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REPORT TO THE CONGRESS



LW095695

Unauthorized Retention In Working Capital Fund Of Money Accumulated For Earned Leave Of Transferred Employees

B-149858

National Bureau of Standards AGC 00126

Department of Commerce AGC 00074

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BY THE COMPTROLLER GENERAL OF THE UNITED STATES

MARCH 10, 1971

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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-149858

To the President of the Senate and the
Speaker of the House of Representatives *CW000001*

This is our report on unauthorized retention, in the working capital fund, by the National Bureau of Standards, Department of Commerce, of money accumulated for earned leave of transferred employees. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Commerce; and the Director, National Bureau of Standards.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General
of the United States

D I G E S T

WHY THE REVIEW WAS MADE

The General Accounting Office (GAO), which is required by law to review the accounting system of each executive agency, has reviewed selected aspects of the National Bureau of Standards accounting system. This report concerns the accounting treatment of the accrued annual leave liability for employees transferred to other Government agencies.

FINDINGS AND CONCLUSIONS

The Bureau maintains a working capital fund for financing the initial cost of certain basic research, development, and testing work performed by the Bureau. The fund is reimbursed for such work from applicable appropriations and other sources, including advances and reimbursements from other Government agencies and non-Government sources. (See pp. 5 to 6.)

Fees to customers for Bureau services include a factor for annual leave earned by Bureau employees.

In fiscal year 1966 the employees of the Bureau's former Central Radio Propagation Laboratory were transferred to the Environmental Science Services Administration (now the National Oceanic and Atmospheric Administration), Department of Commerce. In the following fiscal year, the Bureau treated the reduction in the liability for accrued annual leave of 757 transferred employees as an increase in donated capital. Of the reduction, \$432,589 represented the portion of accrued annual leave recovered by charges to customers and retained in the fund as a result of that treatment. (See pp. 10 to 12.)

Section 13 of the Bureau's Organic Act, as amended (15 U.S.C. 278b), provides that:

"*** The National Bureau of Standards is authorized to utilize in the performance of its functions the Working Capital Fund established by the Act of June 29, 1950 (64 Stat. 275), and additional amounts as from time to time may be required for the purposes of said fund are authorized to be appropriated."

* * * * *

**** The amount of any earned net income resulting from the operation of the fund at the close of each fiscal year shall be paid into the general fund of the Treasury: Provided, That such earned net income may be applied first to restore any prior impairment of the fund." (See p. 9.)

The Bureau operated at a profit in fiscal year 1967 and transferred the amount of such profit to the general fund of the Treasury. GAO believes that the \$432,589 resulting from the reduction of leave liability should have been treated as an extraordinary gain and added to the net income for that year for transfer to the general fund of the Treasury. (See p. 12.)

In GAO's opinion, the retention of the \$432,589 was an augmentation of the Bureau's working capital fund without authority of law. When the Congress specifies the sources of money and property that are to make up the permanent working capital of revolving funds, it is the general rule of law that there may not be additional sources which serve to increase the working capital in the absence of specific statutory authority. (See p. 21.)

A comparable situation occurred in fiscal year 1954 when the Bureau transferred all records, property, employees, and activities of its ordnance research and development programs to the Department of Defense (DOD). The value of the accrued annual leave of the transferred employees amounted to \$642,680. The full amount was retained in the working capital fund after the transfer to DOD. At the time of that transfer, the Bureau did not determine what portion of the \$642,680 worth of accrued annual leave had been funded through fees or reimbursements recovered by the working capital fund. Because pertinent employee records had been disposed of in accordance with the Federal Records Act of 1950, GAO was unable to make a determination and, therefore, has no recommendations regarding that transfer. (See p. 8.)

GAO believes that significant transfers of employees of the Bureau's working capital fund could result in future unauthorized augmentations similar to the two transfers described in this report. GAO noted that a decision had not been made, at the time of its review, on the accounting treatment for the accrued leave of 358 employees of the Clearinghouse for Federal Scientific and Technical Information which was transferred from the Bureau to the Office of the Secretary on September 2, 1970. (See p. 21.)

RECOMMENDATIONS OR SUGGESTIONS

GAO is recommending to the Secretary of Commerce that:

- The Bureau pay into the general fund of the Treasury \$432,589 retained in the working capital fund without authority of law.

--The Department of Commerce's Financial Systems Staff be required to consider the matters discussed in this report and to establish specific guidelines to be followed when accounting for assets and liabilities involved in significant transfers of functions. These guidelines should be submitted to the Comptroller General for approval and included as a part of the Department's Accounting Principles and Standards. (See p. 22.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Director of the National Bureau of Standards disagreed that there was an augmentation of the working capital fund without authority of law. He stated that the Bureau was in substantial disagreement with the financial concepts put forward in GAO's report draft and with the recommendation that funds be transferred to the Treasury. (See apps. I and II.)

The principal reasons for the Director's reaction and GAO's evaluation thereof are discussed on pages 14 to 20.

GAO's recommendations are being made after consideration of the Director's comments. (See p. 22.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

This matter is being reported to the Congress because GAO believes that the Bureau augmented its working capital fund without authority of law.

C o n t e n t s

	<u>Page</u>
DIGEST	1
CHAPTER	
1 INTRODUCTION	4
2 AUGMENTATION OF WORKING CAPITAL FUND WITHOUT AUTHORITY OF LAW	8
Retention of funds representing amounts accumulated for accrued annual leave of employees transferred to ESSA	10
Accrued annual leave of employees trans- ferred to DOD	12
3 AGENCY COMMENTS AND GAO EVALUATION	14
4 CONCLUSIONS AND RECOMMENDATIONS	21
Conclusions	21
Recommendations to the Secretary of Commerce	22
5 SCOPE OF REVIEW	23
APPENDIX	
I Letter dated December 18, 1969, from the Assistant Secretary of Commerce to the General Accounting Office	27
II Letter dated July 30, 1970, from the Assis- tant Secretary of Commerce to the General Accounting Office	38
III Department of Commerce officials responsible for administration of activities discussed in this report	43

ABBREVIATIONS

DOD Department of Defense

ESSA Environmental Science Services Administration

GAO General Accounting Office

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* * * * *

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GAO believes that significant transfers of employees of the Bureau's working capital fund could result in future unauthorized augmentations similar to the two transfers described in this report. GAO noted that a decision had not been made, at the time of its review, on the accounting treatment for the accrued leave of 358 employees of the Clearinghouse for Federal Scientific and Technical Information which was transferred from the Bureau to the Office of the Secretary on September 2, 1970. (See p. 21.)

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The principal reasons for the Director's reaction and GAO's evaluation thereof are discussed on pages 14 to 20.

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CHAPTER 1

INTRODUCTION

The General Accounting Office has reviewed the accounting treatment of the accrued annual leave liability for employees of the National Bureau of Standards, Department of Commerce, transferred to the Department of Defense (DOD) and the Environmental Science Services Administration (ESSA) (now the National Oceanic and Atmospheric Administration), Department of Commerce, in fiscal years 1954 and 1966, respectively. The scope of our review is included on page 23.

The National Bureau of Standards, which was established by the act of March 3, 1901 (31 Stat. 1449, as amended; 15 U.S.C. 271-290), is the principal focal point in the Federal Government for ensuring maximum application of the physical and engineering sciences to the advancement of technology in industry and commerce. To accomplish this purpose, the Bureau conducts research and provides services in three broad program areas: (1) basic measurement standards, (2) materials research, and (3) engineering standards and applied technology.

The Bureau is composed of five major organizational units, each of which is primarily concerned with one or more of the aforementioned program areas. These units are the Institute for Basic Standards, the Institute for Materials Research, the Institute for Applied Technology, the Center for Radiation Research, and the Center for Computer Sciences and Technology.

The activities of the Bureau within these broad areas include:

1. The development and maintenance of national standards for physical measurements.
2. The coordination of these standards with those of other nations.
3. The calibration of instruments in terms of the national standards for the Nation's scientific community, industry, and commerce.

4. The development and dissemination of measurement techniques, standard reference materials, standard reference data, and engineering measurements and performance criteria.
5. The conduct of research in the properties of materials.
6. The development of automatic data processing standards and the conduct of research in computer sciences and techniques.

Costs incurred during fiscal year 1970 by the Bureau totaled about \$88.8 million. Of this amount about \$2.4 million was incurred for construction and maintenance of plant and facilities and the remaining \$86.4 million was incurred for Bureau program operations.

Of the total Bureau staff of about 4,050 at June 30, 1970, about 3,420 were located at Bureau headquarters in Gaithersburg, Maryland, and the nearby Washington, D. C., area and about 630 were located at Boulder, Colorado.

The Bureau is engaged in certain basic research, development, and testing work which is financed by direct appropriations; other Federal agencies; State and local governments; the District of Columbia Government; and private institutions, enterprises, and individuals.

A working capital fund, which initially finances the cost of all work performed by the Bureau, is periodically reimbursed for the work from applicable Bureau appropriations and other receipts, including advances and reimbursements from other Government agencies and non-Government organizations, gifts, and bequests.

Working capital fund

The Bureau's working capital fund was established by the Deficiency Appropriation Act of 1950, dated June 29, 1950 (64 Stat. 275), which provided for the original appropriation as follows:

"For the establishment of a working capital fund, to be available without fiscal year limitation, for expenses necessary for the maintenance and operation of the National Bureau of Standards, including the furnishing of facilities and services to other Government agencies, not to exceed \$3,000,000. Said fund shall be established as a special deposit account and shall be reimbursed from applicable appropriations of said Bureau for the work of said Bureau, and from funds of other Government agencies for facilities and services furnished to such agencies pursuant to law. Reimbursements so made shall include handling and related charges; reserves for depreciation of equipment and accrued leave; and building construction and alterations directly related to the work for which reimbursement is made."

The land, buildings, equipment, and certain other assets and liabilities of the Bureau, in addition to the original \$3 million appropriation, were transferred to the fund and considered a part of the corpus of the fund when it was established on July 1, 1950.

On August 3, 1956, the Organic Act of the Bureau (15 U.S.C. 271) was amended, authorizing the Bureau to utilize the working capital fund in the performance of its functions and for any activity for which provision was made in the appropriations which reimbursed the fund (15 U.S.C. 278b(a) and (b)).

Because the original appropriation was not considered adequate to cover current operating requirements, the Departments of State, Justice, Commerce, and the Judiciary Appropriation Act of 1952, enacted October 22, 1951 (65 Stat. 593), provided an additional \$2 million for the working capital fund. In addition, the fund has been increased by about \$8 million through transfers from the Bureau's appropriated funds for research and technical services and construction of facilities. Thus the funds appropriated and transferred to the working capital fund as of June 30, 1970, totaled about \$13,284,100.

A list of principal Department of Commerce officials responsible for the administration of activities discussed in this report is presented as appendix III.

CHAPTER 2

AUGMENTATION OF WORKING CAPITAL FUND

WITHOUT AUTHORITY OF LAW

In our opinion, the Bureau augmented its working capital fund without authority of law by retaining funds representing the major portion of accrued annual leave of employees transferred from the Bureau to ESSA. When the Congress specifies the sources of money and property that are to make up the permanent working capital of revolving funds, it is the general rule of law that there may not be additional sources which serve to increase the working capital in the absence of specific statutory authority.

The portion of accrued annual leave of the employees of the Bureau's former Central Radio Propagation Laboratory, which was reimbursed by payments from customers for whom services were performed, was retained in the working capital fund in fiscal year 1967 following the transfer of the Laboratory to ESSA in fiscal year 1966. In our opinion, the reduction of the liability resulted in an extraordinary gain of \$432,589 which should have been, but was not, included in the payment of fiscal year 1967 net income into the general fund of the Treasury. The accrued annual leave of the employees transferred, as it is used in the future, will be paid from appropriations to ESSA.

Also about \$642,680, representing the total accrued annual leave of the Bureau employees engaged in ordnance research and development programs, was retained in the working capital fund following the transfer of these programs and employees to DOD in fiscal year 1954. At the time of the transfer, the Bureau did not make a determination of the portion of the \$642,680 worth of accrued annual leave that had been funded by payments from customers and represented an extraordinary gain. Because pertinent records of the employees involved in the fiscal year 1954 transfer had been disposed of in accordance with the Federal Records Act of 1950, we were unable to make this determination and therefore we have no recommendations regarding that transfer. We have included, however, certain details of the transfer to DOD on pages 12 and 13.

Section 13 of the Bureau's Organic Act, as amended (15 U.S.C. 278b), provides, in part, that:

"*** The National Bureau of Standards is authorized to utilize in the performance of its functions the Working Capital Fund established by the Act of June 29, 1950 (64 Stat. 275), and additional amounts as from time to time may be required for the purposes of said fund are authorized to be appropriated."

* * * * *

"*** The amount of any earned net income resulting from the operation of the fund at the close of each fiscal year shall be paid into the general fund of the Treasury: Provided, That such earned net income may be applied first to restore any prior impairment of the fund."

The above provisions of law supplement the basic authority for the establishment of the fund as originally authorized in the Deficiency Appropriation Act of 1950.

Our review showed that, except for fiscal years 1954 and 1963, operation of the fund had resulted in net income which was paid into the general fund of the Treasury. The impairments sustained in fiscal years 1954 and 1963 were restored by applying net income earned in succeeding years.

In our report to the Congress on the operations of the Bureau for fiscal years ended June 30, 1951, and June 30, 1952 (B-114821, May 10, 1954), we stated that the Bureau had not recognized the liability for employees' accrued annual leave existing at the inception of the working capital fund in 1950. The report stated also that, as a result, the accrued annual leave liability was understated and the donated capital was overstated. In fiscal year 1953, the Bureau recognized the liability existing at the inception of the fund by establishing an accrued annual leave liability of \$1.4 million and reducing the donated capital account. This treatment eliminated the need for the Bureau to fund the \$1.4 million of initial liability from charges to customers.

A project cost accounting system is maintained to accumulate the costs of projects undertaken by the working capital fund. The charges to projects for labor costs include, in addition to the employee's compensation, a factor for annual leave earned, sick leave and other categories of leave used, paid holidays, and adjustments to bring the accrued annual leave liability account into agreement with the total of the individual employee balances. This factor is then recovered, in cash, by billing customers for whom services are performed. The term "funded" is used in this report to describe the portion of the accrued annual leave liability which is recovered by charges to customers. The accrued leave liability account is reduced when the employees use the leave. According to Bureau financial statements, the accrued annual leave liability at June 30, 1970, was about \$3.6 million.

Retention of funds representing
amounts accumulated for
accrued annual leave of
employees transferred to ESSA

Effective October 1965, Department of Commerce Order No. 2-A, dated July 13, 1965, transferred the Central Radio Propagation Laboratory and its employees, funds, records, and property to ESSA, also a constituent agency of the Department. In October 1965 the Bureau and ESSA entered into a memorandum of understanding which provided that, except for executive direction from ESSA, the Laboratory would in effect continue to operate as a part of the Bureau and the Bureau would continue to account for the Laboratory in the Bureau's working capital fund for the remainder of fiscal year 1966.

On July 2, 1966, the accounting function relating to the 757⁽¹⁾ employees of the Laboratory was transferred to ESSA from the Bureau. At that date the transferred employees had a total accrued annual leave balance of 102,615 hours valued at about \$520,130. An entry was made in the

¹Although the journal voucher supporting the entry showed that 757 employees were transferred, ESSA officials produced records that supported a transfer of only 720 employees.

Bureau's accounting records reducing the accrued annual leave liability and increasing the donated capital for this amount. The reduction in the liability consisted of funded and unfunded accrued annual leave, but the donated capital was increased under the assumption that the entire reduction of the liability was unfunded.

We computed the maximum amount of the accrued leave for the transferred employees, which could have been assumed by the fund at its inception on July 1, 1950, to be \$87,541. This amount represented the value of the maximum leave balance for 52 employees transferred to ESSA, who were employed by the Bureau at July 1, 1950, and whose leave balances at that date were assumed by the working capital fund.

The leave balances of the remaining 705 transferred employees, who began their employment with the Bureau subsequent to July 1, 1950, and the increases to the assumed leave balances of the aforementioned 52 employees were funded by charges made through the Bureau's working capital fund. An inventory of the fund's accrued annual leave of its employees is taken semiannually as a basis for adjusting the leave rate factor included in the charges. These periodic adjustments, in addition to such variations as those attributable to changes in the value of leave, reflect the net effect of transfers of leave balances to and from the fund without reimbursement.

We computed the maximum accrued leave amount of \$87,541 for the 52 employees, which was included in the existing leave balance at the inception of the working capital fund, in the following manner. We obtained for each of the 52 employees the General Schedule grade and step levels at July 1, 1950, from records available at the ESSA personnel office at the Boulder Laboratories in Boulder and at the Bureau headquarters in Gaithersburg. After computing the maximum leave balances for the 52 employees at July 1, 1950, we multiplied each balance by the hourly earnings rate determined from a Civil Service Commission table of General Schedule pay rates which were in effect at that time. Our computation showed that \$87,541 was the maximum possible value of accrued annual leave at July 1, 1950, for the 52 transferred employees who were at the

Bureau at the inception of the fund. Therefore, of the total accrued leave balance of \$520,130 for the employees transferred to ESSA, \$432,589 was the minimum amount which had been funded by payments from customers for whom services had been performed.

As stated previously, the accounting entry made by the Bureau to reflect the transfer of employees to ESSA reduced the accrued leave liability and increased the donated capital by \$520,130. The donated capital account, however, should have been increased by no more than \$87,541 and the difference should have been treated as an extraordinary gain, because it represents the portion of the liability reduction which had been funded by charges to customers. Since the Bureau operated at a profit in fiscal year 1967, the extraordinary gain from the reduction of the liability would have increased the net income by a minimum of \$432,589. Therefore a minimum of \$432,589 representing the funded accrued annual leave of the transferred employees, in addition to the net income in fiscal year 1967, should have been transferred to the general fund of the Treasury.

A Bureau official informed us that, at the time of the transfer to ESSA, the legal implications of this matter were not considered and that the decision to reduce the liability by a transfer to donated capital and to retain the funds, rather than to transfer them to the Treasury, was approved by top Bureau management. We were advised that the decision was based on the opinion that this was the proper accounting treatment.

Accrued annual leave of employees
transferred to DOD

Pursuant to a statement of understanding between the Secretary of Defense and the Secretary of Commerce, all records, property, employees, and activities of the ordnance research and development programs of the Bureau were transferred to DOD on September 27, 1953. The transferred activities consisted of the divisions of ordnance development, electromechanics, and electronic ordnance and one section each of the divisions of electronics and electricity, all located in Washington, D.C., and the guided missile laboratory located in Corona, California. The activities of the

Washington laboratories were transferred to the Diamond Ordnance Fuse Laboratories, Army Ordnance Corps, Department of the Army. The guided missile laboratory in Corona was transferred to the Corona Ordnance Laboratory, Navy Bureau of Ordnance, Department of the Navy.

As a result, a total of about 1,700 Bureau employees were transferred to DOD. The value of the accrued annual leave of these employees amounted to about \$642,680; however, the Bureau did not determine what portion was funded through fees or reimbursements recovered by the Bureau's working capital fund at the time of the transfer. We were unable to make this determination, because pertinent employee records were disposed of in accordance with the Federal Records Act of 1950.

CHAPTER 3

AGENCY COMMENTS AND GAO EVALUATION

We initially considered the entire amounts of the two reductions in accrued annual leave liability to be augmentations of the working capital fund and proposed that the Bureau pay the total amount of \$1,162,810 into the general fund of the Treasury. Comments of the Director, National Bureau of Standards, on this proposal were sent to us by the Assistant Secretary of Commerce on December 18, 1969. Our consideration of his comments prompted us to perform additional work to identify that portion of the accrued leave which, we believe, should be considered unfunded. We sent copies of the revised report draft to the Department on May 6, 1970, and the Assistant Secretary submitted additional comments of the Director to us on July 30, 1970. The Director requested that consideration be given to both responses and that the entire contents of his comments be included in the report. The comments of both dates are included as appendixes I and II.

The Director disagreed with our findings that there was an augmentation of the working capital fund without authority of law. He stated in the second of the two responses that the Bureau remained in substantial disagreement with the financial concepts put forward in the report draft and with the resultant proposal of a transfer of funds to the Treasury. The reasons given by the Director for the disagreement are contained in the two responses and relate principally to (1) the appropriate accounting treatment for extraordinary gains, (2) the reduction in fund capital relative to the reduction in fund activities, (3) consistency in accounting for all items involved in the transfer, and (4) the premises used in our computation of the funded leave.

In the earlier response, the Director questioned whether nonoperating income was a segment of net income within the meaning of the legislation which requires net income to be paid into the general fund of the Treasury. (See pp. 34 to 35.) We had used the term "nonoperating income" to refer to the funded portion of the liability for accrued

annual leave of the employees transferred. After further consideration, as described below, we classified the reduction of the liability as an extraordinary gain to be included in net income.

In his response to the revised report draft, the Director stated that adjustments for such extraordinary items as leave transactions should be handled through donated surplus and should not be considered a part of earned net income. He added that:

"We believe the maintenance of donated surplus accounts in the operation of revolving funds is an accepted practice. We believe such accounts are customarily used to handle unusual and 'one-time' transactions affecting the capital of the fund that should not be considered in the calculation of net income or loss."

We agree that the use of a donated surplus or similar account is an accepted practice in revolving fund accounting. Such an account is necessary to adequately show the equity of the Government.

The Bureau's opinion that unusual and one-time transactions affecting the capital of the fund should not be considered in the calculation of net income or loss, however, does not conform with generally accepted accounting principles. Opinion No. 9 of the Accounting Principles Board, American Institute of Certified Public Accountants, concludes that net income should reflect all items of profit and loss recognized during the period with the sole exception of certain prior period adjustments described in the opinion. The opinion states that extraordinary items should be segregated from the results of ordinary operations and should be shown separately in the income statement with a disclosure of their nature and amount. On the basis of criteria described in the opinion for determining extraordinary items and prior period adjustments, we believe that the reduction of the accrued annual leave liability should have been considered an extraordinary gain and included in net income for fiscal year 1967.

In commenting on our position that the reduction of the capital of the fund is consistent with the reduction of the fund's activities brought about by the transfer, the Director stated that the Bureau did not agree with this concept as it applied to the cost of equipment which had not been fully recovered through depreciation. According to the Bureau, the equipment transferred to ESSA had a book value of \$2,096,000, and the Director suggested that the Bureau should have recovered the book value as a part of the transfer.

If, as suggested by the Director, the working capital fund were to recover the book value of the equipment transferred, the reduction in working capital fund resources would be offset by an increase in net working capital and the fund would be restored to the level maintained before the transfer. We continue to believe that the reduction in the working capital fund resources is consistent with the reduction in fund activities, just as an increase in fund activities normally justifies an expansion of the fund resources.

The question of accounting consistency was raised by the Director in his statement that:

"In the event we must include leave adjustments in the computation of profit or loss, then we believe all such transactions should be so treated, including property and equipment transactions."

It was contended in the first response, and pointed out again in the second, that, had a loss been computed on the property and equipment transfer, the subject transaction with ESSA would have resulted in a net loss of over \$900,000 to the working capital fund. The Director computed the loss as follows:

Unrecovered working capital fund cash invested in the equipment transfer to ESSA	\$2,096,000
Reduction in leave liability described in GAO's report (original draft)	<u>1,162,810</u>
Total loss to working capital fund	<u>\$ 933,190</u>

We believe that the nonreimbursable transfer of property and equipment should not be considered a loss in the computation of net income when the transfer presumes a corresponding reduction in the fund's activities, regardless of the accounting treatment accorded the transfer of the leave liability. If a loss had been computed on the transfer of property and equipment as suggested by the Director, the effect would have been to restore the fund by the amount of the unrecovered investment without regard to the reduction in activities and needs.

The Director indicated that a 1971 appropriation request for \$950,000 for equipment and standard reference materials might not have been necessary if the Bureau had been able to recover the value of the transferred assets. We noted, however, that appropriation requests in similar amounts were made annually for several years prior to the transfer in 1967. There is no evidence that the latest request is attributable to the loss in transferred assets. Although it is true that the fund can be increased either through recovering the book value of the transferred assets or through the appropriation process; we believe that, in the absence of evidence that the funds are needed to replace transferred assets, the former method of increasing the fund is not appropriate.

We do not agree that consistency requires all items involved in a transfer to be handled as adjustments to donated capital without consideration of the effects of the transfer on prior determinations of income. Charges for accrued leave earned by the 757 employees after July 1, 1950, were made to the fund and were matched with revenues in prior years' determinations of income, but the transfer of the liability precluded the payment of these charges by the fund. Consequently, an extraordinary gain arising from the reduction of the liability to the fund was realized.

The Director commented on the method we used to compute the funded portion of the reduction in liability, as follows:

*** You have indicated that of the 757 employees transferred to ESSA, only 52 were employed by the Bureau on July 1, 1950, when all NBS employees'

leave liabilities were assumed by the Fund. This assumption discounts the various leave liabilities assumed for the remaining 705 employees that transferred from other Government agencies to the Fund without reimbursement for leave, and also disregards terminal leave settlements paid for these, as well as other, employees who retired or left the Fund for outside employment during the period from 1950 to 1966. Nor was it considered that the billing rate of the Fund during this period did not include a factor for leave liabilities assumed July 1, 1950, and, subsequently, liquidated with no reimbursement of the Fund for prior liability."

We recognize that methods other than the specific identification of employees whose leave was assumed by the fund at its inception might ordinarily be acceptable; however, we believe that the amount for the unfunded annual leave of the 52 employees, which we determined by this method, is reasonable and that the method is appropriate in view of the accounting policies expressed by the Director. (See pp. 31 to 32, app. I.) Under these policies, gains and losses were not determined for employees whose annual leave balances were assumed at the inception of the fund and who were separated before the transfer.

As discussed on page 11, the leave liabilities for the 705 transferred employees who began their employment with the Bureau subsequent to July 1, 1950, were funded by charges made through the Bureau's working capital fund. The funding of the assumed leave liabilities resulted from periodic adjustments of the charges.

In the matter of terminal leave settlements, the Bureau appears to be following the policy stated by the Director that:

"*** Perhaps there are some gains--there are also some losses--we do not know the net effect, and we believe that it would be too costly, in relation to the materiality of the result to account for the history of each employee in such situations."

He stated also that the Bureau had paid terminal leave settlements from funds accumulated against the liability even though portions of the leave were unfunded. The Bureau also gained, however, by retaining funds which represented funded leave of employees who transferred to other Government agencies.

Regarding the Director's comment that we did not consider the leave liabilities assumed on July 1, 1950, we stated on page 12 that the \$432,589 was arrived at by subtracting the maximum possible value of the annual leave assumed at July 1, 1950, from the value of the leave balance at the date of transfer. We considered the remainder of the \$432,589 to have been funded subsequent to July 1, 1950, by adjustments to the leave rate factor used in billing customers. Therefore our computation recognized the fact that the leave assumed at July 1, 1950, was not funded through the working capital fund.

The Director noted that:

"*** staff of the General Accounting Office were involved in establishing the Working Capital Fund and many of the sub-accounts, including the leave reserve, and were consulted on operating policies."

He also referred to GAO reviews of the leave reserve account after 1950. Our records do not show that we were involved in the development of the specific leave accounting policies discussed in this report. Furthermore the Director attributes the policies explained on pages 31 and 32 of appendix I solely to the Bureau. Although a prior report referred to the change in donated capital as a result of the fiscal year 1954 transfer to DOD, the review, which was of a general financial nature, did not concentrate on the accounting treatment for the transfer of accrued annual leave liability as such.

The Director commented that there is a lack of official guidance in connection with Governmental reorganizations, particularly where revolving funds are involved. Since our review was limited to the working capital fund of

the Bureau, we are unable to comment on transfers with respect to other funds and agencies. A copy of this report will be furnished to the Office of Management and Budget for its consideration, however, and we intend in future reviews to give particular attention to the accounting treatment relating to transfers of employees.

CHAPTER 4

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

When the Congress specifies the sources of money and property that are to make up the permanent working capital of revolving funds, it is the general rule of law that there may not be additional sources which serve to increase the working capital in the absence of specific statutory authority.

The statutes pertaining to the creation and operation of the working capital revolving fund direct that appropriations comprise the capital of the revolving fund; that facilities and services furnished therefrom be on a reimbursable basis; and that earned net income, except for purposes of capital restoration, be paid into the general fund of the Treasury. The authority to include a charge for a reserve for accrued leave was for the purpose of placing the fund on a wholly reimbursable basis.

There is nothing in the legislative history or elsewhere to indicate that an excess in the funded reserve resulting from the elimination of a liability for accrued leave could be used to increase the capital of the revolving fund. Therefore retention of the funds, representing the funded accrued annual leave of the transferred employees, in the revolving fund as donated capital was an augmentation of the fund without authority of law. We have estimated that the minimum amount of the funded accrued leave of the transferred employees that was retained in the revolving fund was \$432,589.

We believe that significant transfers of employees of the Bureau's working capital fund could result in future unauthorized augmentations similar to the two transfers described in this report. We noted that a decision had not been made, at the time of our review, on the accounting treatment for the accrued leave of 358 employees of the Clearinghouse for Federal Scientific and Technical Information transferred from the Bureau to the Office of the Secretary on September 2, 1970.

RECOMMENDATIONS TO THE SECRETARY OF COMMERCE

We recommend that funds in the amount of \$432,589, retained in the working capital fund without authority of law, be paid into the general fund of the Treasury, as required by the provisions of section 13 of the Bureau's Organic Act, as amended.

We recommend further that the Department of Commerce Financial Systems Staff be required to consider the matters discussed in this report and to establish specific guidelines to be followed when accounting for all assets and liabilities involved in significant transfers of functions. These guidelines should be submitted to the Comptroller General for approval and should be included as a part of the Department's Accounting Principles and Standards.

The guidelines should provide that, in any future reorganizations which might result in a transfer of a significant number of employees, a determination be made as to the amount of leave which has been funded. This portion of the leave liability, if not paid to another revolving fund receiving the transferred employees, should be treated as income in the year of the transfer.

CHAPTER 5

SCOPE OF REVIEW

Our review, which was conducted primarily at Bureau headquarters in Gaithersburg, included an examination of the legislation which authorized the working capital fund, Reorganization Plan No. 2 of 1965, and the procedures followed in accounting for the transfer of employees from the Bureau to ESSA in fiscal year 1966 and to DOD in fiscal year 1954.

We reviewed also personnel and payroll records maintained at the Bureau and obtained pertinent information from ESSA's Research Laboratories in Boulder. We discussed the transfers with Department of Commerce and Bureau officials. We were unable to make a detailed review of the transfer to DOD, because applicable records had been disposed of in accordance with normal Government practice. Our review did not include an evaluation of the basis and authority for the various increases in the capital of the fund above its initial capital of \$3 million.

APPENDIXES



THE ASSISTANT SECRETARY OF COMMERCE
WASHINGTON, D.C. 20230

Dec 18 1969

Mr. Henry Eschwege
Associate Director
Civil Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This is in reply to your letter of December 16, 1968 and the first finding of a proposed report to the Congress on the "Need for Improvement in the Financial Management System of the National Bureau of Standards".

We have reviewed the comments of the National Bureau of Standards and believe that they are appropriately responsive to the matters discussed in the report.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Larry A. Jobe".

Larry A. Jobe

Enclosure



U.S. DEPARTMENT OF COMMERCE
National Bureau of Standards
Washington, D.C. 20234

Mr. Henry Eschwege
Associate Director
Civil Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your letter of December 16, 1968, and the first finding of your draft report to the Congress, "Need for Improvement in the Financial Management System of the National Bureau of Standards." Both the letter and the report allege that the Bureau retained funds representing accrued annual leave of employees transferred from the Working Capital Fund, thereby augmenting the Fund without authority of the law. The report recommends that \$1,162,810 applicable to these annual leave transactions should be paid into the General Fund of the Treasury. We believe that the Working Capital Fund was not augmented, thus the action of the Bureau has been consonant with the law.

BACKGROUND

The Reserve for Leave account was established as a current liability of the Fund shortly after its inception on recommendation of the General Accounting Office. At that time, it was pointed out that an accrued annual leave liability of about \$1 million was due to employees who had earned such leave prior to their transfer to this organization. Therefore, an adjustment of \$1,409,461 was made, in accordance with recommendations of the General Accounting Office, based on an inventory of annual leave due each employee, to record the liability and to reduce the donated capital of the Fund in fiscal year 1953. In September 1953, 1,700 employees, with \$642,680 of accrued annual leave, were transferred to the Department of Defense; and in July 1966, 757 employees, with \$520,130 of accrued annual leave, were transferred to the Environmental Science Services Administration. Adjustments were made in both of these cases increasing the donated capital of the Fund and reducing the leave liability for a total of about \$1.1 million, leaving an unadjusted balance of about \$246,000 of the original reduction of donated capital.

As a response to your draft report, we have reviewed those back records that remain available. Our review has disclosed that (1) with respect to the 1953 transaction, the three-year limitation for settlement of certifying officer's accounts, as set forth in 31 U.S.C. 82i, expired long ago and, accordingly, the certifying officer's accounts have been

settled either by your office or by the statutory limits of the act. Therefore, the records have been disposed of in accordance with the Federal Records Act of 1950; and also (2) the pertinent records of the employees involved in the July 1966 transfer had been transferred with the employees. Because we are unable to reconstruct the detail facts and figures, our response is made on a conceptual basis in accordance with established accounting procedures.

DEFINING THE ISSUES

Both the letter and the report use technical terms such as "depositing funds in the Treasury," "funded reserve," "funded accrued annual leave," "capital of the fund," and "nonoperating income." We understand that these terms have the following meanings:

- (1) depositing funds in the Treasury -- depositing cash, otherwise available to pay payrolls and vendors, to miscellaneous receipts in the general fund of the Treasury.
- (2) funded reserve -- cash set aside for a currently undetermined use.
- (3) funded accrued leave -- an annual leave balance supported by cash set aside for the purpose of liquidating the liability.
- (4) funds provided, and funds applied -- although not used in the report, these terms are related to the issues and are the net working capital, consisting of current assets less current liabilities as defined by Treasury Circular No. 966.
- (5) capital of the Fund -- net worth, or the residual of total assets less total liabilities.
- (6) nonoperating income account -- We have not been able to locate a definition of such an account in any governmental accounting regulations. We would define the account to consist of significant charges and credits extraneous to the regular operation of the Fund relating to current and prior years. The activities in the account would be reported on lines 26 and 27 of the Standard Form 221, Statement of Income and Expense and Changes in Accumulated Net Income or Deficit, in accordance with paragraph 51 of Treasury Circular No. 966. The criteria for determining the significant entries to such an account would be substantially those set forth in Accounting Principles Board Opinion No. 9, American Institute of Certified Public Accountants.

FUNDS AS A CASH CONCEPT

The operation of the Bureau's Working Capital Fund accounting system with respect to annual leave is to record the cost of annual leave as

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earned, and then to recover, in cash, the cost of annual leave by billing the cost to applicable appropriations for which services are performed, and to finance the leave when taken through the disbursement of cash resources managed within the Fund. Accordingly, the total cost billed to appropriations includes a rate factor applied to productive labor designed to recover annual leave earned each year. A normal residual of the annual leave earned less the annual leave taken at any time is the annual leave liability. A practical test of the annual leave rates, the comparison of the annual leave liability account with an inventory of annual leave owed to each employee, is made twice each year and the rates subsequently adjusted to correct variations.

In fiscal year 1952, the General Accounting Office pointed out that there were a significant number of employees on the payroll who, prior to their transfer to the Fund, had accumulated annual leave balances which should be recognized as a current liability. Accordingly, an inventory of the value of annual leave due each employee was taken and the annual leave liability account, which then amounted to about \$626,000, was increased by \$1,409,000 with a corresponding reduction in the donated capital of the Fund. The Fund received no cash or other current assets to finance this leave; therefore, the adjustment was disclosed in the financial statements (Budget Document, 1955, P. 475, Statement of Source and Application of Funds) as an element of funds applied entitled, "Adjustment of Fund Principal for Annual Leave Assumed at Inception." The practical interpretation of this financial presentation was that the Fund had reduced by \$1.4 million of its net working capital (or its ability to pay current bills) by increasing its current liability for the payment of annual leave, and now had a \$1.4 million annual leave liability for which it had received no cash resources to liquidate. Moreover, because the leave rate is based on annual leave earned, it had no means of obtaining cash through billing based on leave rates applied.

The value of accrued annual leave when the \$1.4 million was computed in fiscal year 1953 was about \$646,000. This leave was earned by personnel subsequent to assignment to the Fund and probably included in the billings to appropriations. As we have previously stated, it is not possible to ascertain how much of the \$626,000 of annual leave was applicable to the employees transferred in 1953. Nor may we determine how much of the \$520,000 of annual leave applicable to the employees transferred in 1966 was billed. There are many conditions which affect an employee's annual leave account, as shown in the following examples:

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DAYS OF ANNUAL LEAVE

<u>Employee</u>	<u>July 1, 1950 Transferred In</u>	<u>1950 - 1953 Net Accrued</u>	<u>September 1953 Transferred Out</u>
A	30	-0-	30
B	30	-0-	30
C	20	10	30
D	20	-0-	-0-

Employee A transfers in with 30 days annual leave, the general legal limit. Normally he will take all the leave he earns each year. Therefore, if all other factors remain stable he will transfer out with the same value of leave that he transferred in. The logical adjustment on his transfer out is a reversal of the entry made on his transfer in (adjust donated capital).

Employee B transfers in under the same conditions as employee A, but gets a raise in salary soon after the transfer. The value of leave taken and the value of leave transferred out are in excess of the value transferred in. The logical adjustment on his transfer out is to adjust the donated capital for the increased value since there probably was not time to consider the raise in the leave rate. If the same employee transferred out in 1966, the increase in value compared to the leave transferred in was probably included in the cost of operations and billed as income to the Fund. In this case, a later adjustment of the annual leave account would be a belated academic recognition of the opening balance paid by the Fund.

If employee B retired rather than transferred out, the Fund would have paid out more than it had billed and should be made whole, possibly by offsetting gains on other employees transferring out.

Employee C transfers in with 20 days and accumulates a net of 10 days annual leave which is accrued and billed by the Fund. Possibly the 10 days accrual should be transferred to other appropriations or to the general fund of the Treasury. Employee C, however, would be subject to the same accrual complexities with respect to raises in salary, retirement, and length of service as would employee B.

Employee D transfers in and then leaves the service immediately. Logically, his accrued leave should be a reversal of the transfer in, but in practice was probably paid out of the Fund's earnings from other employees' accruals.

The rationale that we have used is generally adopted in such complex situations where it is considered too costly to perform accounting in such a detailed manner; namely, that on a going concern basis these complexities offset and the Fund can pay for normal leave taken, including that transferred in, as a part of financing the payroll. In significant accretions

and liquidations not incurred in the ordinary course of business we have also adopted the policy that the individual situations should be disregarded and we should assume that personnel transferred out should be accounted for consistently with those transferred in. Perhaps there are some gains -- there are also some losses -- we do not know the net effect, and we believe that it would be too costly, in relation to the materiality of the result to account for the history of each employee in such situations.

The transfer of 1,700 employees to the Department of Defense in September 1953 occurred within a year of the original annual leave adjustment. Conceivably, the Fund could have received some cash for annual leave earned by employees either before or after the adjustment. It is, however, impractical at this time to reconstruct the situation, considering such factors as annual leave taken, annual leave lost, and terminal leave taken which had to be financed from sources other than recovery of annual leave earned. The principal of the Fund had been reduced by the \$1.4 million and the transfer was very material with respect to annual leave. Therefore, consistent treatment dictated recording this significant liquidation in the same manner as the previous significant accretion in liabilities. The annual leave liability of \$643,000 applicable to employees transferred was recorded as a reduction of the liability and an increase of the capital of the Fund. The effect of this adjustment was to offset net working capital previously reduced, therefore, the transaction was presented in the financial statements (Budget Document 1966, P. 499, Statement of Sources and Application of Funds) as an element of funds provided. The net effect of these adjustments, \$766,000 (\$1,409,000 less \$643,000), was a reduction in the donated capital of the Fund.

A similar situation prevailed with respect to the July 1966 transfer and similar adjustments were made. After the second adjustment only \$246,000 of the original reduction of the capital of the Fund remained.

We believe that our accounting for annual leave applicable to the two transfers of employees did not provide any excess funded accrued annual leave or funded reserves, in the sense of providing excess cash, but rather was consistent with the establishment of the \$1.4 million liability for employees transferred to the Fund.

FUND AS A SELF BALANCING ACCOUNTING ENTITY (ASSETS = LIABILITIES + U. S. EQUITY) CONCEPT

If the \$1.4 million annual leave liability initially assumed by the fund is considered as funded in the sense of being a part of the total assets and liabilities assumed at initial capitalization, then the entire transaction should be considered with respect to assets and liabilities in the two transfers.

The adjustment of \$1.4 million, however, while serving to clarify the results of assuming the annual leave liability of employees earned prior

to their assignment to the Fund does not provide any substantive change in effect on the Fund compared to recognizing the liability at initial capitalization. The initial cash of the Fund was obtained from an appropriation of \$3 million. Our review of the legislative history of the appropriation disclosed that the \$3 million had no relation to specific assets or liabilities to be included in the Fund, but was to cover the payment of salaries and other operating costs for a short period of time necessary to organize the Fund on a self-sustaining basis. The total principal of the Fund at initial capitalization consisted of the \$3 million appropriation, and about \$25 million of donated net capital comprised of assets and liabilities other than cash. About \$24 million of the initial capitalization was fixed assets. Had the annual leave liability been recognized when the fund was established initially, the donated capital would have been \$1.4 million less and the Fund would have a liability for which it had no means of obtaining cash based on leave rates applied. The two transfers involved not only personnel but also a substantial amount of Bureau-owned fixed assets. Following is a tabulation of net book value of the assets transferred out in each of the situations discussed in the report.

To Department of Defense	\$1,401,378
To Environmental Science Services Administration (Net Fund investment amount only)	<u>2,096,000</u>
TOTAL	<u>\$3,497,378</u>

In addition to the net amount shown above, \$5,788,000 of special purpose and \$510,000 of fully depreciated fixed assets, plus \$7,693,000 of donated fixed assets were transferred to the Environmental Science Services Administration. It is apparent that a substantial reduction in the investments as well as the capital of the Fund was involved in the transfer. These reductions were also recognized by reducing the donated capital of the Fund at the time of transfer. Whereas we cannot agree that the leave liability was ever fully funded in cash, we believe it is apparent that by the most conservative calculation that it may be demonstrated that reductions in funds in the sense of total assets and liabilities originally capitalized have occurred, rather than increased in connection with the two transfers in the amount of at least \$900,000 as shown below:

Unrecovered Working Capital Fund cash invested in the equipment transfer to Environmental Science Services Administration	\$2,096,000
Reduction in leave liability described in your report	<u>1,162,810</u>
Total Loss to Working Capital Fund	<u>\$ 933,190</u>

We believe that if the annual leave assumed at initial capitalization was funded in the sense of including all assets and liabilities in the definition, then consistency would dictate using the same definition for significant accretions and decrements of the Fund's activities. In this sense, the Fund has not established any excess funded annual leave, or funded reserves, because it has transferred out more net value of assets than liabilities.

THE NONOPERATING INCOME CONCEPT

The concept of a nonoperating income account, is not readily defined in governmental accounting regulations, although the Treasury Department, in Treasury Circular No. 966 provides for handling prior years' charges and credits as an adjustment to the results of annual operations. This treatment parallels the so-called "clean surplus" theory long discussed in the accounting profession.

The Bureau would have no objection to establishing such an account (1) although this has not been the established practice of GAO and (2) the use of such an account, while providing some benefit in analytical facility would have no effect on the handling of the annual leave transactions.

If consistent definitions and criteria are to be observed in administering a nonoperating income (or loss) account, then all gains and losses should be cleared through the account, including those recognized on the disposal of fixed assets. We believe that the gains and losses on disposal of fixed assets would have to be included in the account, as well as the adjustments to the annual leave liability, because all of these residual balances arise from an inability to realize fully the investment value (or under the criteria in 2 GAO 12.5 the estimated value) of the assets.

If all gains and losses applicable to prior years' activities are consistently included in the nonoperating income (or loss) account in the year in which recognized, then the account, in essence, would acquire all of the transactions applicable to the funded liabilities as discussed in this letter under the caption "FUND AS A SELF BALANCING ACCOUNTING ENTITY (ASSETS = LIABILITIES + U. S. EQUITY)." The account, therefore, would each year reflect the prior year charges and credits as we have described them under the fund concept. The account would show the two transfers discussed in your report as a net loss. In this sense, the account would be a vehicle for collecting in a systematic manner the same information which is now used to adjust directly the donated capital of the Fund. In other words, we believe that nonoperating income would not be a segment of operating income as an accounting concept.

There may be a question of whether the account would have meaning with respect to amounts to be paid into the general fund of the Treasury. The legislation governing such payments, 15 U.S.C. 278b(f) provides that, "any earned net income resulting from the operation of the Fund at the

close of each fiscal year shall be paid into the general fund of the Treasury." (Underscoring supplied.) The legislative history of the act is silent as to the intent of this language. In view of the specific reference to the underscored language there may be some question as to whether nonoperating income should be paid into the general fund of the Treasury. You may wish to consider this in connection with the statement made on page 13 of the report that nonoperating income is a segment of net income. As we have stated previously, the annual leave cost billed to appropriations is based on a rate designed to recover annual leave earned each year. We believe that this procedure is consistent with the above legislative requirement that net income resulting from operations each year be determined. Had we established our annual leave rate at a higher level, designed to recover cash for financing the leave liability assumed, we would have recovered more than annual leave earned each year and, accordingly, would have charged annual appropriations in excess of the yearly cost of operations of the working capital fund operations.

Conclusions

It may be that there should be a principle or standard governing adjustments for leave earned and billed when reorganizations affecting revolving funds take place. Perhaps this aspect of the increase or decrease in resources should be made a part of the reorganization plan and cleared with your office and, as now required, with the Bureau of the Budget. It would not be appropriate, however, to settle the problems other than prospectively; therefore, the Working Capital Fund should not be required to deposit funds to miscellaneous receipts of the Treasury as a result of the subject transactions.

If it is decided to prescribe a principle or a standard governing the transfer of annual leave liabilities to and from revolving funds with cash, there are a number of problems which should be considered. It would add several significant complications to the accounting and financial management of revolving funds as follows:

(1) If deposits must be made in connection with the past transactions, it will be necessary to also request the Congress to fund the reduction in net working capital, since the cash balance of the Fund is not sufficient to make a substantial payment as you suggest. Present investment requirements indicate that additional funds will be requested from the Congress in the near future.

(2) If cash may have to be returned to the Treasury as a result of future transfers, prudent management would dictate that there be established a reserve for such contingencies on a going concern basis. Adoption of this concept would indicate a cash balance be maintained with an attendant increase in interest charges to the Treasury.

(3) In future accretions to revolving funds, there would be required the receipt of cash to cover the annual leave liabilities assumed. We do not understand how this can be accomplished with respect to appropriations approved on an obligation basis because these appropriations are available only for leave paid.

(4) Your draft report, in essence, illustrates a dilemma as to the treatment of appropriations, such as revolving funds administered and financed entirely on a cost basis, compared to appropriations financed annually on an obligation basis. The 1953 transfers were made to the Army Industrial Fund, and the Navy Industrial Fund, also revolving funds, which, it appears, were placed in the same position with respect to financing the annual leave liability as was our Working Capital Fund. Our deposit to miscellaneous receipts would not, in this case, alleviate the problem of having another appropriation which receives services from these funds ultimately finance this leave. On the other hand, the second transfer was to an agency supported by annual appropriations for which the leave is financed on an obligation basis. In this case, based on our belief that the Working Capital Fund received no excess cash to fund the leave, we believe that the Government has incurred no adverse effects from the transaction.

Other comments

We suggest the following revisions in the text of the report:

(1) In the second paragraph on page 13 of the draft report, the statement is made that in your report (B-114821, November 1, 1955), you stated that the value of the accrued annual leave of the transferred employees amounted to \$642,680. However, the funds representing the accrued annual leave were not transferred to the Department of Defense or to the general fund of the Treasury. We read this to mean that you had made such a recommendation in your report, but the report does not contain such a recommendation. In order to clarify the report, we suggest that the second sentence be deleted; the point is made in the conclusions.

(2) In the first paragraph on page 14, the statement is made that no legal consideration had been given to this matter. There has been a considerable amount of legal as well as accounting consideration given to your report at all levels in the Department of Commerce as well as the General Accounting Office, and we believe that you may wish to revise the paragraph accordingly.

(3) Again, in the last paragraph on page 14, the statement is made that the authority to include a charge for a reserve for accrued leave was ostensibly for the purpose of placing the Fund on a wholly reimbursable basis. (Underscoring supplied.) We believe that the legislative history of the Working Capital Fund is quite clear in the intent that annual leave charges were for the purpose of placing the Fund on a wholly reimbursable

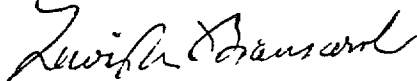
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basis. We suggest that the word "ostensibly" be deleted.

(4) Finally, in the last paragraph on page 14, the statement is made "that earned net income, except for purposes of capital restoration shall be paid into the general fund of the Treasury." The statute states "The amount of any earned net income resulting from the operation of the fund at the close of each fiscal year shall be paid into the general fund of the Treasury," (Underscoring supplied). You may want to correct the technical inaccuracy in view of the importance of this phrase to the issues involved.

We request that the entire contents of our response be included in any report that you may issue on this subject.

Sincerely,



L. M. BRANSCOMB
Director



THE ASSISTANT SECRETARY OF COMMERCE
WASHINGTON, D.C. 20230

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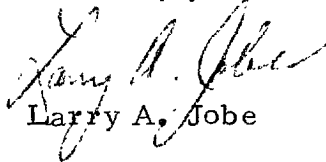
Mr. Henry Eschwege
Associate Director
Civil Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This is in reply to your letter of May 6, 1970, requesting comments on a proposed report to the Congress on the "Augmentation of Working Capital Fund in the Amount of Funded Leave Remaining Unpaid After the Transfer of a Large Number of Employees, National Bureau of Standards, Department of Commerce."

We have reviewed the comments of the National Bureau of Standards and believe they are appropriately responsive to the matter discussed in the report.

Sincerely yours,


Larry A. Jobe

Enclosure



U.S. DEPARTMENT OF COMMERCE
National Bureau of Standards
Washington, D.C. 20234

JUL 13 1970

Mr. Henry Eschwege
Associate Director
Civil Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your letter of May 6, 1970, transmitting a draft report to the Congress alleging the augmentation of the Bureau's Working Capital Fund without authority of law as a result of the accounting treatment of the accrued leave of certain employees transferred to the Environmental Science Services Administration, Department of Commerce. We previously commented on an earlier draft report on this same subject. We note that you have made changes in this report to incorporate some of our views. We believe that additional consideration should be given to our previous comments as well as to those provided in this letter. We should point out that we remain in substantial disagreement with the financial concepts put forward in the reports, and the resulting recommendation of a transfer of funds to the Treasury.

We note that the report considers that extraordinary gains or losses that occur from time to time, such as leave transactions, should be considered as part of the computation of earned net income which we are obliged to deposit to the General Fund of the Treasury as miscellaneous receipts. Our position is that adjustments for such unusual items should be handled through donated surplus and not considered as a part of earned net income. We believe the maintenance of donated surplus accounts in the operation of revolving funds is an accepted practice. We believe such accounts are customarily used to handle unusual and "one-time" transactions affecting the capital of the fund that should not be considered in the calculation of annual net income or loss.

In the event we must include leave adjustments in the computation of profit or loss, then we believe all such transactions should be so treated, including property and equipment transactions. If this had been done over the years, it is very likely we would have deposited to the General Fund of the Treasury as miscellaneous receipts much less in profits than under the present system. The subject transaction with ESSA would, as we pointed out previously, have resulted in a net loss of over \$900,000 to the Working Capital Fund. As also stated previously, we believe that thorough consideration of the effects of such reorganizations on working capital should include review of the net effect.

We note that you state on page 16 of the revised report that the reduction of the capital of the fund is consistent with the reduction of the fund's activities brought about by the transfer. We do not agree with this concept as it applies to General Purpose Equipment of which there was an unrecovered cost amounting to \$2,096,000. This amount represents what is tantamount to a temporary loan to the activity which is expected to be paid back from operating funds for use by other activities. General Purpose Equipment is of the type that may be generally useful throughout the Bureau, as opposed to Special Purpose and Donated Equipment, which is identified with a particular program, and in which the Working Capital Fund has no investment.

The investment requirements of the Working Capital Fund are not related to particular programs or activities in any single year, but are based on the priorities established by Bureau management after a review of needs for working capital. Investments may bear little relationship with the number of personnel; for example, in the procurement of computers or performance of reimbursable services. Further, working capital frequently is invested in equipment needed to start new programs without the benefit of a direct appropriation, nor the possibility of recovery from discontinued programs requiring no further capital investment. Requests for investment funds recently have been on the order of twice the amount available in any one year.

In our budget for Fiscal Year 1971 we are requesting from the Congress direct appropriations of \$950,000 to maintain required levels of investment in equipment and standard reference materials. Had we not lost an anticipated recovery of \$900,000 in working capital through transfer of assets to ESSA, these requests might not have become necessary.

We do not agree that the premises used in the revised draft are valid for computing a recommended deposit of \$432,589 to the General Fund of the Treasury as a miscellaneous receipt. You have indicated that of the 757 employees transferred to ESSA, only 52 were employed by the Bureau on July 1, 1950, when all NBS employees' leave liabilities were assumed by the Fund. This assumption discounts the various leave liabilities assumed for the remaining 705 employees that transferred from other Government agencies to the Fund without reimbursement for leave, and also disregards terminal leave settlements paid for these, as well as other, employees who retired or left the Fund for outside employment during the period from 1950 to 1966. Nor was it considered that the billing rate of the Fund during this period did not include a factor for leave liabilities assumed July 1, 1950, and, subsequently, liquidated with no reimbursement of the Fund for prior liability.

We believe that the original conception of the leave reserve as a commingled account, and treatment of comparable transactions on a first-in, first-out basis, is in accord with generally accepted accounting principles, as we have explained previously in our response of November 21, 1969. We still assert, therefore, that the Working Capital Fund was not augmented without authority of law because of the subject leave transactions. We might note that staff of the General Accounting Office were involved in establishing the Working Capital Fund and many of the sub-accounts, including the leave reserve, and were consulted on operating policies. There has also, since 1950, been review of the leave reserve account with GAO staff.

We recognize that there is little official guidance on the handling of assets and liabilities in connection with Governmental reorganizations, and that this is particularly evident where revolving funds are involved. In the absence of official standards, we believe we have handled the numerous working capital transactions involved in several reorganizations and transfers on a reasonable and equitable basis. Our treatment of the leave reserve has, we believe, been consistent in the handling of gains and losses. While we believe there is a need for more formal guidance on the disposition of assets and liabilities in Governmental reorganizations, we respectfully disagree that the recommended transfer of NBS funds to the Treasury would be appropriate or equitable in this instance.

We request that the entire contents of our comments of this date and of our previous response, dated November 21, 1969, be included in any report that you may issue on this subject.

Sincerely,


LEWIS M. BRANSCOMB
Director

BEST DOCUMENT AVAILABLE

DEPARTMENT OF COMMERCE OFFICIALS
RESPONSIBLE FOR ADMINISTRATION OF
ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
<u>OFFICE OF THE SECRETARY</u>		
SECRETARY OF COMMERCE:		
Maurice H. Stans	Jan. 1969	Present
C. R. Smith	Mar. 1968	Jan. 1969
Alexander B. Trowbridge	June 1967	Mar. 1968
Alexander B. Trowbridge (acting)	Feb. 1967	June 1967
John T. Connor	Jan. 1965	Jan. 1967
ASSISTANT SECRETARY FOR SCIENCE AND TECHNOLOGY:		
Richard O. Simpson (acting)	Dec. 1970	Present
Myron Tribus	Mar. 1969	Nov. 1970
Allen V. Astin (acting)	Feb. 1969	Mar. 1969
John F. Kincaid	Oct. 1967	Feb. 1969
Allen V. Astin (acting)	July 1967	Sept. 1967
J. Herbert Hollomon	May 1962	July 1967
<u>NATIONAL BUREAU OF STANDARDS</u>		
DIRECTOR:		
Lewis M. Branscomb	Sept. 1969	Present
Allen V. Astin	June 1952	Aug. 1969
ASSOCIATE DIRECTOR FOR ADMINISTRATION:		
Robert S. Walleigh	Sept. 1955	Present