Before the Government Reform Subcommittee on Government Efficiency and Financial Management

U.S. House of Representatives

For Release on Delivery
expected at
2:00 p.m. EDT
Wednesday
May 19, 2004

NASA Financial Management

Statement of

The Honorable Robert W. Cobb

Inspector General

National Aeronautics and Space Administration

Mr. Chairman, Ranking Member, and Members of the Subcommittee:

Thank you for the opportunity to discuss financial management at the National Aeronautics and Space Administration (NASA). The Office of Inspector General has identified NASA's efforts to improve financial management as one of the most serious management and performance challenges facing Agency leadership.

As requested in your letter of April 26, 2004, my statement addresses the findings of NASA's FY 2003 financial audit and reviews the efforts to improve overall financial management at the Agency.

OVERALL SUMMARY

In January 2004, the independent auditor—PricewaterhouseCoopers—conducting NASA's audit pursuant to the Chief Financial Officers Act and under the direction of the Office of Inspector General, determined that it could not render an opinion on NASA's financial statements for FY 2003. The disclaimer resulted from NASA's inability to provide the auditor with sufficient evidence to support the financial statements and complete the audit within time frames the Office of Management and Budget established.

The disclaimer on the FY 2003 financial statements followed an unqualified[1] FY 2002 audit opinion and a disclaimed audit opinion in FY 2001. The FY 2002 unqualified opinion was the consequence of a so-called "heroic" effort of the independent auditor PricewaterhouseCoopers. A heroic audit effort occurs where assurance on the financial statements is established through substantially expanded transaction testing rather than the auditor placing reliance on systems of internal control. Such a heroic effort was not possible in FY 2003 because of dependency on a new automated financial management system.

The reports that the independent auditor submitted identified instances of non-compliance with generally accepted accounting practices, material weaknesses in internal controls, and non-compliance with the Federal Financial Management Improvement Act. Many of the weaknesses the audit disclosed resulted from a lack of effective internal control procedures and problems with NASA's conversion during FY 2003 from 10 separate systems to a new single integrated financial management program (IFMP).

NASA management recognizes that it faces enormous challenges in improving financial management and has developed an improvement plan—the NASA Financial Management Improvement Plan. The plan is designed to ensure that the IFMP provides accurate, timely, and consistent information. The plan's high-level goals appear appropriate for the task but will require a commitment of sufficient resources and the establishment of reasonable time frames to achieve them. This will be a challenge given NASA's decentralized organizational structure, the limited human capital resources in the

[1]An unqualified opinion means that the financial statements are presented fairly, in all material respects in conformity with accounting principles generally accepted in the United States.

Chief Financial Officer's organization, and the ongoing development and deployment of key components of the IFMP.

In the near term, the pervasiveness of NASA's control weaknesses and the inability to produce complete and accurate financial data will most likely result in a disclaimer of opinion in the FY 2004 audit. The outlook for financial statement audits is highly dependent on whether an independent auditor can rely on NASA's system of internal controls and its ability to generate complete and accurate financial statements from its Core Financial Module,[2] a key component of the IFMP. Additionally, establishing reliable internal controls will be a particular challenge with respect to NASA-owned, contractor-held assets, a significant balance sheet item.

Internal control weaknesses from FY 2003 and prior years still exist. Data conversion issues also have not been fully resolved. NASA has already operated for the first seven months of FY 2004 under key internal controls that could not be relied on. However, in order to improve internal controls, NASA is in the process of developing and documenting uniform policies and procedures that will be disseminated to all NASA installations. NASA must ensure that these policies and procedures are strictly and consistently followed by installations in order to improve overall financial management and remove barriers to an unqualified or clean financial statement opinion.

NASA also is experiencing great difficulty in generating complete and accurate financial data. Quarterly financial statements that the Office of Management and Budget require for the periods ending December 31, 2003, and March 31, 2004, were not prepared from the Core Financial Module. Those interim financial statements were based entirely on estimated amounts. While accounting standards and Office of Management and Budget guidance allow for the use of estimates, the wholesale use of estimates was not contemplated or considered acceptable by these guidelines. NASA management has not demonstrated whether quarterly financial statements for June 30, 2004, will be produced from the Core Financial Module.

NASA management is currently performing intense efforts to fully define and implement all required components (programming changes) that will enable the Core Financial Module to produce the financial statements. However, because accurate and complete financial statements have never been produced by the Core Financial Module and data conversion problems are extensive, the Office of Inspector General is skeptical that the Core Financial Module will be able to deliver accurate and complete financial statements for June 30, 2004.

If NASA is unable to receive an opinion on its financial statements in FY 2004, there will be an impact on subsequent audits. The auditor's ability to opine on all the principal

[2]The Core Financial Module consists of the standard general ledger, accounts receivable, accounts payable, budget execution, purchasing, fixed assets, cost management, and general systems management.

statements[3] in FY 2005 is highly dependent on determining whether balances from the FY 2004 statements are reliable. While the auditor could in theory perform audit procedures to establish opening FY 2005 balances, this would be impractical considering the time limitations imposed by the new accelerated reporting deadlines and the scope of work that would be required. In the view of the Office of Inspector General, the best result NASA could expect in FY 2005 is an opinion only on its Balance Sheet.[4]

Although NASA may be able to receive an opinion on its Balance Sheet, a reasonable possibility exists that the FY 2005 opinion would have to be qualified[5] because of contractor-held property. NASA reported that contractors held approximately $7.8 billion (net) in property in FY 2003, and NASA remains highly dependent on its contractors to provide them with property information. Internal controls must be improved to provide assurance that accurate and reliable property information is provided on an ongoing basis. A qualification would, on the FY 2005 opinion, in turn affect the FY 2006 audit and delay the possibility of receiving an unqualified opinion on all the financial statements until FY 2007 at the earliest.[6]

FY 2003 AUDIT DISCLAIMER

The independent auditor conducting the audit of the FY 2003 financial statements, PricewaterhouseCoopers, disclaimed from rendering an opinion based on its determination that NASA did not provide sufficient documentary evidence to support the statements. A major factor that contributed to NASA's inability to provide sufficient evidence to support its statements was the Agency's conversion during FY 2003 from 10 legacy accounting systems to the Core Financial Module of the new single integrated financial management system. The conversion led to significant problems with data quality and accuracy that NASA was unable to resolve. Ultimately, the Agency delivered inaccurate and incomplete FY 2003 third quarter financial statements to PricewaterhouseCoopers—statements that were critical for achieving the accelerated reporting deadline. Subsequently, year-end financial statements were delivered to PricewaterhouseCoopers late and in a similar condition. That situation resulted in PricewaterhouseCoopers's inability to complete the audit by the January 30, 2004, deadline.

[3]The five principal financial statements are the Balance Sheet, Statement of Net Cost, Statement of Net Position, Statement of Budgetary Resources, and Statement of Financing.

[4]Such an opinion would not cover the other four principal financial statements.

[5]A qualified opinion means that, except for certain line items, the financial statements are presented fairly, in all material respects in conformity with accounting principles generally accepted in the United States.

[6]Generally, a clean opinion must be rendered on the prior year's Balance Sheet for an organization to receive a clean opinion on all of the financial statements in the subsequent year. This is because reliable opening balances from the previous year are necessary to opine on the current year.

Implementation of IFMP Was Key to Preparing Auditable Financial Statements

In FY 2003, NASA undertook an ambitious plan to implement the Core Financial Module of the IFMP and accelerate the preparation and audit of its financial statements by two and one-half months to November 15, 2003. The Office of Management and Budget encouraged agencies to meet a November 15 reporting deadline in FY 2003 even though the November 15 deadline was not required by the Office of Management and Budget to be met until FY 2004. NASA and PricewaterhouseCoopers developed an agreed-upon plan to achieve the accelerated date in FY 2003. The success of the plan was highly dependent on successful implementation of the Core Financial Module as well as accurate and complete conversion of legacy accounting system data.

NASA attempted to establish a single integrated system twice before.[7] In its third attempt to implement an integrated financial system—the IFMP—NASA used lessons learned from its two prior efforts. NASA benchmarked other successful business systems and developed a new strategy. The goal of the latest effort is to modernize and improve the Agency's business processes by implementing eight individual projects (or modules) in the areas of financial management, procurement, human resources, and logistics.

Using a pilot center and wave approach (implementing Centers in stages), NASA implemented the Core Financial Module at Headquarters and the Centers. The Marshall Space Flight Center was the pilot Center, and the Core Financial Module was implemented at Marshall in October 2002. The Core Financial Module was then rolled out in three waves at the remaining NASA Centers:

- Wave 1 (October 2002) – Glenn Research Center
- Wave 2 (February 2003) – Headquarters, Johnson Space Center, Kennedy Space Center and Wave 2A (April 2003) – Ames Research Center
- Wave 3 (June 2003) – Langley Research Center, Goddard Space Flight Center, Dryden Flight Research Center, Stennis Space Flight Center

During the Agency rollout, the Core Financial Module replaced the legacy financial systems at each of the NASA Centers, building on the results of the previous waves and the pilot Center implementation at Marshall.

Conversion to the Integrated System Created Complex Accounting Problems

Conversion of legacy accounting data into the Core Financial Module significantly impacted the quality and timeliness of financial information and created complex accounting problems. In NASA's data conversion implementation process, transaction data from prior fiscal years were entered into the new financial system as though that data

[7] NASA's first effort—NASA Accounting and Financial Information System (NAFIS)—started in 1989 and was cancelled in early 1995. The second effort started in early 1995 and was cancelled in early 2000.

were current year activity. As a result, current year activity was immediately and significantly overstated. Transaction populations provided to PricewaterhouseCoopers for statistical sample testing could not be easily used. NASA could not present the data in a form that would allow PricewaterhouseCoopers to select appropriate samples for testing of FY 2003 transactions. Furthermore, NASA did not provide sufficient documentation that would support identification, resolution, and correction of those transactions.

The PricewaterhouseCoopers review and testing of June 30, 2003, interim statements was critical in determining whether NASA could produce auditable statements and meet the planned accelerated reporting schedule for FY 2003. The most significant errors included:

- The inability to reconcile the amount reported as Fund Balance with the Treasury (cash) to the general ledger;

- A $204 million line item in a principal financial statement (Consolidated Statement of Financing) that could not be explained or supported; and

- The inability to properly classify transactions for presentation on key financial statements (Balance Sheet and Statement of Net Cost).

Although management identified the errors noted above, they were unable to resolve them in a timely manner and, therefore, testing of June 30, 2003, account balances by PricewaterhouseCoopers was deferred to testing September 30, 2003, account balances. Those errors were symptomatic of more pervasive issues that were to become evident at year-end.

NASA management asserted that errors in the June 30, 2003, financial statements would be corrected in the September 30, 2003, year-end financial statements. However, when NASA first attempted to prepare the year-end financial statements, it concluded that significant problems still existed with the accuracy of the statements. NASA's efforts to correct those problems led to significant delays in its completion of the financial statements and compilation of documentation that supported the amounts and disclosures in the financial statements, including the support for resolution of the June 30, 2003, financial statement errors.

Due to the delays, NASA management delivered the year-end financial statements to the Office of Inspector General and PricewaterhouseCoopers on December 10, 2003, rather than on October 22, 2003, as originally planned. During the period of delay, the Office of Inspector General and PricewaterhouseCoopers requested information about the delays, but NASA management demurred and would not discuss the extent or nature of the problems in detail and suggested that disclosure would not further (and could interfere with) the efforts they were making to solve the problems in generating statements.

During its audit testing and review of the year-end financial statements, PricewaterhouseCoopers noted significant adjustments and differences. PricewaterhouseCoopers found that in preparing the statements, NASA posted numerous adjustments outside of the IFMP system. In its review of these adjustments, PricewaterhouseCoopers noted that the value of 87 adjustments was approximately $582 billion. Of the $582 billion in adjustments, nearly $565 billion was related to data conversion errors, and NASA could not provide for nearly the entire amount documentary evidence that would support the purpose and the validity of the adjustments.

Because of the magnitude of the adjustments and the inability of NASA to readily provide adequate supporting documentation, PricewaterhouseCoopers was unable to complete the audit even within the non-accelerated Office of Management and Budget due date of January 30, 2004. PricewaterhouseCoopers issued its disclaimer of opinion and cited in its Report on Internal Controls five reportable conditions,[8] including four conditions considered material weaknesses.[9]

PricewaterhouseCoopers Audit Identified Significant Weaknesses in NASA's Internal Controls

NASA continues to have weaknesses in internal controls. Internal controls are the policies and procedures an organization uses to safeguard assets and ensure accurate financial reporting. Examples of internal controls include appropriate reviews and approvals of transactions, accounting entries, and systems output; timely reconciliations; accurate recording of transactions; and adequate supervision. PricewaterhouseCoopers reported five significant weaknesses in internal controls:

- The first condition, and perhaps the most serious material weakness, was that NASA lacked a sufficient audit trail to support that its FY 2003 financial statements were presented fairly. That condition was a direct result of significant problems NASA encountered with conversion of data from its legacy systems to its IFMP financial systems. During testing, PricewaterhouseCoopers found that NASA did not maintain or have readily available—as the General Accounting Office and Office of Management and Budget guidance require—sufficient documentation to support its financial statements.

- The second condition, also a material weakness, was that NASA lacked effective internal controls surrounding its *Fund Balance with Treasury* (cash)

[8]American Institute of Certified Public Accountants standards define "reportable condition" as significant deficiencies in the design or operation of internal control that in the auditor's judgment could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

[9]American Institute of Certified Public Accountants standards define "material weakness" as a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

reconciliations.[10] Reconciliations of cash are critical and necessary to ensure that transactions are completely and accurately recorded and that the reported balances are correct. To correct cash imbalances between NASA and Treasury, NASA made adjustments of $2 billion, net, to its *Fund Balance with Treasury* to agree with Treasury's reported balance at September 30, 2003. Sufficient documentary evidence could not be provided to explain the adjustments. Such an unexplained adjustment to cash means that other accounts within the financial statements could have been significantly misstated, leading to incorrect and inaccurate reporting. The lack of effective reconciliations increases the risk of fraud, waste, abuse, and mismanagement.

- The third material weakness, which was a repeat condition, was that NASA's procedures for preparing its financial statements still needed improvement. In its FY 2002 Report on Internal Controls, PricewaterhouseCoopers found significant weaknesses in the compilation of NASA's financial statements and recommended that NASA improve its overall financial reporting procedures. While NASA demonstrated some progress in implementing PricewaterhouseCoopers's recommendation in FY 2003, significant weaknesses in the compilation of the financial statements remained. The delays in generating the FY 2003 financial statements were one example cited by PricewaterhouseCoopers. In addition, upon review of the financial statements, PricewaterhouseCoopers noted inconsistencies that should have been identified and corrected by NASA management through its internal quality control review of the financial statements.

- The fourth material weakness, also a repeat condition, was that NASA still lacked adequate controls to reasonably assure that property, plant, and equipment and materials were accurately and completely presented in its financial statements. PricewaterhouseCoopers reported a material weakness in this area during the FY 2002 audit. The weakness was primarily as a result of the lack of internal controls within NASA and at NASA contractors to ensure proper reporting and resulted in net errors of $2.8 billion. During FY 2003, NASA management created an overall corrective action plan designed to remedy deficiencies communicated within the FY 2002 audit report. However, problems remained after implementation.

- The fifth reportable condition related to the IFMP computing environment, which was responsible for processing NASA's significant financial applications. PricewaterhouseCoopers identified improvements needed to strengthen the design and implementation of NASA's information security program for the IFMP system. PricewaterhouseCoopers suggested improvements in IFMP security design and implementation, security controls over access to systems, general

[10] In its report titled, "Financial Audit, Issues Regarding Reconciliations of Fund Balances with Treasury Accounts," the General Accounting Office notes that the reconciliation process that agencies perform between their Fund Balances and Treasury accounts is an important tool in ensuring that the federal government is able to accurately measure the full cost of its programs**.**

controls in the distributed client server, and clarification of oversight functions supporting IFMP’s security program.

EFFORTS TO IMPROVE OVERALL NASA FINANCIAL MANAGEMENT

This year NASA management has taken initial steps toward improving financial management by developing an improvement plan to address the reported internal control weaknesses and to strengthen internal controls related to the business processes within the Agency. Similarly, the Office of Inspector General and the General Accounting Office have identified significant findings and have provided recommendations to NASA management to address its concerns.

NASA’s Corrective Action Plans

NASA asserts that successful completion of the NASA Financial Management Improvement Plan will provide accurate, timely, and consistent financial management information; deliver tools to efficiently manage resources; and provide stewardship of NASA’s budgetary resources. The NASA Financial Management Improvement Plan is designed also to address: budget and financial policies and procedures, property accountability, erroneous payments, travel and purchase card delinquency, data stabilization, standards management reporting, the NASA working capital fund, and establishing an audit committee.

The high-level goals of the NASA Financial Management Improvement Plan master schedule appear to be appropriate given the state of NASA’s financial systems and underlying records. However, because of the magnitude of the problems and the shortfalls in human resources, how the critical actions can be completed by the early to mid-Summer 2004 planned due date is unclear. While the intent may be to set stretch goals and keep individuals intensely focused on achieving these goals, setting realistic goals and meeting those goals is crucial to restoring NASA’s credibility in financial management.

NASA faces significant challenges in each of the key areas of the improvement plan. The Office of Inspector General believes that NASA has insufficient civil service staff to carry out its plan. NASA management has responded to this challenge by establishing a hiring plan and extensive use of contractor personnel. While heavy reliance on contractor support is necessary to get NASA financial management through the transition, the contractors are not planned to be a lasting part of the solution. The use of contractor support raises several concerns including: the role of contractors involved in the development of written policies and procedures; the transfer of knowledge and continuity of operations when civil service staff is left with the workload; and the ability of civil service staff to assume the role and workload of the contractors. The Office of Inspector General also questions whether the Chief Financial Officer organization has sufficient senior staff to meet the significant challenges.

Office of Inspector General and General Accounting Office Oversight

The Office of Inspector General has completed several audits of NASA's IFMP that found problems associated with NASA plans to test transactions before full implementation of the Core Financial Module and support full cost accounting. The audits also found significant problems with resolving data conversion and processing issues, schedule slippage, travel module reporting and interface, and information technology security planning and implementation.

In our completed Core Financial Module audits,[11] the Office of Inspector General reported that NASA did not develop a plan that resolved complex accounting issues and did not configure the Core Financial Module to adequately support full cost accounting. The Office of Inspector General also reported that the Agency did not plan to test and resolve any transactions, reports, and testing discrepancies before the full NASA-wide implementation of the Core Financial Module. In addition, the Agency did not use the contractor-developed IFMP Knowledge Sharing System to document and disseminate lessons learned. The Agency has accepted our recommendations and has taken appropriate remedial actions.

The Agency is facing serious challenges in implementing the remainder of the IFMP. As of May 5, 2004, the eight IFMP projects and their actual or scheduled completion dates are:

- Resume Management (completed in March 2002)
- Position Description Management (completed in October 2002)
- Travel Management (completed in May 2003)
- Core Financial (completed in June 2003)
- Budget Formulation (January 2005)
- Procurement Management (Fiscal Year 2006)
- Human Capital (Fiscal Year 2007)
- Integrated Asset Management (Fiscal Year 2008)

The Office of Inspector General audit of the Budget Formulation Module[12] noted that the scheduled implementation date had slipped from February 2004 to January 2005. Because of that slippage, NASA's planned use of the IFMP to implement cost-based budgeting—the final component necessary for full cost management—will be delayed until FY 2006. The module is experiencing significant processing performance problems. NASA did not include the input of critical users when developing the system

[11]"IFMP Core Financial Management Data Conversion Procedures" (Report No. IG-03-028, September 29, 2003); "IFMP Core Financial Testing Procedures" (Report No. IG-03-028, September 29, 2003); and "Integrated Financial Management Program Core Financial Module Conversion to Full Cost Accounting" (Report No. IG-03-015, May 30, 2003).

[12]"Integrated Financial Management Program Budget Formulation Module (BFM)" (Report No. IG-04-017, March 30, 2004).

and initially did not include five key requirements.[13] Only through successful implementation of the Budget Formulation Module will NASA be able to use IFMP to implement full cost management.

The Integrated Asset Management (Asset) Module, used to account for the Agency's contractor-held assets and its property, plant, and equipment, is scheduled to be implemented in FY 2008. Until that time, NASA must account for its contractor-held assets using alternative methods outside of the IFMP. The last three financial statement audits that the Office of Inspector General conducted reported material weaknesses in contractor-held property. Without a viable Asset Module, formidable challenges will remain.

NASA is currently responding to the Office of Inspector General draft audit report on the Travel Module[14] that found that the Travel Module was not in compliance with Federal travel system requirements in two key areas: (1) required reporting capabilities, and (2) interface with the Core Financial Module. The lack of compliance with Federal requirements in those two areas creates a management control weakness in which NASA management is unable to monitor and document Agency travel expenditures and transactions from initiation through final posting to Agency accounting records.

The Office of Inspector General also performed a limited scope audit of Information Technology (IT) security planning and implementation for the Core Financial Module. That audit was coordinated with PricewaterhouseCoopers to avoid duplication of efforts. The audit report makes several recommendations that are designed to improve segregation of duties, controls over locally developed programs, and the investigation of IFMP security-related incidents. Those control improvements should reduce the risk of financial system compromise and the processing of unauthorized transactions. The Agency concurred with the recommendations and is in the process of taking corrective actions.[15] The General Accounting Office also issued four reports in November 2003 detailing weaknesses in IFMP.[16]

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[13]The requirements were (1) data integrity business checks that would ensure that budget planners do not assign the wrong appropriation to a project, (2) full system traceability (audit trail), (3) restricted access to embargoed budget data, (4) acceptable system response time, and (5) an on-line quick reference tool. Those five key system requirements were critical to Center program and project staff in developing their bottoms-up budget data and is the primary reason that NASA needed those requirements included in the initial release.

[14] "IFMP Travel Module" (Assignment No. A-01-061-04. Draft report issued April 15, 2004).

[15] Integrated Financial Management Program Core Financial Project Information Technology Security Planning and Implementation (Assignment No. A-02-024-00, Report No. IG-04-016, March 31, 2004).

[16] General Accounting Office (GAO) reports are: "Business Modernization – NASA's Challenges in Managing Its Integrated Financial Management Program" (Report No. GAO-04-255, November 2003); "Business Modernization – Disciplined Processes Needed to Better Manage NASA's Integrated Financial Management Program" (Report No. GAO-04-118, November 2003); "Information Technology – Architecture Needed to Guide NASA's Financial Management Modernization" (Report GAO-04-43, November 2003); and "Business Modernization – NASA's Integrated Financial Management Program Does Not Fully Address Agency's External Reporting Issues" (Report No. GAO-04-151, November 2003).

OUTLOOK FOR THE FUTURE

The future of financial management at NASA is at a crossroads. Accurate, complete, and timely financial information is critical for the successful and effective management of NASA's programs and projects. Sound internal controls and accounting practices will facilitate a successful independent financial audit. Without successful implementation of NASA's IFMP, those goals will be difficult, if not impossible, to achieve. NASA must resolve long-standing weaknesses and address data integrity problems associated with the conversion.

The Office of Inspector General is closely monitoring NASA's efforts to improve financial management through oversight of the financial audit being conducted by NASA's new independent public accountant, Ernst & Young. The Office of Inspector General also will be conducting other activities to assess financial management including auditing the overall status of IFMP. The Office of Inspector General believes it is important that NASA gets its financial management in order so that the Congress and the public can have full confidence in Agency expenditures of taxpayer dollars.