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Statement of
The Honorable Elizabeth Robinson
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before the

Subcommittee on Investigations and Oversight
Subcommittee on Space and Aeronautics
House Committee on Science and Technology
U.S. House of Representatives

Chairman Miller, Chairwoman Giffords, and Members of the Subcommittees, thank you for the opportunity to appear today to discuss the NASA FY 2009 audit report and the Agency's plan for correcting the longstanding material weakness identified in the auditor's disclaimed opinion on the Agency's financial statements. As the independent auditors and Inspector General have noted in their reports, NASA has made significant progress in improving its financial processes and systems. In fact, in FY 2009 NASA eliminated a longstanding material weakness related to financial systems, analyses, and oversight. However, while progress has been made, the Agency's financial management challenges have not yet been fully resolved.

The FY 2009 disclaimed audit opinion is the 7th consecutive disclaimed opinion NASA has received. NASA received its last unqualified opinion in FY 2002, when the Agency's independent auditors, PricewaterhouseCoopers, identified two material weaknesses; one related to controls over the Agency Property, Plant, and Equipment (PP&E) and the other related to controls over processes used to prepare financial statements and the Performance and Accountability Report. In FY 2002, NASA operated with 10 separate and unique center-based accounting systems. Information from these systems was integrated through electronic spreadsheets at the Agency level and consolidated into one Agency financial statement. In 2003, in line with Federal guidance, NASA implemented a new Agency-wide financial system that replaced the financial systems at its 10 centers and required the conversion and integration of data from those legacy systems.

This new integrated system was intended to improve access to information by decision makers across the Agency, standardize and speed reporting, and reduce costs. While NASA has since realized many of its initial goals and expectations, at the time, the Agency's Inspector General noted in testimony of May 2004 before the House Subcommittee on Government Efficiency and Financial Management, that "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)." In 2003, the Agency received a disclaimed opinion.

NASA has been working to resolve those auditor-reported weaknesses over the past six years through systems improvements, data cleanup initiatives, policy and process changes, and staff training and development. As displayed in the attached chart, "Summary of Material Weaknesses During the Past Eight Years," the Agency's efforts have reduced the four material weaknesses in FY 2003 to one material weakness in FY 2009.

As of September 30, 2009, NASA's one outstanding material weakness was related to internal controls over legacy PP&E and materials contracts. The legacy PP&E weakness is related to internal control weaknesses in the Agency's space exploration PP&E, particularly the International Space Station (ISS) and the Space Shuttle. NASA's space exploration assets had a total net book value of $8.9 billion as of September 30, 2009, comprising 77 percent of total PP&E ($11.6 billion) and 38 percent of total assets ($23.7 billion). The independent auditor's *Report on Internal Control* also identified two significant deficiencies. The first is related to processes used to estimate NASA's Environmental Liability. The auditors noted that while NASA continues to make year-to-year progress, the Agency also continues to have weaknesses in its ability to generate auditable Environmental Liability estimates on a timely basis. The second deficiency is related to a lack of substantial compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA), including a lack of integration between NASA's real property system and its core financial system. The independent auditors and the NASA Inspector General noted that this year's disclaimed opinion resulted from the continued weaknesses in internal controls over accounting for legacy PP&E.

<u>Background: Weaknesses in Controls Over Legacy PP&E and Materials Contracts</u>

The Federal accounting standards related to space exploration property have changed over the years, with serious impacts on NASA's financial statements.

When the Federal accounting standard for Property, Plant, and Equipment (Statement of Federal Financial Accounting Standards [SFFAS] No. 6, *Accounting for Property, Plant, and Equipment*) was introduced in 1996, space exploration equipment (including the ISS and Space Shuttle) was placed into a category called Federal Mission PP&E. SFFAS No. 6 contained explicit requirements for the costs of space exploration property to be expensed in the year incurred; no asset balances were to be maintained or reported for space exploration PP&E on the Agency's balance sheet. A separate category of PP&E, called General PP&E, was established at this time to address accounting requirements for more traditional PP&E (including buildings and land). Unlike Federal Mission PP&E, General PP&E are recognized as assets and are reported on an entity's balance sheet. Determining a balance for General PP&E assets requires tracking costs at the individual asset level and expensing (depreciating) those costs over a specified period of years. Consistent with these standards, NASA expensed all space exploration equipment in the year that costs were incurred.

The Federal Financial Accounting Standards Advisory Board (FASAB) reversed this guidance in 1998 through SFFAS No. 11, *Amendments to Accounting for Property, plant, and Equipment: Definitions*, which also replaced the definition of Federal Mission Property with "National Defense (ND) PP&E." SFFAS No. 11 changed the existing accounting guidance for space exploration equipment, and now required NASA to meet the SFFAS No. 6 General PP&E standards for tracking, recording and depreciating historical costs for each individual asset. However, NASA's processes and long-standing contracts for acquiring ISS and Space Shuttle assets were established to comply with Federal Mission PP&E requirements, not General PP&E. These practices rely on contractors to report the balances of contractor-held property, in accordance with guidelines set forth in the NASA FAR Supplement.

NASA has introduced compensating controls, introduced new accounting policies, revised accounting processes, increased the frequency and improved the quality of contractor property reporting, and implemented new property accounting systems to improve its accounting for the Agency's PP&E and to provide program management with the necessary information to support programmatic decision making. However, since NASA does not have the documentation required to support its space exploration asset balances under General PP&E standards and since there are no comparable assets with which to establish a reasonable balance, the auditors have continued to report a material weakness related to controls over legacy PP&E and disclaimed audit opinions.

Both the ISS and Space Shuttle are scheduled for retirement in this decade. Continuing depreciation of these space exploration assets is bringing the net asset balances on the balance sheet to levels that will become immaterial to the financial statements. The Shuttle assets are being depreciated through their expected useful life based on their current schedule for retirement in 2010, and the International Space Station is being depreciated based upon a 15-year specification life, through 2016, which would not change, in accordance with accounting requirements, if the ISS is extended beyond this period. While the International Space Station depreciation schedule naturally leads to 2016 as an outside date for resolution of this PP&E issue, NASA has been working to achieve a timelier, albeit still cost efficient and effective, solution for this issue.

Legacy PP&E Improvements

In FY 2007, NASA obtained guidance from the FASAB's Accounting and Auditing Policy Committee (AAPC) to reclassify certain space exploration assets as research and development expenses, per Financial Accounting Standard No. 2, *Accounting for Research and Development Cost*. In addition to more appropriately classifying the costs for these assets, this also focused the legacy property issue to primarily the ISS and Space Shuttle assets.

Also in 2007, NASA implemented a new policy and related procedures for identifying the cost of individual assets throughout such assets' acquisition lifecycle, consistent with SFFAS No. 6. The procedural changes facilitate the identification, verification and reconciliation of asset values for assets created or developed under contracts awarded after implementation of the revised policy and to certain large pre-existing contracts.

Additionally, during FY 2008, the Agency implemented a new asset management module within its core financial management system. This module integrates personal property equipment data with the core financial accounting system, addressing a key part of the prior year's material weakness and a noted non-compliance with FFMIA. This module provides: (1) more accurate, timely recording and valuation of PP&E; (2) improved valuation, capitalization, and depreciation processes; (3) improved audit trail of capitalized PP&E; (4) greater standardization of property management processes; and (5) elimination of many manual processes.

In FY 2009, NASA performed a review of the processes used to track, validate and record costs for the ISS and Space Shuttle. This review resulted in changes to NASA's capitalization policies for Space Shuttle launch costs and for ISS Integration and Operations costs. Following this review, NASA recorded a subsequent downward adjustment to the net book value of the ISS.

The review also supported NASA's preparation for the release of SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, & Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* on October 14, 2009. This standard is intended to provide entities, like NASA, who have significant investments in assets but, at the time these assets were acquired, did not have adequate controls or systems in place to capture historical PP&E costs, with a cost effective method for complying with Federal property accounting standards.

NASA Planned Corrective Actions

1. As recommended by the independent auditor, NASA will adopt SFFAS No. 35 to establish auditable values for those legacy assets – including NASA's space exploration PP&E, particularly the ISS and Space Shuttle – for which the Agency does not have the necessary historical cost records or for which it would not be cost effective to recreate such records. SFFAS No. 35 amends existing accounting standards to clarify that reasonable methods of estimating historical cost and accumulated depreciation may be used to value general property, plant, and equipment. As FASAB notes in the standard, use of estimates is a more cost-effective means of valuing certain assets than reconstructing actual historical amounts based on inadequate or non-existent accounting records.

   The adoption of SFFAS No. 35 requires NASA management to identify and adopt a basis for determining reasonable estimates of historical cost information. Implementation of the standard will require collaboration between the Agency and its auditor on the basis for the reasonable estimate, the approach for implementing that basis, the information required to support the resulting estimates, and the timeframe within which the estimates can be generated. Working through a process for implementing SFFAS No. 35 is a challenge for the Agency that may impact NASA's approach and timeline for resolving the legacy PP&E weakness. SFFAS No. 35 provides NASA with a way forward, but it is not a pre-defined solution to the Agency's one remaining material weakness.

2. NASA will also continue to identify key PP&E control activities as a part of the Agency's on-going Continuous Monitoring Program (CMP). The CMP is a monthly process that provides for robust and rigorous reviews to validate the quality and sufficiency of information for key accounts and accounting transactions. Changes in key processes, like those associated with the valuation of legacy PP&E, will be accompanied by reviews and, if required, improvements in the related CMP control activities.

3. Additionally, NASA will integrate its real property assets, which comprise 8 percent of NASA's total asset value, into the core financial system's asset management module in FY 2010. This will improve overall PP&E accounting, and will address a specific FFMIA weakness identified in the auditor's Report on Internal Control.

Conclusion

In closing, NASA has taken clear and positive steps toward resolving its financial management weaknesses. Today, using current systems and processes, NASA is able to track and control its funds, account for the costs related to individual programs and projects, and manage the Agency's day-to-day operations. The Agency remains committed to resolving the legacy property weaknesses, particularly through the guidance contained in the recently released SFFAS No. 35. Combined with the Agency's rigorous on-going control reviews and the introduction of additional system capabilities, we expect our efforts will result in a more acceptable audit outcome and opinion.

Chairman Miller and Chairwoman Giffords, I would be pleased to respond to any questions that you or the other Members of the Subcommittees may have.

Summary of Material Weaknesses During the Past Eight Years

Material Weakness	FY 2002 Unqualified (PwC)	FY2003 Disclaimer (PwC)	FY2004 Disclaimer (EY)	FY2005 Disclaimer (EY)	FY2006 Disclaimer (EY)	FY2007 Disclaimer (EY)	FY2008 Disclaimer (EY)	FY 2009 Disclaimer (EY)
Property, Plant, and Equipment– Legacy Assets (PP&E)	X	X	X	X	X	X	X	X
Financial Stmt. Preparation *Identified as part of FSAO FY04*	X	X						
Lack sufficient audit trail		X						
Fund Balance with Treasury (FBWT) *Rolled into FSAO FY06*		X	X	X				
Financial, Systems, Analyses, and Oversight (FSAO) *			X	X	X	X	X	
IFMP (SAP) control environment			X					

* Aspects related to Unfunded Environmental Liability (UEL) and FFMIA compliance reported as significant deficiencies in FY 2009.