances for less than what was obligated. Unobligated trust fund balances not available represent amounts that must be apportioned by the OMB before being used to incur obligations.

Clearing accounts are used for unidentified remittances presumed to be applicable to budget accounts but are being held in the clearing account because the specific appropriation account is not yet known. Deposit account balances represent amounts withheld from employees' pay for U.S. Savings Bonds and state tax withholdings that will be transferred in the next fiscal year.

3. Investments

(In Thousands of Dollars)

	September 30, 2004				
	Par Value	Amortization Method	Discounts and Premiums, Net	Interest Receivable	Net Amount Invested
Intragovernmental Non-Marketable Securities	\$ 14,067	Interest Method	\$ 2,862	\$ 148	\$ 17,077
	September 30, 2003				
	Par Value	Amortization Method	Discounts and Premiums, Net	Interest Receivable	Net Amount Invested
Intragovernmental Non-Marketable Securities	\$ 13,942	Interest Method	\$ 3,050	\$ 146	\$ 17,138

Intragovernmental securities are non-marketable Treasury securities issued by the Bureau of Public Debt.

Effective interest rates range from 0.846 percent to 6.6 percent and from 0.876 percent to 5.262 percent for the fiscal year ended September 30, 2004 and September 30, 2003, respectively.

The interest method was used to amortize discounts and premiums.

National Aeronautics and Space Administration
Notes to Financial Statements

4. Accounts Receivable, Net
(In Thousands of Dollars)

September 30, 2004			
	Accounts Receivable	Allowance for Uncollectible Accounts	Net Amount Due
Intragovernmental	\$ 116,365	\$ —	\$ 116,365
Public	50,591	(798)	49,793
Total	\$ 166,956	\$ (798)	\$ 166,158

September 30, 2003			
	Accounts Receivable	Allowance for Uncollectible Accounts	Net Amount Due
Intragovernmental	\$ 61,144	\$ —	\$ 61,144
Public	4,492	(885)	3,607
Total	\$ 65,636	\$ (885)	\$ 64,751

5. Operating Materials and Supplies
(In Thousands of Dollars)

	September 30, 2004	
	2004	2003
Operating Materials and Supplies, Held for Use	\$ 2,948,792	\$ 2,676,245
Operating Materials and Supplies, Held in Reserve for Future Use	3,239	3,232
Total	\$ 2,952,031	\$ 2,679,477

Operating Materials and Supplies, Held for Use are tangible personal property held by NASA and its contractors to be used for fabricating and maintaining NASA assets. They will be consumed in normal operations. Operating Materials and Supplies, Held in Reserve for Future Use are tangible personal property held by NASA for emergencies for which there is no normal recurring demand but that must be immediately available to preclude delay, which might result in loss, damage, or destruction of government property, danger to life or welfare of personnel, or substantial financial loss to the government due to an interruption of operations. All materials are valued using historical costs, or other valuation methods that approximate historical cost. NASA Centers and contractors are responsible for continually reviewing materials and supplies to identify items no longer needed for operational purposes or that need to be replaced. Excess, obsolete, and unserviceable items have been removed from these amounts. There are no restrictions on these items.

National Aeronautics and Space Administration
Notes to Financial Statements

6. Property, Plant, and Equipment, Net
(In Thousands of Dollars)

	September 30, 2004		
	Cost	Accumulated Depreciation	Net Asset Value
Government-owned/Government-held			
Land	\$ 115,132	\$ —	\$ 115,132
Structures, Facilities, and Leasehold Improvements	5,305,594	(3,839,144)	1,466,450
Theme Assets	40,456,990	(22,450,519)	18,006,471
Equipment	2,018,816	(1,338,509)	680,307
Capitalized Leases (Note 10)	4,920	(316)	4,604
Internal Use Software and Development	31,839	(9,957)	21,882
Work-in-Process (WIP)	5,808,684	—	5,808,684
Total	\$ 53,741,975	\$ (27,638,445)	\$ 26,103,530
Government-owned/Contractor-held			
Land	\$ 8,076	\$ —	\$ 8,076
Structures, Facilities, and Leasehold Improvements	801,131	(542,559)	258,572
Equipment	9,947,438	(7,862,657)	2,084,781
Work-in-Process	6,154,258	—	6,154,258
Total	16,910,903	(8,405,216)	8,505,687
Total Property, Plant, and Equipment	\$ 70,652,878	\$ (36,043,661)	\$ 34,609,217

	September 30, 2003		
	Cost	Accumulated Depreciation	Net Asset Value
Government-owned/Government-held			
Land	\$ 115,132	\$ —	\$ 115,132
Structures, Facilities, and Leasehold Improvements	5,575,501	(3,852,518)	1,722,983
Theme Assets	36,003,528	(18,105,281)	17,898,247
Equipment	1,926,673	(1,278,218)	648,455
Capitalized Leases (Note 10)	273	(59)	214
Internal Use Software and Development	22,600	(4,473)	18,127
Work-in-Process (WIP)	8,119,053	—	8,119,053
Total	\$ 51,762,760	\$ (23,240,549)	\$ 28,522,211
Government-owned/Contractor-held			
Land	\$ 8,076	\$ —	\$ 8,076
Structures, Facilities, and Leasehold Improvements	755,344	(502,054)	253,290
Equipment	9,940,395	(7,408,231)	2,532,164
Work-in-Process	5,308,795	—	5,308,795
Total	16,012,610	(7,910,285)	8,102,325
Total Property, Plant, and Equipment	\$ 67,775,370	\$ (31,150,834)	\$ 36,624,536

Theme Assets are property, plant and equipment specifically designed for use in a NASA program. Equipment includes special tooling, special test equipment, and Agency-peculiar property, such as the Shuttle and other configurations of spacecraft (engines, unlaunched satellites, rockets, and other scientific components) unique to NASA space programs. Structures, Facilities, and Leasehold Improvements includes buildings with collateral equipment, and capital improvements, such as airfields, power distribution systems, flood control, utility systems, roads, and bridges. NASA also has use of certain properties at no cost. These properties include land at the Kennedy Space Center withdrawn from the public domain and land and facilities at the Marshall Space Flight Center under a no cost, 99-year lease with the U.S. Department of the Army. Work-in-Process is the cost incurred for property, plant, and equipment items not yet completed. Work-in-Process includes equipment and facilities that are being constructed. WIP includes the fabrication of assets that may or may not be capitalized once completed and operational. If it is determined to not meet capitalization criteria (i.e., less than two years useful life) the project will be expensed to the Statement of Net Cost to match outputs to inputs.

NASA has Station bartering agreements with international agencies including the European Space Agency and the National Space Agency of Japan. NASA barter with these other space agencies to obtain Station hardware elements in exchange for providing goods and services such as Space Shuttle transportation and a share of NASA's Station utilization rights. The intergovernmental agreements state that the parties will seek to minimize the exchange of funds in the cooperative program, including the use of barter to provide goods and services. As of September 30, 2004, NASA has received some assets from these parties in exchange for future services. However, due to the fact that fair value is indeterminable, no

National Aeronautics and Space Administration
Notes to Financial Statements

value was ascribed to these transactions in accordance with APB No. 29. Under all agreements to date, NASA's Station Program's International Partners Office expects that NASA will eventually receive future NASA-required elements as well with no exchange of funds.

NASA reports the physical existence (in terms of physical units) of heritage assets as part of the required supplemental stewardship information.

7. Other Liabilities

(In Thousands of Dollars)

	September 30, 2004		
	Current	Non-Current	Total
Intragovernmental Liabilities			
Advances From Others	\$ 90,568	\$ —	\$ 90,568
Workers' Compensation	6,854	8,933	15,787
Employer Contributions and Payroll Taxes	440	—	440
Liability for Deposit and Clearing Funds	781	—	781
Custodial Liability	2,082	—	2,082
Lease Liabilities	—	—	—
Other Liabilities	1,214	—	1,214
Contract Holdbacks	—	—	—
Other Accrued Liabilities	—	—	—
Subtotal	101,939	8,933	110,872
Accounts Payable for Closed Appropriations	947	3,042	3,989
Total Intragovernmental	\$ 102,886	\$ 11,975	\$ 114,861
Liabilities from the Public			
Unfunded Annual Leave	\$ —	\$ 166,448	\$ 166,448
Employer Contributions and Payroll Taxes	14,324	—	14,324
Accrued Funded Payroll	59,037	—	59,037
Advances From Others	82,838	—	82,838
Contract Holdbacks	2,509	—	2,509
Custodial Liability	(2,082)	—	(2,082)
Other Accrued Liabilities	21,438	—	21,438
Contingent Liabilities	—	36,205	36,205
Lease Liabilities	2,255	—	2,255
Liability for Deposit and Clearing Funds	9,189	—	9,189
Other Liabilities	5,673	—	5,673
Subtotal	195,181	202,653	397,834
Accounts Payable for Closed Appropriations	34,746	44,560	79,306
Actuarial FECA Liability	—	68,876	68,876
Total Liabilities from the Public	\$ 229,927	\$ 316,089	\$ 546,016
Total Other Liabilities	\$ 332,813	\$ 328,064	\$ 660,877

National Aeronautics and Space Administration
Notes to Financial Statements

7. Other Liabilities (Continued)
(In Thousands of Dollars)

	September 30, 2003		
	Current	Non-Current	Total
Intragovernmental Liabilities:			
Advances From Others	\$ 50,242	\$ —	\$ 50,242
Workers' Compensation	8,470	6,854	15,324
Accrued Funded Payroll	6,362	—	6,362
Accounts Payable for Closed Appropriations	—	32	32
Liability for Deposit and Clearing Funds	6	—	6
Custodial Liability	2,056	—	2,056
Lease Liabilities	—	—	—
Total Intragovernmental Liabilities	\$ 67,136	\$ 6,886	\$ 74,022
Liabilities from the Public:			
Unfunded Annual Leave	\$ —	\$ 158,627	\$ 158,627
Accrued Funded Payroll	61,623	—	61,623
Actuarial FECA Liability	—	69,446	69,446
Accounts Payable for Closed Appropriations	1,649	31,328	32,977
Advances From Others	142,294	—	142,294
Contract Holdbacks	1,680	—	1,680
Custodial Liability	280	—	280
Other Accrued Liabilities	38,029	—	38,029
Contingent Liabilities	—	1,023	1,023
Lease Liabilities	100	—	100
Liability for Deposit and Clearing Funds	(47,454)	—	(47,454)
Total Liabilities from the Public	\$ 198,201	\$ 260,424	\$ 458,625
Total Other Liabilities	\$ 265,337	\$ 267,310	\$ 532,647

National Aeronautics and Space Administration
Notes to Financial Statements

8. Liabilities Not Covered by Budgetary Resources
(In Thousands of Dollars)

	September 30, 2004		
	Current	Non-Current	Total
Intragovernmental Liabilities:			
Workers' Compensation	\$ 6,854	\$ 8,933	\$ 15,787
Accounts Payable for Closed Appropriations	947	3,042	3,989
Total Intragovernmental	\$ 7,801	\$ 11,975	\$ 19,776
From the Public:			
Environmental Cleanup Costs	—	986,891	986,891
Unfunded Annual Leave	—	166,448	166,448
Actuarial FECA Liability	—	68,876	68,876
Contingent Liabilities	—	36,205	36,205
Subtotal	—	1,258,420	1,258,420
Accounts Payable for Closed Appropriations	34,746	44,560	79,306
Total from the Public	34,746	1,302,980	1,337,726
Total Liabilities Not Covered by Budgetary Resources	\$ 42,547	\$ 1,314,955	\$ 1,357,502
September 30, 2003			
	Current	Non-Current	Total
Intragovernmental Liabilities:			
Workers' Compensation	\$ 8,470	\$ 6,854	\$ 15,324
Accounts Payable for Closed Appropriations	—	32	32
Total Intragovernmental	8,470	6,886	15,356
From the Public:			
Environmental Cleanup Costs	—	1,096,109	1,096,109
Unfunded Annual Leave	—	158,627	158,627
Actuarial FECA Liability	—	69,446	69,446
Accounts Payable for Closed Appropriations	1,649	31,328	32,977
Contingent Liabilities	—	1,023	1,023
Total From the Public	1,649	1,356,533	1,358,182
Total Liabilities Not Covered by Budgetary Resources	\$ 10,119	\$ 1,363,419	\$ 1,373,538

See Note 1 for further discussion of liabilities not covered by budgetary resources.

National Aeronautics and Space Administration
Notes to Financial Statements

9. Non-Entity Assets
(In Thousands of Dollars)

	September 30, 2004		
	Intragovernmental	Due from the Public	Total Non-Equity Assets
Accounts Receivable, Net	\$ 2,082	\$ (2,082)	\$ —

Based on a review of FY 2004 transactions reported in custodial activity, NASA determined the transactions did not represent custodial activity.

	September 30, 2003		
	Intragovernmental	Due from the Public	Total Non-Equity Assets
Accounts Receivable, Net	\$ 2,056	\$ 3,229	\$ 5,285

Accounts receivable related to closed appropriations, which will be deposited in miscellaneous receipts, are included in Non-Entity Assets. These amounts represent NASA's custodial activity and are not separately identified on the Balance Sheet as the amounts are immaterial.

10. Leases
(In Thousands of Dollars)

	As of September 30	
	2004	2003
Capital Leases—Summary of Assets Under Capital Lease		
Equipment	\$ 4,920	\$ 273
Accumulated Amortization of Liability	(2,665)	(173)
	\$ 2,255	\$ 100

Capital leases consist of various types of computer equipment with non-cancelable terms longer than one year, a fair market value of \$100,000 or more, a useful life of two years or more, and agreement terms equivalent to an installment purchase. The increase from 2003 to 2004 was due to the receipt of two new leases.

Future Minimum Lease Payments

Fiscal Year	
2005	\$ 2,092
2006	267
2007	—
2008 and After	—
Future Lease Payments	2,359
Less: Imputed Interest	(104)
Net Capital Lease Liability	\$ 2,255
Lease Liabilities Covered by Budgetary Resources	\$ 2,255
Lease Liabilities Not Covered by Budgetary Resources	—
Total Lease Liabilities	\$ 2,255

National Aeronautics and Space Administration
Notes to Financial Statements

10. Leases (Continued)
(In Thousands of Dollars)

Operating Leases

Operating leases includes those leases that are not capital leases and are for a non-cancelable period in excess of one year. NASA's FY 2004 operating leases are for an airplane hangar, warehouse storage, copiers, office trailers, and land.

Future Minimum Lease Payments

	<u>Land and Buildings</u>	<u>Equipment</u>	<u>Total</u>
2005	\$ 691	\$ 12,051	\$ 12,742
2006	14	11,314	11,328
2007	14	8,665	8,679
2008	14		14
2009 and After	—	—	—
Total Future Lease Payments	\$ 733	\$ 32,030	\$ 32,763

Entity as Lessor

Operating Leases

Future Projected Receipts

Fiscal Year	<u>Land and Buildings</u>
2005	\$ 423
2006	372
2007	351
2008	347
2009 and After	803
Total Future Operating Lease Receivables	\$ 2,296

NASA leases and allows use of its land and facilities by the public and other government entities for a fee.

National Aeronautics and Space Administration
Notes to Financial Statements

11. Gross Cost and Earned Revenue By Budget Functional Classification

(In Thousands of Dollars)

Functional Classification	For the Period Ending September 30, 2004		
	Gross Cost	Earned Revenue	Net Cost
General Science, Space, and Technology	\$ —	\$ —	\$ —
Transportation	—	—	—
Research and General Education Aids	—	—	—
Total	\$ 17,108,068	\$ (678,516)	\$ 16,429,552

The breakdown by budget sub-function was not available for FY 2004. The budget sub-function code was not configured in SAP at the beginning of the fiscal year, so most transaction were posted without the budget sub-function code.

Functional Classification	For the Period Ending September 30, 2003		
	Gross Cost	Earned Revenue	Net Cost
General Science, Space, and Technology	\$ 12,537,907	\$ (731,216)	\$ 11,806,691
Transportation	169,562	(606)	168,956
Research and General Education Aids	—	—	—
Total	\$ 12,707,469	\$ (731,822)	\$ 11,975,647

12. Statement of Net Cost

(In Thousands of Dollars)

Costs not Assigned to Space Flight Capabilities or Science, Aeronautics, and Exploration

	Fiscal Year 2004
Property, Plant, and Equipment	\$ 2,444,722
Office of Inspector General	25,874
Other	(995,668)
Total	\$ 1,474,928

The Statement of Net Cost recognizes post-employment benefit expenses of \$252 million and \$130 million for fiscal years 2004 and 2003, respectively.

The expense to Office of Personnel Management represents NASA's share of current and estimated future outlays for employee pensions, life and health insurance. Additionally, the statement includes \$936 thousand and \$630 thousand for fiscal years 2004 and 2003, respectively, for the Judgment Fund. The expense attributable to Treasury's Judgment Fund represents amounts paid directly from the Judgment Fund.

13. Statement of Budgetary Resources

(In Thousands of Dollars)

Apportionment Categories of Obligations Incurred

The amounts of direct and reimbursable obligations incurred against amounts apportioned under Categories A and B are displayed below:

	Direct	Reimbursable	Total
2004	\$ 15,313,397	\$ 679,067	\$ 15,992,464
2003	\$ 14,859,449	\$ 778,297	\$ 15,637,746

The amounts of obligations incurred against amounts apportioned under Category A are \$1,000.

NASA compared the amounts reported the Statement of Budgetary Resources and the actual amounts reported in the Budget of the United States Government as required by SFFAS No. 7 for FY 2003 and identified no material differences.

The Budget of the United States Government with actual amounts for FY 2004 was not published as of November 15, 2004. The comparison for FY 2004 will be performed when the Budget of the United States Government is published.

National Aeronautics and Space Administration
Notes to Financial Statements

14. Net Cost by Program
(In Thousands of Dollars)

Fiscal Year 2004

In August 2004, NASA restructured from six Strategic Enterprises—Human Exploration and Development of Space, Space Science, Earth Science, Biological and Physical Research, Aerospace Technology, and Education Programs to four Mission Directorates—Exploration Systems, Space Operations, Science, and Aeronautics Research.

The Statement of Net Cost is presented on a non-comparative basis due to the organizational transformation that occurred in August 2004 of six Strategic Enterprises to four Mission Directorates. This note requires a detailed breakdown by mission directorates, which was not available due to the late year transformation.

Program/Operating Expenses by Enterprise

	<u>2003</u>
Human Exploration and Development of Space	
Space Shuttle	\$ 3,008,611
Space Station	1,510,049
Space Operations	69,342
Investment and Support	145,031
Payload Utilization and Operations	217,999
Mission Communications Services	(46,608)
Space Communications Services	295,008
U.S./Russian Cooperative	52
Total Human Exploration and Development of Space	\$ 5,199,484
Space Science	
Space Science	\$ 2,757,024
Earth Science	
Earth Science	\$ 1,268,837
Biological and Physical Research	
Biological and Physical Research	\$ 1,330,037
Aerospace Technology	
Aerospace Technology	1,083,956
Advanced Space Transportation	5,533
Commercial Technology	107,880
Total Aerospace Technology	\$ 1,197,369
Education (formerly Academic Programs)	
Education	168,956
Total Enterprise Program Costs	\$ 11,921,707
Costs Not Assigned to Enterprises	
Other Programs	53,940
Total Costs Not Assigned to Enterprises	\$ 53,940
Net Cost of Operations	\$ 11,975,647

Depreciation expenses in the amount of \$3,348,775 for FY 2003 has been allocated to the applicable programs based on percentage of current year labor hours per project. Capitalized costs in the amount of \$5,530,942 for FY 2003 has been allocated to the applicable programs based on percentage of current year labor hours per project.

**National Aeronautics and Space Administration
Notes to Financial Statements**

15. Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources on the Balance Sheet and the Change in Components Requiring or Generating Resources in Future Periods

Liabilities Not Covered by Budgetary Resources of \$1,357,502 and \$1,373,538 for fiscal years 2004 and 2003, respectively, represent NASA's environmental liability, FECA liability to DOL and employees, contingent liabilities, accounts payable for closed appropriations and leave earned but not taken (See Note 8, Liabilities Not Covered by Budgetary Resources). Only a portion of these liabilities will require or generate resources in future periods.

16. General Information

During FY 2003, NASA replaced ten disparate accounting systems and over 120 ancillary subsystems that had been in operation at our Centers for the past two decades with a commercial off-the-shelf, Agency-wide, Integrated Financial Management system (SAP Core Financials application module). In meeting our goal of having one Agency-wide financial system, FY 2004 is the first full year in which the SAP Core Financial system was used by all NASA activities, providing the opportunity to produce consolidated financial statements and other Agency-wide reports directly from SAP. Although much progress has been made in improving our financial systems processes, the Agency has had some significant system conversion and data integrity challenges that we are aggressively identifying and resolving.

NASA closed FY 2003 with a number of known data integrity issues that were corrected during FY 2004. The correction of prior year transactions resulted in the misstatement of many budgetary and proprietary nominal accounts, as the financial management system could not distinguish between current transactions and corrections to prior year transactions posted in the current year.

The data integrity issues from FY 2003 resulted in the opening balances in many budgetary and proprietary accounts being misstated when FY 2004 opened. Correct FY 2004 beginning balances could not be established in SAP, as the system could not distinguish between current transactions and corrections to prior year transactions posted in the current year. The existing opening balances in SAP could not be updated for prior correction activity.

The configuration and data integrity issues from FY 2003 and during FY 2004 caused misstatements in accounts that contained trading partner data. This limited NASA's ability to reconcile and resolve differences with trading partners (other Federal agencies) and eliminate intra-entity transactions (activity between Centers).

During a review of a depreciation calculation, an error of approximately \$200 million was discovered that caused an overstatement of depreciation expense for FY 2004. There was not sufficient time to accurately record an adjustment and re-produce the financial statements.

Through various internal control procedures, NASA identified anomalies and abnormalities that were being researched when the fiscal year closed. These items caused misstatements in many budgetary and proprietary accounts. NASA will continue to aggressively research, document, and resolve these items during FY 2005.

NASA identified functionality and configuration issues in SAP that created inappropriate transactional postings, which resulted in abnormal balances and misstatement of other balances. In some cases, the functionality or configuration issues could only be corrected at the beginning of a fiscal year, or when additional functionality is provided by SAP Corporation. In other cases, SAP has limited functionality that could not be configured to capture the proper data. Many of the transactional corrections for these items were accomplished during FY 2004.

**National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Heritage Assets
For the Fiscal Year Ended September 30, 2004**

Federal agencies are required to classify and report heritage assets, in accordance with the requirements of SFFAS No. 8, "Supplementary Stewardship Reporting."

Heritage Assets are property, plant, and equipment that possess one or more of the following characteristics: historical or natural significance; cultural, educational, or aesthetic value; or significant architectural characteristics.

Since the cost of heritage assets is usually not determinable, NASA does not place a value on them or establish minimum value thresholds for designation of property, plant, or equipment as heritage assets. Additionally, the useful lives of heritage assets are not reasonably estimable for depreciation purposes. Since the most relevant information about heritage assets is their existence, they are qualified in terms of physical units, as follows:

	2003	Additions	Withdrawals	2004
Buildings and Structures	40	—	4	36
Air and Space Displays and Artifacts	540	9	53	496
Art and Miscellaneous items	1,017	4	5	1,016
Total Heritage Assets	1,597	13	62	1,548

Heritage Assets were generally acquired through construction by NASA or its contractors, and are expected to remain in this category, except where there is legal authority for transfer or sale. Heritage assets are generally in fair condition, suitable only for display.

Many of the buildings and structures are designated as National Historic Landmarks. Numerous air and spacecraft and related components are on display at various locations to enhance public understanding of NASA programs. NASA eliminated their cost from its property records when they were designated as heritage assets. A portion of the amount reported for deferred maintenance is for heritage assets.

For more than 30 years, the NASA Art Program has documented America's major accomplishments in aeronautics and space. During that time, more than 200 artists have generously contributed their time and talent to record their impressions of the U.S. Aerospace Program in paintings, drawings, and other media. Not only do these art works provide a historic record of NASA projects, they give the public a new and fuller understanding of advancements in aerospace. Artists are, in fact, given a special view of NASA through the "back door." Some have witnessed astronauts in training or scientists at work. The art collection, as a whole, depicts a wide range of subjects, including Shuttle launches, aeronautics research, the Hubble Space Telescope, and even virtual reality.

Artists commissioned by NASA receive a small honorarium in exchange for donating a minimum of one piece to the NASA archive, which now numbers more than 800 works of art. In addition more than 2,000 works have been donated to the National Air and Space Museum.

In accordance with SFFAS No. 8, heritage assets that are used in day-to-day government operations are considered "multi-use" heritage assets that are not used for heritage purposes. Such assets are accounted for as general property, plant, and equipment and are capitalized and depreciated in the same manner as other general property, plant, and equipment. NASA has 84 buildings and structures considered to be "multi-use" heritage assets. The values of these assets are included in the property, plant, and equipment values shown in the financial statements.

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Year Ended September 30, 2004
(In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications

In August 2004, NASA restructured from six Strategic Enterprises—Human Exploration and Development of Space, Space Science, Earth Science, Biological and Physical Research, Aerospace Technology, and Education Programs—to four Mission Directorates: Exploration Systems, Space Operations, Science, and Aeronautics Research.

This schedule could not be provided due to the organizational transformation that occurred in August 2004 of six Strategic Enterprises to four Mission Directorates. The detailed breakdown of the appropriations by research and development was not available due to the late year transformation.

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Years Ended September 30
(In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications

	2003	2002	2001	2000	1999
	(Restated)				
Human Exploration and Development of Space					
Space Station (a)					
Basic Research	\$ —	\$ —	\$ —	\$ —	\$ —
Applied Research	—	—	—	—	99,678
Development	—	—	—	—	2,456,172
Subtotal	\$ —	\$ —	\$ —	\$ —	\$ 2,555,850
Space Operations					
Basic Research	\$ 69,342	\$ 369,737	\$ 147,869	\$ 457,582	\$ —
Applied Research	—	—	92,419	—	—
Development	—	—	129,386	—	430,503
Subtotal	\$ 69,342	\$ 369,737	\$ 369,674	\$ 457,582	\$ 430,503
Investment and Support (b)					
Basic Research	\$ —	\$ —	\$ —	\$ —	\$ —
Applied Research	—	27,453	164,241	—	—
Development	—	—	—	—	—
Subtotal	\$ —	\$ 27,453	\$ 164,241	\$ —	\$ —
Payload Utilization and Operations					
Basic Research	\$ —	\$ —	\$ —	\$ —	\$ —
Applied Research	217,999	180,888	153,324	419,452	375,970
Development	—	—	—	—	—
Subtotal	\$ 217,999	\$ 180,888	\$ 153,324	\$ 419,452	\$ 375,970
HEDS Total	\$ 287,341	\$ 578,078	\$ 687,239	\$ 877,034	\$ 3,362,323
Space Science (SSE)					
Space Science					
Basic Research	\$ 995,286	\$ 988,677	\$ 581,163	\$ 818,718	747,763
Applied Research	—	—	—	—	816,433
Development	1,761,738	1,836,115	1,179,937	1,625,216	979,212
Subtotal	\$ 2,757,024	\$ 2,824,792	\$ 1,761,100	\$ 2,443,934	\$ 2,543,408
Planetary Exploration					
Basic Research	\$ —	\$ —	\$ —	\$ 11,152	\$ 10,049
Applied Research	—	—	—	—	10,972
Development	—	—	—	22,137	13,160
Subtotal	\$ —	\$ —	\$ —	\$ 33,289	\$ 34,181
SSE Total	\$ 2,757,024	\$ 2,824,792	\$ 1,761,100	\$ 2,477,223	\$ 2,577,589
Earth Science (ESE)					
Basic Research	\$ 629,343	\$ 544,676	\$ 255,678	\$ 494,956	\$ 358,782
Applied Research	71,055	105,661	55,161	97,018	130,625
Development	568,439	837,850	434,577	1,052,397	1,252,260
ESE Total	\$ 1,268,837	\$ 1,488,187	\$ 745,416	\$ 1,644,371	\$ 1,741,667
Biological and Physical Research (BPR) (c)					
Basic Research	\$ 396,351	\$ 209,573	\$ 69,603	\$ 107,951	\$ 162,858
Applied Research	804,673	415,546	112,221	166,746	119,548
Development	129,013	95,064	32,338	46,586	14,239
BPR Total	\$ 1,330,037	\$ 720,183	\$ 214,162	\$ 321,283	\$ 296,645

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Years Ended September 30 (Continued)
(In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications (Continued)

	2003	2002	2001	2000	1999
	(Restated)				
Aerospace Technology (AT)					
Aerospace Technology					
Basic Research	\$ —	\$ —	\$ —	\$ 144,053	\$ 356,546
Applied Research	1,083,956	2,398,468	1,039,635	906,288	910,027
Development	—	—	—	83,937	20,595
Subtotal	\$ 1,083,956	\$ 2,398,468	\$ 1,039,635	\$ 1,134,278	\$ 1,287,168
Advanced Space Transportation					
Basic Research	—	—	—	—	—
Applied Research	5,533	16,049	83,971	512,409	569,775
Development	—	—	—	—	—
Subtotal	\$ 5,533	\$ 16,049	\$ 83,971	\$ 512,409	\$ 569,775
Commercial Technology					
Basic Research	3,776	—	—	—	99,080
Applied Research	104,105	342,302	127,697	171,591	45,341
Development	—	12,415	—	6,224	23,510
Subtotal	\$ 107,881	\$ 354,717	\$ 127,697	\$ 177,815	\$ 167,931
AT Total	\$ 1,197,370	\$ 2,769,234	\$ 1,251,303	\$ 1,824,502	\$ 2,024,874
Education (formerly Academic Programs)					
Basic Research	121,649	81,271	97,112	71,504	93,339
Applied Research	47,307	33,844	42,017	39,873	19,657
Development	—	—	—	—	13,823
Education Total	\$ 168,956	\$ 115,115	\$ 139,129	\$ 111,377	\$ 126,819
Total Research and Development Expenses by Program	\$ 7,009,565	\$ 8,495,589	\$ 4,798,349	\$ 7,255,790	\$ 10,129,917
Non-Research and Development Expenses by Enterprise by Programs/Applications					
	2003	2002	2001	2000	1999
	(Restated)				
Human Exploration and Development of Space (HEDS)					
Space Shuttle	\$ 3,008,610	\$ 3,232,011	\$ 2,100,835	\$ 3,303,230	\$ 3,285,407
Space Station	1,510,049	1,727,749	(1,253,026)	2,754,089	—
Investment and Support	145,031	438,428	—	—	—
Space Communication and Data Services	295,008	(18,363)	25,776	—	184,978
Safety, Reliability, and Quality Assurance	—	69,868	40,037	—	—
Mission Communication Services	(46,608)	253,654	32,199	—	—
U.S. Russian Cooperative	52	(2)	208	22,124	151,396
HEDS Total	\$ 4,912,142	\$ 5,703,345	\$ 946,029	\$ 6,079,443	\$ 3,621,781
Space Science (SSE)					
Planetary Exploration	—	(232)	787	—	—
SSE Total	\$ —	\$ (232)	\$ 787	\$ —	\$ —
Other Programs	\$ 53,940	\$ 138,969	\$ 131,737	\$ 1,271	\$ 832
Reimbursable Expenses	-	-	-	\$ 737,498	\$ 817,810
Total Non-Research and Development Expenses by Program	\$ 4,966,082	\$ 5,842,082	\$ 1,078,553	\$ 6,818,212	\$ 4,440,423
Total Program Expenses	\$ 11,975,647	\$ 14,337,671	\$ 5,876,902	\$ 14,074,002	\$ 14,570,340

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Years Ended September 30 (Continued)

NASA makes substantial research and development investments for the benefit of the United States. These amounts are expensed as incurred in determining the net cost of operations.

NASA's research and development programs include activities to extend our knowledge of Earth, its space environment, and the universe, and to invest in new aeronautics and advanced space transportation technologies that support the development and application of technologies critical to the economic, scientific, and technical competitiveness of the United States.

Investment in research and development refers to those expenses incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas to develop new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of:

- **Basic research:** Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind;
- **Applied research:** Systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met; and
- **Development:** Systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

The strategies and resources that NASA uses to achieve its performance goals are highlighted in Part I: Management Discussion and Analysis of this report. It also provides information regarding the relationship between performance outcomes and outputs to the stewardship investments outlined above. See the FY 2004 Performance Highlights section of Part I for further details.

(a) OMB revised its rules in FY 2000, and no longer considered International Space Station as Investment in Research and Development, as in previous years. Therefore, in FY 2000, Space Station became part of Non-Research and Development Expenses by Program.

(b) In FY 2002, NASA's appropriation structure was realigned to incorporate the functions of the former Mission Support appropriation to Science, Aeronautics and Technology and the Human Space Flight. This realignment changed the functionality from a Research and Development program to both Research and Development and Non-Research and Development, as indicated on the schedule above.

(c) In FY 2001, NASA established a new Enterprise, Biological and Physical Research. This initiative transferred Life and Microgravity Science and Applications activities to Biological and Physical Research.

Enterprise/Program/Application Descriptions

- The **Human Exploration and Development of Space** seeks to expand the frontiers of space and knowledge by exploring, using, and enabling the development of space.
- The **Space Station**, referred to as the International Space Station, is a research facility in low Earth orbit in which U.S., Russian, Canadian, European, and Japanese astronauts are conducting unique scientific and technological investigations in a microgravity environment.
- **Space Operation's** goal is to provide highly reliable and cost-effective space operations services in support of NASA's science and aeronautics programs.
- The **Investment and Support** Rocket Propulsion Test Support activity will continue to ensure NASA's rocket propulsion test capabilities are properly managed and maintained in world class condition.
- The **Payload Utilization and Operations** program is the "one-stop shopping provider" for all customer carrier needs and requirements for safe and cost effective access to space via the Space Shuttle.

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Years Ended September 30 (Continued)

Enterprise/Program/ Application Descriptions (Continued)

- **Space Science** seeks to understand the evolution and destiny of the universe and its galaxies, stars, and planetary bodies, and the potential for life in the solar system and beyond.
- The **Planetary Exploration** program encompasses the scientific exploration of the solar system, including the planets and their satellites, comets, and asteroids.
- **Earth Science** develops a scientific understanding of the Earth system and its response to natural and human-induced changes to enable improved prediction of climate, weather, and natural hazards for present and future generations.
- **Biological and Physical Research** affirms NASA's commitment to the essential role biology will play in the 21st century, and supports the high-priority biological and physical sciences research needed to achieve Agency strategic objectives.
- **Aerospace Technology** works to advance U.S. preeminence in aerospace research and technology. The Enterprise aims to greatly improve air travel, making it safer, faster, and quieter as well as more affordable, accessible, and environmentally sound.
- **Advanced Space Transportation** will create a safe, affordable highway through the air and into space by improving safety, reliability, and operability, while significantly reducing the cost of space transportation systems.
- NASA's **Commercial Technology Program** facilitates the transfer to the private sector NASA inventions, innovations, discoveries, or improvements developed by NASA personnel or in partnership with industry and universities.
- **Education (formerly Academic Programs)** consists of two components, the Educational Program and the Minority University Program. Together, these two components of the Academic Programs effort provide guidance for the Agency's interaction with the formal and informal education community.
- The **Space Shuttle** is a partially reusable space vehicle that provides several unique capabilities to the United States space program. These include retrieving payloads from orbit for reuse; servicing and repairing satellites in space; safely transporting humans to and from space; launching Station components and providing an assembly platform in space; delivering facilities to the Station; and providing stowage and support services for research payloads traveling to and from the Station.
- **Space Communications and Data Services** supports NASA's Enterprises and external customers with communication and data relay and tracking services that are responsive to customer needs.
- The **Safety, Reliability, and Quality Assurance** program invests in the safety and success of NASA missions by assuring that sound and robust policies, processes, and tools for safety, reliability, quality assurance, and engineering disciplines are in place and applied throughout NASA.
- The **Mission Communication Services** program, one part of NASA's Space Communications program, provides support to the breadth of NASA missions, including planetary and interplanetary missions; human space flight missions; Earth-orbiting and spacecraft missions; suborbital missions; and aeronautical test flight systems.
- The **U.S./Russian Cooperative** program includes all flight activities in support of the joint space missions involving the Space Shuttle and the Russian *Mir* Space Station.
- **Other Programs** includes the mission of the Office of Inspector General and programs not directly supportive of a single Enterprise.

National Aeronautics and Space Administration
Required Supplementary Information
Combined Schedule of Budgetary Resources
For the Year Ended September 30, 2004
(In Thousands of Dollars)

Current year activity (opening balances) is required to prepare the required supplemental information for the combined statement of budgetary resources. This information was not available, as discussed in Note 16.

National Aeronautics and Space Administration
Required Supplementary Information
Combined Schedule of Budgetary Resources
For the Year Ended September 30, 2003
(In Thousands of Dollars)

	Science, Aeronautics, and Technology	Human Space Flight	Mission Support	Other	Total
Budget Authority					
Appropriation	\$ 9,207,665	\$ 6,230,900	\$ —	\$ 12,789	\$ 15,451,354
Net Transfers (+ or -)	66,927	(67,052)	—	—	(125)
Unobligated Balance					
Brought Forward, October 1 (+ or -)	659,339	377,404	72,421	18,756	1,127,920
Spending Authority from Offsetting Collections					
Earned					
Collected	461,595	251,582	6,854	—	720,031
Receivable from Federal Sources	9,868	(4,746)	(2,505)	—	2,617
Change in Unfilled Orders					
Advance Received	(44,539)	16,445	(4,073)	—	(32,167)
Without Advance	(30,496)	(39,173)	5,466	—	(64,203)
Recoveries of Prior Year Obligations—Actual	102,953	12,613	65,940	24	181,530
Permanently Not Available					
Cancellations of Expired/No-Year Accounts	(30,734)	(3,672)	(10,784)	(543)	(45,733)
Pursuant to Public Law	(59,850)	(15,242)	—	(166)	(75,258)
Total Budgetary Resources	\$ 10,342,728	\$ 6,759,059	\$ 133,319	\$ 30,860	\$ 17,265,966
Obligations Incurred					
Direct					
Category A	\$ —	\$ —	\$ —	\$ 1,000	\$ 1,000
Category B	8,734,422	6,002,344	98,242	23,441	14,858,449
Reimbursable					
Category B	528,963	249,366	(412)	380	778,297
Unobligated Balance					
Balance Currently Available	1,039,535	496,006	14,429	723	1,550,693
Trust Funds	—	—	—	3,616	3,616
Not Available, Other	39,808	11,343	21,060	1,700	73,911
Total Status of Budgetary Resources	\$ 10,342,728	\$ 6,759,059	\$ 133,319	\$ 30,860	\$ 17,265,966
Obligated Balance, Net as of October 1	\$ 3,747,214	\$ 1,696,630	\$ 186,863	\$ 2,700	\$ 5,633,407
Obligated Balance, Net End of Period					
Accounts Receivable	(43,030)	(17,654)	(416)	—	(61,100)
Unfilled Customer Orders from Federal Sources	(6,627)	15,728	479	—	9,580
Undelivered Orders	2,680,715	879,291	47,133	1,651	3,608,790
Accounts Payable	1,522,115	800,315	30,752	1,091	2,354,273
Outlays					
Disbursements	8,775,101	6,301,967	137,842	24,755	15,239,665
Collections	(417,056)	(268,028)	(2,780)	—	(687,864)
Less: Offsetting Receipts	—	—	—	6	6
Net Outlays	\$ 8,358,045	\$ 6,033,939	\$ 135,062	\$ 24,749	\$ 14,551,795

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions
For the Year Ended September 30, 2004
(In Thousands of Dollars)

Intragovernmental Assets

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Advances and Prepaid Expenses
Treasury	\$ 7,629,298	\$ 17,077	\$ 69	\$ —
Air Force	—	—	53,431	—
Army	—	—	9,046	—
Commerce	—	—	25,569	—
Navy	—	—	9,868	—
National Science Foundation	—	—	177	—
Secretary of Defense	—	—	5,521	—
Transportation	—	—	5,264	—
Other	—	—	7,420	—
Total	\$ 7,629,298	\$ 17,077	\$ 116,365	\$ —

Intragovernmental Liabilities

Agency	Accounts Payable	Closed Accounts Payable	Workers' Compensation	Liability for Deposit and Clearing Funds
Air Force	\$ 23,117	\$ 75	\$ —	\$ —
Army	489	(477)	—	—
Commerce	258	242	—	—
Energy	13,550	(12)	—	—
Labor	32	—	15,787	—
Navy	3,876	(1)	—	—
Interior	—	—	—	—
National Science Foundation	2,488	—	—	—
Secretary of Defense	6,571	10	—	—
Treasury	525	—	—	—
Transportation	(1,111)	—	—	—
Other	20,188	4,152	—	781
Total	\$ 69,983	\$ 3,989	\$ 15,787	\$ 781

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions
For the Year Ended September 30, 2004 (Continued)
(In Thousands of Dollars)

Intragovernmental Liabilities (Continued)

Agency	Advances from	Other Liabilities	Employer	Custodial Liability
	Others		Contributions and Payroll Taxes	
Air Force	\$ 45,703	\$ —	\$ —	\$ —
Army	17,004	—	—	—
Commerce	8,246	—	—	—
Energy	192	—	—	—
Office of Personnel Management	—	—	440	—
Interior	—	—	—	—
National Science Foundation	3	—	—	—
Navy	1,563	—	—	—
Secretary of Defense	6,178	—	—	—
Transportation	5,021	—	—	—
Treasury	9	—	—	—
Veteran's Affairs	4,737	—	—	—
Other	1,912	1,214	—	2,082
Total	\$ 90,568	\$ 1,214	\$ 440	\$ 2,082

Agency	Intragovernmental	Intragovernmental
	Revenue	Expense
Air Force	\$ 248,641	\$ 133,668
Army	45,515	41,111
Commerce	209,911	16,540
Energy	2,415	125,409
Environmental Protection Agency	1,552	262
National Science Foundation	1,031	12,515
Navy	51,570	35,633
Secretary of Defense	45,304	88,567
Transportation	17,874	17,649
Treasury	221	2,765
Interior	2,906	21,329
Agriculture	4,879	3,756
Veteran's Affairs	932	282
Other	(15,766)	556,989
Total	\$ 616,985	\$ 1,056,475

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions
For the Year Ended September 30, 2003
(In Thousands of Dollars)

Intragovernmental Assets

Agency	Fund Balance with Treasury	Investments	Accounts Receivable	Advances and Prepaid Expenses
Treasury	\$ 7,492,506	\$ 17,138	\$ 62	\$ —
Air Force	—	—	21,890	—
Army	—	—	5,423	—
Commerce	—	—	14,380	2,581
Navy	—	—	4,203	4,438
National Science Foundation	—	—	37	380
Secretary of Defense	—	—	9,732	—
Transportation	—	—	1,693	—
Other	—	—	3,724	—
Total	\$ 7,492,506	\$ 17,138	\$ 61,144	\$ 7,399

Intragovernmental Liabilities:

Agency	Accounts Payable	Closed Accounts Payable	Workers' Compensation	Liability for Deposit and Clearing Funds
Air Force	\$ 17,187	\$ —	\$ —	\$ —
Army	872	—	—	—
Commerce	12,630	—	—	—
Energy	9,402	—	—	—
Labor	—	—	15,324	—
Navy	292	—	—	—
Interior	9,872	—	—	—
National Science Foundation	2,723	—	—	—
Secretary of Defense	18,979	—	—	—
Treasury	91	—	—	—
Transportation	4,605	—	—	—
Other	20,278	32	—	6
Total	\$ 96,931	\$ 32	\$ 15,324	\$ 6

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions
For the Year Ended September 30, 2003 (Continued)
(In Thousands of Dollars)

Agency	Advances from		Accrued	
	Others	Lease Liabilities	Funded Payroll	Custodial Liability
Air Force	\$ 8,253	\$ —	\$ —	\$ —
Army	888	—	—	—
Commerce	5,029	—	—	—
Energy	660	—	—	—
Office of Personnel Management	—	—	6,362	—
Interior	2,975	—	—	—
National Science Foundation	3,032	—	—	—
Navy	3,874	—	—	—
Secretary of Defense	13,140	—	—	—
Transportation	3,422	—	—	—
Treasury	45	—	—	—
Veteran's Affairs	4,334	—	—	—
Other	4,590	—	—	2,056
Total	\$ 50,242	\$ —	\$ 6,362	\$ 2,056

Agency	Intragovernmental Revenue
Air Force	\$ 142,991
Army	19,497
Commerce	28,409
Energy	70,892
Environmental Protection Agency	1,332
National Science Foundation	17,246
Navy	6,480
Secretary of Defense	145,949
Transportation	23,789
Treasury	1,108
Interior	18,720
Agriculture	8,112
Veteran's Affairs	977
Other	172,058
Total	\$ 657,560

**National Aeronautics and Space Administration
Required Supplementary Information
Deferred Maintenance
For the Year Fiscal Ended September 30, 2004**

NASA has deferred maintenance only on its facilities, including structures. There is no significant deferred maintenance on other physical property, such as land, equipment, Theme assets, leasehold improvements, or assets under capital lease. Contractor-held property is subject to the same considerations.

NASA developed a Deferred Maintenance parametric estimating method (DM method) in order to conduct a consistent condition assessment of its facilities. This method was developed to measure NASA's current real property asset condition and to document real property deterioration. The DM method produces both a parametric cost estimate of deferred maintenance, and a Facility Condition Index. Both measures are indicators of the overall condition of NASA's facility assets. The DM method is designed for application to a large population of facilities; results are not necessarily applicable for individual facilities or small populations of facilities. Under this methodology, NASA defines acceptable operating condition in accordance with standard comparable to those used in private industry, including the aerospace operating condition in accordance with standards comparable to those used in private industry, including the aerospace industry.

While there have been no significant changes in our deferred maintenance parametric estimating method this year, there have been several administrative changes, including reclassifying building real property to personal property, and better estimates of current value, had a significant impact on the FY 2004 deferred maintenance and facility condition assessment. Using the DM method, NASA has an Agency-wide Facility Condition Index (FCI) for FY 2004 of 3.7 on a scale of 1 to 5, and NASA's estimate of its backlog of maintenance and repair is approximately \$1.67 billion for both active and inactive facilities. The NASA target Agency-wide average FCI is 4.3.

Deferred maintenance related to heritage assets is included in the deferred maintenance for general facilities. Maintenance is not deferred on active assets that require immediate repair to restore them to safe working condition and have an Office of Safety and Mission Assurance Risk Assessment Classification Code 1 (see NASA STD 8719.7).



NOV 15 2004

TO: Administrator
Chief Financial Officer

SUBJECT: Audit of the National Aeronautics and Space Administration's
Fiscal Year 2004 Financial Statements

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 (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In the enclosed *Report of Independent Auditors*, E&Y disclaimed an opinion on NASA's financial statements for the fiscal year ended September 30, 2004. 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* includes five reportable conditions of which four 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, (2) reconciling differences in the Fund Balance with Treasury, (3) assuring that property, plant, and equipment and materials are presented fairly in the financial statements, and (4) securing the computing environment that supports the Integrated Financial Management Program. The final reportable condition concerns weaknesses in NASA's controls for estimating environmental liability.

The E&Y *Report on Compliance with Laws and Regulations* identifies several instances in which NASA's financial management systems did not substantially comply with *Federal Financial Management Improvement Act (FFMIA)* requirements. For example, the report notes that certain subsidiary systems, including property, are not integrated with the Core Financial Module. The report also questions whether the Agency fully complied with the *Improper Payment Information Act of 2002* because NASA's risk assessment focused on payments related only to firm-fixed price contracts and because the Agency did not prepare an estimate of improper payments.

Many of the issues identified by E&Y are attributable to implementation problems and weaknesses in the Core Financial Module, which is the backbone of the Agency's

Integrated Financial Management Program. We believe that a lack of consistency in the way financial data was processed in the less disciplined legacy environment contributed to the data conversion and integrity problems the Agency is now facing. While the Agency faces a formidable challenge completing implementation of the Integrated Financial Management Program, we believe the decision to implement a single integrated Agency-wide system was correct. Had the Agency not elected to implement an integrated financial system, we sincerely doubt that even heroic efforts by NASA and its auditor using the legacy systems would have resulted in reliable financial reporting within the accelerated time frames now required of Executive Branch agencies. Replacing the disparate legacy accounting systems at the nine NASA Centers and Headquarters with an integrated financial system represents a critical step to improving the Agency's financial management.

To address the weaknesses that E&Y reported, NASA should finalize and implement its Financial Management Improvement Plan with particular emphasis on:

- Ensuring that the Chief Financial Officer's Office is staffed to address the Agency's financial management and accountability challenges.
- Ensuring that accounting policies and procedures are consistent with applicable standards and are consistently applied.
- Establishing internal controls that provide reasonable assurance that the financial statements are supported, complete and accurate.
- Identifying and correcting data conversion and integrity problems in the Core Financial Module.
- Implementing recommendations made in E&Y's *Report on Internal Control*, and those made by our office and the Government Accountability Office.

E&Y is responsible for each of the enclosed reports and the conclusions expressed within. 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 the audit, reviewed reports submitted by E&Y, and ensured that they 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 sheet of the National Aeronautics and Space Administration (NASA) as of September 30, 2004, and the related consolidated statement of net costs, statements of changes in net position and financing, and combined statement of budgetary resources for the fiscal year then ended. These financial statements are the responsibility of NASA's management. The financial statements as of September 30, 2003, and for the fiscal year then ended, were reported on by other auditors whose report dated January 20, 2004 disclaimed an opinion on those statements and described certain departures from generally accepted accounting principles regarding disclosures related to significant differences between its Fund Balance with Treasury balance per its general ledger and Treasury's reported balance, consistency of presentation of the statement of financing, and certain matters relating to a change in fiscal year 2003 in NASA's approach in allocating depreciation expenses and capitalized costs.

During fiscal year 2003, NASA implemented an Integrated Financial Management Program (IFMP) 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 the IFMP system. During fiscal year 2004, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control and develop policies and procedures—much of which took place in the last quarter of fiscal year 2004. Additionally, management indicated that the Core Financial Module could not link manual adjustments/corrections to the original transaction. Further, NASA was unable to provide a subsidiary listing of outstanding balances to support certain financial statement balances including accounts payable and undelivered orders, and management was unable to represent that its financial statements were fairly stated. As a result of these limitations, we were unable to obtain sufficient evidential support for the amounts presented in the consolidated balance sheet as of September 30, 2004, and the related consolidated statement of net costs, statements of changes in net position and financing, and combined statement of budgetary resources for the fiscal year then ended.

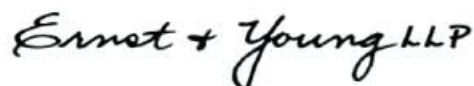
Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheet as of September 30, 2004, and the related consolidated statement of net costs, statements of changes in net position and financing, and combined statement of budgetary resources for the fiscal year then ended.

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In its preparation and analysis of its September 30, 2004 financial statements, NASA's management identified certain configuration and data integrity issues and significant errors in balances reported on its financial statements. The footnotes to the financial statements describe certain departures from accounting principles generally accepted in the United States of America in NASA's fiscal year 2004 financial statements.

The information presented in the Management's Discussion and Analysis (MD&A), 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) Bulletin 01-09, *Form and Content of Agency Financial Statements*. 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 timeframes established by OMB, because of the limitations on the scope of our audit of the financial statements, discussed above. Additionally, we were unable to assess control risk relevant to NASA's intra-governmental transactions and balances, as required by OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, because reconciliations were not performed with certain Federal trading partners as required by OMB Bulletin 01-09. Finally, as discussed in Footnote One, programs identified in the 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 October 29, 2004, 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 controls 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.



Washington, D.C.
October 29, 2004

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, 2004, and have issued our report thereon dated October 29, 2004. 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, 2004, and the related consolidated statement of net costs, statements of 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 by obtaining an understanding of NASA's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls. We limited our internal control testing to those controls necessary to achieve the objectives described in Office of Management and Budget (OMB) Bulletin No. 01-02, *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 (FMFIA) of 1982, such as those controls relevant to ensuring efficient operations. The objective of our work was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants (AICPA), reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions 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 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. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters discussed in the following paragraphs involving the internal control and its operation that we consider to be reportable conditions. We consider the first four matters noted—Financial Systems, Analyses and Oversight; Fund Balance with Treasury; Property; and Integrated Financial Management Program (IFMP) Systems Control Environment—to be material weaknesses.

MATERIAL WEAKNESSES

Financial Systems, Analyses and Oversight (Modified Repeat Condition)

Overview

OMB Circular A-127 requires that financial statements be the culmination of a systematic accounting process. The statements are to result from an accounting system that is an integral part of a total financial management system containing sufficient structure, effective internal control, and reliable data. As more fully described in NASA's draft Financial Management Improvement Plan, 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, specifically the Core Financial Module. The Core Financial Module replaced 10 disparate Center-level accounting systems and the NASA Headquarters accounting system, along with approximately 120 ancillary subsystems in operations for the past two decades. This conversion effort necessitated complex, extensive data cleanup, which was not always successfully completed.

NASA's management identified significant errors beginning with its September 30, 2003, financial statements resulting from the implementation of the IFMP system. During FY 2004, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control, and develop policies and procedures. In its preparation and analysis of its September 30, 2004, financial statements, NASA's management continued to identify configuration and data integrity issues and significant errors in balances reported on its financial statements. Additionally, NASA's management indicated that the Core Financial Module could not provide an audit trail for certain transactions and was unable to provide subsidiary listings and certain supporting documentation.

NASA continues to work towards resolving issues noted in the FY 2003 financial statement audit report related to the lack of an integrated financial management system and inadequate financial accounting and supervisory review processes. Management reported certain actions, including:

- Financial Statement Preparation. Although management acknowledges weaknesses in the underlying data which preclude reliance on the statements at this time, IFMP has been configured to crosswalk standard general ledger accounts to the financial statements and selected notes to the financial statements, in accordance with OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, and the United States Standard General Ledger crosswalks prescribed by the Department of the Treasury (Treasury). Accordingly, the financial statements are produced directly from IFMP.

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- Policies and Procedures. NASA published eight volumes of the new NASA Financial Management Requirements: Budget Execution, Accounting, Cost, External Reporting, Anti-Deficiency Act, Contract Financial Management, Grant Financial Management, and Working Capital Fund Policies and Requirements. Supplemental policy guidance was distributed for property, full cost implementation, and reimbursable agreements.
- Property. In addition to publishing definitive property, plant and equipment policy in the NASA Financial Management Requirements document in September 2004, major contracts were amended to require monthly reporting of property values. Process improvements in valuation practices and increased oversight by NASA and outside reviewers are included in ongoing efforts to improve reporting by contractors.
- Fund Balance with Treasury. NASA continues to make progress in resolving its Fund Balance with Treasury imbalance. While not completely reconciled, major differences identified in the FY 2003 financial statement audit have been researched and we were informed that many have been corrected. Corrective actions will continue into FY 2005.
- Organization Structure. NASA reorganized its operations so that certain procurement functions and the Chief Financial Officer (CFO) functions within the Centers report directly to NASA's CFO. Additionally, as part of the reorganization, NASA established a quality assurance office in the Office of the CFO to evaluate the efficacy of agency-wide management controls.

Although progress was made, significant financial management issues continue to impair NASA's ability to accumulate, analyze, and distribute reliable financial information. Our review of the internal control disclosed numerous weaknesses in NASA's ability to report accurate financial information on a timely basis. NASA's Core Financial System lacks integration with certain subsidiary systems, does not facilitate the preparation of the financial statements, and contains insufficient internal control to detect and support the correction of invalid entries in a timely fashion. Additionally, NASA personnel were not consistently utilizing uniform accounting processes that record, classify, and summarize information for the preparation of financial statements. Finally, NASA lacked formalized procedures to analyze accounting data, and sufficient source documentation to support reported financial information. Integrated financial systems, a sufficient number of properly trained personnel, 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.

Lack of Integrated Financial Management System

The NASA financial management systems are not compliant with the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA requires agencies to implement and maintain financial management systems that comply with Federal financial management systems requirements as defined by the Joint Financial Management Improvement Program (JFMIP). 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 lack of an integrated

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financial management system continues to impair NASA 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 JFMIP, certain aspects of the NASA accounting system lack integration and does not conform to the requirements currently specified by the JFMIP. As identified in Footnote Sixteen to the financial statements, NASA's management continues to identify data integrity and configuration issues in the Core Financial System which results in inappropriate transactional postings. Additionally, the Core Financial System is unable to provide detailed listings of balances to support NASA's September 30, 2004, reported balances. Finally, certain subsidiary systems, including property, are not integrated with the Core Financial System. Specific weaknesses noted include:

- During our audit work, we were unable to obtain a listing of balances from the Core Financial System. Specifically, we were unable to obtain a listing of balances to support accounts receivable, accounts payable, and undelivered orders to support financial statement amounts as of September 30, 2004. Additionally, NASA was unable to provide subsidiary listings of cash receipts and cash disbursements to support their budgetary outlays during the fiscal year. Currently, the Centers are able to provide certain subsidiary listings; however, the listings are being generated from ad-hoc processes, not directly from the Core Financial System.
- The Core Financial System does not provide for tracking manual or non-routine or correction entries with linkage back to the original transaction or the capability to isolate manual adjustments. As a result, adjustments and corrections cannot be readily identified.
- Certain subsidiary systems, including property, are not integrated with the Core Financial System. Entries for contractor-held property, totaling \$8.5 billion, are recorded into the Core Financial System using manual vouchers.
- NASA's management continues to identify certain transactions that are being posted incorrectly due to improper configuration within the Core Financial System.
- Due to systematic limitations, NASA Centers are developing alternative approaches to ensure data and financial management information is readily available to make critical decisions. These alternatives are inconsistent between Centers and may cause varied results in reporting from the Centers to Headquarters.

Financial Statement Preparation and Analysis

During FY 2003, NASA implemented the Core Financial Module of the IFMP system. Because of the complexity of its conversion and the pervasiveness of errors identified in the Core Financial Module as of September 30, 2003, financial statements amounts reported were found to be unreliable and not complete. Specific issues identified related to data integrity issues, limitations requiring system configuration updates, lack of sufficient audit trails and

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documentation, incorrect transactions within the Core Financial Module, and insufficient analyses and weaknesses in internal control to identify material misstatements in a timely fashion.

For purposes of preparing interim financial statements during FY 2004, NASA made the decision to utilize estimates in preparing its financial reporting to OMB and Treasury because financial statements generated from the Core Financial System were deemed unreliable. The estimates were based on Treasury reports, FY 2003 balances, and/or budgetary or planned outcomes. Our review of the June 30, 2004 interim financial statements generated by the Core Financial System identified the following:

- A difference of \$5.3 billion between the assets on the balance sheet generated from the Core Financial System and the sum of liabilities and net position.
- The net costs of operations on the consolidated statement of net costs did not agree to the net costs of operations located on the statement of financing—the difference totaling approximately \$2 billion.
- Obligations incurred on the statement of budgetary resources did not agree to obligations incurred on the statement of financing—the difference totaling approximately \$4 million.

The pervasiveness of these errors prevented us from performing significant substantive audit procedures on NASA's June 30, 2004, financial statements.

Although NASA generated its financial statements from the Core Financial System at September 30, 2004, NASA's management continued to identify similar issues during FY 2004. As discussed in Footnote Sixteen of the September 30, 2004, financial statements, NASA's management reported that the correction of prior year transactions during FY 2004 resulted in misstatements to many budgetary and proprietary nominal accounts because the Core Financial System could not distinguish between current year transactions and the corrections to prior year transactions without processing the corrections as prior period adjustments or reopening FY 2003 to process the corrections as current year activity. Additionally, the data integrity issues identified during FY 2003 continued to impair FY 2004 opening balances. Finally, NASA continued to identify functionality and configuration issues that impaired its ability to prepare accurate and complete financial statements. For example, in our review of the September 30, 2004, financial statements, we noted the following concerns:

- During our testing, we identified situations where costs are not recorded properly. 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 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

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Financial Management Regulations require costs to be accrued in the period in which they are incurred and any corresponding liability to be recorded as an account payable, regardless of the associated amounts obligated.

- The Core Financial System was unable to provide a breakdown of costs by the four mission directorates which NASA has identified as significant segments. This is not consistent with the requirements of SFFAS No. 4.
- We noted instances where the Core Financial System did not agree to the crosswalk provided that supports the financial statements. Management indicated that manual adjustments were required to ensure accuracy in the reported balances and consistency among statements. The majority of the adjustments related to the Statement of Budgetary Resources.

Additional Controls Need to be Strengthened

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 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.

Because significant weaknesses exist in the Core Financial System, management must compensate for the weaknesses by implementing and strengthening additional controls that will ensure errors and irregularities are detected in a timely manner. The weaknesses identified impact NASA's ability to report accurate financial information. During FY 2004, 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. The following represents specific areas that need enhanced periodic reconciliation and analysis procedures:

- Manual or Non-Routine Transactions. The Core Financial System does not provide for tracking of non-routine or correction entries with linkage back to the original transaction. Non-routine transactions are high risk and should be closely monitored. We noted that there was no unique identifier in the system to easily access these transactions.
- Certification of NASA Center Activity. Although the majority of financial activity is processed in the Centers, the Center CFO offices are not required to (1) certify that financial transactions are complete, accurate, and have been properly recorded, and (2) perform high level analytical procedures to ensure balances are not materially misstated. Further, there is limited headquarters review of monthly financial reconciliation and analyses procedures.

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- Policies and Procedures. Until September 2004, NASA did not have formalized policies and procedures for developing its financial statements, the financial reporting analyses functions, or certain transactional processes. As a result, certain inconsistencies between Centers and Headquarters personnel were identified in the processing of similar transactions. The GAO's Standards for Internal Control in the Federal Government requires that internal control and all transactions need to be clearly documented in properly maintained management directives, administrative policies, or operating manuals. Once formalized policies are completed, personnel should be properly trained to ensure policies are properly implemented and adhered to.
- Assessment of Improper Payments. During FY 2004, NASA has informed OMB of the status of its implementation of the Improper Payment Information Act of 2002 (IPIA). In its risk assessment, NASA identified and tested only those payments related to firm-fixed price contracts from each of the centers. Although the IPIA discusses consideration of other types of payments that should be considered, including Federal awards made by recipients and sub-recipients subject to the Single Audit Act Amendments of 1996 as well as Federal grants and sub-grants expended by for-profit and non-U.S. based entities not subject to that Act, NASA did not test these payments or document the rationale for not considering these payments as part of the risk assessment.
- Documentation. 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 whether a grant accrual was required to be reported as part of its financial statements as of September 30, 2004.
- Correction of Errors. NASA was unable to identify and resolve errors in postings to the subsidiary ledgers and the general ledger in a timely fashion. During our testing of Undelivered Orders, we noted three transactions totalling more than \$560 million that management identified as improper transactions caused by configuration issues within the Core Financial System. Some transactions dated back as early as March 2004 but are not expected to be resolved until FY 2005. Management at the Center has requested assistance from Headquarters to resolve the issue.
- Supervision and Review. During our testing of one of the larger theme assets, we noted that NASA made a \$191 million error in calculating depreciation. The error appears to be the result of an error in a formula on a spreadsheet that the reviewer did not identify.

The GAO's *Standards for Internal Control in the Federal Government* indicates that internal control monitoring should assess the quality of performance over time and ensure that findings of audits and other reviews are promptly resolved. Without appropriate monitoring and oversight of contractor operations, deficiencies in internal control may allow material misstatements to occur without being identified in a timely manner.

Given the severity of these issues, including system and process limitations and expertise needed in the new and future financial reporting requirements, it will take a sustained commitment and a qualified support team to resolve these issues in preparation for FY 2005 and future years.

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 NASA:

- Continue to improve its financial reporting and internal quality review procedures to reasonably assure that information presented in the Performance and Accountability report are accurate and are consistent with the requirements of OMB Bulletin No. 01-09.
- Configure the Core Financial System to provide a breakdown of net costs consistent with programs identified in NASA's strategic plan and in the Management, Discussion, and Analysis section of the Financial Statements.
- To ensure accuracy and completeness of work performed, supervisory reviews should be guided by preparation of a comprehensive checklist. For example, the process of supervisory review at Headquarters and the Centers should be enhanced to identify errors in a more timely fashion. This should include enhancements to high-level analysis; the development of an archiving mechanism so that historical information is available for future trending; and enhancements to oversight procedures to monitor the implementation of control procedures to provide independent checks of validity, accuracy, and completeness of amounts reported to NASA.
- Continue to refine its procedures to provide a mechanism for NASA Headquarters to monitor Centers' activities and enforce compliance with NASA financial management procedures. We suggest that a systematic methodology be devised to ensure that accounting policies and procedures are in compliance with generally accepted accounting principles. While the IFMP provides Center and Headquarters personnel access to certain transactions and account balance information, we encourage management to also access related support from Centers, review subsidiary ledgers for reasonableness, and obtain reconciliations and account analyses for review to ensure their timely preparation and resolution.
- Complete and document analytical procedures to ensure that logical relationships exist between various financial statement amounts, and that the relationships between the different statements and line items within each statement are appropriate. Variances from expected results should be researched and resolved.
- Revise its NASA-wide detailed timeline with specific milestones to ensure ample time and resources are available to complete the following tasks associated with preparing the financial statements and other elements of the Performance and Accountability report: (1) data collection, (2) data validation, (3) data compilation, and (4) detailed quality review.
- 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

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issues that date back to system conversion in 2003.

- Devise short-term and long-term resolutions to IFMP systematic and integration issues and the lack of internal controls surrounding costs in excess of obligations and downward adjustments.
- Formally document roles and responsibilities of its Headquarters, IFMP Competency Center, and Center financial management personnel to ensure appropriate accountability is achieved at each level. Additionally, we recognize that resource limitations may constrain NASA's ability to execute its mission. Management should continue to focus on filling key vacancies within the financial management organization.
- Provide additional training for financial personnel to ensure that they understand their role in processing transactions, performing account analyses and reconciliations, maintaining supporting documentation, and updating their knowledge of financial reporting requirements.

Further Research Required to Resolve Fund Balance with Treasury Differences (Modified Repeat Condition)

An agency's Fund Balance with Treasury represents monies an agency can spend for authorized transactions, which are based on budget spending authorizations and are made available through Treasury warrants. Amounts available are increased or decreased as monies are collected and disbursed. Although Treasury serves as the central processing facility for federal entities, Treasury does not maintain independent accounting records of each agency's Fund Balance with Treasury, but relies instead on monthly data reported by each agency for its record of agency collections, disbursements, and Fund Balance with Treasury.

Throughout FY 2003, NASA implemented, in phases, a commercial off-the-shelf, Agency-wide, integrated financial management system that replaced 10 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, NASA posted year-end adjustments outside its Core Financial System, 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.

As NASA indicated in its Management, Discussion and Analysis section of the Performance and Accountability report, we were informed that NASA has been able to resolve a substantial portion of the Fund Balance difference with Treasury. During FY 2004, the NASA Headquarters and its centers expended much effort analyzing the FY 2003 year-end adjustments to the Fund Balance with Treasury account and the impact to other related accounts. As a result, NASA classified the transactions into four major categories: document conversion, canceled

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appropriations, trust fund transfer, and other reconciling items. Year-end adjustments involved thousands of transactions that were not processed through the new financial system, not coded correctly, or were included erroneously in the new system during the conversion.

Although we were informed that many errors from FY 2003 were resolved, significant errors within the accounting system are still being identified. As of September 2004, NASA had not completely identified and resolved certain errors that still exist within the Core Financial system. For example, we identified an absolute value difference of \$313 million between the Core Financial System and the Treasury balance. In addition, the total amount reported in NASA's Budget Clearing Account as of September 30, 2004 was \$19 million. These amounts may include the data conversion adjustments identified during FY 2003, as well as additional differences that have occurred throughout FY 2004. These balances will require further research to determine the cause of the errors and resulting resolutions.

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.

Recommendation

We recommend that NASA improve its current procedures to ensure that all reconciling items are thoroughly researched, timely resolved, and reviewed by appropriate Center and Headquarters CFO personnel. In addition, NASA should retain all reports and documentation used in performing its Fund Balance with Treasury reconciliations to ensure that detailed documented explanations and resolution actions are maintained for a sufficient audit trail.

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 (PPE), totaling approximately \$34.6 billion, identified serious weaknesses in internal control that if not corrected could prevent material misstatements from being detected in a timely manner. NASA's management acknowledged these weaknesses in its Management, Discussion and Analysis to its financial statements and its FY 2004 FFMA Statement of Assurance.

During FY 2003, NASA's management created an overall Corrective Action Plan to remedy deficiencies identified within prior year audit reports. During FY 2004, progress was made in implementing aspects of the plan. For example, NASA:

- Established a quality assurance program, utilizing the Defense Contract Audit Agency's (DCAA) services to review policies and procedures as well as, test transactions of NASA's significant contractors,

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- Developed new policies and procedures to be fully implemented during FY 2005,
- Amended certain major contracts to require monthly reporting of property values, and
- Provided training to its contractors on a variety of topics germane to the audit issues identified in prior year audit reports and its own analysis and observations of several contractor locations.

NASA's approach to recognizing and accounting for fixed assets is heavily dependent on activities at its contractors, and subsequent reviews to determine amounts which should be capitalized. Currently, NASA expenses all costs 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 costs will not be properly capitalized. Until NASA successfully implements a single integrated system for reporting property, and develops a methodology to identify costs that need to be capitalized as the transaction is processed, the Agency will continue to experience difficulties in recording these transactions. Additionally, further emphasis on processes at the contractor locations, the Centers and Headquarters is needed to ensure that amounts reported in its financial statements are reliable.

During our testing, we noted significant weaknesses in the property area. The weaknesses we noted during FY 2004, most of which are consistent with last year's audit report, relate primarily to insufficient internal controls surrounding contractor-held PPE, materials and NASA-held theme assets and NASA-held work in progress (WIP). For example:

- The FY 2003 audit report recommended that NASA require contractors to create plans to resolve their respective deficiencies and NASA establish internal controls and policies and procedures to ensure the plans are created and carried out. In FY 2004, NASA established a quality assurance program, using the DCAA's services to review policies and procedures as well as test transactions of NASA's significant contractors. One component of DCAA's work is to review previous year's findings, including contractors' progress with resolution of deficiencies. We reviewed the results of DCAA's reviews and found that for the majority of the contractors visited, there does appear to have been improvement in the contractor's attempts to address and correct deficiencies in FY 2004. We believe, however, that continuous monitoring will be required to ensure further improvement is noted.
- Consistent with the FY 2003 recommendations, NASA should ensure that all of its contractors have formal policies and procedures to detect and correct errors reported on the NASA Form (NF) 1018. Additionally, it was recommended that NASA require its contractors to review PPE and Materials reported by subcontractors on NF 1018 before submitting the information to NASA. Within its new quality assurance program, DCAA's review program requires a determination as to whether or not the contractors have formal policies and procedures to detect and correct errors; and whether or not the contractor is performing validation of its subcontractor data. As a result of applying their procedures to the March 31, 2004 quarterly report, DCAA identified an error of approximately \$300 million in the computation of WIP. Since the error was not detected

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by the contractor's review process nor was it detected by the validation procedures performed by the NASA property branch, policies and procedures may not have been fully implemented.

- In FY 2003 the prior year auditors recommended that NASA transition its Corrective Action Plan into an annual "Audit Plan" that establishes annual objectives pertinent to the Agency's specific PPE and materials internal control and financial statement reporting goals. In FY 2004, NASA developed a matrix which identifies the high, medium and low risk contractors. The matrix was populated with such elements as significant findings and internal control deficiencies and significant amounts of property holdings. High risk contractors are scheduled to be reviewed every year, while medium and low risk contractors will be reviewed on a rotating basis at regular intervals. Based on the results of the DCAA's procedures, the development of a matrix to identify high, medium and low risk contractors was a beneficial process. Given the fact that the DCAA procedures were performed for most contractors as of March 31, 2004, this control only applied to the first six months of the year. NASA needs to continue to further refine the process in order that DCAA perform the agreed-upon procedures for the high risk contractors as close to September 30 as possible. This would provide additional assurance that any possible large errors that had not been detected by controls at the contractor or through the validation procedures performed by NASA personnel would be identified in order that the corrections could be made in a timely manner for the preparation of the annual financial statements. Finally, it is suggested that NASA re-evaluate each contractor annually for purposes of classifying it as a high risk, medium risk or low risk contractor.
- The FY 2003 audit report recommends that the development and update of policies and procedures related to property occur and training be provided to the appropriate parties to ensure an understanding of current requirements. On September 30, 2004, NASA management completed its update to its policies and procedures manual; however, because it was not completed until year-end, any effects to accounting and reporting of property would not be observed until FY 2005. Because of the new training manual and the expected implementation of the Contractor Held Asset Tracking Software (CHATS) to facilitate its contractor reporting process in FY 2005, annual training of personnel will continue to be essential to update the NASA contractor representatives, NASA property accountants, and property administrators on property-related requirements.
- During FY 2003, it was recommended that NASA further modify the NF 1018 reporting process for the remaining contractors to report on a quarterly basis. The contractual requirement for monthly reporting by contractors with anticipated property balances in excess of \$10 million in property should allow for more timely and accurate reporting by the contractors. In FY 2004, NASA developed and implemented an estimation methodology in regard to categories of contractor held property. This methodology was designed to estimate the change in contractor held property for the period from June 30, 2004 to September 30, 2004, and to be used as a method to record the balances as of September 30, 2004 for most of the contractor held property. The estimates were revised, as appropriate, based on additional feedback from certain of the large contractors. However, certain calculations in the estimation process were dependent upon information

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provided by the contractors for the nine-month period ended June 30, 2003 and the nine-month period ended June 30, 2004—neither period which had been validated under the new quality assurance process.

- For FY 2005, NASA should further evaluate the estimation process to determine if the contractor held property balances can be subjected to certain agreed-upon procedures to be performed by DCAA much later in the fiscal year. In addition, as a result of the monthly reporting by the large contractors and the new CHATS project, we also suggest that NASA further analyze whether the estimation process should be continued in future years or are there other options available to utilize current data from the contractors as a result of the monthly reporting by large contractors and any new information available as a result of the CHATS implementation.
- As originally recommended last year, NASA should continue to ensure compliance with its documentation requirements by monitoring its contractors through management reviews and inspection visits. Additionally, NASA should continue to require complete supporting documentation for all PPE and Materials transactions, specifically for asset transfers. Finally, NASA should create a reconciliation process to reconcile all of its asset transfers on a quarterly basis and include within that process formal confirmations between the issuing contractor and the receiving contractor.

Beginning in FY 2004, as part of its new quality assurance program, an ongoing portion of DCAA's work is to validate that selected transfers are properly documented and recorded. One of the procedures that DCAA performs as a part of its engagement is to send a confirmation to the sending/receiving party with regard to the specific transfer in/transfer out transaction that is being tested to insure the proper recording of the transfer as well as to establish that both parties of the transaction have made the proper entry on a timely basis.

- In addition, a component of NASA Headquarter's validation process of contractors' quarterly property reports is to review the documentation of significant transfers and to ensure that the transfer is reconciled between the two contractors. However, as a result of the significant number of transfers between and among contractors, we recommend that NASA continue to explore the possibility of creating a process to reconcile all of its asset transfers on a monthly/quarterly basis with a formal confirmation process between the issuing contractor and the receiving contractor.
- The FY 2003 audit report recommended that NASA create formal policies and procedures to ensure all appropriate costs are capitalized as part of NASA theme assets (formerly NASA held assets in space) and NASA-held WIP accounts. In addition, it recommended the development of formal cost allocation policies for theme assets, including specificity of what costs are required to be capitalized and what costs should be expensed. Additionally, NASA management should enhance its theme assets policy to specifically include what costs should be capitalized/expensed, including a uniform list of cost identifiers (e.g., Unique Project Numbers [UPNs]) that support each of those assets to ensure its policy is consistently applied and that a sufficient audit trail exists documenting management's assertions surrounding the value of each asset.

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In FY 2004, NASA undertook a project to review its policies (both accounting and procedural) with respect to theme assets (previously referred to as assets in space) to identify the specific costs that should be capitalized and those that should be expensed. This policy incorporated financial and engineering authoritative guidance, as well as NASA program/project management policy to ensure the consistent application and documentation. However, due to the uniqueness of these assets, management has deferred implementation of this policy until NASA has (1) coordinated this approach with other agencies with similar assets, and (2) presented the approach to the Federal Accounting Standards Advisory Board, in order to ensure all federal requirements are fully implemented.

Recommendation

We recommend that NASA continue to focus on resolving prior year issues and completing its implementation of suggested recommendations and corrective action plans. In addition, we recommend that NASA fundamentally revisit its approach to capitalizing property. We also recommend that all NASA obligation documents and expenditures be coded to identify whether they relate to a property acquisition. Outlays so calculated would create a control for comparison to recorded property transactions and subsidy ledgers, be they NASA activities or contractors.

Improvements in the IFMP Control Environment Are Needed (Modified Repeat Condition)

As discussed above, over the last several years NASA has been migrating its accounting and financial management systems to a new system and processing environment intended, upon full implementation, to provide a comprehensive entity wide resource planning (ERP-SAP within NASA) system. Our assessment of the IFMP computing environment that supports NASA's significant financial applications indicated that several improvements are needed to strengthen the design and operating effectiveness of the Agency's information security program.

Weaknesses were identified at NASA in three control areas:

- Access Controls
- Systems Software
- Segregation of Duties

Access controls. When properly implemented, access controls can help ensure that critical systems assets are physically safeguarded and that logical access to sensitive computer programs and data is granted to users only when authorized and appropriate. Access controls over computer operating systems and data communications software are also closely related. Weaknesses in such controls can compromise the integrity of sensitive Agency data and increase the risk that such data may be inappropriately used and/or disclosed.

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Access control weaknesses continue to be identified and represent a significant risk to the IFMP program. Procedures were not consistently followed for monitoring unused IDs, locked IDs, or access re-certifications. User accounts were not deactivated after several consecutive failed login attempts and auditing was not set up to help investigate failed attempts. The use of the Password Wizard for generating initial passwords, the use of complex passwords, and the change of user passwords at regular intervals were not enforced on certain systems across the Agency. Users were also not prohibited from selecting previously used passwords. In addition, a significant number of users had access to sensitive SAP transaction codes and authorizations, files, and queries. Changes to SAP user security profiles that were made to allow temporary powerful access to the production environment were not appropriately documented.

During penetration vulnerability testing at the Marshall Space Flight Center, weaknesses were identified related to user account and password management, Internet security, and systems software configuration. These weaknesses were identified in peripheral infrastructure systems critical to SAP.

Systems software. Systems software represents computer programs designed to operate and control the processing activities of computer hardware and related equipment. Systems software helps coordinate the input, processing, output, and data storage associated with all of the applications that are processed on a specific system. Weaknesses in such controls can compromise the integrity of sensitive Agency data and increase the risk that such data may be inappropriately used and/or disclosed.

System software weaknesses continue to be identified and represent a significant risk to the IFMP program. Testing of changes to system software was not always documented. Unnecessary services were enabled and access to sensitive system software utilities and system and object privileges were not appropriately controlled. Operating systems were not always updated to incorporate the latest available system fixes and security upgrades. In addition, system files were not adequately protected by file permissions and the Agency was unable to provide evidence of audit log reviews.

Segregation of Duties. Segregation of duties controls provide policies, procedures, and an organizational structure to prevent one or more individuals from controlling key aspects of computer-related operations and thereby conducting unauthorized actions or gaining unauthorized access to assets or records. Segregation of duties weaknesses continues to be identified and represent a significant risk to the IFMP program. We were informed that in order to correct errors attributed by NASA to weaknesses within the SAP industry solution used by NASA, a significant number of SAP application support personnel were given access to the development and production environments. This access enabled these individuals to potentially make unauthorized changes to the production environment and potentially be involved in the direct processing of accounting transactions. Also, additional competency center staff were occasionally granted additional roles to make changes directly in the production environment. Although we were informed that the competency center monitors all changes made to production data through its change management system, there is a risk that changes could be made to production data that bypass these change management and monitoring controls.

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The level of risk associated with the matters noted depends in part upon the extent to which compensating controls (such as reconciliations and robust reviews of output) are in place and operating effectively during the audit period. Certain of these 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 the risks regarding safeguarding of assets. Within the context of the overall ineffective control environment referenced in the accompanying comments, the information technology related issues discussed above merit management focus.

Recommendation

NASA should implement controls to address deficiencies in access controls, systems software controls, and segregation of duties to include:

- Monitoring and reviewing the activities of users with powerful access privileges and eventually segregating such production access and ability to create accounting transactions from the development function.
- Consistently following procedures related to user account management.
- Implementing stronger password controls and restricting user access to programs and data to the minimum level required by the user's responsibilities.
- Disabling unnecessary system software services, restricting access to sensitive software utilities, and updating operating systems in a timely manner.

REPORTABLE CONDITION

Internal Controls in Estimating NASA's Environmental Liability Require Enhancement

During our review of NASA's environmental liability estimates totaling \$986 million as of September 30, 2004, and related disclosures to the financial statements, we noted weaknesses in NASA's ability to generate an auditable estimate of its environmental unfunded liabilities and to identify disclosure items because of a lack of sufficient, auditable evidence. In general, we noted the following:

- NASA's Accounting, Environmental and Legal functions' roles and responsibilities for the estimation of the unfunded environmental liability are not sufficiently defined to ensure appropriate integration and input into the process. NASA's accounting function defers to the environmental practice in preparation of the estimates, resulting in environmental professionals interpreting accounting requirements.
- As of September 2004, NASA personnel and its contractors had not received sufficient policies, procedures and training in the process for estimating environmental liabilities. Although NASA released in June 2004 an environmental cost restoration handbook to

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provide guidance to the NASA centers, the handbook was not adequately detailed to support a reliable estimate.

- NASA did not have adequate, auditable documentation to support its 2004 environmental liability estimates.
- NASA does not have documented quality control or quality assurance procedures to ensure the accuracy of the unfunded environmental liability estimates.

Roles and Responsibilities Need Further Refinement

During our testing of the unfunded environmental liability estimates, we were informed that NASA's environmental professionals prepared the estimates without direction or oversight from the Office of the CFO. Specifically, we were advised that the Office of the CFO deferred to NASA's Environmental Management Division (EMD) as experts in the preparation of the estimates. As a result of this division of responsibility, NASA's EMD made interpretations of federal accounting requirements in isolation without input and oversight from the CFO's office. We also noted that the CFO's office and NASA Legal Counsel were not interacting with the Department of Justice attorneys who were managing third-party claims on behalf of NASA in a manner that would allow NASA to recognize those liabilities when they are probable and estimable, in accordance with guidance provided in "*Interpretation of Federal Financial Accounting Standards Interpretation No. 2, Accounting for Treasury Judgment Fund Transactions, an interpretation of Statement of Federal Financial Accounting Standards (SFFAS) No. 4 and No. 5.*"

Increased Guidance and Training Required

The preparation of NASA's unfunded environmental liability estimates requires an understanding of environmental cost estimating and related accounting guidance. During the audit, NASA indicated that its Remedial Project Managers lacked sufficient environmental cost estimating experience to adequately prepare the estimates. To mitigate this deficiency, NASA is implementing the use of the Integrated Data Evaluation and Analysis Library (IDEAL) cost-estimating software. IDEAL generates estimates through the use of parametric cost models. However, based on our review, the users did not have a sufficient understanding of how the IDEAL system worked. This was evidenced by their questions about the software and the correction of prior year estimates.

NASA's environmental personnel received minimal accounting guidance and training. This lack of guidance and training resulted in several findings including: estimating liabilities in a manner that was inconsistent with accounting guidance on "probable" and "reasonably estimable"; inadequate quantification, categorization and tracking of changes in the year-to-year estimation process; lack of quantification and disclosure of "possible" environmental liabilities for financial statement purposes; improper presentation of a range of environmental estimates in financial statements; and improperly accruing for environmental liabilities associated with NASA-owned tanks and landfills.

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NASA recently issued guidance in June 2004; however, not all centers/facilities were familiar with the guidance on probable and reasonable, and estimable determinations contained within this document.

Documentation to Support Liability Need Improvements

NASA did not consistently document the assumptions it used to prepare its unfunded environmental liability estimates. During our audit testing, NASA's environmental personnel often could not explain or provide documentation as to how, or why, they selected a specific estimate at several of its centers/facilities. Also, during the audit we were told that there was limited sharing of experiences/information between centers/facilities to ensure that similar liabilities at different locations were estimated consistently within NASA.

Insufficient Quality Control over Center Estimates

During the audit we could not find evidence to support that NASA performed an independent quality review of the unfunded environmental liability estimates prepared by the centers/facilities. While NASA's environmental personnel at Headquarters did perform a review of the estimates, we observed errors that may have been identified had a more formal review occurred. For example, we noted the inclusion of certain costs associated with funded liabilities and installed equipment in the unfunded environmental liability estimates.

We also observed that the organizational structure described earlier allowed the Environmental personnel to make accounting decisions without oversight from the Office of the CFO. This included using a higher end estimate, when no point in the range is better than any other. NASA environmental personnel described this use of "higher-end" estimates as being "conservative." This is not consistent with Federal Financial Accounting and Auditing Technical Release Number 2.

Finally, we believe it is important that the IDEAL model be periodically reconciled with actual spending to validate the model. Currently, IDEAL has not been validated and accredited for estimating NASA remediation scenarios in accordance with OMB and NASA guidelines. NASA indicated that some models within IDEAL were evaluated under a Department of Defense (DOD) contract. However, a review by the DOD's Office of Inspector General indicated similar concerns regarding validation of the model.

Recommendation

We recommend that NASA document the process that it uses to prepare its unfunded environmental liability estimates. After the process is outlined, NASA should perform an analysis to help ensure the proper NASA personnel are participating. The analysis should help identify who in the process has responsibility and authority and who should be consulted and informed for each step. The benefit of this approach is that it would allow the CFO's office to

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determine the level of organizational integration among departments and where in the process input from the CFO’s office is needed.

NASA has numerous policies, procedures and reports. To support the centers/facilities in the preparation of these estimates, NASA should conduct a gap analysis for each step of the newly outlined process to determine where there is conflicting or inadequate information or training. NASA should then develop an “evergreen” document of the current policies, procedures, guidance and training that is available in preparation of the estimate. This should be reviewed at an annual training conference.

NASA should also validate the tools (including IDEAL) and methodology used at the center/facility level to prepare the unfunded, environmental liability estimates.

OTHER MATTERS

Summary of FY2003 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issue	FY 2004 Status
Material Weaknesses:		
NASA lacks sufficient audit trail to support that its FY 2003 Financial Statements are presented fairly	Documentation regarding significant accounting events, recording of non-routine transactions and post closing adjustments, as well as correction and other adjustments made in connection with data conversion issues must be strengthened	Modified Repeat Condition
NASA lacks effective Internal Controls surrounding its Fund Balance with Treasury Reconciliations	Supporting documentation to support application of rigorous reconciliation processes was not available. Unreconciled differences were identified in the FY 2003 year-end reconciliations	Modified Repeat Condition
NASA processes for preparing its Financial Statements still require improvement	Processes to prepare financial statements were not executed in a sufficiently timely and rigorous manner to support meeting reporting deadlines established by OMB	Modified Repeat Condition

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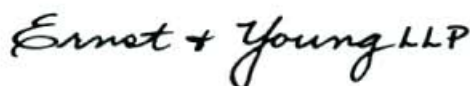
Issue Area	Summary Control Issue	FY 2004 Status
<u>Material Weaknesses:</u>		
NASA still lacks adequate controls to reasonably assure that Property, Plant and Equipment and Materials are presented fairly in the Financial Statements	Controls relating principally to contractor-held PPE and materials and NASA-held Assets in Space and WIP need improvement; headquarters oversight needs improvement	Modified Repeat Condition
<u>Reportable Conditions:</u>		
Security Controls in NASA's Financial Statements Environment need improvement	IFMP Security Design and Implementation needs improvement, IFMP Security and General IT controls need to be strengthened, Oversight function supporting IFMP Security program needs improvement	Modified Repeat Condition, classified as material weakness in FY 2004 due in part to segregation of duties issues and interaction with weaknesses in financial management control processes

* * * * *

In addition, with respect to NASA's internal control over Required Supplementary Stewardship Information (RSSI) and performance measures reported in the Management, Discussion and Analysis, we were unable to apply certain procedures prescribed by OMB Bulletin No. 01-02, because of the limitations on the scope of the audit of the financial statements, as discussed in our Report of Independent Auditors, dated October 29, 2004. Further, we did not audit and do not express an opinion on such controls.

We also noted certain other matters involving internal controls that we will report to NASA management in a separate letter dated October 29, 2004.

This report is intended solely for the information and use of management and 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.



October 29, 2004
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 consolidated financial statements of the National Aeronautics and Space Administration (NASA) as of September 30, 2004, and have issued our report thereon dated October 29, 2004. 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, 2004, and the related consolidated statement of net costs, statements of 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. 01-02, *Audit Requirements for Federal Financial Statements*, 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 NASA's financial management systems substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger 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 lacks integration and does not conform to the requirements currently specified by the Joint Financial Management Improvement Program. As identified in Footnote Sixteen to the financial statements, NASA's management continues to identify data integrity and configuration issues in the Core Financial system which results in inappropriate transactional postings. Additionally, the core financial system is unable to provide detailed listings of balances to support NASA's September 30, 2004, reported balances for accounts receivable, accounts payable and undelivered orders. Finally, certain subsidiary systems, including property, are not integrated with the Core Financial system.

Report on Compliance with Laws and Regulations

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- Issues with the Core Financial System continue to hinder NASA's ability to identify and resolve certain issues with its Fund Balance with Treasury amounts.
- Data within NASA's financial system have not been validated as reliable and may not be reliable to support NASA's financial statements.
- Weaknesses identified in NASA's financial management systems' access and application controls are significant departures from requirements specified in OMB Circulars A-127, *Financial Management Systems*, and A-130, *Management of Federal Information Resources*.
- 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 Financial Management Requirements, require costs to be accrued in the period in which they are incurred and any corresponding liability to be recorded as an account payable, regardless of the associated amounts obligated. However, NASA has 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 is not recorded in NASA's general ledger until further research is performed. Instead, these differences are stored outside of its general ledger until additional funds are obligated and the excess costs (and the corresponding liabilities) can be recorded. Similarly, the Core Financial Module will not allow negative costs or downward adjustments to be recorded in the general ledger. We believe that NASA's accounting treatment of costs in excess of obligations and downward adjustments during fiscal years 2003 and 2004 represent noncompliance with the Federal accounting standards requirements and SGL requirements under FFMIA.

The Report on Internal Control includes 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 management agrees with the facts as presented, and that relevant comments from the NASA's management responsible for addressing the noncompliance are provided as an attachment to this report.

Additionally, NASA has informed OMB of the status of its implementation of the Improper Payment Information Act of 2002 (IPIA). In its risk assessment, NASA identified and tested those payments related to firm-fixed price contracts from each of the Centers. Although the IPIA discusses consideration of other types of payments, NASA did not explicitly consider these payments as part of the risk assessment process or prepare an estimate of improper payments, but did note that audit efforts by nonfederal auditors with respect to grantees and by government auditors with respect to certain NASA contracts aid in identifying and mitigating improper payments. As of September 30, 2004, NASA may not have fully complied with the IPIA requirements.

Report on Compliance with Laws and Regulations
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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 the management and 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

October 29, 2004
Washington, D.C.

National Aeronautics and
Space Administration
Headquarters
Washington, DC 20546-0001



November 9, 2004

Reply to Attn of:

Office of the Chief Financial Officer

TO: Inspector General

FROM: Chief Financial Officer

SUBJECT: Management Response to Report of Independent Auditors

We appreciate the efforts of the Office of Inspector General, and its contractor Ernst & Young, LLP, to audit National Aeronautics and Space Administration's (NASA) FY 2004 balance sheet and accompanying financial statements. We acknowledge that, because of data integrity issues, internal control challenges, and residual system conversion matters, you were not able to express an opinion on the FY 2004 balance sheet and accompanying statements.

Your audit report identified four material weaknesses – Financial Systems, Analysis, and Oversight; Fund Balance with Treasury; Property; and Integrated Financial Management Program (IFMP) Core Financial module Control Environment – and numerous recommendations to resolve those weaknesses. All of these identified weaknesses are inherent in a financial system migration of this magnitude. NASA has taken the important step to streamline the financial operations and management information systems. By doing so, the effort has revealed systemic problems that were not apparent over the past decade. While clean opinions might have resulted from maintaining the old systems and procedures, keeping the status quo would have resulted in the same systemic challenges being perpetuated. This is an opportunity to create a solid foundation for the future and we appreciate your support throughout this process.

Our challenges are many, but we are determined to significantly improve our internal management control environment and to produce auditable financial statements that provide timely and relevant financial information to the NASA leadership and external stakeholders. We will aggressively assess and implement all recommendations made by Ernst & Young, LLP, and will work with your office to develop and implement corrective action plans that are responsive and measurable to demonstrate that we are moving forward in reforming financial management at NASA and adhering to the recommendations of the FY 2004 audit findings.



Again, I appreciate all of your support and assistance as NASA continues the journey towards attaining the goal of being the “Best in Government” when it comes to financial management operations. It is a tough journey but one worth the trip – as the results will place the Agency in a solid position to meet the new vision of – moon, Mars and beyond.

Cordially,



Gwendolyn Sykes