

**Testimony before the Science Subcommittee on Space and Aeronautics and  
the Government Reform Subcommittee on Government Management, Finance  
and Accountability**

**U.S. House of Representatives**

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**Financial Management at NASA:  
Challenges and Next Steps**

**Statement of**

**The Honorable Robert W. Cobb**

**Inspector General**

**National Aeronautics and Space Administration**



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Chairmen, Ranking Members, and Members of the Subcommittees:

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

My testimony will address the specific questions in your letter of October 7, 2005, regarding NASA's financial management challenges and next steps.

### Implementation of the Core Financial Module

NASA received a disclaimer of opinion on its financial statements as a result of the Independent Public Accountant (IPA) audits in FY 2003 by PricewaterhouseCoopers and in FY 2004 by Ernst & Young LLP (E&Y); a disclaimer of opinion is expected from E&Y again for FY 2005 because NASA has been unable to provide auditable financial statements and sufficient evidence to support statements throughout the fiscal year. The reports that the IPAs have submitted identify instances of noncompliance with generally accepted accounting principles, reportable conditions<sup>1</sup> (with most being material weaknesses<sup>2</sup>) in internal controls, and noncompliance with the Federal Financial Management Improvement Act (FFMIA) and the Improper Payments Information Act of 2002 (IPIA). Many of the weaknesses the audits disclosed resulted from a lack of effective internal control procedures and continued data integrity issues, as well as problems related to NASA's conversion in FY 2003 from 10 separate systems to a new single Integrated Enterprise Management Program (IEMP).<sup>3</sup> NASA implemented the Core Financial module<sup>4</sup> in FY 2003. Now, 2 years later, the Agency cannot produce auditable financial statements because the data in the module is incomplete and inaccurate.

### Persistent Internal Control Weaknesses

Internal control weaknesses from FY 2004 still exist today, which have impacted the FY 2005 audit, and data conversion issues have not been fully resolved. For example, incomplete data was transferred to the Core Financial module and, in some cases, that data was posted to the

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<sup>1</sup> American Institute of Certified Public Accountants standards define reportable conditions 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.

<sup>2</sup> American Institute of Certified Public Accountants standards define a 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.

<sup>3</sup> IEMP was previously referred to as the Integrated Financial Management Program (IFMP). The IEMP processes NASA's significant financial applications.

<sup>4</sup> The Core Financial module consists of the standard general ledger, accounts receivable, accounts payable, purchasing, cost management, and general systems management.

wrong accounts. NASA's continued problems in resolving its internal control weaknesses have contributed to its inability to produce complete and accurate financial statements. Many of NASA's internal control deficiencies are material weaknesses that have been reported for several years, as shown in Table 1. Two of the most significant material weaknesses are property, plant, and equipment and materials (PP&E) and Fund Balance with Treasury (FBWT).

<b>Table 1. Internal Control Deficiencies</b>						
Fiscal Year		2005	2004	2003	2002	2001
Independent Public Accountant		E&Y	E&Y	PwC <sup>1</sup>	PwC	PwC
Audit Opinion		Disclaimer <sup>2</sup>	Disclaimer	Disclaimer	Unqualified	Disclaimer
Internal Control Deficiencies	General Controls Environment <sup>3</sup>	—	material weakness	reportable condition	reportable condition	—
	Property, Plant, and Equipment and Materials	material weakness <sup>2</sup>	material weakness	material weakness	material weakness	material weakness
	Financial Statement Preparation Process and Oversight	material weakness <sup>2</sup>	material weakness	material weakness	material weakness	—
	Fund Balance with Treasury	material weakness <sup>2</sup>	material weakness	material weakness	—	—
	Audit Trail and Documentation to Support Financial Statements <sup>4</sup>	—	—	material weakness	—	—
	Environmental Liability Estimation	reportable condition <sup>2</sup>	reportable condition	—	—	reportable condition
	Information Systems Controls <sup>5</sup>	—	—	—	—	reportable condition

<sup>1</sup> PricewaterhouseCoopers.

<sup>2</sup> Expected, based on E&Y's preliminary testing.

<sup>3</sup> General Controls Environment weaknesses have been mostly resolved for FY 2005. The segregation of duties component of this weakness will be included in the Financial Statement Preparation Process and Oversight weakness in FY 2005.

<sup>4</sup> The weakness on Audit Trail cited in FY 2003 continued to exist in FY 2004 and FY 2005; however, the auditor included it in the overall Financial Statement Preparation Process and Oversight weakness in FY 2004 and is expected to do the same in FY 2005.

<sup>5</sup> This area includes disaster recovery tests, systems constraints, logical access controls, and access controls to mainframe, and included four individual reportable conditions cited in FY 2001 that continued to exist in FY 2002; however, the auditor included them in the General Controls Environment weakness in FY 2002.

### Inadequate Corrective Action Plans

The Agency has not been able to articulate with clarity comprehensive action plans for how it will address its internal control weaknesses or its financial management problems. Over the past 3½ years, the Agency has attempted to develop several corrective action plans to correct the identified weaknesses, but those plans have not outlined a clear strategy for resolving those weaknesses, nor have they been put into final form. My office continues to work with the Office of the Chief Financial Officer (OCFO), as it has for the past 3½ years, toward solutions.

NASA must solve these issues by coordinating and implementing corrective action plans that are the product of NASA program and institutional leadership, within parameters set by financial management and accounting laws and regulations. The plans must be detailed enough to ensure successful implementation with desired results.

You have asked

**What progress has NASA made in addressing the financial management challenges identified in the audit reports from the past two years? Specifically, address each of the following areas identified in previous audits:**

- **internal control weaknesses and financial statement preparation procedures, including inconsistent procedures among NASA Centers;**
- **discrepancies in Fund Balance with Treasury;**
- **controls over Property, Plant, and Equipment and Materials; and controls over estimating NASA's environmental liability.**

- **What progress has NASA made in addressing the financial management challenges identified in the audit reports from the past two years?**

NASA has demonstrated some limited progress in addressing three of its four reported material weaknesses and one reportable condition from the FY 2004 audit. NASA has made significant progress in correcting the fourth material weakness reported by E&Y in FY 2004, "Improvements in the IFMP Control Environment" (included as part of the General Controls Environment shown in Table 1).

NASA also achieved some limited success in producing interim financial statements from its Core Financial module, although many manual adjustments were still necessary. NASA generated its year-end financial statements directly from the Core Financial module. It accomplished this by posting adjustments in the module, rather than manually adjusting the financial statements. We are assessing the appropriateness and accuracy of those posted adjustments. Other areas of progress include the implementation of reconciliation procedures for selected general ledger accounts and preparing checklists for Centers to complete and sign to certify the transactions. We also note that the OCFO has added additional personnel, filled key leadership positions, and established a Quality Assurance office. The Quality Assurance office has the responsibility of providing oversight and quality control reviews of financial management and assisting the Centers with compliance issues. In addition, the Center Chief Financial Officers now report to the NASA Chief Financial Officer instead of the Center directors.

NASA also made some progress on the material weakness in "Property, Plant, and Equipment and Materials" by developing an Internet-based Contractor Held Asset Tracking System (CHATS) for contractors to report information on their contractor-held, NASA-owned property.

- **Specifically, address each of the following areas identified in previous audits: . . . internal control weaknesses and financial statement preparation procedures**

NASA's procedures for preparing financial statements have improved since the preparation of the FY 2004 statements. Specifically, the OCFO implemented a checklist for completing the statements, supervisory reviews of the statements are now documented, and an analysis for each line item is now prepared to ensure adjustments are made when required.

For the three interim (quarterly) reporting periods during FY 2005, the OCFO produced its quarterly financial statements from the Core Financial module but had to make many high dollar-value line item adjustments. Those adjustments had to be made because of data integrity and configuration issues with the Core Financial module. For example, "unexpended appropriations" was decreased by \$1.157 billion; "cumulative result of operation" was increased by \$626 million; and "appropriations received" was decreased by \$296 million.

Based on reviews by E&Y and my office of the first, second, and third quarter statements, the Balance Sheet from the Core Financial module did not balance (i.e., assets do not equal liabilities plus equity). In addition, E&Y could not always find an audit trail from the Core Financial module general ledger accounts to the financial statements. NASA needs to consistently ensure that the general ledger accounts are properly mapped to the financial statements and adjustments are properly supported. Also, Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires that financial reporting meet the objective of providing program managers with relevant and reliable information related to program costs. However, the OCFO does not report net costs by mission directorate.

Subsidiary Account Ledgers. During FY 2004, E&Y found that the OCFO could not routinely provide listings of subsidiary balances to support accounts receivable, accounts payable, and undelivered orders, as well as cash receipts and cash disbursements. These problems have not been fully resolved during the FY 2005 audit. In order for E&Y to test the account balances, NASA had to create reports from the subsidiary ledgers for accounts receivable, accounts payable, and undelivered orders. Once E&Y auditors started testing the sample account balances from those prepared reports, they noted that the subsidiary ledgers did not have running balances, but were just a list of actual transactions. As a result of receiving transaction data and not balances, E&Y had to redesign its testing procedures to recreate the account balances. In addition, when E&Y tried to test the account balances for cash receipts and cash disbursements, it determined that those accounts contained prior-year transactions. Those prior-year transactions had been included in reports to the Treasury covering FY 2005 activity.

Adjustments and Corrections. PricewaterhouseCoopers found that the Core Financial module does not allow the OCFO to identify, differentiate, and track non-routine and corrected transactions from original transactions or prior-year transactions (e.g., prior-period adjustments). During FY 2005, NASA made adjustments in its current-year financial data to correct errors from the FY 2003 data conversion. It is important for the auditors, as well as the OCFO, to quantify the dollar impact of prior-period adjustments because the financial statements should only represent current-year activity. At the present time, this cannot be done in the Core Financial module.

Prior to the preparation of the FY 2005 year-end financial statements, thousands of adjustments were recorded outside the Core Financial module to address data conversion errors. The manner in which the Agency corrects those errors loses the audit trail. Specifically, to record the adjustments within the Core Financial module, users deleted the incorrect transaction completely and entered the correct transaction in its place. The needed solution is reversing the incorrect entry and entering the correction (which would leave an audit trail).

- **Specifically, address each of the following areas identified in previous audits: . . . including inconsistent procedures among NASA Centers**

E&Y's internal controls testing at NASA Centers during FY 2005 determined that the Centers have various workaround procedures, which are outside of normal, established accounting procedures. For example, one Center had its own tracking system to ensure compliance with the Prompt Payment Act, while another Center used the Core Financial module for that purpose.

To improve its financial practices, NASA created standardized Financial Management Requirements (FMRs), which are designed to enable consistent financial policies, processes, and data management among NASA Headquarters and its Centers. NASA has released 13 FMRs since September 2004. NASA released eight FMRs at the end of FY 2004 and five during FY 2005. These FMRs include policies and procedures applicable to such critical financial management processes as budget execution, accounting, external reporting, internal management controls, and periodic monitoring of controls and activities. We have not assessed whether the FMRs comply with accounting principles and practices.

The OCFO's Quality Assurance office completed quality assistance visits to NASA Centers and at Headquarters in September 2005. The visits focused on determining the adequacy of compliance at Centers and affected Headquarters organizations, to include compliance with NASA's FMRs. The visits were also an opportunity for the Quality Assurance office to assist with any questions or concerns in identifying and improving financial management practices and internal controls and to assess the current financial management control structure. We are awaiting the results of these visits. All indications from discussions with the personnel who made the visits is that, if they had to provide a red, yellow, or green rating, most Centers would receive a yellow rating. My office has not assessed the quality assurance process, but we note that the office is understaffed and has been required to fulfill multiple obligations beyond quality assurance.

- **Specifically, address each of the following areas identified in previous audits: . . . discrepancies in Fund Balance with Treasury;**

NASA still has unresolved discrepancies with its FBWT. As of September 30, 2005, NASA's FBWT account was \$59 million higher than Treasury's balance. This figure is a net number. The absolute value of the difference is \$1.13 billion when you add together the differences, at the Center level, of "Application of Funds." E&Y is currently reviewing the reconciliation and

the underlying information. E&Y’s audit of NASA’s FY 2004 financial statements also found differences between the two fund balances.

The FY 2003 audit report from PricewaterhouseCoopers found that NASA posted year-end adjustments of approximately \$1.743 billion to decrease the Core Financial module’s balance to that of the Treasury’s balance. Those year-end adjustments to the FBWT account were not recorded in the Core Financial module.

On March 24, 2005, we issued a memorandum to the Chief Financial Officer addressing NASA’s corrections of approximately \$1.598 billion of the net \$1.743 billion discrepancy in the FY 2003 FBWT. Our work on the FBWT through March 2005 led us to conclude that the remaining amount of net adjustments to be corrected was \$144 million. It should be noted that while the net amount was \$144 million, the absolute value of those adjustments (when increases and decreases to the FBWT account are added together) was \$7.018 billion. Table 2, which we included in the memorandum to the Chief Financial Officer, shows the absolute and net values of the adjustments, the amounts of OCFO corrections, and the amounts we verified.

<b>Table 2. FY 2003 FBWT Account Adjustments and Corrections</b> (as of March 11, 2005)				
<u>Area</u>	<u>Adjustments</u>		<u>Corrections</u>	
	<u>Absolute Value</u>	<u>Net Value</u>	<u>Made by OCFO</u>	<u>Verified by OIG</u>
Document Conversion	\$1,107,764,967	\$1,107,764,967	\$1,106,184,777	\$1,100,898,909
Canceled Appropriations	490,427,221	490,427,221	490,427,221	490,427,221
Trust Fund Transfer	1,001,441	1,001,441	1,001,441	1,001,441
Other Reconciling Items	7,018,223,532	144,088,468	unknown	0
<b>Total</b>	<b>\$8,617,417,161</b>	<b>\$1,743,282,097</b>	<b>\$1,597,613,439</b>	<b>\$1,592,327,571</b>

On May 31, 2005, the OCFO issued comprehensive, Agencywide FBWT reconciliation procedures to each Center to ensure that monthly reviews and correction of data would be consistent across all Centers. We believe those procedures will ensure consistency and also readily identify differences to be resolved. The OCFO’s Quality Assurance office has been conducting onsite quality assistance reviews of Center compliance with the new procedures. We anticipate reviewing those results when they are finalized.

As of September 30, 2005, the OCFO reported that the remaining FY 2003 adjustments requiring correction totaled a net of \$23 million, meaning NASA’s FBWT account was still \$23 million higher than what Treasury reported. While this is significant progress from March 2005, when we reported a net of \$144 million adjustments remaining in the “Other Reconciling Items” category, we have not yet had an opportunity to validate the corrections made. Preliminary documentation provided by the OCFO does not provide sufficient competent evidence. For example, the \$144 million we reported comprised three journal vouchers posted outside of the Core Financial module at the end of FY 2003. Our initial review of OCFO’s analysis to support the \$23 million does not show that those vouchers have been corrected in the system.

- **Specifically, address each of the following areas identified in previous audits: . . . controls over Property, Plant, and Equipment and Materials**

For the last 3 years, internal controls over PP&E has been identified as a material weakness. PP&E totals approximately \$34.6 billion and comprises more than 75 percent of NASA's assets. The reported weaknesses were due primarily to a lack of PP&E capitalization policy and NASA's reliance on contractors to value property they hold.

NASA had hoped that the implementation of the Integrated Asset Management (IAM) module would serve as a cornerstone to the resolution of NASA property problems. However, in June 2005, NASA postponed the implementation of the IAM module pending architectural review.

Lack of PP&E Capitalization Policy. Over the past two fiscal years (FYs 2003 and 2004), auditors have recommended that NASA implement a formal capitalization policy for property. The Agency has implemented a number of initiatives to deal with issues concerning PP&E, but it has not articulated what the elements of a properly working property management and accounting system would involve. The internal control report from the FY 2004 audit articulates what NASA needs to do:

NASA's approach to recognizing and accounting for fixed assets is heavily dependent on activities at its contractors, and subsequent reviews to determine amounts that 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.

This is the heart of the findings of material weaknesses in accounting for PP&E identified in the past several financial statement audits. Fundamentally, NASA has not yet addressed the problem. For example, NASA has not established a system that relies on the Agency's personnel, not contractors, to establish what costs are capitalized and expensed as the dollars on a particular contract are spent.

As part of NASA's ongoing efforts to address the capitalization issue, the OCFO put out a white paper in September 2005 with an analysis of theme assets and a proposed capitalization policy for theme assets. While dialogues continue between my office and the OCFO regarding the analysis and proposed policy, theme asset capitalization is just one component of the overall property capitalization problem reported over the years. Therefore, NASA's focus on implementing capitalization policy for theme assets by itself does not adequately address the PP&E weakness articulated in the FY 2004 report.

Lack of NASA Validation of Contractor-Held PP&E. In both the FY 2004 and the FY 2003 financial statement audits, NASA validation of information provided by contractors concerning contractor-held PP&E was cited as a weakness. At the time of those audits, NASA contractors periodically reported PP&E values to NASA manually on a spreadsheet called NASA Form 1018, a process that the IPAs stated was prone to error. At a minimum, they recommended that

NASA ensure that all of its contractors have formal policies and procedures in place to detect and correct errors in PP&E values the contractors report to NASA. During E&Y's FY 2004 audit, it found a \$300 million computational error in the NASA Form 1018s. The error, which was discovered by neither the contractors nor NASA's validation process, highlights the control weaknesses in this area.

To address the problem, NASA automated its contractor PP&E reporting process in FY 2005 by implementing CHATS. While replacing the manual process with an automated one is a step in the right direction, data is still entered manually because CHATS does not interface with the contractors' systems. Therefore, we do not believe that CHATS decreases the risk of errors. Further, PP&E data can be entered by a single contractor representative, and there appears to be no evidence of supervisory review of the PP&E reporting process at the contractors.

NASA's approach to the PP&E validation process was to decentralize it by shifting validation responsibilities to the NASA Centers. NASA stated that decentralizing the validation responsibilities allows NASA Headquarters to focus more effectively on conducting oversight of the process. NASA now holds regularly scheduled teleconferences with property accountants at various NASA Centers and contractors to discuss the status of the corrective actions taken to resolve previously reported deficiencies. The periodic teleconferences will help NASA resolve some of the problems. However, decentralizing the PP&E validation process requires effective oversight by NASA Headquarters and a strong internal control environment at the Centers. As NASA's control weakness in this area is persistent, it is imperative that NASA Headquarters develop a strategic plan for how effective oversight will be accomplished. We also note that there are two reporting systems for contractor-held assets that are not being reconciled (CHATS and NASA Form 533s, used by contractors to report project costs as costs are being incurred).

Also, in FY 2004, NASA developed procedures to address the contractor-held PP&E deficiency, including risk assessment of various contractors to be used by the Defense Contract Audit Agency (DCAA) in reviewing contractor-held property for its FY 2005 audit. NASA is relying on the results of DCAA's work to provide a review of contractors' corrective action plans for previously reported deficiencies. E&Y is in the process of reviewing that work.

- **Specifically, address each of the following areas identified in previous audits: . . . controls over estimating NASA's environmental liability.**

NASA's environmental liabilities totaled \$986 million in FY 2004. E&Y identified NASA's ability to generate an auditable estimate of its unfunded environmental liabilities as a weakness during E&Y's FY 2004 audit of those liabilities and related financial statement disclosures. The reportable condition occurred because of four problem areas in NASA's estimation process: roles and responsibilities; training; documentation; and quality assurance procedures.

Roles and Responsibilities. During the FY 2004 audit, E&Y noted that roles and responsibilities for the estimation of unfunded environmental liabilities were not sufficiently defined to ensure appropriate integration and input into the estimation process. Specifically, NASA's accounting function deferred to the Environmental Management Division for

preparing estimates. As a result, environmental professionals were interpreting accounting requirements. During E&Y's testing of FY 2005 internal controls over the environmental estimation process, the auditors noted that OCFO representatives were present at Centers during some portions of the environmental liability estimation process, but that their role was limited to that of audit liaison. The OCFO still has not taken on the role as the principal accounting decisionmaker in the environmental liability estimation process.

Training. In FY 2004, E&Y reported that NASA personnel and its contractors had not received sufficient training in the process for estimating environmental liabilities. Although NASA released a handbook on environmental cost restoration in June 2004 to provide guidance to the NASA Centers, the handbook is not detailed enough to produce auditable estimates. In June 2005, NASA's Environmental Management Division conducted estimation training and invited OCFO participation, but OCFO employees did not attend. While that training is a step in the right direction, joint training needs to be held that addresses detailed estimation processes and requirements to produce auditable estimates. E&Y noted that the training left Center estimators with many unanswered questions regarding the estimation process.

Documentation. E&Y reported during FY 2004 that NASA did not have adequate, auditable documentation to support its FY 2004 environmental liability estimates. NASA developed a corrective action plan for the environmental liability estimation weakness, but did not submit it to E&Y until late in FY 2005. E&Y testing for the FY 2005 audit indicates that the OCFO is still not able to provide sufficient documentation. In addition, E&Y noted that the Environmental Management Division was not in agreement with some of E&Y's findings, which could further delay implementation of corrective actions. Until such actions are taken, NASA will not be in a position to provide documentation that will stand audit scrutiny.

Quality Assurance Procedures. E&Y reported in FY 2004 that NASA did not conduct formal, independent quality reviews of the Centers' environmental liability estimates before including the estimates in NASA financial statements. In FY 2005, NASA created an advocate role at each of the Centers to review estimates before including them in the financial statements. Although NASA is not conducting formal, independent quality reviews, E&Y stated that the creation of an advocate role is a positive step forward; however, that advocate role must be staffed appropriately, and procedures and requirements for the review, including formal documentation, must be implemented.

- **What financial management challenges remain?**

There are three basic requirements for sound financial management: (1) financial statement amounts are obtained from the financial management system and adjustments outside of the system are generally limited, (2) financial statement amounts agree with the general ledger trial balance, and (3) detailed transactions are maintained in subsidiary ledgers that agree with the amounts reported on the financial statements. NASA's financial management system, specifically the Core Financial module, does not meet those requirements. The outlook for future financial statement audits is highly dependent on whether an IPA can rely on NASA's system of internal controls, NASA's ability to generate complete and accurate financial statements from its Core Financial module, and NASA's ability to provide a clear and accurate

audit trail. In addition, establishing reliable internal controls will be a particular challenge with respect to NASA-owned, contractor-held assets, a significant Balance Sheet item. Data integrity is an issue for both challenges.

- **What are the underlying causes of these challenges?**

E&Y found that NASA's financial records continued to be plagued with data integrity issues, which adversely affected NASA's ability to prepare accurate financial statements for FY 2005. NASA made adjustments to the interim financial statements outside of the system to arrive at the amounts reported externally on the financial statements either because of continuing data integrity issues related to NASA's conversion in FY 2003 from 10 separate systems to a new single system or because current-year transactions were not properly processed.

The following are some examples of problems that have been identified during the FY 2005 audit:

- SAP<sup>5</sup> functionality creates inappropriate transaction postings in some account balances. For example, during the third quarter of FY 2005, NASA reported that accounts payable balances existed that were considered invalid because they related to canceled appropriations.
- SAP could not distinguish between current-year transactions and corrections to prior-year transactions posted in the current year.
- During reporting for the third quarter of FY 2005, amounts reported for financial statement line items had to be manually adjusted to arrive at the amounts NASA reported to the Office of Management and Budget. For example, "unexpended appropriations" was decreased by \$1.157 billion; "cumulative result of operation" was increased by \$626 million; and "appropriations received" was decreased by \$296 million. NASA indicated that the adjustments were due to corrections posted in the current year in an effort to resolve data integrity issues from prior years.
- The SAP configuration for NASA's Core Financial module does not capture all relevant information for financial reporting. For example, the OCFO stated that information relating to recovery of prior-year obligations (upward and downward obligation adjustments) is not routinely isolated in SAP-produced reports.

These financial management system deficiencies will result in E&Y's inability to determine whether NASA's financial statements are fairly stated in all material aspects.

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<sup>5</sup> The IEMP software, procured from Systems, Applications, and Programs (SAP) Public Sector and Education, Inc., is referred to as SAP.

- **How will the new requirements levied in Office of Management Budget Circular A-123, “Management’s Responsibility for Internal Control” present new challenges to NASA’s financial management efforts?**

Given that NASA has three multi-year repeat weaknesses in internal controls, it will have difficulty in meeting documentation requirements under the revised OMB Circular A-123, *Management’s Responsibility for Internal Control*, dated December 21, 2004. We noted three new, specific requirements in the OMB Circular: (1) documenting the Agency’s understanding of its internal controls over financial reporting; (2) documenting the assessment process of internal controls, which align with management’s assertions for each account or group of accounts over financial reporting; and (3) documenting the tests of operating effectiveness of controls whose design is deemed effective or moderately effective. These new requirements must be met starting in FY 2006.

The key message underlying the three requirements is documentation. Competent and sufficient documentation supporting NASA’s financial statements is required but continues to be a challenge for NASA, judging by the delay E&Y experienced in obtaining updates from NASA on E&Y’s previous year’s “cycle memorandums.” Cycle memorandums document the auditor’s understanding of the key processes surrounding financial transactions. It provides the policies regulating the process, the procedures followed in the process, and the types of internal control procedures present and in operation throughout the Agency. In order for NASA to meet the OMB Circular’s FY 2006 requirements, NASA must meet the challenge of documenting its own understanding of controls over financial reporting.

- **What progress has NASA made in implementing an integrated financial management system?**

NASA continues to make progress in implementing IEMP. The Agency has completed implementation of several modules in addition to the Core Financial module:

- Resume Management, a resume-based hiring system (March 2002);
- ERASMUS, a Web-based project portfolio management system (October 2002);
- Position Description Management, the automated preparation and classification of NASA position descriptions (October 2002);
- Travel Manager, a Web-based travel authorization and voucher system (May 2003);<sup>6</sup>
- E-Payroll, the migration of NASA’s payroll and personnel system to the Department of Interior (August 2004);
- Recruitment One-Stop Phase II, the transmission of NASA’s vacancy announcements to the Office of Personnel Management (October 2005); and

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<sup>6</sup> In March 2007, NASA plans to replace Travel Manager with E-Travel, which is part of the President’s E-Gov initiatives and is the General Services Administration’s vendor for travel.

- Agency Labor Distribution System, a standardized, single NASA system for calculating and allocating labor costs (October 2005).

Most recently, on October 18, 2005, NASA implemented Phase I of Project Management Information Improvement (PMI<sup>2</sup>). PMI<sup>2</sup> is a data management process—the result of a study to develop an approach and strategy to expand the functionality of NASA’s Core Financial module. The purpose of PMI<sup>2</sup> is to improve project information management by aligning both technical and financial work breakdown structures, allowing a single data management structure. Such an alignment is needed for managers to exercise sound financial management of their programs and projects. My office is in the process of reviewing the implementation of PMI<sup>2</sup> Phase I. During our review, we found that NASA had not adequately communicated the changes that would result from PMI<sup>2</sup> Phase I and the benefits resulting from those changes. In addition, the PMI<sup>2</sup> Project Office had not provided Headquarters and the Centers with clear and definitive implementation steps and milestones to be met. In a September 2005 memorandum, we made several recommendations to the OCFO to correct these problems. In response to our memorandum, the NASA Administrator sent an “all hands” e-mail stressing the importance of PMI<sup>2</sup> and providing additional information on communications and training events. While this has been a high-risk implementation, we believe that it has been successful thus far.

However, NASA has experienced some difficulty in implementing systems that are critical for budget development, financial reporting, and full-cost management. Specifically, the Budget Formulation module was canceled in November 2004 because the NASA OCFO determined that the module no longer met the Agency’s budget requirements. We noted in our March 2004 audit report on the Budget Formulation module<sup>7</sup> that its development did not include the input of critical users, the module experienced significant processing performance problems, and the module initially did not include five key system requirements.<sup>8</sup> In addition, implementation of the IAM module, which was to be used to account for the Agency’s contractor-held assets and its PP&E, was postponed pending architectural review. Currently, NASA must account for its contractor-held assets using alternative methods outside of the IEMP. The last three financial statement audits have reported material weaknesses in internal controls over contractor-held property.

One of NASA’s most significant planned developments is the SAP Version Update (SVU). During FY 2005, NASA was informed by SAP’s manufacturer that it would no longer be supporting SAP version 4.6c, implemented by NASA in FY 2003, and that NASA would have to upgrade its financial management system. NASA initiated its SVU project in September 2005 to manage the implementation of the upgrade. The implementation will occur as part of the Competency Center Release Management process next October for an FY 2007 startup.

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<sup>7</sup> “Integrated Financial Management Program Budget Formulation Module (BFM)” (IG-04-017, March 30, 2004).

<sup>8</sup> 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 online quick reference tool. Those five key system requirements were critical to Center program and project staff in developing their bottom-up budget data.

According to the IEMP Program Office, the SVU should deliver enhanced functionality to the existing Core Financial module, including

- improved data integrity based on SAP Funds Management redesign,
- improved processes for reducing errors and mispostings,
- additional automation of adjustment accounting entries,
- improvements to the budget distribution process,
- analysis and potential redesign of lower level funds control and funds distribution,
- addressing program/project management needs by modifying business processes and systems architecture to unbundle management reporting from general ledger accounting through analytical staff and data warehouse configuration, and
- streamlined year-end processing starting with FY 2007 year-end processing.

Collectively, these improvements, if realized through the SVU, should contribute to improving NASA's financial tracking and reporting. To ensure that the SVU project is successful, an effective project governance structure and process must be established that will integrate and prioritize the diverse requirements that will be levied on the project through the active participation and commitment of key stakeholders. We have initiated a review to determine whether NASA has established an effective project governance structure and process to manage the SVU.

In June 2005, the NASA Administrator directed the re-baselining of IEMP, which included renaming the program (from IFMP), reworking schedules, and revising the funding source. The most dramatic impact on IEMP as a result of the re-baselining was the change in funding source from multiple Headquarters and Center general and administrative overhead accounts to a single program line item, effective for FY 2006. That change resulted in the IEMP Program Office developing new business processes for budget execution. The use of one funding source should ultimately result in a more accurate accounting of the full cost of IEMP because it consolidates all costs, regardless of which Center incurred them, into one budget line item. The FY 2006 budget for IEMP showed that the total estimated program cost for development and implementation of all IEMP modules was about \$746 million for FY 2000 through FY 2010. However, that did not include the costs for Center implementation or annual system maintenance. We were told that the FY 2007 budget request consolidates all known IEMP costs, including Center implementation costs, into one program line item.

- **How have the problems with the financial management system affected the agency's ability to effectively manage its programs?**

Until NASA has a fully operational and integrated financial management system, it will not be able to address its longstanding financial management practice and business process issues. IEMP in its current state will not routinely provide program managers and other key stakeholders and decisionmakers—including the Congress—with the financial-related information needed to estimate costs, measure program performance, and ensure accountability. For example, the Core Financial module does not appropriately capture PP&E

or transaction-level information in its general ledger, which is needed to provide independent control over these assets. As a result, program managers and cost estimators continue to use systems outside of IEMP and other labor-intensive means to capture the data they need to manage their programs.

The Government Accountability Office previously reported that the Core Financial module does not comply with the objectives of the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. SFFAS No. 4 is aimed at achieving three general objectives: (1) providing program managers with relevant and reliable information relating costs to program outputs, (2) providing relevant and reliable cost information to assist the Congress and executives in making decisions about allocating Federal resources and evaluating program performance, and (3) ensuring consistency between costs reported in general purpose financial reports and costs reported to program managers. Because this information is not available through the Core Financial module, program managers will continue to rely on hard-copy reports, electronic spreadsheets, or other means to monitor contractor performance. Consequently, NASA risks operating with two sets of books—one that is used to report information in the Agency’s general-purpose financial reports and another that is used by program managers to run NASA’s projects and programs.

Finally, until the Core Financial module is operating properly, the Agency will experience internal control deficiencies in its financial accounting procedures that will increase the likelihood of errors and irregularities. During its FY 2005 testing, E&Y auditors found that duties were not adequately segregated for some Core Financial module users. For example, some users were given one role to create or maintain purchase orders and another role to enter vendor invoices. The effect of allowing a user those dual roles could be that a single person could authorize both the purchase and the payment for that purchase.

- **What does NASA need to do to address its remaining financial management deficiencies, including staffing, budget, etc.?**

At the beginning of FY 2005, the OCFO was authorized to maintain a level of 121 staff members. NASA reduced this to 103 positions by March 31, 2005. In June 2005, the Administrator authorized additional resources to the OCFO to ensure that NASA is adequately staffed to improve financial management and reporting capabilities. The total OCFO ceiling of authorized positions at the end of FY 2005 was 132. In October 2005, NASA completed an Institutional Requirements Review of the Headquarters workforce requested by the Administrator to assess consistency of Headquarters staffing with the Agency’s revised strategic direction. The review recommended setting the OCFO ceiling at 103. NASA has a reclama process that will allow each area to request a ceiling adjustment, and the Chief Financial Officer has stated that the reduction levied on the OCFO will severely affect its ability to meet the Administrator’s goal to improve financial management.

- **What areas of NASA’s current corrective action plan need increased attention?**

In order for NASA to address its financial management problems, it will need to articulate a strategy that addresses both the problem—the financial management system and the resulting internal control weaknesses causing the recording and reporting of inaccurate and incomplete data to the financial statements—and the actions required to resolve those problems, including the personnel and other resources needed to fix the problems. Once the corrective action plans have been developed, approved, and implemented, our IPAs will need to test those plans to ensure Agency compliance.

In FY 2003, NASA management prepared a NASA Financial Management Improvement Plan. I reported last year<sup>9</sup> that the plan appeared to be designed to improve the organization of the OCFO and to improve financial policies and procedures. One purpose of that plan was to provide a detailed framework for correcting the deficiencies identified during the financial statement audits in order to achieve an audit opinion. Since then, that plan has gone through several draft iterations and is now referred to as the Financial Leadership Plan (FLP). The draft FLP establishes goals, priorities, and supporting initiatives for improving overall financial management within the Agency. According to OCFO personnel, the FLP will be used to isolate and monitor progress on specific areas targeted for improvement in financial management and includes specific strategic initiatives. NASA has already started to integrate some of those initiatives with other related activities, including NASA’s IEMP project milestones. However, my office reported in November 2004, in March 2005, and in April 2005, that the plan does not appear to

- articulate a strategy that discusses the scope of each problem, the actions required to resolve the problem, and the personnel and other resources that will be required;
- ensure that the strategy defines specific roles and responsibilities of other Agency organizations, including Center finance offices, for carrying out corrective actions, and that the Center plans for improving financial management support the strategy;
- compare the personnel and resources required to execute the strategy against existing resources to determine what actions can realistically be accomplished and when;
- establish relative priorities, based on available resources, that focus first on actions to ensure that the Agency can correctly process current-year transactions; or
- contain realistic milestones and completion dates. If a date cannot be determined, then the plan should indicate that the date is to be determined (TBD) later.

Our continuing efforts to obtain comprehensive corrective action plans to address the internal control deficiencies identified during NASA’s financial statement audits have largely been unsuccessful. NASA senior management continues to provide only high-level, broadly worded proposed initiatives that lack sufficient detail and strategies to address the outstanding deficiencies. My office, along with the OCFO, is engaged in a conversation with the Administrator in identifying the best path forward.

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<sup>9</sup> Statement before the House Government Reform Subcommittee on Government Efficiency and Financial Management, “NASA Financial Management,” May 19, 2004.