National Aeronautics and
Space Administration

Office of Inspector General
Washington, DC 20546-0001

December 11, 2007

TO: Chief Financial Officer
Director, Facilities Engineering and Real Property Division

FROM: Assistant Inspector General for Auditing

SUBJECT: Final Memorandum on NASA's Accounting for Real Property Leased to Other Entities (Report No. IG-08-004; Assignment No. S-08-001-00)

During the annual audit of NASA's financial statements, the independent public accounting firm conducting the audit identified that NASA's policies did not adequately address accounting for real property that NASA owns but leases to another entity. The Office of Inspector General (OIG) conducted a review to determine whether NASA is properly accounting for leased real property in accordance with applicable accounting standards. (See Enclosure 1 for details on the review's scope and methodology.)

Executive Summary

We found that when NASA leases its real property to another entity, and the terms of the lease do not meet the criteria of a capital lease, NASA improperly removes that property from its general ledger. As a result, leased real property currently owned by NASA with a capitalized value of approximately $295 million was removed from the general ledger. We estimated the book value of these properties to be approximately $65 million as of September 30, 2007.

Our October 19, 2007, draft of this memorandum recommended that the Chief Financial Officer (CFO) and the Director, Facilities Engineering and Real Property Division (FERPD), revise NASA's applicable policies and procedures to fully address the proper accounting for real property that NASA owns but leases to another entity, to include both capital and operating leases. We also recommended that the CFO analyze NASA's leased real property for adjustments that should be made to the accounting records.

The Deputy CFO's comments, with concurrence from the Director, FERPD, on the draft of this memorandum are responsive (see Enclosure 3). We will close the recommendations upon completion and verification of management's corrective actions.

Background

Applicable Accounting Standards. The Statement on Auditing Standards (SAS) No. 91, "Federal GAAP [Generally Accepted Accounting Principles] Hierarchy," April 2000, outlines the hierarchy of GAAP for Federal entities, which includes requirements published by the Federal Accounting Standards Advisory Board (FASAB), the American

Institute of Certified Public Accountants (AICPA), and the Financial Accounting Standards Board (FASB).

SAS No. 91 also states that the auditor of financial statements of a Federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Examples of other accounting literature include Governmental Accounting Standards Board (GASB) Statements, Interpretations, Technical Bulletins, and Concepts Statements.

FASAB's Statement of Federal Financial Accounting Standards (SFFAS) No. 6, "Accounting for Property, Plant, and Equipment," June 1996, states in Paragraph 18 that property, plant, and equipment (PP&E) includes "property owned by the reporting entity in the hands of others." Further, Paragraph 20 specifies that if a lease at its inception does not meet the criteria outlined as a capital lease, then the lease should be classified as an operating lease. SFFAS No. 6 does not, however, outline the accounting treatment for operating leases. Following the Federal GAAP hierarchy detailed in SAS No. 91, the accounting literature to which Federal entities should refer for guidance on the accounting treatment of operating leases is the FASB's Financial Accounting Standard No. 13, "Accounting for Leases," November 1976. Paragraph 19 of Financial Accounting Standard No. 13 states:

> Operating leases shall be accounted for by the lessor as follows:
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> a. The leased property shall be included with or near property, plant, and equipment in the balance sheet. The property shall be depreciated following the lessor's normal depreciation policy, and in the balance sheet the accumulated depreciation shall be deducted from the investment in the leased property.
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> b. Rent shall be reported as income over the lease term as it becomes receivable according to the provisions of the lease. However, if rentals vary from a straight-line basis, the income shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit from the leased property is diminished, in which case that basis shall be used.

NASA Real Property Accounting Process. NASA maintains a NASA-wide data system for real property. This system is referred to as the Real Property Inventory (RPI). The RPI was established to provide an easy-to-use, automated method for maintaining and reporting real property data. According to property personnel in the Office of the CFO (OCFO), when real property owned by NASA has been leased to another entity, and the lease does not meet the criteria for a capital lease, the status within the RPI is reflected as either "Reimbursable" or "Outgrant." However, these terms are not defined in NASA Policy Directive (NPD) 8800.14C, "Policy for Real Property Management," July 2004; NASA Procedural Requirements (NPR) 8800.15A, "Real Estate Management Program Implementation Manual," September 2003; or Volume 6, Chapter 4, "Property, Plant and Equipment," November 2006, of NASA's Financial Management Requirements (FMR).

NASA's Policies and Procedures Inadequately Addressed Leased Property

We noted that reference to leased property in the relevant NPD, NPR, and FMR chapters for real property is very limited (see Enclosure 2 for details). Even though existing policy and guidance does not specifically address how to treat operating leases involving NASA-owned real property from an accounting perspective, OCFO's property personnel stated that such property is removed from the accounting system by recognizing the full amount of the net book value as depreciation expense in the year that the property is leased to another entity. The real property, however, remains in the real property management system (i.e., the RPI).

Our review of the FMR found that Subsection 040510 (Volume 6, Chapter 4, Section 0405) states that real property coded in the RPI as "inactive or not in use by NASA including Reimbursable, Stand-by, Mothballed, Abandoned, and Demolished will also be promptly removed from the capitalized PP&E accounts." Our discussions with OCFO property personnel indicated that they consider "Reimbursable" to refer to leased real property where NASA is the lessor (the owner of the property). As a result, the FMR could be interpreted as requiring the removal of leased assets from the accounting records. Similar language is included in FMR Subsection 040604 of Section 0406, "NASA Held Real Property" (Volume 6, Chapter 4).

Further, OCFO personnel at Ames Research Center, Kennedy Space Center, Langley Research Center, and Marshall Space Flight Center stated that the procedures for the billing and collection of income from leased property are the same as procedures for reimbursable agreements, which are addressed in FMR Volume 16, "Reimbursable Agreements," June 2006. Those FMR procedures include the following activities:

- each reimbursable agreement will be assigned a project work breakdown structure (WBS);
- costs will be billed monthly;
- advances, if received, will be liquidated by the billings; and
- collections will be credited to the NASA appropriation that was used to fund the reimbursable work.

Volume 16 does not provide specific details of the accounting treatment (e.g., debits and credits posted in the general ledger) for those activities. Additionally, Volume 16 does not specifically address or refer to operating leases when NASA is the lessor. However, FMR Subsection 020605, "Application of Reimbursements Received" (Volume 16, Chapter 2), does discuss how receipts from reimbursable work will generally be applied to the fiscal year appropriation from which the cost of providing the service was paid unless the receipt must be applied to a miscellaneous receipt account at Treasury.

FMR Subsection 020605 continues, stating that the two following factors must be considered when determining whether the receipt will be applied to an appropriation or miscellaneous receipt account at Treasury:

> 1. In cases where the NASA appropriation includes specific funding to support the reimbursable work NASA cannot retain funds received from customers for this work.
>
> 2. NASA must be assured that funds received represent reasonable compensation for costs incurred. Any reimbursement received in excess of the actual full cost incurred must be returned to the customer. The only exception to this would be agreements with non-federal customers where NASA charges market price and the market price exceeds NASA's full cost. In that situation, the reimbursement received that exceeds full cost must be deposited to the Treasury Miscellaneous Receipts Account, unless specific legislation authority, such as Enhanced Use Lease Demonstration[*] authority, permits retention by the Agency.

The high-level procedures for the billing and collection of reimbursable agreements outlined in the FMR are consistent with the activities we would expect for the billing and collection of rent under lease agreements. We did not perform, however, any specific procedures on transactions to determine adherence with these procedures as we relied solely on inquiry of OCFO personnel at the aforementioned Centers. Further, our inquiries were general in nature and did not address specifics (e.g., debits and credits for each billing and collection activity). Even though we do not have concerns with the overall process, the written policies and procedures for reimbursable agreements do not indicate that they should be followed for the billing and collection of income from leased property.

Improper Accounting for NASA Property with Operating Leases

We reviewed Capitalization Reconciliation Reports (CRRs), generated from the RPI, as of August 27, 2007, for real property at all NASA sites. We found that Ames Research Center, Langley Research Center, and Wallops Flight Facility lease real property to other entities under operating leases.

The CRRs showed 55 real property items with an acquisition cost of at least $100,000 (i.e., the capitalization threshold) with a status classification of either outgrant or reimbursable. The total acquisition cost of these real property items is approximately $295 million. Of the 55 items, it appeared that 27 properties would not be fully depreciated by the end of fiscal year 2007. Using the straight-line depreciation method,

[*] The Enhanced Use Lease Demonstration, as described in Title 42, United States Code (U.S.C.), Section 2459j, authorizes NASA's Administrator to lease to any person or entity (Federal or non-Federal) real property under NASA's jurisdiction at no more than two NASA Centers. NASA identified Ames Research Center and Kennedy Space Center as its two demonstration sites. According to the provisions of 42 U.S.C. 2459j, the lessee shall provide consideration for the lease at fair market value unless the lessee is a Federal entity, and then the consideration would be equal to the full cost to the lessor in connection with the lease. Consideration may be one or a combination of the following forms: (a) payment of cash; (b) the maintenance, construction, modification, or improvement of facilities on real property; (c) the provisions of services to the lessor; or (d) use by the lessor of facilities on the property. Cash consideration received will remain available until expended.

we estimated the net book value of the 27 properties to be approximately $65 million as of September 30, 2007, and an annual depreciation expense of slightly less than $3.5 million. The CRRs only reflect the cumulative total of the acquisition cost and the initial date that the property was placed in service. They do not provide details in regard to the cost of the initial property acquisition, cost of subsequent improvements, if any, and the year that such improvements were made. As such, we were unable to determine the exact number of real property items that were not fully depreciated and the corresponding net book value and depreciation expense.

We noted that the CRR for Kennedy Space Center did not reflect any properties as outgrant or reimbursable, despite Kennedy being one of NASA's Enhanced Use Lease Demonstration sites. Therefore, we obtained and reviewed spreadsheets provided by the OCFO that listed all real property items leased to other entities. Our review identified leased property (land) at Kennedy and additional leased property not only at Ames, Langley, and Wallops, but also at Glenn Research Center, Goddard Space Flight Center, the Jet Propulsion Laboratory, Johnson Space Center, Kennedy, Marshall, and Stennis Space Center. The classification of these additional properties per the CRRs was either active, abandoned, heritage, mothballed, standby, or active/heritage. Under NASA's policy, only the properties classified as active and active/heritage would be recorded in the general ledger. Kennedy's land leased under the Enhanced Use Lease Demonstration authority is classified in the RPI as active. The spreadsheets did not specify the percentage of the real property that is being leased or the acquisition cost of the real property. Regardless, this is an indicator that additional real property items being leased to other entities have been removed from NASA's accounting records.

Conclusion

In our judgment, the OCFO does not account for NASA's real property leased to other entities under an operating lease in accordance with applicable accounting standards. The applicable accounting standards require that leased property remain within the lessor's accounting records instead of being removed, which is NASA's accounting treatment.

We were informed by OCFO's property personnel that the treatment of leased personal property (e.g., equipment), whereby NASA is the lessor, is the same as it is for real property. The accounting standards do not differentiate between personal property and real property, so the accounting treatment of such property would be the same.

Recommendations, Management's Response, and Evaluation of Management's Response

Recommendation 1.a. We recommended that the NASA Chief Financial Officer and the Director, Facilities Engineering and Real Property Division, review and revise the relevant FMR sections and NPR to clarify the policy and procedures related to the recording of leased real property whereby NASA is the lessor under both capital and operating leases. Topics to be considered for inclusion in the revisions are the definition of terms used to indicate that property has been leased to another entity, reference to the accounting procedures for reimbursable agreements for the recording of collections under leases, and the procedures for recording leased assets in the accounting records. During the revision process, there should be coordination between the OCFO and FERPD to ensure that the terminology being used by each office is consistent.

> **Management's Response.** Comments provided by the Deputy CFO, with concurrence from the Director, FERPD, concurred with the recommendation. The Deputy CFO stated that OCFO and FERPD were in the process of revising the applicable policy and procedural documents and expected the policy updates to be completed by July 31, 2008.

> **Evaluation of Management's Response.** The Deputy CFO's planned action is responsive. The recommendation is resolved and will be closed upon completion and verification of management's corrective action.

Recommendation 1.b. We recommended that the NASA Chief Financial Officer and the Director, Facilities Engineering and Real Property Division, provide training on the revised FMR and NPR as a result of the above recommendation to OCFO and FERPD personnel at both Headquarters and the Centers affected by the revisions.

> **Management's Response.** The Deputy CFO concurred, stating that revised guidance will be discussed at annual training.

> **Evaluation of Management's Response.** The Deputy CFO's planned action is responsive. The recommendation is resolved and will be closed upon completion and verification of management's corrective action.

Recommendation 2.a. We recommended that the NASA Chief Financial Officer perform an analysis of all real property leased to other entities under an operating lease. The analysis should identify all relevant property with costs that meet or exceed the capitalization threshold and for which the useful life has not expired. Based on the results of the analysis, an adjustment should be recorded in the accounting records. When determining the adjustment amount, consideration should be given and a determination made as to whether the adjustment or a portion thereof should be recorded as a prior period adjustment.

> **Management's Response.** The Deputy CFO concurred, stating that an analysis of all capital real property leased to other entities had been performed and that the analysis resulted in a restatement of the FY 2006 financial statements in the amount of $68 million.

> **Evaluation of Management's Response.** The Deputy CFO's comments are responsive. The recommendation is resolved and will be closed upon completion and verification of management's corrective action.

Recommendation 2.b. We recommended that the NASA Chief Financial Officer perform research and analysis on the accounting treatment of leased personal property where NASA is the lessor to determine whether the accounting treatment is in accordance with accounting standards. If OCFO's research and analysis discloses that the accounting treatment is not in accordance with accounting standards, then the OCFO should develop and implement recommendations similar to our recommendations for real property.

> **Management's Response.** The Deputy CFO concurred, stating that additional research and analysis will be performed on all leased property.
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> **Evaluation of Management's Response.** The Deputy CFO's planned action is responsive. The recommendation is resolved and will be closed upon completion and verification of management's corrective action.

We appreciate the courtesies extended during our review. If you have any questions, or need additional information, please contact Mr. Mark Jenson, Financial Statement Audits Director, at 202-358-0629 or me at 202-358-2572.

signed

Evelyn R. Klemstine

3 Enclosures

cc:
Assistant Administrator for Infrastructure and Administration
Deputy Chief Financial Officer
Executive Director, Ernst & Young LLP

Scope and Methodology

We performed this review from August through October 2007. However, the review was limited in that we did not follow generally accepted government auditing standards. We also did not review related internal controls. The purpose of the review was to identify whether or not the apparent lack of guidance for leased property, as identified by the financial statement auditors from Ernst & Young, LLP, resulted in NASA improperly accounting for such property. As a result, the scope of the OIG review was limited to determining applicable criteria, reviewing NASA policies and procedures, and conducting a cursory review of records for leased property. However, we believe that the evidence obtained during this limited review nonetheless provides a reasonable basis for our findings and conclusions.

We obtained and examined CRRs generated by the RPI for NASA sites; OCFO spreadsheet listings of real property items leased to other entities; and the following NASA and regulatory guidance: FMR Volumes 6 and 16, NPD 8800.14C, NPR 8800.15A, Financial Accounting Standard No. 13, SAS No. 91, and SFFAS No. 6. We interviewed OCFO personnel at Headquarters and personnel at Ames, Kennedy, Langley, and Marshall to clarify our understanding of the accounting treatment of leased property when NASA is the lessor in terms of the recording of the property and the rental income in the general ledger.

Computer-Processed Data. Although we based our conclusions on evidence gathered from computer-processed data from the RPI and spreadsheets, we believe that evidence to be reliable based on our confirmation of specific instances with appropriate Headquarters and Center personnel.

Prior Coverage. We did not identify any reports issued during the last 5 years that specifically addressed NASA's accounting for leased property.

Applicable NASA Guidance

NPD 8800.14C

No reference to leased real property.

NPR 8800.15A

No reference to leased property other than Paragraph 1.5.38, "Outgrants," which discusses the tracking of outgrant property in the property management system. Specifically, this paragraph states that "the Real Property records will be annotated and documented in all cases involving outgrants for the use of NASA property by other parties. Real Property so granted will, during the term of the grant, be considered part of the NASA-owned Real Property and will be reported as such."

FMR Volume 6, Chapter 4, "Property, Plant and Equipment"

Section 0410, "Leased Property," discusses only the accounting policies and procedures for PP&E leased by NASA (i.e., NASA is renting property from another entity) and subject to capitalization. This section does not address the accounting policies and procedures when NASA is the lessor.

Section 0405, "Policies and Procedures," does not specifically refer to the accounting treatment of leased real property when NASA is the lessor. Subsection 040510 does, however, indicate that real property coded in the RPI as "inactive or not in use by NASA including Reimbursable, Stand-by, Mothballed, Abandoned, and Demolished will also be promptly removed from the capitalized PP&E accounts." Assuming the term "Reimbursable" refers to leased real property where NASA is the lessor, as indicated by OCFO property personnel, then it appears that the policy is to remove the leased asset from the accounting records. Similar language is included in Subsection 040604 of Section 0406, "NASA Held Real Property."

Management's Comments

National Aeronautics and Space Administration
Headquarters
Washington, DC 20546-0001

November 30, 2007

Reply to Attn of:
Office of the Chief Financial Officer

TO: Assistant Inspector General for Auditing

FROM: Deputy Chief Financial Officer

SUBJECT: Response to Draft Memorandum on National Aeronautics and Space Administration's (NASA) Accounting for Real Property Leased to Other Entities (Assignment No. S-08-001-00)

We are providing you with comments on the Office of Inspector General (OIG) draft report entitled "NASA's Accounting for Real Property Leased to Other Entities (Assignment No. S-08-001-00)."

In the subject report, you made four recommendations to the Chief Financial Officer and the Director of Facilities Engineering and Real Property Division to properly account for real property that NASA owns, but leases to another entity. Two of the OIG recommendations relate directly to the combined efforts of the Offices of the Chief Financial Officer (OCFO) and Facilities Engineering and Real Property Division (FERPD), currently underway. Our comments related to your recommendations follow:

Recommendation 1: We recommend that the NASA Chief Financial Officer and the Director, Facilities Engineering and Real Property Division:

a. review and revise the relevant FMR sections and NPR to clarify the policy and procedures related to the recording of leased real property whereby NASA is the lessor under both capital and operating leases. Topics to be considered for inclusion in the revisions are the definition of terms used to indicate that property has been leased to another entity, reference to the accounting procedures for reimbursable agreements for the recording of collections under leases, and the procedures for recording leased assets in the accounting records. During the revision process, there should be coordination between the OCFO and FERPD to ensure that the terminology being used by each office is consistent.

b. provide training on the revised FMR and NPR as a result of the above recommendation to OCFO and FERPD personnel at both Headquarters and the Centers affected by the revisions.

Response: Management concurs that additional guidance should be added to the relevant FMR sections to include definitions of terms used to indicate that property has been leased to another entity and the procedures for recording leased assets in the accounting records.

However, it should be noted that property under operating leases, where NASA is the lessor, is included in the value of the real property general ledger accounts. "Outgrant" is the very broad term that includes all actions that grant others an "estate" in our property. Outgrants include leases, permits, and easements. The noted finding relates to the broad category of Outgrants rather than strictly leased property.

The Offices of the CFO and FERPD are currently in the process of making revisions to the applicable policy and procedural documents to ensure that the documents are in accordance with Federal Accounting Standards and the terminology, as defined in the NPR 8800.15A, Section 1.5.3.8, Title 14 C.F.R, Section 1204.501 (Codification of the Space Act Authority), and National Space Act authority, is consistent across the various Mission Support Offices. The expected completion date for the Policy revisions is July 31, 2008.

Management also concurs that annual property training should incorporate discussions on the revised guidance per accounting for outgrants. Additionally, the OCFO will coordinate with the FERPD to include guidance on the different categories of property status, including the difference between active and inactive property, to ensure consistency between OCFO and FERPD in the annual training. Training sessions will be held no later than June 30, 2008.

Recommendation 2: We recommend that the NASA Chief Financial Officer:

a. perform an analysis of all real property leased to other entities under an operating lease. The analysis should identify all relevant property with costs that meet or exceed the capitalization threshold and for which the useful life has not expired. Based on the results of the analysis, an adjustment should be recorded in the accounting records. When determining the adjustment amount, consideration should be given and a determination made as to whether the adjustment or a portion thereof should be recorded as a prior period adjustment.

b. perform research and analysis on the accounting treatment of leased personal property where NASA is the lessor to determine whether the accounting treatment is in accordance with accounting standards. If OCFO's research and analysis discloses that the accounting treatment is not in accordance with accounting standards, then the OCFO should develop and implement recommendations similar to our recommendations for real property.

Response: Management concurs with the recommendation to perform an analysis of all Capital real property leased to other entities under an operating lease with specific emphasis on Outgranted property. During the FY 2007 Year-end close, the OCFO analyzed all real property items with an Outgrant status in the NASA Real Property Inventory Database (NRPI). Based upon the analysis, it was determined that 49 buildings and/or structures and facilities (2 SSC, 47 ARC) that are outgranted to other entities were not properly accounted for in the general ledger. Consequently, the FY 2006 financial statements were restated to reflect a $68M prior period adjustment.

The OCFO will coordinate with the Facilities Engineering and Real Property Division to ensure that all future Outgrant transactions are properly recorded in the NRPI and on supporting documentation.

Management also concurs with the recommendation that additional research and analysis should be performed on all leased property regardless of the property category. We will perform an analysis by the end of the second quarter of FY 2008. If the research determines that the accounting treatment is not in accordance with accounting standards, an adjustment will be made.

Thank you for your continued interest and for the opportunity to provide comments. We look forward to our continued partnership in ensuring that NASA's Property balances are accurately stated in accordance with Generally Accepted Accounting Principles. This letter is submitted in concurrence with the Director of Facilities Engineering and Real Property Division. If you have any questions or need additional information, please contact Leslie Hyland, Director, Financial Management Division, at (202) 358-2645.

Terry Bowie

Terry Bowie