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NATIONAL RECONNAISSANCE OFFICE

14675 Lee Road
Chantilly, VA 20151-1715

23 August 2016

Mr. John Greenewald, Jr.
[REDACTED]

Dear Mr. Greenewald:

This is in response to your request dated 16 June 2016 and received in the National Reconnaissance Office (NRO) on 17 June 2016. Pursuant to the Freedom of Information Act (FOIA), you requested a copy of the final report by the NRO Inspector General, on the investigation entitled: "Office of Inspector General Audit of the National Reconnaissance Office Fiscal Year 2014 Financial Statements Closed 11/24/14."

Your request has been processed in accordance with the FOIA, 5 U.S.C. § 552, as amended. A thorough search of our files and databases located one document totaling thirty two (32) pages responsive to your request. This document is being released to you in part.

Material that is denied is being withheld pursuant to FOIA exemptions:

(b)(1), as properly classified information under Executive Order 13526, Sections 1.4(c) and (e);

(b)(3), which is the basis for withholding information exempt from disclosure by statute. The relevant withholding statute is 10 U.S.C. § 424, which provides (except as required by the President or for information provided to Congress), that no provision of law shall be construed to require the disclosure of the organization or any function of the NRO; the number of persons employed by or assigned or detailed to the NRO; or the name or official title, occupational series, grade, or salary of any such person; and

(b)(5), which applies to information that is predecisional and deliberative in nature.

You have the right to appeal any adverse determination to the NRO Appellate Authority, 14675 Lee Road, Chantilly, VA 20151-1715, within 90 days of the above date. Should you decide to do this, please explain the basis of your appeal. The FOIA also provides that you may seek dispute resolution for any adverse determination through the NRO FOIA Public Liaison and/or through the Office of Government Information Services (OGIS). Please refer to the OGIS public web page at <https://ogis.archive.gov/> for additional information.

If you have any questions, please call the Requester Service Center at (703) 227-9326 and reference case number F-2016-00090.

Sincerely,

A handwritten signature in cursive script, reading "Patricia B. Camerese".

Patricia B. Camerese
FOIA Public Liaison

Attachment: Audit of the National Reconnaissance Office Fiscal Year
2014 Financial Statements (32 pages)

(U) AUDIT REPORT

~~UNCLASSIFIED//FOR OFFICIAL USE ONLY~~**NATIONAL RECONNAISSANCE OFFICE**

Office of Inspector General
14675 Lee Road
Chantilly, VA 20151-1715



14 November 2014

MEMORANDUM FOR DIRECTOR, NATIONAL RECONNAISSANCE OFFICE
PRINCIPAL DEPUTY DIRECTOR, NATIONAL RECONNAISSANCE
OFFICE
DEPUTY DIRECTOR, NATIONAL RECONNAISSANCE OFFICE
DIRECTOR, BUSINESS PLANS AND OPERATIONS DIRECTORATE

SUBJECT: (U) Audit of the National Reconnaissance Office Fiscal Year
2014 Financial Statements (Project Number 2014-009 A)

(U) This memorandum transmits the final results of the PwC, LLP Audit of the National Reconnaissance Office (NRO) Fiscal Year (FY) 2014 Financial Statements and the results of the Office of Inspector General (OIG) review thereof. The audit opinion is being issued to accompany the financial statements; therefore, this audit report should not be disseminated separately from those financial statements. The PwC audit report dated 14 November 2014 is attached and includes the following:

- (U) *Independent Auditor's Report*, which includes the PwC audit opinion on the NRO FY 2014 Financial Statements;
- (U) *Independent Auditor's Report on Internal Control over Financial Reporting*; and
- (U) *Independent Auditor's Report on Compliance and Other Matters*.

(U) Background

(U) The NRO OIG engaged the independent public accounting firm of PwC to audit the NRO FY 2014 financial statements in order to express an independent opinion regarding those statements. The contract between PwC and the NRO OIG requires that the audit be performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States; Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*; and the Government Accountability Office/President's Council on Integrity and Efficiency *Financial Audit Manual*.

(U) To ensure the quality of the audit work performed, we reviewed PwC's approach and planning of the audit, evaluated the qualifications and independence of the auditors, monitored the progress of the audit at key points, reviewed and accepted PwC's audit report, and performed other procedures that we deemed necessary. Our review was not intended to enable us to express an opinion on: a) the NRO financial statements, or conclusions about the effectiveness of NRO internal controls; b) whether the NRO's financial management systems substantially complied with the Federal Financial Management

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SUBJECT: (U) Audit of the National Reconnaissance Office Fiscal Year 2014 Financial Statements (Project Number 2014-009 A)

Improvement Act of 1996 (FFMIA); c) or whether the NRO complied with applicable laws and regulations. PwC is responsible for the attached auditor's report dated 14 November 2014 and conclusions expressed in the report. However, our review disclosed no instances where PwC did not comply, in all material respects, with *Government Auditing Standards*.

(U) Objectives and Scope

(U) The objectives of the audit were to evaluate (1) the reliability of the data supporting the financial statements; (2) the accuracy of the statements produced; and (3) the adequacy of footnote disclosures in accordance with guidance issued by the Federal Accounting Standards Advisory Board, the OMB, and other authoritative guidance as appropriate. The auditors also reviewed internal controls and compliance with laws and other matters related to the objectives and followed up on prior-year audit findings.

~~(U//FOUO)~~ Given the sensitivity of NRO's compartmented programs, and to limit the need-to-know, the OIG validated the classification of annex transactions to ensure accurate presentation and disclosure on the financial statements. We provided the results of our testing to PwC for inclusion in the audit results.

(U) Audit Results

~~(U//FOUO)~~ PwC issued an **unmodified opinion** on the NRO FY 2014 Financial Statements. An unmodified opinion means that the financial statements present fairly, in all material respects, the financial position and the results of the entity's operations in conformity with generally accepted accounting principles. The auditors also identified two material weaknesses and two significant deficiencies listed below. PwC made detailed recommendations for remediation of the reported findings, which are included in the attached *Independent Auditor's Report on Internal Control over Financial Reporting*.

- ~~(U//FOUO)~~ *Material Weakness Finding #1* - The NRO needs to strengthen its controls over Property, Plant and Equipment (PP&E) and the proper classification and recording of contract and transaction by others (TBO) disbursements.
- ~~(U//FOUO)~~ *Material Weakness Finding #2* - The NRO needs to strengthen processes to develop and monitor execution of accounting policy, guidance and methodologies.
- ~~(U//FOUO)~~ *Significant Deficiency Finding #3* - The NRO needs to strengthen system access and monitoring controls.
- ~~(U//FOUO)~~ *Significant Deficiency Finding #4* - Improvements are needed in the documentation and implementation of segregation of duties within the NRO's financial system environments.

(U) The NRO management concurred with all findings and recommendations. The full text of management comments, including plans for implementation of recommendations, is included in the Agency Financial Report.

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SUBJECT: (U) Audit of the National Reconnaissance Office Fiscal Year
 2014 Financial Statements (Project Number 2014-009 A)

(U) OIG Comments on Internal Control Deficiencies

~~(U//FOUO)~~ In FY 2014, NRO leadership demonstrated their commitment to improve the control environment at the NRO. Through new policies, procedures, and system enhancements, the NRO took measured steps of improvement. However, implementation of new policies and procedures takes time to obtain the desired outcome. Therefore, it is important to note that the audit results are a reflection of the control environment that existed prior to the implementation of new policies and procedures. As a result, we caution that management must be realistic when gauging the results of the FY 2014 audit.

~~(U//FOUO)~~ This year PwC identified [redacted] in audit adjustments, down from [redacted] last year, which is a substantial decrease. Although the results indicate improvements in terms of dollars, the number of errors did slightly increase. In addition, the current NRO financial environment necessitates a tremendous reliance on manual journal vouchers (JVs) and poses a significant risk to the organization. In FY 2014, the NRO created and posted 1,293 JVs (17,677 lines of accounting) with a gross value of [redacted]. While PwC did not identify any material errors, the JV process is intensive to create, review, and maintain those entries. Overall, the NRO needs to continue improving and automating internal controls throughout the organization to reduce the risk of material errors.

(U) If you have any questions, please contact me at [redacted]
 [redacted] (nonsecure) or [redacted]
 [redacted] at [redacted]
 (nonsecure).


 Adam G. Harris
 Inspector General

Attachments:

1. (U) Independent Auditor's Report (U)
2. (U) Independent Auditor's Report
 on Internal Control over Financial
 Reporting ~~(S//NOFORN)~~
3. (U) Independent Auditor's Report
 on Compliance and Other Matters
~~(S//NOFORN)~~

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**Independent Auditor's Report**

(U) To the Director of the National Reconnaissance Office and the Inspector General for the National Reconnaissance Office:

(U) Report on the Financial Statements

(U) We have audited the accompanying financial statements of the National Reconnaissance Office (NRO) which comprise the balance sheets as of September 30, 2014 and 2013, and the related statements of net cost and changes in net position, and the combined statements of budgetary resources, and the related notes to the financial statements for years then ended, which collectively comprise NRO's financial statements.

(U) Management's Responsibility for the Financial Statements

(U) Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

(U) Auditor's Responsibility

(U) Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits 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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

(U) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Report of Independent Auditors
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(U) Opinion

(U) In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the NRO as of September 30, 2014 and 2013, and its net cost and changes in net position and budgetary resources for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

(U) Other Matters**(U) Required Supplementary Information**

(U) Accounting principles generally accepted in the United States of America require that the accompanying *Management's Discussion and Analysis (MD&A)*; *Required Supplementary Information (RSI)*; and, *Required Supplementary Stewardship Information (RSSI)* be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board and OMB Circular A-136, *Financial Reporting Requirements*, who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information and the required supplementary stewardship information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we have obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

(U) Other Information

(U) Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The *Table of Contents*; *Introduction*; *Message from the Director*; *A Message from the Chief Financial Officer*; *Other Information*; and, *Appendices* are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we do not express an opinion or provide any assurance on the information.

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Report of Independent Auditors
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(U) Other Reporting Required by *Government Auditing Standards*

(U) In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2014, on our consideration of the NRO's internal control over financial reporting and our report dated November 14, 2014, on its compliance and other matters for the year ended September 30, 2014. 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 performed in accordance with *Government Auditing Standards* in considering NRO's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "PRICEWATERHOUSECOOPERS LLP". The signature is written in a cursive, flowing style.

McLean, VA
November 14, 2014

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**Independent Auditor's Report on Internal Control Over Financial Reporting Based
on an Audit of Financial Statements Performed in Accordance with Government
Auditing Standards**

(U) To the Director of the National Reconnaissance Office and
the Inspector General for the National Reconnaissance Office:

(U) We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the National Reconnaissance Office (NRO), which comprise the balance sheet as of September 30, 2014, and the related statements of net cost and changes in net position, and the combined statement of budgetary resources, and the related notes to the financial statements for the year then ended, which collectively comprise the NRO's financial statements, and have issued our report thereon dated November 14, 2014.

(U) Internal Control Over Financial Reporting

(U) In planning and performing our audit of the financial statements, we considered the NRO's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NRO's internal control. Accordingly, we do not express an opinion on the effectiveness of the NRO's internal control.

(U) We limited our control testing to those controls necessary to achieve the following OMB control objectives that provide reasonable, but not absolute assurance, that: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws and regulations, including laws governing the use of budget authority, laws, regulations, and government-wide policies identified in Appendix E of OMB Bulletin No. 14-02, and other laws and regulations that could have a direct and material effect on the financial statements.

(U) We did not test all internal controls relevant to the operating objectives broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

(U) 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

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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.

(U) Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, in the remainder of this report, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies. These deficiencies are noted on the following pages.

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~~(U//FOUO)~~ **Finding 1: The NRO needs to strengthen its controls over Property, Plant, and Equipment and the proper classification and recording of contract and transaction by others disbursements.**

(U) Summary Status: Material Weakness (Prior Year Finding #1)

(U) For several years, we have reported that the NRO lacks the appropriate internal controls to ensure that Property, Plant, and Equipment (PP&E) transactions are appropriately classified as assets within the balance sheet or classified as expenses within the statement of net cost. The appropriate classification of these transactions is a key accounting attribute and has a direct and material effect on the accuracy of the NRO's financial statements.

(U) Beginning in 2010, the NRO implemented a series of manually intensive, detective internal controls to validate the cost classification of contract transactions and transactions by others (TBOs). The NRO implemented these controls to accurately report the costs incurred to build, acquire, and deploy assets. The NRO needed these controls as its existing business model did not support an effective means to accurately classify these costs.

(U) Since 2010, the NRO has continued to modify and implement additional manual controls to accurately classify costs. For example, the NRO developed the Contract Modification Activity Report (CMAR), which includes the systemic review of selected transactions, to address the risk associated with modifications to the work activity after the NRO definitized the contract line item number (CLIN). The modification of work activity after the CLIN has been established can result in the inaccurate accumulation of costs.

(U) The NRO also established the Cost Accumulation Policy Compliance Officer (CAPCO) role to address some of the contract/TBO classification challenges. When fully implemented, inclusive of the policies, procedures, tools and training, the CAPCO process should provide a mechanism for the program offices and Business, Plans, and Operations (BPO) to effectively ensure that front-end decisions are validated to support the accurate accumulation of costs incurred. To achieve the CAPCO objectives, everyone associated with the PP&E transaction cycle, not just BPO, will need to understand and support the business process changes associated with the CAPCO process.

~~(U//FOUO)~~ Also in 2014, the NRO implemented a new control to complete a secondary review of the decisions to classify a CLIN as Acquisition Management Costs (AMC). Testing completed during the fiscal year (FY) evidenced the continued existence of AMC classification errors; however, the new control prevented approximately of AMC classification errors.

(U) Notwithstanding the NRO's continued efforts to address the complex issues associated with the classification of costs, we continued to note errors in the transactions sampled during our audit. Table 1 below presents the gross values of the CLINs and TBOs that the NRO needed to correct as a result of our audits since 2011.

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FY 2011	FY 2012	FY 2013	FY 2014
Audit Adjustments	Audit Adjustments	Audit Adjustments	Audit Adjustments

Table 1 is U//FOUO

(U//FOUO) The FY 2014 audit adjustments of [redacted] presented in Table 1 represent the total costs associated with 119 errors in the classification of work activity disbursements. The majority of these errors can be attributed to the following:

- (U) The NRO needs to improve the Definitized CLIN Activity Report (DCAR) control. This control is executed by the Audit Sustainment Team (AST) and the Program Operations Team (PO) to validate the accuracy of the CLIN classification. The PO focuses on reviewing those items related to the NRO's major satellite and ground acquisitions while the AST reviews the remaining items. The AST/PO's review of the program's setup of individual CLINs is typically limited to a review of the Statement of Work (SOW) which may not include all the information needed to assess the accuracy of the CLIN classification. Other information available to the AST/PO to validate the accuracy of the CLIN includes, but is not limited to, the Engineering Change Proposals (ECPs), Price Negotiation Memorandums (PNMs), Memorandums for the Record (MFRs) and/or Task Orders. If the AST/PO consistently reviewed these additional documents, in addition to the SOWs, the team would gain additional insight to the actual CLIN work activity to improve accounting classification decisions.
- (U//FOUO) The NRO needs to improve the AMC secondary review. As noted this review prevented [redacted] errors in the fiscal year. However, we noted [redacted] of errors related to AMC in the current year. Most of these errors occurred prior to the implementation of the new control, but errors were also noted subsequent to the implementation of the new control.
- (U//FOUO) The NRO has not developed and implemented a comprehensive plan to ensure the accurate classification of costs associated with the development of the NRO Infrastructure Service Provider (NISP). The NISP is a far reaching infrastructure program which incorporates the information technology (IT) infrastructure and application service provider services at the NRO. Due in part to the lack of accounting guidance for the NISP, we noted 41 classification errors totaling [redacted].
- (U//FOUO) The NRO needs to conduct additional training to educate those individuals responsible for the establishment of new contracts or the modification of existing contracts to ensure that enhancements to existing ground assets are classified appropriately. We noted 26 CLINs/TBOs, valued at [redacted] where enhancements to ground hardware system assets and ground software system assets were occurring but the costs associated with those enhancements were not being capitalized.

(U) The underlying cause of these findings can be traced to design weaknesses in the preventative controls used to accumulate and report costs in the PP&E transaction cycle. Specifically, the controls used to establish contracts or to modify contracts were not designed to ensure that the corresponding work activity was accurately classified. Lacking the appropriate

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preventative controls, the NRO has been dependent on inefficient and costly controls at the end of the process to find and correct errors. These detective controls are complex, heavily dependent on human interaction, and subject to error.

(U) Recommendations:

(U//FOUO) The NRO needs to finalize the design and fully implement the CAPCO. This includes the finalization of all CAPCO policies and procedures. The NRO also needs to ensure that training regarding all elements of the CAPCO is provided to all individuals involved with the design, acquisition, installation, and use of PP&E. The NRO needs to complete a "quick review" once the CAPCO is implemented to determine if the internal control objectives regarding classification are being achieved. Also, the NRO needs to develop a set of metrics by which it can monitor and enforce compliance with the CAPCO.

(U) Until such time as the NRO is able to fully implement the CAPCO, we recommend the following:

1. (U) The NRO should modify the design of the DCAR review to require the AST/PO teams to review the SOWs, ECPs, PNMs, MFRs and other available documentation associated with the work activity for each CLIN. The AST/PO teams should be required to meet with program officials to confirm the full scope of work activity associated with each CLIN. The information gathered through the review of available documentation and interviews with program officials should be summarized and maintained to support the final decisions of the AST/PO teams.
2. (U) The NRO should improve the effectiveness of the new secondary AMC classification control, review the control to determine if additional training regarding the control, or if any adjustments to the control, are warranted.
3. (U) The NRO needs to develop and implement a comprehensive set of policies to assess the differing work activity covered by the NISP and to ensure that these costs are accurately classified. Until such time as this guidance is developed and implemented, the NRO needs to develop a methodology to ensure that the commingled NISP costs are accurately allocated to the Balance Sheet and the Statement of Net Cost in order to prevent errors in the financial statements.
4. (U) The NRO should evaluate the existing guidance for ground hardware system and ground software system enhancements. If the guidance is incomplete or inaccurate, or if it does not meet the needs of the users, it should be updated as soon as possible. If the guidance is complete and accurate, the NRO should provide additional training to ensure that it is used appropriately to guide decisions related to ground asset enhancements.

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The PwC logo consists of the letters 'pwc' in a bold, lowercase, sans-serif font. Above the letters is a small graphic of a staircase or a series of horizontal bars of varying lengths, creating a stepped effect.

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~~(U//FOUO)~~ **Finding 2: The NRO needs to strengthen processes to develop and monitor execution of accounting policy, guidance and methodologies.**

(U) Summary Status: Material Weakness (Prior Year Finding #2)

(U) During FY 2014, the NRO strengthened accounting policy and methodologies by creating new guidance and methodologies to address some of the prior year gaps that had been noted in their financial processes. In addition, the NRO continued to review the existing business operations to identify gaps where the business policy and accounting policy were not properly matched. This is a difficult process to manage as the business operations of the NRO are in a constant state of change as new threats emerge, and existing technologies used by the NRO to address the threats improve.

(U) However, in FY 2014, we continued to note instances where the NRO's accounting policies and procedures related to significant business activities were not designed, modified, or implemented to accurately report on the NRO's operations. Specifically, we noted:

1. ~~(U//FOUO)~~ The NRO completed a new ground accounting policy and late in the fiscal year the policy was implemented for certain types of ground assets. The NRO created the policy to clarify: 1) the accounting treatment associated with ground hardware assets and ground software assets; 2) when to classify activity as an enhancement to these assets; and, 3) when these assets should be considered fully constructed and placed in service. After the policy guidance was implemented, several errors were made related to the classification of assets (as either Ground Hardware or Ground Software). The errors were attributed to lack of clarity in the new policy guidance and inconsistent implementation of the guidance.
2. ~~(U//FOUO)~~ During the fiscal year, the NRO initiated a process to review the validity of the useful life expectancies used to depreciate the NRO's fleet of satellites. The NRO finalized this review without updating key life expectancy assumptions. Using the out-of-date assumptions, the NRO incorrectly changed the life expectancy for certain satellites. The incorrect life expectancies were then used to calculate and record the depreciation expense for the satellites within the June 30, 2014 financial statements. Subsequent to the preparation of the interim financial statements, the NRO corrected the out-of-date assumptions and corrected the depreciation calculations for the year-end financial statements.
3. ~~(U//FOUO)~~ During the fiscal year, the NRO created and posted 1,293 journal vouchers (JVs) (17,677 lines of accounting) with a gross value of [redacted]. The NRO uses JVs to process standard and non-standard transactions and also to correct errors. While we did not note any material errors in JVs this year, we did observe instances where the initial evidence used to justify the business purpose of the JV was incomplete. Furthermore, the sheer volume of entries that the NRO produces on an annual basis poses a significant risk to the accuracy of the financial statements due to the manually intensive process necessary to create, review, and post those entries.

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4. ~~(S//TK//NF)~~ During the fiscal year,

5. ~~(U//FOUO)~~ The NRO does not have a policy in place to ensure that obligations incurred prior to the end of the fiscal year are entered in the general ledger in the correct fiscal period. We tested 49 obligations entered in the general ledger during October 2014 and determined that 4 of those obligations were authorized in FY 2014, but entered in the general ledger in FY 2015.
6. ~~(U//FOUO)~~ Beginning in our FY 2010 Report of Independent Auditor's on Internal Control, we recommended that the NRO develop an accounting policy for transferred materials and parts. The NRO did not address this area during FY 2014; therefore, the risk of misstatement continues to exist.

(U) Recommendations:

1. ~~(U//FOUO)~~ The NRO should review and update significant accounting policies to ensure that they are properly aligned with the NRO's ever-changing business model. Furthermore, the NRO needs to ensure that all material business transactions, inclusive of those related to changes in the NRO's business model, are supported by a comprehensive accounting policy. The NRO should use the information gathered to develop and implement appropriate policies to fill the gaps using a top-down approach. A detailed project management schedule should be developed and implemented to ensure the completion of this gap analysis in a timely manner. The NRO should be mindful of existing Federal guidance, such as the Chief Financial Officer Council's *Implementation Guide for OMB Circular A-123, Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting* or the Government Accountability Office's *Standards for Internal Control in the Federal Government* ("Green Book"). Policy guidance developed and the controls implemented to support the accounting guidance should be complete, supported by accounting principles generally accepted in the United States, and approved prior to implementation of the policies. Training should be provided to ensure that the new policies are accurately implemented.
2. (U) The NRO needs to improve the process for ensuring that changes or modifications to existing policies and procedures are fully reviewed and approved by the appropriate BPO officials before they are implemented.
3. (U) The NRO should complete a comprehensive analysis of the types of JVs completed on a monthly, quarterly, and annual basis. The NRO should ensure that modifications or adjustments to the existing systems could not be implemented to eliminate the need for some of the recurring JVs. The NRO should also ensure that the business rationale for

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each JV is clearly stated and fully supported prior to the approving or entering the JVs in the general ledger.

4. (U) The NRO needs to fully document the valuation methodologies used to value each class of satellites. The NRO also needs to ensure that appropriate controls are designed and implemented to ensure that satellites are accurately valued when placed in service.
5. (U) The NRO should develop a process to ensure obligations are recorded in the appropriate fiscal period.
6. (U) The NRO should develop and implement accounting guidance for key transactions, such as the tracking of transferred materials and spares.

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~~(U//FOUO)~~ **Finding 3: The NRO needs to strengthen system access and monitoring controls.**

(U) Summary Status: Significant Deficiency (Prior Year Finding #3)

~~(U//FOUO)~~ The NRO did not effectively develop and implement a process compliant with National Security Systems (NSS) Instruction No. 1253, *Security Categorization and Control Selection for National Security Systems*, dated March 2012 and NRO policy, for access management and monitoring controls. We identified deficiencies in the NRO's controls for authorization, revalidation, and deactivation of users on the significant financial and financial support systems. We also observed

(U) Access Authorization, Revalidation and Deactivation/Removal

~~(U//FOUO)~~ The core NRO financial systems include the NRO Financial Information System (NFIS) [redacted] which are supported by the NRO Management Information System (NMIS). Each of these systems has a separate access management process for authorization, revalidation, and deactivation.

~~(U//FOUO)~~ *NMIS and NRO-wide:* The NRO Account Action Process (NAAP) is used to manage NMIS account authorization and revalidation. NMIS privileged users (PU) are required to have a separate form completed and authorized for elevated access. We noted 3 [redacted] NMIS PUs sampled did not have a NAAP or a PU request form on file. Furthermore, the NRO relies on an informal, manual process to revalidate NRO-wide PU access based on an incomplete population, evidenced by the fact that 4 [redacted] PUs sampled were not included in the NRO-wide PU tracking database.

~~(U//FOUO)~~ [redacted] The [redacted] access management policies and procedures require that application general or privileged access should only be awarded after proper authorization. We noted that 3 of [redacted] users tested did not have the appropriate approvals for the level of access granted. We noted that 4 of [redacted] application users did not have the appropriate approvals on the access request forms and 1 PU of [redacted] infrastructure users tested did not have an access request form. Additionally, the Communications System Directorate (COMM)/[redacted] did not design a process for conducting an annual revalidation of PUs that included users' permissions and of [redacted] elevated users including application users and infrastructure users.

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(U//~~FOUO~~) During the fiscal year, the NRO implemented changes to its out-processing to identify, deactivate, and remove network and application access for terminated and transferred individuals. The process leverages the Automated Out-processing and Relocation System (AORS), which is a self-reporting system, and added a quarterly Directorate and Office (D and O) led process for reporting of all separated and transferred individuals. While this additional step is time intensive, it has partially mitigated [redacted]

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[redacted] However, the D and O quarterly reporting process can take [redacted] access. COMM [redacted] user accounts. Based on our testing, we identified out-processed individuals with active accounts on the significant financial systems.

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- (U//~~FOUO~~) 2 NFIS users maintained an active account after separating from the NRO.
- (U//~~FOUO~~) [redacted] users maintained an active account after separating from the NRO.
- (U//~~FOUO~~) [redacted] user maintained an active elevated account after separating from the NRO.
- (U//~~FOUO~~) [redacted] users could not validate the continued need for elevated access after transferring within the NRO.

(U//~~FOUO~~) The NRO Business Function (NBF) 50, *Information Technology, Information Assurance, and Information Management (IT-IA-IM) NRO Directive (ND) 53-22, NRO Management Information System Account Qualifications and Access Management*, and ND 52-2, *System Access*, require user accounts to be disabled if inactive for more than 60 consecutive days. This process helps minimize the impact of the out-processing and account disabling deficiencies. However, the NMIS inactivity review process was not operating effectively since the NRO did not deactivate [redacted] NMIS accounts after 60 days of inactivity.

(U//~~FOUO~~) Additionally, we observed [redacted]

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(U) Monitoring

(U//~~FOUO~~) The Information Assurance Standards Document (IASD) Revision B requires the collection of audit logs and the review of the audit logs as a monitoring control. We observed deficiencies in the NRO's monitoring procedures at all three levels tested; (1) NMIS network level, (2) [redacted] enterprise level, and (3) financial applications level.

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(U//FOUO) The NMIS System Security Plan (SSP) requires the Information System Security Officer (ISSO) to collect and review audit logs. The COMM ISSO did not provide evidence of any log reviews. Additionally, the NMIS SSP does not establish a review schedule and does not identify the key events that should be reviewed by the ISSO. We noted that NMIS system administrators developed a process to review audit logs and provided evidence of the review; however, this process did not mitigate the lack of an independent review of system administrator activity.

(U//FOUO) COMM [redacted] to capture audit logs generated by the financial applications at the [redacted] levels using ArcSight. Though system, application, and security logs were collected towards the end of the fiscal year, ArcSight was unavailable because of [redacted] resulting in [redacted] Enterprise Network, NFIS, and [redacted] logs not being captured for [redacted] months. Additionally, COMM [redacted] experienced intermittent failures with its [redacted]. As a result of these two simultaneous failures, COMM [redacted] was unable to retain complete audit logs for these [redacted] months. After the recovery of ArcSight, COMM [redacted] did not review the audit logs because they did not configure ArcSight to identify and log the key areas of risk. Consequently, the volume of logs generated outmatched COMM [redacted] ability to adequately review and clear the logs.

(U//FOUO) COMM [redacted] did not perform adequate monitoring at the application level for NFIS [redacted] around sensitive transaction data and processes supporting financial data. COMM [redacted]

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[redacted] Key transactions and reference data has not been defined by the data owners of NFIS [redacted] and [redacted] for periodic review to confirm the proper processing of transactions in the applications. NFIS allows for approved users to perform overrides on the application and these actions are captured through audit logs. Although a review of the overrides is performed, it is not designed to assess if the override was appropriate. Additionally, COMM [redacted] and BPO did not perform periodic reviews of reference data, threshold, or reports to ensure the completeness, accuracy, and validity of the information output from the financial applications.

(U//FOUO) The implementation of effective access controls across the NRO is fundamental to creating a secure set of controls designed to restrict [redacted]

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(U) Recommendations:

~~(U//FOUO)~~ We continue to recommend that the NRO strengthen logical and physical access management by developing and implementing controls to protect its financial data and systems.

1. ~~(U//FOUO)~~ COMM should improve the effectiveness of the account authorization and revalidation process.
 - ~~(U//FOUO)~~ Implement a process to periodically review compliance and effectiveness of the NAAP, including verifying that forms are appropriately authorized before access is granted to the NMIS.
 - ~~(U//FOUO)~~ Implement a process that includes actively tracking all NMIS PUs and requiring an annual revalidation to confirm access needed to perform job responsibility is consistent with the concept of least privileges.
 - ~~(U//FOUO)~~ Implement a process that reviews the quality and effectiveness of the COMM [redacted] authorization and revalidation process for NFIS [redacted] users. Any identified gaps in the processes should be remediated (e.g., updated access request forms be created and/or authorized) and where appropriate policies and procedures should be updated to be consistent with Federal standards, NRO policies, and organization practices.
 - ~~(U//FOUO)~~ COMM [redacted] should ensure all [redacted] infrastructure users follow the account management policy requiring the completion of a valid authorization form. Develop and implement revalidation procedures for [redacted] infrastructure and [redacted] elevated users that are performed at least annually.
 - ~~(U//FOUO)~~ COMM [redacted] should document procedures for an enhanced PU revalidation to ensure that privilege users' current roles and permissions were appropriate and within expected parameters.
2. ~~(U//FOUO)~~ The NRO should evaluate the process efficiency of the quarterly D and O out-processing reporting to determine if improvements can be made in the timeliness of removing out-processed individuals.
3. ~~(U//FOUO)~~ COMM [redacted] financial application security administrator should fully leverage the NRO out-processing list created through the new entity-wide procedures, using self-reporting and D and O level reporting, to improve the effectiveness of the COMM [redacted] out-processing procedures.
4. ~~(U//FOUO)~~ COMM/NISP should review its process of disabling inactive NMIS accounts. A process should be implemented to confirm that all inactive user accounts are disabled after the NRO defined period of 60 days.
5. ~~(U//FOUO)~~ COMM should develop and implement procedures for the ISSO to review NMIS system and security audit logs on a prescribed schedule. COMM should define and implement a process to review privileged user activities and actions; the review should be performed by a group or individual that is independent from the privileged

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users. The reviewer should maintain a record of the audit log review to evidence completion and action taken to address any unusual activity.

6. (U//~~FOUO~~) COMM [] should develop and implement procedures to review COMM [] system, application, and security logs on a prescribed schedule. The reviewer(s) should maintain a record of the audit log review to evidence completion and action taken to address any unusual activity. COMM [] should coordinate with the NFIS, [] data owners to define key areas of risk requiring review and develop procedures for the review of these key areas. COMM [] should fully evaluate, finalize, and implement the process to capture and effectively review audit logs related to key functional transactions and changes to data, as well as identifying a more effective process to monitor and review overrides performed. COMM [] should also implement monitoring of PUs on the [] Enterprise Network, NFIS, []
7. (U//~~FOUO~~) COMM [] should identify and document hardware and software that support key processes within the [] Enterprise Network. For each piece of hardware and software identified, a contingency plan should be developed and documented which will lead to the timely reconstitution of the hardware or software in the event of failures. Management should also determine and document acceptable downtime for the key hardware and software identified.
8. (U//~~FOUO~~) COMM [] should implement a process that includes actively tracking all [] individuals and requiring an annual revalidation to confirm the continuing need for data center access at these facilities according to job function. []
 [] Results of the review should be documented and maintained.

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~~(U//FOUO)~~ **Finding 4: The NRO needs to strengthen financial system and application segregation of duties.**

(U) Summary Status: Significant Deficiency (New Finding)

~~(U//FOUO)~~ COMM [] did not effectively identify, document, and implement access restrictions considering incompatible duties that should be segregated within the [] Enterprise Network, NFIS, []. We identified deficiencies in design and effectiveness of the NRO's controls segregating key functionalities in the system and application environments as well as weaknesses in monitoring individuals with approved conflicting duties. Control deficiencies related to segregation of duties increase the potential that errors or fraudulent acts could be performed without the appropriate checks necessary to protect the integrity and accuracy of financial data.

(U) [] *Enterprise Network Segregation of Duties*

~~(U//FOUO)~~ COMM/ [] finalized the [] *Segregation of Duties Policy and Guide* in May 2014. This policy and procedures provide direction over the segregation of duties supporting the organizations PUs across the [] Enterprise Network. However, while this policy and procedures were in existence for four and a half months of the fiscal year, we noted that it did not accurately reflect the operating environment. Specifically, the policy and procedures did not align with current system roles as defined in the Linux, Oracle, and Windows environments nor provide sufficient granularity of system permissions to determine whether access was appropriately segregated for all PUs. As a result, PU access and permissions were not segregated for information security management, network administration, system administration, data administration, quality assurance/testing, application programming, and system engineering.

~~(U//FOUO)~~ NRO configuration management policy requires a controlled approval process to move changes through the development, testing, and production environments. However, the COMM/ [] did not separate [] Enterprise Network PU access to prevent a single PU from being able to develop a change and migrate the change into production without appropriate approvals. Additionally, COMM/ [] did not document or implement a process to periodically monitor logs for system, application, and database changes to identify unauthorized changes or to confirm compliance with the existing configuration management procedures. Failing to segregate PU access between the development and production environments could allow a PU to develop an unauthorized change and implement that change in the production environment without following established change management procedures. This could affect the confidentiality, integrity and availability of the system or financial applications.

~~(U//FOUO)~~ COMM/ [] has not established procedures to monitor existing, approved segregation of duties conflicts. For business purposes, COMM/ [] grants users access with known segregation of duties conflict. However, to manage the associated risk these users'

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activities should be monitored. Management had not conducted periodic reviews to determine whether controls for monitoring incompatible duties were functioning as intended.

(U) *NFIS Segregation of Duties*

(U//~~FOUO~~) COMM [redacted] policies did not adequately address the identification and segregation of NFIS incompatible duties in the *NFIS Segregation of Duties Policy and Guidelines*. This policy was last updated in October 2012 and did not include evidence of management review and approval. Consequently, the segregation of duties matrix was inaccurate, application roles with segregated abilities requiring waivers were not documented, unused and unassigned Momentum application roles were present, and high risk NFIS roles were not addressed in the policy. We identified [redacted] holding those roles that violated the NFIS segregation of duties matrix, which allowed these individuals to perform NFIS transactions that BPO identified as needing to be segregated.

(U//~~FOUO~~) We observed that NFIS configurations limited the NRO's ability to segregate sensitive duties and responsibilities. Application users have the ability to create and process transaction documents and supervisors performing reviews and approving transactions have the ability to edit transaction data before final submission, rendering the segregation of duties ineffective. Although BPO designed detective controls to prevent errors as a result of these segregation of duties limitations, the controls did not cover all document types. COMM [redacted] and BPO were not monitoring known segregation of duties issues for the entirety of the fiscal year.

(U) [redacted] *Segregation of Duties*

(U//~~FOUO~~) The [redacted] application has segregation of duties issues that could impact the NRO's financial application and data residing therein. [redacted] system administrators have application access and permissions to perform financial related tasks, which allowed users to perform any actions on the application. [redacted] system administrator actions on the application were not being monitored by an independent party and a periodic review of known segregation of duties conflicts on the application were not regularly performed to reduce the risk associated with the granted privileges. Identified and approved segregation of duty roles on the application and support network were not audited and monitored to ensure that inappropriate actions are not taken. However, COMM [redacted] did not implement an effective monitoring process to mitigate this risk during the fiscal year.

(U//~~FOUO~~) [redacted] *Segregation of Duties*

(U//~~FOUO~~) The [redacted] *Segregation of Duties Policy* was not updated since September 2011 with information that identifies roles and functions that need to be separated, authorized exceptions to the policy, and a process to monitor the activities performed by the conflicting users that pose a potential risk to the security of the environment. Additionally, [redacted] PUs roles and permissions were not separated to prevent one individual from being able to develop a change and migrate the change into production. [redacted] PUs have the ability to develop changes and circumvent the change management process, to migrate a change to production without being reviewed or

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approved. COMM/[] has not performed an analysis of the [] application's roles and permissions to identify sensitive transactions and incompatible duties. As a result, COMM [] was not monitoring [] users with access to sensitive and incompatible.

(U//~~FOUO~~) The lack of an up-to-date segregation of duties policy could result in a user being assigned conflicting or incompatible roles. The lack of policy and implementation of segregation of duties presents a risk that individuals could perform actions on the application that could adversely impact financial data without the knowledge of management.

(U) Recommendations:

(U//~~FOUO~~) We recommend that COMM [] develop, refine, and implement its segregation of duties policies and procedures, including identifying segregation conflicts and implementing monitoring of those actions. Specifically, COMM [] should:

1. (U) Segregation of Duties Policy and Procedures
 - (U//~~FOUO~~) Update and implement the [] *Segregation of Duties Policy and Guide* to identify roles, responsibilities, and functions, as they are defined in the system, which need to be separated among PUs. Conflicting roles and permissions should be defined, formally approved, and monitored by independent personnel. Procedures and controls should be developed, documented, and implemented to verify that new users are not granted incompatible duties. Procedures and controls should be developed, documented, and implemented to periodically review all PU access to verify that users have not been granted incompatible duties.
 - (U//~~FOUO~~) Implement a process to periodically review and update the *NFIS Segregation of Duties Policy and Guidelines*. Application changes such as new document types, categories, roles, and waivers should be reflected in the policy. All sensitive transactions and activities, including vendor table access and the ability to create/edit and process document types should be identified within the policy.
 - (U//~~FOUO~~) Update and implement the [] segregation of duties policy which identifies roles and functions needed to be separated among users, requires documentation of exceptions to the segregation of duties policy, and involves a process to monitor the activities performed by users with conflicting roles.
2. (U) Application Segregation of Duties
 - (U//~~FOUO~~) Research and implement a solution to mitigate the risk to financial data with regard to the NFIS processes that allow for the ability to "create and process" a document type or edit transaction data by the reviewer/approver before final processing. The ability for [] should be separated.
 - (U//~~FOUO~~) [] application privileged users should be segregated or a process should be implemented to monitor the activity of the [] privileged users in the application.

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3. (U) Review and Monitoring of Segregation of Duties

- (~~U//FOUO~~) Define key PU activities and implement a program to monitor these activities for the financial systems.
- (~~U//FOUO~~) Perform periodic reviews over segregated duties and high risk transactions on each application commensurate with the risk identified to financial data.
- (~~U//FOUO~~) Implement a process to periodically review NFIS document types, categories, and roles; remove unnecessary document types, categories, and roles.

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(U) Response to Findings

(U) The NRO's written response to the findings identified in our audit is included immediately following the audit reports. NRO's response was not subjected to the auditing procedures applied in the audit of the financial statements and accordingly, we express no opinion on it.

(U) Purpose of this Report

(U) This purpose of this report is solely to describe the scope of our testing of internal control and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "PRICEWATERHOUSECOOPERS LLP". The signature is written in a cursive, slightly slanted style.

McLean, VA
November 14, 2014

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**Independent Auditor's Report on Compliance and Other Matters Based on an
Audit of Financial Statements Performed in Accordance with *Government
Auditing Standards***

(U) To the Director of the National Reconnaissance Office and
the Inspector General for the National Reconnaissance Office:

(U) We have audited, 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. 14-02, *Audit Requirements for Federal Financial Statements*, the financial statements of the National Reconnaissance Office (NRO), which comprise the balance sheet as of September 30, 2014, and the related statements of net cost and changes in net position, and the combined statement of budgetary resources, and the related notes to the financial statements for the year then ended, which collectively comprise the NRO's financial statements, and have issued our report thereon dated November 14, 2014.

(U) Compliance and Other Matters

(U) As part of obtaining reasonable assurance about whether the NRO's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, including laws governing the use of budgetary authority, laws, regulations, government-wide policies identified in Appendix E of OMB Bulletin No. 14-02 and other laws and regulations that could have a direct and material effect on the determination of financial statements. Under the *Federal Financial Management Improvement Act (FFMIA)*, we are required to report whether the NRO's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

(U) We limited our tests of compliance to the provisions of the laws and regulations cited above; however, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

(U) The results of our tests of compliance with the laws and regulations described above disclosed instances of noncompliance with the following laws and regulations or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 14-02, which are described below.

- (U) ***Federal Managers' Financial Integrity Act (FMFIA) of 1982***: Subsection (a) (3) of this law requires that agency operations properly record and account for transactions to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over assets.

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Report on Compliance and Other Matters
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~~(U//FOUO)~~ We noted financial reporting areas where the NRO did not proactively develop and consistently implemented accounting policy, accounting positions, or methodologies to mitigate the risk of errors in financial reporting in a timely manner. For example, we noted a lack of adequate policy relating to transferring program materials and spares and for ensuring obligations are posted to the correct fiscal year. In addition, the NRO has made significant progress in the development of a ground accounting policy; however, the policy on how to account for the NISP still needs to be developed and implemented.

~~(U//FOUO)~~ The results of our tests disclosed instances, described below; where the NRO's financial management systems did not substantially comply with applicable Federal accounting standards and with Federal financial management systems requirements.

- ~~(U//FOUO)~~ **The NRO's accounting for property, plant, and equipment (PP&E) did not substantially comply with applicable Federal accounting standards.**

~~(U//FOUO)~~ We noted weaknesses in the NRO's system of internal control affecting the NRO's ability to comply with Statement of Federal Financial Accounting Standard No. 6, *Accounting for Property, Plant, and Equipment*, reporting criteria during the fiscal year. Specifically, we noted control weaknesses related to the identification and separation of expenditures between capital and expense accounts within the core financial system.

- ~~(U//FOUO)~~ **The NRO's financial management system is not in substantial compliance with Federal financial management systems requirements.**

~~(U//FOUO)~~ We noted that the NRO's financial management systems did not substantially comply with the Federal financial management system requirements of FFMA in two specific areas.

~~(U//FOUO)~~ First, the NRO did not reconcile non-program and contractor-held PP&E information contained in the general ledger with subsidiary system data. This matter coupled with the matter described in the preceding paragraph indicates that the NRO's financial management system did not substantially comply with the Federal system requirements of OMB Circular A-123, Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996*. The internal control weaknesses surrounding the accounting for capital and expense expenditures outside of the NRO's general ledger and the lack of integration between the NRO's general ledger and PP&E subsidiary system inhibit management's ability to generate complete and reliable financial information in accordance with Federal financial management systems requirements.

~~(U//FOUO)~~ Second, the NRO's financial management systems did not substantially comply with the Federal financial management system requirements of FFMA due to the information system weaknesses reported in both the fiscal year 2014 Report of Independent Auditor's on Internal Control and the Independent Evaluation of NRO Compliance with *Federal Information Security Management Act (FISMA)*. Ongoing weaknesses in internal control over the NRO's information processing facilities and resources supporting the NRO's financial systems significantly impair its ability to adequately protect financial information in accordance with requirements outlined in OMB Circular A-130, *Management of Federal Information Resources*.

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Report on Compliance and Other Matters
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(U) Significant facts pertaining to the matters referred to above, including recommendations for remedial actions are discussed in a separate Report of Independent Auditor's on Internal Control, dated November 14, 2014.

(U) Purpose of this Report

(U) The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's compliance. Accordingly, this communication is not suitable for any other purpose.

PriceWaterhouseCoopers LLP

McLean, VA
November 14, 2014

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(U) FINANCIAL STATEMENTS

(U) The NRO prepares its illustrative financial statements in accordance with OMB Circular No. A-136, *Financial Reporting Requirements*. Figure 32 below summarizes the financial statements required by OMB, as well as those that are applicable to the NRO.

(U) Figure 32 – Summary of NRO Financial Statements

(U) Financial Statement	(U) Description
(U) Balance Sheet	(U) The balance sheet presents, as of a specific time, amounts of future economic benefits owned or managed by the NRO (assets), amounts owed by the NRO (liabilities), and amounts which comprise the difference (net position).
(U) Statement of Net Cost (SNC)	(U) The SNC presents the NRO's net cost of operations, as a whole, by major responsibility segments, which align with the goals and outputs of the NRO mission, as described in Figure 33 in Note 1 – <i>Significant Accounting Policies</i> .
(U) Statement of Changes in Net Position (SCNP)	(U) The SCNP reports the change in net position during the reporting period, which is affected by changes in cumulative results of operations and unexpended appropriations.
(U) Statement of Budgetary Resources (SBR)	(U) The SBR provides information about how budgetary resources are made available as well as their status at the end of the reporting period. It is the only financial statement derived from the NRO's budgetary general ledger accounts. The SBR has been reformatted starting in FY 2013 to conform with the requirements found in OMB Circular No. A-136.
(U) Statement of Custodial Activity (SCA)	(U) The SCA is required for entities that collect nonexchange revenue for the General Fund of the Treasury, a trust fund, or other recipient entities. The NRO collects and returns immaterial nonexchange revenue to the Treasury by the end of the FY, and therefore does not produce the SCA.

Figure 32 is (U)

NATIONAL RECONNAISSANCE OFFICE

BALANCE SHEET

As of 30 September 2014 and 2013

(Dollars in Thousands)

	2014	2013
ASSETS (Note 2):		
Intragovernmental:		
Fund Balance With Treasury (Note 3)	(b)(1)	
Appropriations Receivable (Note 5)	(b)(3) 10 USC ± 424	
Advances to Others (Note 6)		
Total Intragovernmental		
Cash and Other Monetary Assets (Note 4)		
General Property, Plant and Equipment, Net (Note 7)		
Other (Note 9)		
TOTAL ASSETS		
Heritage Assets (Note 8)		
LIABILITIES (Note 10):		
Intragovernmental:		
Accounts Payable (Note 13)	(b)(1)	
Advances From Others (Note 15)	(b)(3) 10 USC ± 424	
Other (Note 14)		
Total Intragovernmental		
Accounts Payable (Note 13)		
Other (Note 14)		
TOTAL LIABILITIES		
Commitments and Contingencies (Note 17)	(b)(1)	
NET POSITION:	(b)(3) 10 USC ± 424	
Unexpended Appropriations		
Cumulative Results of Operations		
TOTAL NET POSITION		
TOTAL LIABILITIES AND NET POSITION		

The accompanying notes are an integral part of these statements.

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NATIONAL RECONNAISSANCE OFFICE

STATEMENT OF NET COST

For the Years Ended 30 September 2014 and 2013

(Dollars in Thousands)

Program Costs by Responsibility Segment (Notes 18 and 19):	2014	2013
RESEARCH & TECHNOLOGY		
Gross Costs		
Less: Earned Revenue	(b)(1)	
TOTAL NET COSTS	(b)(3) 10 USC \pm 424	
MISSION GROUND STATIONS		
Gross Costs		
Less: Earned Revenue	(b)(1)	
TOTAL NET COSTS	(b)(3) 10 USC \pm 424	
ACQUISITION MANAGEMENT		
Gross Costs	(b)(1)	
Less: Earned Revenue	(b)(3) 10 USC \pm 424	
TOTAL NET COSTS		
LAUNCH		
Gross Costs		
Less: Earned Revenue		
TOTAL NET COSTS	(b)(1)	
Cost Not Assigned To Programs	(b)(3) 10 USC \pm 424	
Less: Earned Revenues Not Attributed to Programs		
NET COST OF OPERATIONS		

The accompanying notes are an integral part of these statements.

~~(SECRET//NOFORN)~~

NATIONAL RECONNAISSANCE OFFICE

STATEMENT OF CHANGES IN NET POSITION
For the Years Ended 30 September 2014 and 2013
(Dollars in Thousands)

	2014	2013
Cumulative Results of Operations:		
Beginning Balance		
Budgetary Financing Sources:		
Appropriations Used		
Other Financing Sources (Non-Exchange):		
Transfers In/Out Without Reimbursement	(b)(1)	
Imputed Financing (Note 11)	(b)(3) 10 USC ± 424	
TOTAL FINANCING SOURCES		
NET COST OF OPERATIONS		
NET CHANGE		
CUMULATIVE RESULTS OF OPERATIONS		
Unexpended Appropriations:		
Beginning Balance		
Budgetary Financing Sources:		
Appropriations Received		
Appropriations Transferred In/Out	(b)(1)	
Other Adjustments	(b)(3) 10 USC ± 424	
Appropriations Used		
Total Budgetary Financing Sources		
TOTAL UNEXPENDED APPROPRIATIONS		
NET POSITION		

The accompanying notes are an integral part of these statements.

~~(SECRET//NOFORN)~~

NATIONAL RECONNAISSANCE OFFICE

STATEMENT OF BUDGETARY RESOURCES
For the Years Ended 30 September 2014 and 2013
(Dollars in Thousands)

	2014	2013
BUDGETARY RESOURCES:		
Unobligated Balance Brought Forward, October 1, Gross		
Recoveries of Prior Year Unpaid Obligations		
Other Changes in Unobligated Balance		
Unobligated Balance from Prior Year Budget Authority, Net		
Appropriations	(b)(1)	
Spending Authority from Offsetting Collections	(b)(3) 10 USC ± 424	
TOTAL BUDGETARY RESOURCES		
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred (Note 20)		
Unobligated Balance, End of Period	(b)(1)	
Apportioned (Note 3)	(b)(3) 10 USC ± 424	
Unapportioned (Note 3)		
Total Unobligated Balance, End of Period		
TOTAL STATUS OF BUDGETARY RESOURCES		
CHANGE IN OBLIGATED BALANCE:		
Unpaid Obligations:		
Unpaid Obligations, Brought Forward, October 1		
Obligations Incurred (Note 20)		
Outlays, Gross		
Recoveries of Prior Year Unpaid Obligations		
Unpaid Obligations, End of Period, Gross	(b)(1)	
Memorandum (non-add) entries:	(b)(3) 10 USC ± 424	
Obligated Balance, Start of Year		
Obligated Balance, End of Period, Net (Note 3)		
BUDGET AUTHORITY AND OUTLAYS, NET:		
Budget Authority, Gross		
Actual Offsetting Collections		
BUDGET AUTHORITY, NET		
Outlays, Gross		
Actual Offsetting Collections		
Outlays, Net		
AGENCY OUTLAYS, NET		

The accompanying notes are an integral part of these statements.

~~(SECRET//NOFORN)~~