United States General Accounting Office

GAO

Report to the Administrator, National Aeronautics and Space Administration

February 1988

FINANCIAL REPORTING

NASA Can Improve Compliance With GAO Standards and Treasury Requirements

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GAO/AFMD-88-21

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-228764

February 29, 1988

The Honorable James C. Fletcher
Administrator, National Aeronautics
and Space Administration

Dear Mr. Fletcher:

This report presents the results of our review of the National Aeronautics and Space Administration's (NASA) preparation of its fiscal year 1986 Report on Financial Position, commonly referred to as a balance sheet. This review, one segment of a governmentwide effort, was performed to determine the extent of compliance with the General Accounting Office's (GAO's) and the Department of the Treasury's annual financial reporting requirements.

Although NASA is substantially complying with the requirements and standards for preparing Reports on Financial Position, it could further enhance the reliability of the information contained in the reports. We are recommending that NASA improve its compliance in the areas of reporting accrued liabilities, preparing consolidated financial reports, and disclosing supplemental information.

The Importance of Financial Statements

Comprehensive financial statements at the agency level are important, if not crucial, to providing discipline and cohesiveness in financial management and accounting. Financial statements consistently prepared in accordance with accounting standards offer assurance of quality, reliability, and comparability of data presented. The requirement for such statements will, in turn, provide a strong impetus for agencies to improve the reliability of information produced by their financial management reporting systems. Reliable financial information is needed not only by program managers to more effectively manage their programs but also by external users such as the Congress and the central control agencies, primarily the Office of Management and Budget (OMB) and Treasury to make better informed decisions.

GAO's accounting standards (title 2 of its Policy and Procedures Manual for Guidance of Federal Agencies) require that agency Reports on Financial Position include the total assets, liabilities, and equity of the unit reporting and that the report be prepared from accounting systems containing sufficient discipline, effective internal controls, and reliable data. This requirement has been incorporated in Treasury's reporting financial results of an entity's activities including expenses, revenues, and other financing sources such as appropriations. The Report on Cash Flow summarizes all significant sources available to an agency and the uses made of those resources during the reporting period. The Report on Reconciliation reconciles expenses reported in the Report on Operations with the cash outlays reported to the Treasury.

Adequate implementation of the above initiatives are intended to establish a sound financial management foundation for improving the reliability of accounting systems and, therefore, the financial reports they produce.

Objectives, Scope, and Methodology

Our objectives were (1) to assess how well NASA implemented GAO's and Treasury's annual financial reporting requirements, (2) to determine if there were any problems encountered in meeting these requirements and standards, and (3) to identify any actions needed to improve compliance.

We selected agencies for review based primarily on (1) our analysis of agencies' reports of their financial evaluations made pursuant to the Federal Managers' Financial Integrity Act (FIA) of 1982 (31 U.S.C. 3512(b) and (c)), and (2) the significance of resources that an agency is responsible for managing and controlling. The FIA requires department and agency managers to identify internal controls and accounting systems weaknesses, to correct the weaknesses, and to report annually to the President and the Congress on their progress. The report must also state whether the agency accounting system conforms to our accounting standards.

In analyzing the FIA reports, we considered the severity of the reported accounting weaknesses and the degree of compliance with our accounting standards as the major factors on which we based our selection. Using this criteria, we devised an evaluation methodology and rated each agency according to its overall performance. Based on the ratings, we judgmentally selected agencies that had relatively few weaknesses and compliance problems along with others that reported substantial problems.

We also compared the amount of resources agencies managed and controlled and chose those agencies for which resources were significant in comparison. During fiscal year 1987, NASA was authorized to spend over $10.5 billion and had about 21,800 employees to carry out its missions

Liabilities for Goods and Services Received Should Be Accrued

Our review at the Goddard Space Flight Center showed that the center does not accrue or recognize all of its liabilities for property and services as they are acquired. Title 2, the Treasury requirements, and NASA's own Financial Management Manual require that liabilities be recognized when property is received or services are provided. Title 2 and the Treasury both require accounts payable to be reported in the period when goods and other property are received and when services are performed. Consistent with these requirements, NASA's Financial Management Manual requires that financial transactions be recorded in the period incurred.

Goddard records liabilities for contractor services, employee travel, utilities, and personnel compensation as they occur. However, it does not recognize liabilities for goods and services such as inventory items, supplies, property and services which originate through purchase orders. Instead, these items are recognized when they are processed for payment. A Goddard official told us that the center does not recognize these liabilities because its accounting system does not provide for these accruals. According to the Goddard official, the center is studying the feasibility of recognizing these liabilities as they occur.

Not recognizing these transactions as they occur understates NASA's liabilities on the Reports on Financial Position. If other NASA centers are using the same or similar practices, the liabilities would be further understated.

Intra-Agency Balances Should Be Eliminated From Consolidated Reports

Title 2 and the Treasury Financial Manual require that all intra-agency balances such as receivables and payables be eliminated when consolidated financial statements are prepared. However, our review showed that NASA does not eliminate such balances. These intra-agency balances occur when one NASA center performs work for, but the funding is provided by, another center. The preparer of the Report on Financial Position advised us that since there is a corresponding receivable to offset the payable for each intra-agency transaction, he did not consider the report to be misstated.

We do not agree with this point of view because consolidated reports are based on the concept that they represent the financial position of a single entity—in this case, NASA. Thus, they should reflect only those financial events occurring between NASA and outside entities such as other government agencies or private firms. Failure to eliminate intra-agency

To ensure that NASA fully complies with these standards and requirements, and thus ensure that it provides reliable and useful financial management information to Treasury, we recommend that the Administrator of the National Aeronautics and Space Administration require the NASA Comptroller to

- determine whether other centers are using the same or a similar process as Goddard in accounting for liabilities,
- report liabilities at Goddard and other centers in accordance with GAO and Treasury requirements,
- instruct the supervisor responsible for preparing the Reports on Financial Position to eliminate intra-agency balances when preparing consolidated reports, and
- disclose all of the information required in the supporting schedules to the Reports on Financial Position.

Agency Comments and Our Evaluation

In commenting on a draft of this report, NASA generally agreed with our recommendations but took exception to our conclusion that the information in its Report on Financial Position was not reliable. (A copy of NASA's comments appears in appendix II of this report.) NASA agreed that its report did not disclose information concerning its capitalization policy, the basis it used to value capitalized property, or its method for valuing inventories. However, it contended that these omissions did not affect the reliability of the report and noted that the Department of the Treasury had not required such disclosures prior to the June 1986 advance release of Treasury requirements governing federal agencies' financial reports.

Although the missing disclosures would not, by themselves, make NASA's report unreliable, our position regarding the reliability of the report was not based solely on the lack of disclosure. The major reasons for our questioning the report's reliability were that NASA did not report all accrued liabilities or eliminate intra-agency balances when preparing its consolidated reports.

Regarding its view that Treasury did not specifically require these types of disclosures prior to June 1986, our review of the Treasury document that identified these added disclosure requirements showed that they were applicable to the 1986 statements. Thus, the information on capitalization policy and other matters should have been provided with the fiscal year 1986 Reports on Financial Position.

type" agencies to provide a Report on Operations (TFS Form 221) which is also similar to the Statement of Operations required by the revised title 2. Beginning in fiscal year 1987, Treasury is requiring all agencies to submit the TFS Form 221.

New Accounting Standards

Other changes made to title 2 were the incorporation of new accounting standards. These changes were made to recognize the standards developed by the accounting profession since title 2 was last revised and to address numerous inquiries received by GAO since that time.

The most significant new standard is actuarially computed liabilities. This standard applies to federal benefit programs that determine their liabilities by making actuarial calculations. In general, the standard requires responsible agencies to recognize in their accounting records, and report in the financial statements, a liability for unpaid and estimated claims and future program benefits as well.

As with the revised reporting requirements previously discussed, it is important to recognize that the requirement for federal benefit programs is not new to the federal community. Treasury has been required for years to report to the Congress all of the federal government's liabilities and financial commitments, including actuarially based liabilities, for pension programs and social security in the Statement of Liabilities and Other Financial Commitments report. The Treasury prepares this report from TFS Form 220s submitted by agencies and other reports.

Other new standards have been added to help implement existing standards and to address issues raised by users in recent years. These include:

- comparative financial statements;
- consolidated financial statements;
- prior-period adjustments to financial statements;
- reporting appropriations in the Statements of Financial position, Operations, and Changes in Financial Position; and
- unusual and infrequent items.

Other new standards that are rather narrow in scope and for the most part cover accounting practices being followed but were not in the previous title 2 include:

- debt agreement modifications;

Comments From the National Aeronautics and Space Administration

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

NASA

National Aeronautics and Space Administration

Washington, D C
20546

NOV 25 1987

Reply to Attn of: NPN

Mr. Frederick D. Wolf
Director, Accounting and Financial
Management Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Wolf:

We appreciate the opportunity to review and comment on the GAO Draft report entitled "Financial Reporting: Greater Compliance Needed with GAO Standards and Treasury Requirements."

See comment 1.

NASA is in general agreement with the draft report recommendations. However, we must take exception to the conclusion that NASA reported "unreliable information" in its Report on Financial Position. Specific agency comments are provided in the enclosure.

Sincerely,

M. Peralta
Acting Associate Administrator
for Management

Enclosure

The following are our comments on the National Aeronautics and Space Administration's letter dated November 25, 1987.

GAO Comments

1. Although the missing disclosures would not, by themselves, make NASA's report unreliable, our position regarding the reliability of the report was not based solely on the lack of disclosure. The report has been clarified accordingly. (See page 7.)

2. The Treasury financial reporting requirements containing these additional disclosures were applicable to the 1986 Report on Financial Position. Therefore, the information should have been provided. This issue is addressed on page 7.

3. Our conclusion has been modified to state that the nondisclosure of supplemental information did not affect the reliability of the amounts shown in the report, although it did result in providing incomplete information. (See page 6.)

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National Aeronautics and Space Administration

Washington, D C
20546

Reply to Attn of

NASA Comments on GAO Draft Report Entitled, "Financial Reporting, Greater Compliance Needed with GAO Standards and Treasury Requirements." (GAO/AFMD-88-21), dated October 29, 1987.

We are pleased that your report disclosed that NASA substantially complied with the Department of the Treasury's requirements and Title 2 in preparing its Report on Financial Position.

See comment 1.

As stated by a NASA official during your review, and subsequently recognized in your report, NASA did not disclose narratives of (1) its capitalization policy, (2) the basis used in valuing capitalized property, and (3) the method used for valuing inventories because they were not considered critical to portraying NASA's financial position, and, consequently, would have no impact, whatsoever, upon the reliability of the statistical data in the Report on Financial Position. Actually, such disclosure was not required by the Department of the Treasury prior to the June 1986 advance release of Treasury regulations governing Federal Agencies' Financial Reports, nor, has the Department of the Treasury ever requested supplemental schedules disclosing the basis for valuing plant, equipment and inventories.

See comment 2.

See comment 1.

We shall be happy to comply with this request, but do not believe the absence of this narrative information negates the accuracy of the statistical data in the financial reports. Compliance with this request for the Fiscal Year 1987 reporting requirements, however, will be a bit cumbersome, due to the fact that Treasury has asked for a terminal input submission. We have, however, been advised by a Treasury official that a condensation of our valuation policies would be acceptable; we trust this will be satisfactory with your office.

See comment 3

Prior to final issuance of the GAO draft report, we would appreciate your considering the modification of the terminology describing the GAO conclusion on the reliability of the Report of Financial Position.

If you need additional information or have any questions, please have your representative call Lew Lauria on 453-2273.

Richard J. Powell
Director
Financial Management Division

- entitlements for benefit payments to recipients meeting eligibility requirements established by law, such as the Medicare program;
- fair value of assets and liabilities;
- investments in marketable securities;
- loan guarantees and commitments; and
- regulatory accounting.

Changes to Accounting Standards

The final types of changes involved amending previously issued accounting standards. These changes were made to be consistent with those accounting practices used by state and local governments and the private sector which are also applicable to the federal sector. Other changes were made to respond to agencies' inquiries.

These include changes made to the following standards:

- property, plant, and equipment;
- leases;
- transfer of assets and liabilities between federal agencies; and
- equity of the U.S. government.

Title 2 Revisions

GAO is charged by law to establish accounting standards executive agencies are to follow. In November 1984, GAO issued revised accounting standards (title 2). These revisions include changes to the reporting requirements, addition of new accounting standards, and changes to previously issued standards. A summary of the revisions follows.

Reporting

One of the most significant requirements of the revised title 2 is for summary level financial statements to be prepared annually by all executive agencies as well as for the entire federal government. These statements are required to be prepared from disciplined accounting systems that have effective internal controls and reliable financial data.

The revised title 2 requires four basic financial statements to be prepared in accordance with the accounting standards. They are the (1) Statement of Financial Position, (2) Statement of Operations, (3) Statement of Changes in Financial Position, and (4) Statement of Reconciliation to Budget Reports.

The Statement of Financial Position, also known as a balance sheet, shows an entity's assets, liabilities, and equity as of the reporting date. The Statement of Operations shows the financial results of an entity's activities including expenses, revenues, and other financing sources such as appropriations. The Statement of Changes in Financial Position presents all significant sources and uses of resources available to an agency and the uses made of those resources during the reporting period. The purpose of the Statement of Reconciliation to Budget Reports is to ensure that the financial information presented in the financial statements is consistent with the information presented in budget reports.

It should be emphasized that the revised title 2 is not imposing any sweeping comprehensive reporting requirements on agencies. While the previous title 2 requirements for financial statements were not as explicit or as emphatic as the new requirements, they did, nevertheless, definitely imply such financial reporting by agencies. The previous title 2 included reports similar to those required in the current title with the exception of the Statement of Reconciliation to Budget Reports. Furthermore, year-end financial statements similar to our revised title 2 requirements have been required by the Treasury for some time. The Treasury requires all agencies to provide a Report on Financial Position (TFS Form 220) which is similar to the Statement of Financial Position required by the revised title 2. Treasury further required all "business-

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of action taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report. A written statement must be submitted to the House and Senate Committees on Appropriations with an agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Secretary of the Treasury. Copies will also be made available to others upon request.

We appreciate the cooperation extended to our staff during this assignment.

Sincerely yours,

Frederick D. Wolf
Director

transactions results in overstating NASA's receivables and payables and, consequently, reporting unreliable information to Treasury.

Disclosure of Supplemental Information Can Be Improved

Financial statements are essentially summaries of a large quantity of transactions stated in monetary units. Hence, additional information is needed by the reader to make informed decisions. Such information is commonly provided through accompanying detailed schedules which elaborate on the summarized transactions or by including footnotes to the statements.

The Treasury requires that supplemental disclosures be made in schedule 220.1, Additional Financial Information. This schedule requires disclosure of certain financial information, considered necessary to support the Report on Financial Position, such as restrictions on use of cash, unused borrowing authority, and depreciation method used. Each reporting entity is responsible for assuring that all appropriate disclosures required for fair presentation of its financial position are included in the schedule.

Our analysis of the Report on Financial Position showed that although NASA substantially complied with disclosure requirements, improvements can be made in areas relating to property and inventories. NASA did not disclose (1) its capitalization policy, (2) the basis used in valuing capitalized property, and (3) the method used for valuing inventories. The preparer of the report advised us that this information was not disclosed because it was not considered critical to portraying NASA's financial position.

We believe all of the required information should be disclosed. Although nondisclosure would not necessarily affect the reliability of the report data, disclosing the assumption made or basis on which the financial data is presented affords report users better perspective and therefore allows them to make more informed decisions.

Conclusions and Recommendations

Our review showed that in preparing its Report on Financial Position, NASA substantially complied with GAO and Treasury standards and requirements. However, NASA did not report all accrued liabilities nor did it eliminate intra-agency balances when preparing its consolidated reports thus resulting in providing unreliable information to Treasury. NASA also provided incomplete information in that it did not disclose all of the supplemental information required.

and programs. NASA's fiscal year 1986 Report on Financial Position showed a total of $20.9 billion in assets and $2.8 billion in liabilities.

We reviewed NASA's consolidated report, which includes all of its activities. Our work was done within NASA's Financial Management Division, Agency Accounts and Reports Branch, located in its headquarters office and at the Financial Management Division located at the Goddard Space Flight Center, Greenbelt, Maryland, during the period May through August 1987. We selected NASA headquarters and the Goddard Center for review because these entities have the most significant dollar amounts for the accounts we chose.

We identified NASA's overall process and accounting requirements used to develop the Report on Financial Position. We reviewed the process to determine whether it was adequate to develop reliable reports and whether those reports were prepared in accordance with the Treasury's requirements. We selected property, inventory, accounts receivable, and accounts payable for review. The selected asset accounts represented over 80 percent of total reported assets, and accounts payable represented over 65 percent of total reported liabilities. For these accounts, we also determined whether NASA's accounting requirements conformed to our accounting standards. As part of this effort, we developed a structured interview instrument and used it as a basis for gathering information by interviewing officials from the Financial Management Division, Budget Operations Division, and the Office of Inspector General. We also interviewed officials responsible for carrying out the FIA work.

In addition, we traced the amounts shown on the Report on Financial Position to the general ledger and other records. We did not, however, test the transactions nor did we study and evaluate existing related controls. Except for these qualifications, our review was performed in accordance with generally accepted government auditing standards.

Greater Compliance Needed With GAO Standards and Treasury Requirements

Our review showed that NASA substantially complied with the Treasury's requirements and title 2 in preparing its Reports on Financial Position. We found, however, that NASA can further improve compliance by reporting all accrued liabilities, eliminating intra-agency balances when preparing consolidated reports, and providing supplemental information in the schedules supporting the Reports on Financial Position.

requirements (Treasury Financial Manual). These reports are intended to provide meaningful information helpful in assessing management's stewardship and accountability for the resources entrusted to it.

Efforts by Oversight Agencies to Improve Financial Management and Reporting

GAO's work has often identified problems with financial management systems and reporting in the federal government. GAO, the Treasury, and OMB have taken several initiatives to improve federal financial management and reporting.

In November 1984, we issued changes to title 2 that apply to all federal executive agencies. (See appendix I for a discussion of these changes.) One of the primary changes was a requirement that each agency prepare annual financial statements reflecting its overall financial position and operations. In August 1986, OMB issued the U.S. Government Standard General Ledger with instructions to begin implementation. This general ledger includes a basic chart of accounts, a uniform set of account definitions, a summary of data elements, and a cross-reference to standard external reports. The purpose of the general ledger is to standardize federal agency accounting and to support the preparation of all standard external financial reports required by the Treasury and OMB, as well as those needed for internal agency operations.

Also in August 1986, the Treasury issued its revised requirements for agencies to prepare annual financial statements as a part of the effort to upgrade accounting and financial reporting within the federal government. Beginning in fiscal year 1986, agencies must prepare their financial statements from a budgeting and accounting system which is an integral part of their financial management system. In addition, agencies must eliminate intra-agency balances from their consolidated statements and use accrual accounting in preparing their reports.

For fiscal year 1986, as in prior years, all agencies were required to submit Reports on Financial Position. Reports on Operations were also required to be submitted by all government corporations and by agencies with revolving fund activities. The Treasury augmented its reporting requirements for fiscal year 1987 to include two additional reports and to require all agencies to submit Reports on Operations. The four required reports are: (1) Report on Financial Position, (2) Report on Operations, (3) Report on Cash Flow, and (4) Report on Reconciliation.

The Report on Financial Position shows an entity's assets, liabilities, and equity as of the reporting date. The Report on Operations shows the