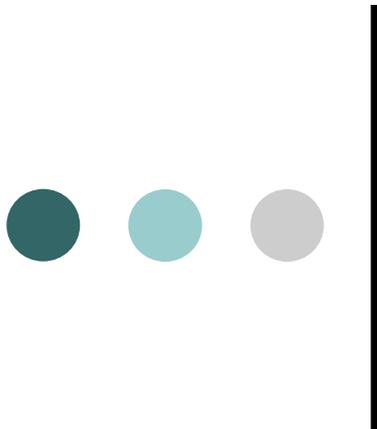


National Aeronautics and Space Administration Advisory Council



Audit, Finance, and Analysis Committee

February 18, 2010

Members:

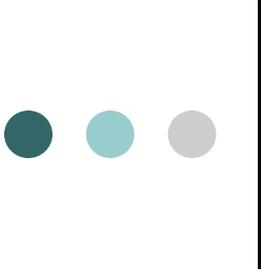
Mr. Robert Hanisee, Chairman

Hon. William Campbell

Hon. Michael Montelongo

Dr. Howard Stanislawski

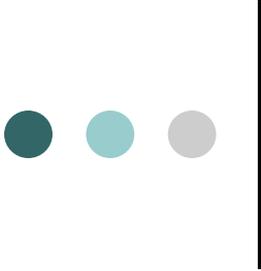
Mr. Jeffrey Steinhoff



Audit, Finance & Analysis Committee

Abridged Agenda

- *Introduction of new committee members*
 - *Hon. William Campbell*
 - *CFO & COO Atlantic Financial Navigation*
 - *CFO, Department of Veterans Affairs*
 - *CFO, U.S. Coast Guard*
 - *Marine and Electrical Engineering*
 - *Jeffrey Steinhoff*
 - *Current Executive Director of KPMG Government Institute*
 - *40 Year Federal Government Career*
 - *GAO. GAO Audit Unit, PCAOB-Principal*
 - *Architect of CFO Act of 1990*
- *2009 Financial Statement Audit Results*
- *CFO Summary Update – Terry Bowie, NASA DCFO*
- *Space Shuttle Disposal of Assets and possible Constellation shut down*
- *Review of 2009 Congressional testimony- Committee Chair, OIG, E&Y, and NASA CFO*
- *Meeting with new NASA IG, Paul Martin*



Fiscal Year 2009 Audit Report

External Auditors: Ernst and Young, LLP

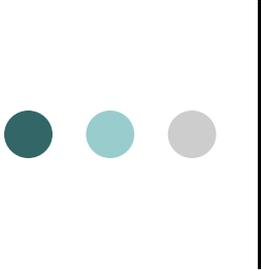
Result: Another disclaimer (7th consecutive)

One Material Weakness

- *Control over legacy PP&E (Repeat Condition)*

Two Significant Deficiencies

- *Estimating NASA's Environmental Liabilities (Modified Repeat Condition)*
- *Financial Management Systems not in compliance with FFMIA (Modified Repeat Condition)*



FY2009 Audit

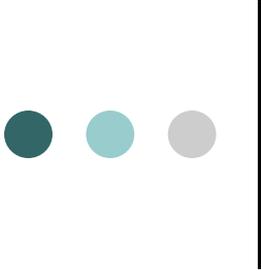
Some Definitions

Material Weakness

A deficiency or a combination of deficiencies in internal controls such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

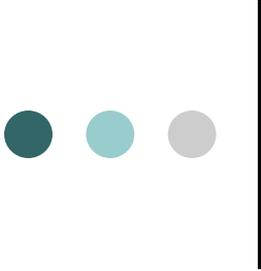
Significant Deficiency

A deficiency or a combination of deficiencies in internal controls that is less severe than a material weakness, yet important enough to merit by those charged with governance. More than one significant deficiency can become a material weakness.



Recapitulation of NASA Financial Control Problems

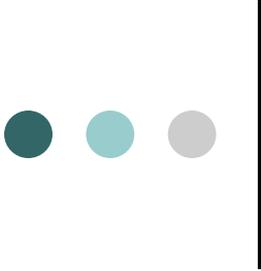
- *1990, GAO placed NASA on it's High Risk List (14 agencies in total)*
- *2002, NASA received unqualified audit opinion (PwC)*
- *Each year thereafter, opinion has been disclaimed—*
 - *PwC in 2003, E&Y thereafter*



Recapitulation of NASA Financial Control Problems (cont'd)

Issues Leading to Disclaimer:

- *Legacy assets (PP&E)-Space Shuttle, International Space Station*
- *Fund Balance with Treasury (2002 - \$1.7B)*
- *Financial, Systems, Analysis, and Oversight*
- *Financial Statement Preparation*
- *Lack of sufficient audit trail*
- *IFMP Control Environment*
- *Environmental Liability estimation*



Financial Control Problems (cont'd)

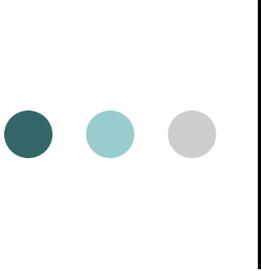
In 2003 and 2004 there were four material weaknesses and one reportable condition

Other Challenges/Problems raised by various oversight entities

- *Control and accounting for NASA owned property*
- *Control of travel expenses (disbursements and reimbursements)*
- *Grant accounting*
- *OCFO Personnel shortfalls, turnover, and morale*

Other Areas of concern to Administrator

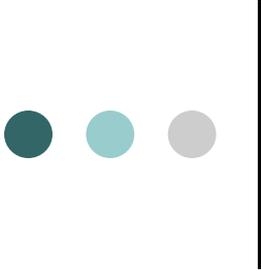
- *Unobligated balances*
- *NASA Shared Services Center (Stennis)*



Genesis of Financial Control problems

In 2005, at a subcommittee hearing, the Inspector General (IG) noted that the Agency's problems were rooted in historic culture.

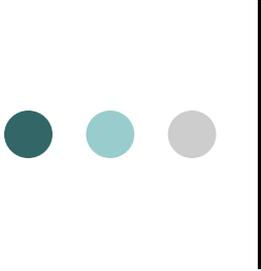
- *NASA Centers operated with a high degree of autonomy and mission focus*
- *Across NASA, there were in use 10 different accounting systems and 120 subsystems*
- *A significant part of the problem was rooted in unreliable historical data*
- *Insufficiently trained personnel at HQ*
- *At Centers, there were weaknesses and insufficient controls to detect mistakes early in the accounting cycle*



Progress Report

In FY2008 Audit, E&Y stated that “significant progress has been made.”

In public testimony, NASA IG stated that “NASA has made significant progress in remediating financial management weaknesses.”

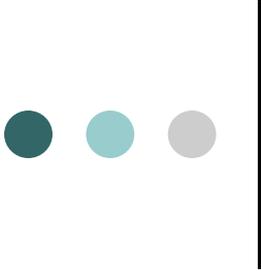


Progress Report

As shown in the following table, NASA has made significant progress in remediating the majority of its material weaknesses in internal controls.

National Aeronautics and Space Administration Office of Inspector General Analysis of NASA's Financial Statement Audit Opinion and Reported Findings								
		FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Independent Auditor		PwC	E&Y	E&Y	E&Y	E&Y	E&Y	E&Y
Audit Opinion		Disclaimer						
1	General Controls Environment	RC	MW					
2	Property, Plant, and Equipment	MW						
3	Financial Statement Preparation Process and Oversight	MW	MW	MW	MW	MW	MW	
4	Fund Balance with Treasury	MW	MW	MW				
5	Audit Trail and Documentation to Support Financial Statements	MW						
6	Environmental Liability Estimation		RC	RC				SD
7	Financial Management Systems Not in Substantial Compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA)							SD

PwC, PricewaterhouseCoopers, LLP; E&Y, Ernst & Young, LLP; RC, Reportable Condition; SD, Significant Deficiency; MW, Material Weakness



Remediation Efforts

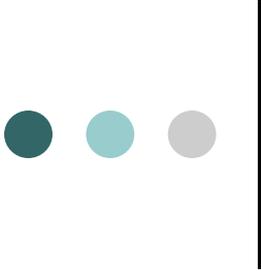
2003, a new common accounting module (SAP) was implemented agency-wide

2006, IEMP (Integrated Enterprise Management Program) completed SAP Version Upgrade (SVU), financial system enhancements, which provided many new improvements and updated the system software

/

2006, the Office of the CFO prepared a corrective action plan (CAP) to address financial control deficiencies

2006, a Continuous Monitoring Program was implemented



The Way Forward

Cleaning of the Remaining Issues

Significant Deficiency

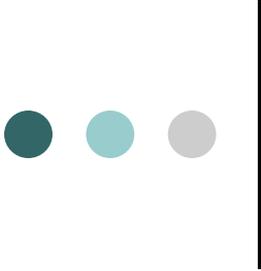
Estimating NASA's Environmental Liability

NASA's Unfunded Environmental Liability stood at \$922 Million as of September 30, 2009.

During 2009, NASA decided that estimates for the first 30 years of a project's life span will be recorded as a liability. However, E&Y believes that if sufficiently reliable engineering estimates beyond 30 years have been developed, those sums should also be booked—NASA will comply.

E&Y is still not completely assured that NASA's Integrated Data Evaluation and Analysis Library (IDEAL) software estimating tool is reliable—NASA will explore approaches to complete IV&V to address these concerns.

E&Y noted weaknesses in NASA's estimation for environmental liabilities for new PP&E. NASA responded but too late to affect FY2009 audit. Should be in compliance in FY2010.



The Way Forward (cont'd)

Significant Deficiency

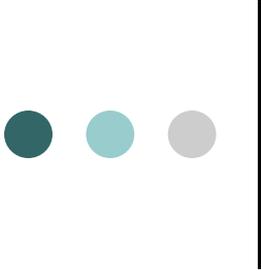
*Financial Management Systems not in substantial compliance with FFMIA
(Federal Financial Management Improvement Act)*

Specific Weaknesses noted include:

*Real property systems not integrated with the Core Financial Module—
this has now been done*

*Issues related to access and change management in the IT audit
process—addressed*

*NASA was unable to meet certain requirements to ensure compliance
with federal accounting standards--addressed*



The Way Forward (cont'd)

Material Weakness

Accounting for Legacy Property, Plant and Equipment Accounting

The Dilemma:

E&Y would not give a full audit opinion until this matter was cleared up

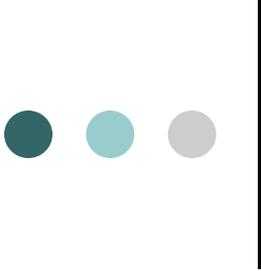
*IG would not authorize NASA to spend the money to go back prior to 2002 to re-create records
NASA OCFO petitioned FASAB to address issues through a clarification of accounting standards*

The result: *SFFAS 35 which states that “reasonable estimation of original transaction data historical cost may be used to value Property, Plant, and Equipment”*

Actions to whittle the problem down to size:

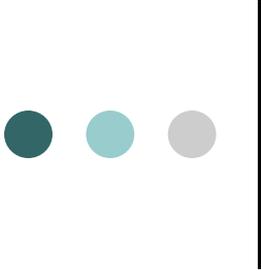
- *2007, NASA wrote off \$12.7B of previously booked “Theme” assets (primarily satellites)*
- *2008, NASA expensed current year ISS launch costs of \$2.9B related to delivery of foreign owned components of ISS*
- *2009, NASA wrote off \$5.2B of previously recorded, but inappropriately booked ISS Launch Costs related to delivery foreign owned components of ISS*
- *FY2010, the Space Shuttle will be de-commissioned removing approximately \$1B of booked PP&E*

9/30/2009 ISS un-depreciated asset value remaining on NASA books is \$5.1 billion



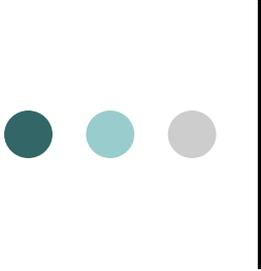
NASA Financial Audit Opinion: Resolving the Financial Reporting Problem Related to the International Space Station

- *NASA has struggled with the valuation of its Property, Plant and Equipment (PP&E), resulting in a disclaimer of opinion by its auditor Ernst & Young LLP and the NASA Inspector General.*
- *The problem centers on legacy assets, primarily the cost valuation of the International Space Station (ISS) predating 2002, and the inability of NASA to provide the audit documentation needed to support NASA's estimate of valuation under federal accounting standards.*
- *The Congress has been concerned about the issue and held hearings last year focused on what NASA needs to do to obtain a clean audit opinion. It challenged the NASA CFO and the auditors to work together to develop workable solutions. I was privileged to testify at that hearing representing the NAC.*



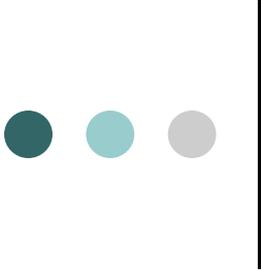
NASA Financial Audit Opinion: Resolving the Financial Reporting Problem Related to the International Space Station

- *The Federal Accounting Standards Advisory Board (FASAB) recognized the nature of the problem, not only for NASA, but for other federal agencies that have extensive PP&E which was acquired in years that predated current accounting standards. In October 2009, it issued a new accounting standard with a clear intent to provide flexibility in estimating practices considering the nature of the property, the feasibility of developing estimates, and the use of the information. The ISS is the type of property that the FASAB had in mind when it issued the new standard.*
- *Fiscal year 2010 provides a window of opportunity to NASA to get over the PP&E material weakness and achieve a clean audit opinion.*
- *NASA's methodology used to develop estimates of its pre-2002 costs of the ISS, which has been a stumbling block.*
- *The Audit, Finance and Analysis Committee has been closely tracking this issue for years and believes the estimating methodology NASA has developed is sound and, if properly implemented, would meet the intent of the new standard.*



NASA Financial Audit Opinion: Resolving the Financial Reporting Problem Related to the International Space Station

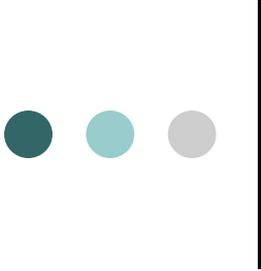
- *The CFO has prepared briefing and other materials that highlight the estimation methodology.*
- *The Committee suggested to the NASA CFO that it do two things to help ensure an understanding and acceptance of its methodology so it can successfully leverage the flexibility included in the new accounting standard to value its legacy PP&E. We view 2010 as the year to make something happen.*
 - *Develop a formal methodology paper that lays out the estimation criteria and the approach being taken by NASA to ensure the estimate is reasonable for the PP&E purchased both pre- and post-2002. The methodology paper would provide a useful tool for NASA to document the basis of its estimation approach and could be shared with NASA's auditors and interested congressional committees.*
 - *Develop the footnotes and disclosures to the financial statements necessary to tell NASA's story and permit a reader to understand the nature of NASA's assets and estimation methodology.*



NASA Financial Audit Opinion: Resolving the Financial Reporting Problem Related to the International Space Station

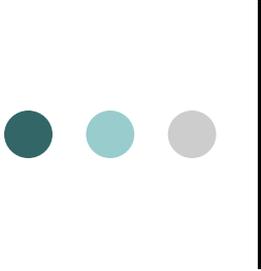
Next steps by the Committee

- *Monitor efforts by the NASA CFO to work with the auditors to gain acceptance of the estimation methodology.*
- *Provide advice to the NASA CFO with respect to the estimation methodology, the articulation of the methodology paper, and the financial statement footnotes and disclosures necessary to support a reasonable estimate that meets the intent and leverages the flexibility provided by FASAB and that will pass the audit test.*



Addressing Challenges in Accounting for Unfunded Environmental Liabilities (UEL)

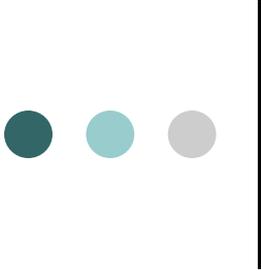
- *Review the Agency's methodology to estimate the UEL for existing programs and assets.*
- *Review the Agency's methodology to estimate the UEL for future programs and assets.*
- *Review the Agency's accounting treatment for both existing and future UELs.*



Audit, Finance, and Analysis Committee

Future Activities

- *Review the effect of future NASA budgets on financial stewardship*
- *Meet with key stakeholders (Deputy Administrator, Inspector General, Ernst & Young engagement audit partner)*
- *Review the financial reporting of Recovery Act funding*
- *Review the accounting treatment for changes to or cancellation of the Constellation Program*
- *Review how OCFO human capital challenges are resolved to ensure continued progress*



Audit, Finance, and Analysis Committee

No specific recommendations at this time.