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General Accounting Office  
Washington, D.C. 20548

Accounting and Information  
Management Division

B-254191

October 13, 1993

Mr. John C. McGuffin, Comptroller  
National Institute of Standards and  
Technology  
Department of Commerce

Dear Mr. McGuffin:

This letter responds to your request for an opinion on the application of the equity standard in Title 2, "Accounting," of GAO's Policy and Procedures Manual for Guidance of Federal Agencies. The Title 2 standard states that when equipment is purchased using appropriated funds, the equity account in the balance sheet reflecting the equipment acquisition, which is an invested capital account, should (1) be reduced by the amount of depreciation expense recognized each period and (2) be credited to an account eventually closed to the cumulative earnings account. The National Institute of Standards and Technology (NIST) has adopted Title 2 for purposes of preparing financial statements for its Working Capital Fund (the Fund). The statements are audited annually by the Department of Commerce's Inspector General (IG).

The basis of your request is the IG's report which cited NIST for noncompliance with the above Title 2 standard. To supplement the descriptions of the accounting treatment in your letter and the IG report, we met with your staff to obtain more information about the reasons behind NIST's accounting treatment and met with the IG's staff to obtain additional information about their report.

The IG recommended that NIST adjust the equity accounts of the Fund to show balances that would have existed had NIST periodically reduced the amounts related to depreciation expense on property acquired through use of an appropriation.

The IG also recommended that NIST consider whether the Fund should return its excess earnings to the Treasury. The IG stated that since the Fund charges customers for the services it performs, it receives twice the amount of the equipment cost, once through the appropriation awarded to acquire the property and once through user charges which include the depreciation expense as a cost in establishing the rate base to charge customers. If NIST had charged the equity account for the same amount as the depreciation expense, (1) the capital investment account would have

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been reduced and (2) the cumulative earnings account of the Fund would have increased, including both the appropriation and the revenues related to depreciated property. Consequently, the IG concluded that the cumulative earnings account would have shown an inflated balance since the Fund receives twice the amount of the equipment, thus raising the question of whether the Fund has excess earnings that should be returned to the Treasury.

Your staff stated, however, that they interpreted Title 2 as not requiring the equity account to be reduced every year if the appropriation used to acquire the equipment was intended to increase the corpus of the Fund. They stated that the appropriation NIST receives each year for the acquisition of property and the revenues it receives from the depreciation included in the rate base are intended to be continuously reinvested in property to replace older, used property for use within the Fund. Your staff also stated that the fiscal year 1994 budget request for the appropriation to be transferred to the Fund includes specific language emphasizing the permanent nature of the appropriation. In addition, your staff stated that the Fund is in a growth period where operations are expanding. Consequently, NIST management believes that the invested capital account reflecting the acquisition of property should not be reduced because of the permanent nature of the appropriation to the Fund.

Title 2 requires the capital investment account in the equity section of the balance sheet to be reduced every year to the extent depreciation expense is recognized. However, an appropriation awarded or transferred for the purpose of acquiring long-lived assets would be continuously retained in the capital investment account if the appropriation is intended to be a permanent capital infusion and not intended to be diminished. In this regard, the appropriation is analogous to an appropriation for initial investment to begin a new activity or an appropriation to expand current operations.

Although NIST is required by law to charge customers for the cost of its capital assets, amounts appropriated to NIST for transfer to the Working Capital Fund are also available for the acquisition of capital assets. Further, federal law provides that NIST does not have to pay to the Treasury net earnings that are applied to (1) restore any prior impairment to the Fund or (2) ensure the availability of capital to replace equipment and inventories. Accordingly, so long as NIST intends to apply appropriations transferred to the Fund in this manner, the appropriations

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constitute a permanent capital infusion. As such, these appropriations meet the Title 2 criteria of a permanent investment. Therefore, in our opinion, NIST should not reduce the capital investment account when depreciation expense is recognized on assets acquired through use of this appropriation.

We discussed our position with Mr. Thomas Gary and others of your staff. We hope this response is helpful to you. Should you have any questions, please contact Mr. John W. Hill, Jr., Director, Audit Support and Analysis, at (202) 512-8549.

Sincerely yours,



Donald H. Chapin  
Assistant Comptroller General

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