

National Aeronautics and
Space Administration



Office of Inspector General
Washington, DC 20546-0001

November 15, 2010

TO: Charles F. Bolden, Jr.
Administrator

Elizabeth Robinson
Chief Financial Officer

FROM: Paul K. Martin 
Inspector General

SUBJECT: Audit of the National Aeronautics and Space Administration's
Fiscal Year 2010 Special-Purpose Financial Statements (Report
No. IG-11-008; Assignment No. A-10-005-03)

The Office of Inspector General contracted with the independent public accounting firm Ernst & Young LLP (EY) to audit NASA's special-purpose financial statements in accordance with the Government Accountability Office's *Government Auditing Standards* and the provisions of Office of Management and Budget Bulletin No. 07-04, "Audit Requirements for Federal Financial Statements," as amended. EY also reported on NASA's consolidated general-purpose financial statements: "Audit of the National Aeronautics and Space Administration's Fiscal Year 2010 Financial Statements" (Report No. IG-11-006, November 12, 2010).

NASA's special-purpose financial statements were prepared in accordance with the guidance provided in the U.S. Department of the Treasury's Financial Manual (TFM), Volume I, Part 2, Chapter 4700. To assist the Department of the Treasury in preparing the Financial Report of the United States Government, NASA's general-purpose financial statements were reclassified into a standard format for consolidation with those of other Federal agencies. In addition, NASA's intragovernmental balances were separated and reported by Federal agency to facilitate the elimination of agency-to-agency transactions.

The audit resulted in a qualified opinion on NASA's FY 2010 special-purpose financial statements due to the valuation of property, plant, and equipment (PP&E) and materials in prior years and the possible effects to the current year reclassified statements of net cost and changes in net position. A qualified opinion means that except for the effects of the matter to which the qualification relates, the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in conformity with U.S. generally accepted accounting principles. The results of the FY 2010 audit were a notable improvement over the FY 2009 audit when the Agency received a disclaimer of opinion due to continued weaknesses in internal controls over accounting for legacy PP&E.

In fulfilling our responsibilities, we monitored the progress of the audit, reviewed EY's report and related documentation, inquired of its representatives, and ensured that EY met contractual requirements. Our review was not intended to enable us to express, and we do not express, an opinion on NASA's special-purpose financial statements, conclusions about the effectiveness of internal controls over financial reporting, or compliance with the TFM.

EY is responsible for the enclosed report and the conclusions expressed therein. Our review, while still ongoing, disclosed no instances where EY did not comply in all material respects with the Government Accountability Office's *Government Auditing Standards*.

Please contact us if you have any questions about the enclosed report.

Enclosure

Report of Independent Auditors

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

We have audited the accompanying reclassified consolidated balance sheet of the National Aeronautics and Space Administration (NASA) as of September 30, 2010, and the related reclassified consolidated statements of net cost and changes in net position for the fiscal year then ended, (hereinafter referred to as the special-purpose financial statements) contained in the special-purpose closing package of the National Aeronautics and Space Administration (NASA.) We were engaged to audit the reclassified consolidated balance sheet of NASA as of September 30, 2009, and the related consolidated statements of net cost and changes in net position for the fiscal year then ended. These special-purpose financial statements are the responsibility of NASA's management. Our responsibility is to express an opinion on these special-purpose financial statements based on our audits.

Except as discussed in the fourth paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and bulletin require that we plan and perform the audit to obtain reasonable assurance about whether the special-purpose financial statements are free of material misstatement. We were not engaged to perform an audit of NASA's internal control over financial reporting for the special-purpose financial statements. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NASA's internal control over financial reporting for the special-purpose financial statements. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the special-purpose financial statement presentation, assessing the accounting principles used and significant estimates made by management, and evaluating the overall special-purpose financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The accompanying special-purpose financial statements and accompanying notes contained in the special-purpose closing package have been prepared for the purpose of complying with the requirements of the U.S. Department of the Treasury's Financial Manual (TFM) Volume I, Part 2, Chapter 4700 solely for the purpose of providing financial information to the U.S. Department of the Treasury and U.S. Government Accountability Office (GAO) to use in preparing and auditing the *Financial Report of the U.S. Government*, and are not intended to be a complete presentation of NASA's financial statements.

During fiscal year 2009, NASA continued its focused efforts to resolve legacy issues identified in its financial management processes and systems. Although significant progress had been made, internal controls related to the accounting for property, plant and equipment (PP&E) and operating materials and supplies (OM&S) were determined to be ineffective in fiscal year 2009. As a result of these deficiencies in internal control, we were unable to obtain sufficient competent evidential support for the amounts presented in the consolidated balance sheet as of September 30, 2009 and the related consolidated statements of net cost and changes in net position and the combined statements of budgetary resources for the fiscal year then ended. Furthermore, these scope limitations affected our ability to audit the following amounts in the accompanying fiscal year 2010 consolidated statements of net costs and changes in net position: (i) the beginning balance of cumulative results of operations; (ii) the cumulative effect of a change in accounting principle for OM&S at October 1, 2009; and (iii) depreciation, PP&E and OM&S related amounts arising from fiscal year 2009 and prior activity which enter into the determination of amounts included in the net cost of operations for fiscal year 2010.

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 reclassified consolidated balance sheet as of September 30, 2009, and the related reclassified consolidated statements of net cost and changes in net position for the fiscal year then ended contained in the special purpose closing package of NASA.

In our opinion, the fiscal year 2010 special purpose financial statements, referred to above present fairly, in all material respects, the financial position of NASA as of September 30, 2010, and except for the effects of such adjustments, if any, on the consolidated net cost of operations and consolidated changes in net position of the matters described above in the fourth paragraph related to PP&E and OM&S balances, its consolidated net cost and consolidated changes in net position for the year ended September 30, 2010, in conformity with accounting principles generally accepted in the United States and the presentation pursuant to the requirements of the TFM Chapter 4700.

As discussed in Note 5 to the reclassified financial statements, NASA has elected to change its method of accounting for OM&S from the consumption method to the purchases method as allowed under Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property* as of October 1, 2009.

The information included in the Other Data is presented for the purpose of additional analysis and is not a required part of the special-purpose financial statements, but is supplementary information required by the TFM Chapter 4700. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methodology and presentation of this information. We also reviewed such information for consistency with the related information presented in NASA's financial statements. However, we did not audit this information, and accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have also issued reports dated November 15, 2010, on our consideration of NASA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws and regulations and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit of principal financial statements performed in accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, and should be considered in assessing the results of our audit.

In planning and performing our work on the special-purpose financial statements, we also considered NASA's internal control over the financial reporting process for the special-purpose financial statements and compliance with the TFM Chapter 4700. NASA's management is responsible for establishing and maintaining internal control over financial reporting, including Other Data, and for complying with laws and regulations, including compliance with the TFM Chapter 4700 requirements.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We found no material weaknesses in internal control over the financial reporting process for the special-purpose financial statements, and our tests of compliance with the TFM Chapter 4700 requirements disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended. However, providing opinions on internal control over the financial reporting process for the special-purpose financial statements or on compliance with the TFM Chapter 4700 requirements were not objectives of our audit of the special-purpose financial statements and, accordingly, we do not express such opinions.

This report is intended solely for the information and use of NASA, the U.S. Department of the Treasury, the OMB and the GAO in connection with the preparation and audit of the Financial Report of the U.S. Government and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 15, 2010
McLean, VA