



G A O

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United States Government Accountability Office
Washington, DC 20548

December 22, 2005

Mr. Thomas N. Cooley
Chief Financial Officer
National Science Foundation

Ms. Christine C. Boesz
Inspector General
National Science Foundation

Subject: *Financial Audit: Restatements to the National Science Foundation's
Fiscal Year 2003 Financial Statements*

As you know, the Secretary of the Treasury, in coordination with the Director of the Office of Management and Budget (OMB), is required to annually prepare and submit audited financial statements of the U.S. government to the President and Congress. We are required to audit these consolidated financial statements (CFS) and report on the results of our work.¹ An issue meriting concern and close scrutiny that emerged during our fiscal year 2004 CFS audit was the growing number of Chief Financial Officers (CFO) Act agencies that restated² certain of their financial statements for fiscal year 2003 to correct errors.³ Errors in financial statements can result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. Frequent restatements to correct errors can undermine public trust and confidence in both the entity and all responsible parties. Further, when restatements do occur, it is important that financial statements clearly communicate, and readers

¹The Government Management Reform Act of 1994 has required such reporting, covering the executive branch of government, beginning with financial statements prepared for fiscal year 1997. 31 U.S.C. § 331 (e). The federal government has elected to include certain financial information on the legislative and judicial branches in the CFS as well.

²A financial statement restatement occurs when an entity either voluntarily or prompted by its auditors or regulators revises public financial information that has previously been reported.

³According to Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Standards No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, prior period financial statements presented should be restated only to correct errors that caused such statements to be materially misstated.

of the restated financial statements understand, that the financial statements originally issued by management in the previous year and the opinion thereon should no longer be relied on and instead the restated financial statements and related auditor's opinion should be used.

Eleven of the 23 CFO Act agencies⁴ restated certain of their financial statements for fiscal year 2003. Five CFO Act agencies had restatements in fiscal year 2003 covering their fiscal year 2002 financial statements. Three CFO Act agencies had restatements covering both years. We noted that the extent of the restatements to CFO Act agencies' fiscal year 2003 financial statements varied from agency to agency, ranging from correcting two line items on an agency's balance sheet to correcting numerous line items on several of another agency's financial statements. In some cases, the net operating results of the agency were affected by the restatement. The amounts of the agencies' restatements ranged from several million dollars to more than \$91 billion.

Nine of the 11 agencies that had restatements for fiscal year 2003 received unqualified opinions on their originally issued fiscal year 2003 financial statements. The auditors for 6 of these 9 agencies issued unqualified opinions on the restated financial statements, replacing the previous unqualified opinions on the respective agencies' original fiscal year 2003 financial statements. The auditors for 2 of these 9 withdrew their unqualified opinions on the fiscal year 2003 financial statements and issued other than unqualified opinions on the respective agencies' restated fiscal year 2003 financial statements because they could not determine whether there were any additional misstatements and the effect of any such misstatements on the restated fiscal year 2003 financial statements. For the remaining agency, the principal auditor of the agency's fiscal year 2004 financial statements was not the principal auditor of the agency's fiscal year 2003 financial statements, and an audit opinion on the agency's restated fiscal year 2003 financial statements was not issued.

Our review focused on the 9 agencies with restatements for fiscal year 2003 that received unqualified opinions on their originally issued fiscal year 2003 financial statements.⁵ These were the Department of Agriculture, Department of State, Department of Justice, Department of Transportation, Department of Health and Human Services, General Services Administration, National Science Foundation (NSF), Nuclear Regulatory Commission, and Office of Personnel Management.

⁴The Federal Emergency Management Agency (FEMA) was transferred to the Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA was no longer required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies for the remainder of fiscal year 2003 and for fiscal year 2004. The DHS Financial Accountability Act, Pub. L. No. 108-330, 118 Stat. 1275 (Oct. 16, 2004), added DHS to the list of CFO Act agencies, increasing the number of CFO Act agencies again to 24 beginning in fiscal year 2005.

⁵The 2 agencies that had restatements for fiscal year 2003 but did not receive unqualified opinions on their originally issued fiscal year 2003 financial statements were the Department of Defense and the Small Business Administration.

Because of the varying nature and circumstances surrounding the restatements, we are issuing a number of separate reports on the matter. This report communicates our observations regarding NSF's fiscal year 2003 restatements. Going forward, we hope that the lessons learned from the fiscal year 2003 restatements, together with our recommendations, will help NSF and its auditor avoid the need for restatements to NSF's future financial statements.

We reviewed four key areas with respect to the restatements of NSF's fiscal year 2003 financial statements: (1) the nature and cause of the errors that necessitated the restatements, including planned corrective actions by the agency and its auditors; (2) the timing of communicating the material misstatement to users of the financial statements; (3) the extent of transparency⁶ exhibited in disclosing the nature and impact of the material misstatement in the financial statements and the reissued auditor's report; and (4) audit issues that contributed to the failure to detect the errors that necessitated the restatements during the audit of the agency's fiscal year 2003 financial statements.

Results in Brief

Failure to properly record the H-1B Nonimmigrant Petitioner Fees⁷ (H-1B) account funds for fiscal years 1999 through 2003 led to the material misstatement of about \$216 million that necessitated the restatements of NSF's originally issued fiscal year 2003 Balance Sheet and Statement of Changes in Net Position. According to the NSF contracted independent public accountant's (IPA) management letter report dated November 4, 2004, NSF's Division of Financial Management (DFM) did not have adequate internal controls to ensure that it provided accurate financial data, which may have contributed to the recording error that necessitated the restatements. NSF's IPA did not discover the error during its audit of NSF's fiscal year 2003 financial statements. In our view, the IPA did not understand that the H-1B account funds are special funds, which are to be accounted for differently than certain other NSF receipts. In addition, we found that the IPA was not aware of the U.S. Department of the Treasury's Financial Management Service (FMS) guidance relating

⁶Transparency is the full, accurate, and timely disclosure of information.

⁷H-1B account funds are fees collected by the U.S. Treasury from employers that employ highly skilled aliens in specialty occupations. The American Competitiveness and Workforce Improvement Act of 1998, Title IV, states that the federal government shall impose a fee on an employer filing a petition relating to granting an alien nonimmigrant status. Fees collected shall be deposited with the Department of the Treasury in a separate account, which shall be known as the H-1B Nonimmigrant Petitioner Account, and disseminated for a variety of uses – such as job training, low-income scholarship program, educational grants, systemic reform activities, duties relating to petitions, and application processing and enforcement.

to the recording of H-1B account funds. Consequently, the IPA did not design or perform adequate audit procedures to detect the accounting errors.

We are making a recommendation to NSF's CFO to address the issues we identified with respect to the H-1B account funds recording error that necessitated the fiscal year 2003 restatements. We are also making a recommendation to NSF's Inspector General to work with the IPA so that audit procedures to detect any future material H-1B account funds recording errors are fully and effectively implemented.

In commenting on a draft of this report, the NSF's CFO and Inspector General, in separate letters, offered their views regarding the materiality of the errors and the impact of the errors on *Net Position*. We have clarified our perspective on both points. The report notes that the recording errors in individual years may not have been material, but that the cumulative effect of the errors on the fiscal year 2003 financial statements was deemed material by NSF's IPA. We also note that *Total Net Position* was unchanged, but that the two distinct components of net position, were misstated.

NSF's Inspector General concurred with our recommendation and stated that her office had instituted procedures to ensure that the IPA designed and performed audit steps to detect any future H-1B account fund recording errors.

Background

In conducting the fiscal year 2004 audit of the CFS, we reviewed the 23 CFO Act agencies' performance and accountability reports for possible restatements and identified 11 agencies that had restated certain of their audited fiscal year 2003 financial statements.

The primary intended users of federal agencies' financial reports are citizens, Congress, federal executives, and federal program managers.⁸ Each of these groups may use federal agencies' financial statements to satisfy their specific needs. Citizens are interested in many aspects of the federal government, particularly federal programs that affect their financial well-being. Congress is interested in monitoring and assessing the efficiency and effectiveness of federal programs. Federal executives, such as central agency officials at OMB and the Department of the Treasury (Treasury), are interested in federal financial statements to assist the President of the United States. OMB assists the President in overseeing the preparation of the federal budget by formulating the President's spending plans, evaluating the effectiveness of agency programs, assessing competing funding demands among agencies, and setting funding priorities. Treasury assists the

⁸Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*.

President in managing the finances of the federal government and prepares the CFS, which is based on audited financial statements prepared by federal agencies. GAO audits the CFS and reports on the results of its audit. Finally, federal program managers use agency financial statements as tools for managing their operations within the limits of the spending authority granted by Congress.

The primary accounting and auditing standards that apply to restatement disclosures by federal entities are the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, and the American Institute of Certified Public Accountants (AICPA) Codification of Auditing Standards, AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.⁹

Objective, Scope, and Methodology

The objective of our review of restatements of NSF's fiscal year 2003 financial statements was to determine the nature and cause of the errors, the transparency and timing of communicating the material misstatements, any audit issues relating to such misstatements, and any actions being taken to help preclude similar errors from occurring in the future.

We reviewed the nature and causes of the restatements, and we also examined corrective actions taken by NSF to help preclude similar errors from occurring in the future. We interviewed the preparers and auditors of NSF's fiscal year 2003 financial statements, including staff from the agency's Office of Inspector General (OIG), and we obtained and reviewed relevant audit documentation. Our work was not designed to and we did not test the accuracy or appropriateness of the restatements.

In our review, we considered certain accounting and auditing standards, including SFFAS No. 21; the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 16, *Prior Period Adjustments*; and the AICPA Codification of Auditing Standards, AU section 420, *Consistency of Application of Generally Accepted Accounting Principles*, AU section 508, *Reports on Audited Financial Statements*, and AU section 561.

We performed our review of the restatements of NSF's fiscal year 2003 financial statements from December 2004 to July 2005 in accordance with U.S. generally accepted government auditing standards.

⁹Generally accepted government auditing standards incorporate AICPA reporting standards and Statements on Auditing Standards unless the Comptroller General of the United States excludes them by formal announcement.

We requested comments on the draft of this report from NSF's CFO and Inspector General or their designees. Written comments from NSF's CFO and Inspector General are reprinted in Enclosures I and II, respectively, and are also discussed in the "Agency Comments and Our Evaluation" section. We also received technical comments from NSF's Inspector General which we have incorporated as appropriate but have not reprinted in Enclosure II.

Issues Related to Restatements of Certain of NSF's Fiscal Year 2003 Financial Statements

With respect to the restatements of NSF's fiscal year 2003 Balance Sheet and Statement of Changes in Net Position, we identified the following two areas that need improvement: (1) accounting for and reporting of the H-1B account funds; and (2) audit procedures over the proper recording of H-1B account funds. These issues are discussed in detail below.

H-1B Account Funds Were Not Properly Recorded

In fiscal year 2004, NSF restated certain of its originally issued fiscal year 2003 financial statements to correct for the improper recording of approximately \$216 million of H-1B account funds for fiscal years 1999 through 2003. Specifically, the H-1B account funds were incorrectly recorded as *Other Appropriations Realized* when received instead of *Appropriated Trust or Special Fund Receipts*. The recording errors caused the *Unexpended Appropriations* and *Cumulative Results of Operations* balances on both the originally issued fiscal year 2003 Balance Sheet and Statement of Changes in Net Position to be materially overstated and understated, respectively, by \$216 million. Although *Total Net Position* was unchanged, these two accounts represent distinct components of net position. In addition, the recording errors in individual years may not have been material, however, the cumulative effect of the errors on the fiscal year 2003 financial statements was deemed material by NSF's IPA.

In February 1999, FMS issued guidance entitled *Unavailable Special Fund Receipt Account Transfers* that provided definitions and descriptive journal entries for recording special funds in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*. The H-1B account funds are NSF's only appropriations that are classified as special funds. NSF incorrectly recorded the H-1B account funds as *Other Appropriations Realized* instead of *Appropriated Trust or Special Fund Receipts* because NSF was not aware of the February 1999 FMS guidance, and as a result, NSF was not aware that such funds were recorded in error. An NSF official told us that they believed, until fiscal year 2004, that they were appropriately recording the receipt of the H-1B account funds.

In July 2004, OMB sent an email following up on a March 2004 notification to NSF staff personnel that the H-1B account funds were incorrectly recorded and that NSF was required to follow the related FMS guidance.¹⁰ NSF staff personnel corrected NSF's error approximately 8 months after the agency was first notified. However, according to NSF officials, NSF management did not become aware of the magnitude of the misstatement until October 2004. Further, the IPA and OIG stated that they were unaware of the H-1B account funds recording error until NSF provided them a draft of the fiscal years 2004 and 2003 comparative financial statements in October 2004 that contained the restatements to the fiscal year 2003 financial statements.

According to the NSF IPA's management letter report dated November 4, 2004, NSF's DFM did not have adequate internal controls to ensure that it provided accurate financial data. The IPA stated that this may have contributed to the recording errors that necessitated the restatements. The IPA's report pointed out that first and second drafts of the comparative fiscal years 2004 and 2003 financial statements provided by DFM contained numerous errors.

To resolve this matter, the IPA generally recommended that NSF's Chief Financial Officer determine the appropriate skills and abilities needed in the DFM organizational structure to fulfill NSF's responsibilities for providing accurate financial data, and implement steps to improve top level supervisory review procedures and practices.

NSF management responded to the IPA's recommendations stating that they believed that normal supervisory controls were in place and that such controls provide the review procedures and practices recommended by the IPA. Nevertheless, NSF management stated that the IPA's recommendations would be incorporated in NSF's annual performance review process. In addition, subsequent to the IPA making its recommendations, NSF filled the office of deputy CFO position which had been vacant for 18 months. According to the IPA, this action will provide better oversight of NSF's financial reporting process.

Audit Procedures were Not Adequately Designed to Detect the Improper Recording of H-1B Account Funds

The above noted material error was not discovered during the audit of NSF's fiscal year 2003 financial statements. In our view, the IPA did not understand that the H-1B account funds are special funds, which are to be accounted for differently than certain other NSF receipts. In addition, we found that the IPA was not aware of the

¹⁰According to OMB's e-mail correspondence dated July 6, 2004, to NSF staff personnel, if the error was not corrected, then the special and trust fund budget authority recorded in NSF's H-1B account funds will not crosswalk into the agency's actual columns of the Program and Financing Schedule in the fiscal year 2006 [President's] Budget.

1999 FMS guidance relating to the recording of H-1B account funds. Consequently, the IPA did not design or perform adequate audit procedures to detect the errors.

According to the *Financial Audit Manual* (FAM),¹¹ the auditor should perform audit procedures to test for all significant assertions¹² in significant financial statement line items and accounts. The FAM states that an assertion is significant if misstatements in the assertion could exceed test materiality for the related line item, account, or disclosure. Based on the materiality of NSF's H-1B account funds recording error, the auditor should have identified the presentation and disclosure assertion as significant and performed audit procedures to determine whether NSF's receipts, annually and in the aggregate, were properly reported in the financial statements. To test for presentation and disclosure, the auditor should perform audit procedures to determine whether (1) accounts are properly classified and described in the financial statements, (2) the financial statements are prepared in conformance with generally accepted accounting principles, and (3) footnotes contain all information required to be disclosed. The IPA performed certain audit procedures during fiscal year 2003 to test budget accounts. However, because the IPA (1) did not understand that the H-1B account funds are special funds, which are to be accounted for differently than certain other NSF receipts, and (2) was not aware of the 1999 FMS guidance relating to the recording of H-1B account funds, the IPA did not design or perform audit procedures to adequately test for the presentation and disclosure assertion as it related to the H-1B account funds.

According to NSF's IPA, it has now obtained and reviewed the February 1999 FMS guidance. The IPA also stated that, beginning with fiscal year 2005, audit procedures will be designed and performed to detect any future H-1B account funds recording errors.

Conclusions

NSF restated certain of its originally issued fiscal year 2003 financial statements and disclosed the material error in the notes to the restated financial statements. Going forward, the key will be for NSF to fully and effectively implement policies and procedures to help ensure that H-1B account funds are properly recorded. It will also be important for NSF's auditor to fully and effectively implement audit procedures to detect any H-1B account funds recording errors that occur in the future.

¹¹GAO/President's Council on Integrity and Efficiency, *Financial Audit Manual*, GAO-01-765G (Washington, D.C.: July 2001), updated by GAO-04-1015G and GAO-04-942G (July 2004).

¹²Financial statement assertions are management representations that are embodied in financial statement components. The assertions can be either explicit or implicit and can be classified into the following categories: (1) existence or occurrence, (2) completeness, (3) rights and obligations, (4) valuation or allocation, and (5) presentation and disclosure.

Recommendations for Executive Action

We recommend that NSF's Chief Financial Officer ensure that NSF fully and effectively implements policies and procedures to properly record H-1B account funds.

We recommend that NSF's Inspector General work with NSF's IPA so that audit procedures to detect any future material H-1B account funds recording errors are fully and effectively implemented.

Agency Comments and Our Evaluation

In commenting on a draft of this report, NSF's CFO and Inspector General, in separate letters, offered their views regarding the materiality of the errors and the impact of the errors on *Net Position*. We have clarified our perspective on both points. Our report makes clear that there was no effect on NSF's *Total Net Position* and that the cumulative effect of the continuing recording errors for fiscal years 1999 through 2003 caused the *Unexpended Appropriations* and *Cumulative Results of Operations* balances on both the originally issued fiscal year 2003 Balance Sheet and Statement of Changes in Net Position to be materially overstated and understated, respectively. The component accounts making up the Statement of Changes in Net Position became increasingly overstated and understated each year until the accounting treatment was corrected for the entire 5-year period in the restated fiscal year 2003 financial statements. To provide more context for this improper accounting and subsequent restatements, we have added language to our report stating that in any 1 year, the recording error of H-1B account fund receipts may not have been material, but that the cumulative effect of the errors on the fiscal year 2003 Balance Sheet and Statement of Changes in Net Position was deemed material by NSF's IPA.

NSF's CFO also stated that OMB's March 2004 notification of the accounting error and need to follow the previously issued 1999 FMS guidance was communicated at the staff level and not formally through the CFO or the deputy CFO, which caused management delays in ensuring the appropriate level of attention to the issue. In our view, agency financial managers should have been aware of and implemented the new accounting guidance in 1999 when it was first issued by FMS, which would have avoided the need for the fiscal year 2003 restatements.

NSF's CFO further stated that the IPA's management letter findings that we reported had no actual bearing on the facts of the restatements and that NSF's management response to the IPA findings should be reflected for proper balance and context. As we noted in this report, NSF's IPA reported in a finding dealing with financial management practices that NSF did not have adequate internal controls to ensure that it provided accurate financial data which may have contributed to the recording

error that necessitated the restatements. To resolve this matter, the IPA generally recommended that NSF's Chief Financial Officer determine the appropriate skills and abilities needed in the DFM organizational structure to fulfill NSF's responsibilities for providing accurate financial data and implement steps to improve top level supervisory review procedures and practices. NSF management responded to the IPA's recommendations stating that they believed that normal supervisory controls were in place and that such controls provide the review procedures and practices recommended by the IPA. Nevertheless, NSF management stated that the IPA's recommendations would be incorporated in NSF's annual performance review process. It should be noted that, in providing its perspective on the IPA-identified issue and management's response, the OIG said the errors in NSF's financial statements and the untimely notification of the need to restate NSF's fiscal year 2003 financial statements demonstrated that management's controls over financial reporting were not adequate or appropriate.

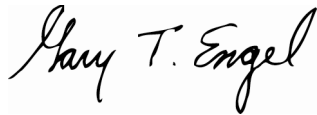
Finally, NSF's Inspector General concurred with our recommendation and stated that her office had instituted procedures to ensure that the IPA designed and performed audit steps to detect any H-1B account fund recording errors. We also received technical comments from NSF's Inspector General which we have incorporated as appropriate.

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Within 60 days of the date of this report, we would appreciate receiving a written statement on actions taken to address these recommendations.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Homeland Security and Governmental Affairs; the Subcommittee on Federal Financial Management, Government Information, and International Security, Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Government Reform; and the Subcommittee on Government Management, Finance and Accountability, House Committee on Government Reform. In addition, we are sending copies to the Fiscal Assistant Secretary of the Treasury and the Controller of OMB. This report is also available at no charge on GAO's Web site at www.gao.gov.

We appreciate the courtesy and cooperation extended to us by your staff throughout our work. We look forward to continuing to work with your offices to help improve financial management in the federal government. If you have any questions about the contents of this report, please contact me at (202) 512-3406 or engelg@gao.gov.

A handwritten signature in black ink that reads "Gary T. Engel". The signature is written in a cursive style with a large, prominent 'G' and 'E'.

Gary T. Engel
Director
Financial Management and Assurance

Enclosure I: Comments from the Chief Financial Officer, National Science Foundation

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

NATIONAL SCIENCE FOUNDATION
4201 WILSON BOULEVARD
ARLINGTON, VIRGINIA 22230

NOV 30 2005

Mr. Gary T. Engel
Director
Financial Management and Assurance
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Engel:

The National Science Foundation (NSF) received your draft report entitled *Financial Audit: Restatements to the National Science Foundation's Fiscal Year 2003 Financial Statements* dated November 3, 2005, and is providing our comments for your consideration. NSF appreciated the extension provided from November 18 to November 30 to provide an appropriate response.

In reviewing the draft, NSF believes the report should include additional information that will allow the reader to put the restatement in perspective and provide more balanced reporting. The restatement was due to the receipt of clarifying guidance on a long-standing accounting treatment of our unique H-1B Nonimmigrant Petitioner Fees funds as follows:

- Since inception, in 1999, of NSF's receipt of H-1B account funds NSF had recorded the funds as *other appropriations realized*. This accounting treatment was due to the funds being provided via a warrant and associated guidance related to recording warrants. NSF believed, until 2005, we were appropriately recording the receipt of the H-1B account funds. We received no information from our reporting oversight agencies until notified that the 1999 FMS guidance should be applied to our unique H-1B account funds.
- Clarifying guidance was communicated at the staff level and not formally through the CFO or the DCFO, which caused management delays in ensuring the appropriate level of attention to the issue.
- This was a one time accounting change to our H-1B funds that resulted in a reclassification and had no net effect on NSF's net position. The report should address that the change was not material to NSF's financial statements, and does not reflect an area that needs improvements or recommendations going forward as noted.

See comment 1.

See comment 1.

See comment 2.

See comment 1.

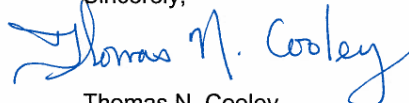
- NSF management is requesting that references to our management letter on pages 5, 10, 11 be removed from this report. The management letter finding referenced by the independent public accounting firm, KPMG, has no actual bearing on the facts of the restatement. However, if these references are retained we request that NSF's management response is also reflected for proper balance and context.

NSF previously provided this information to your staff in communications in May 2005. My staff also relayed our decision process and our resolution actions completed. We view this restatement as a simple clarification of a long-standing accounting treatment. NSF has a history of financial management excellence and we are proud of our track record as a recognized leader in financial reporting.

We appreciate the cooperation provided by your staff and the opportunity to respond to the draft report. We respectfully request your consideration of our comments.

If you have any questions concerning our response, please contact me at (703) 292-8200 or John Lynskey at (703) 292-8280.

Sincerely,



Thomas N. Cooley
Chief Financial Officer

The following are GAO's comments on the November 30, 2005, letter from the National Science Foundation's, Chief Financial Officer.

GAO Comments

1. See "Agency Comments and Our Evaluation" section.
2. It would be inappropriate to categorize the correction for a material error in NSF's financial statements as merely a reclassification. Although *Total Net Position* was unchanged, these two accounts represent distinct components of net position. Specifically, according to Statements of Federal Financial Accounting Concepts No. 2, *Entity and Display, Cumulative Results of Operations* generally includes the amounts accumulated over the years by an entity from its financing sources less its expenses and losses, while *Unexpended Appropriations* represents appropriations not yet obligated or expended, including undelivered orders.

Further, IPA officials told us that they considered the error to be material and concluded that NSF needed to restate the fiscal year 2003 financial statements and disclose in the comparative fiscal years 2004 and 2003 financial statements that certain fiscal year 2003 balances have been restated. The IPA's audit report states that NSF's fiscal year 2003 Balance Sheet and Statement of Changes in Net Position were restated. In addition, the notes to NSF's comparative fiscal years 2004 and 2003 financial statements includes a note disclosure titled "Restatement" that discusses the restatements.

Enclosure II: Comments from the Inspector General, National Science Foundation

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

NATIONAL SCIENCE FOUNDATION
4201 Wilson Boulevard
ARLINGTON, VIRGINIA 22230



November 30, 2005

Mr. Gary T. Engel
Director
Financial Management and Assurance
U.S. Government Accountability Office
Washington, DC 20548

Dear Mr. Engel,

Thank you for the opportunity to comment on your draft report entitled *Financial Audit: Restatements to the National Science Foundation's Fiscal Year 2003 Financial Statements*.

In your draft report you recommended that "NSF's Inspector General work with NSF's IPA so that audit procedures to detect any future material H-1 B Nonimmigrant Petitioner Fees (H-1B) account funds recording errors are fully and effectively implemented." We agree with the GAO report recommendation and that the H-1B fees were incorrectly reported in NSF's financial statements for fiscal years 1999 to 2003. For the most recent fiscal year 2005 financial statements, we instituted procedures to ensure that the IPA designed and performed audit steps to detect any H-1B account funds recording errors. However, we believe the report should include additional information that will allow the user to put the finding in perspective and provide more balanced reporting. Specifically:

- 1 The fact that the special fund receipts are not material to NSF's overall financing sources needs to be disclosed in the report. The report indicates that the \$216 million represents the cumulative amount received by NSF from 1999 through to 2003. However, in any one year, the special fund receipts were less than 2% - 5% of total funds received (1.2% of total appropriations received in fiscal year 2003).
- 2 The report should state that there was no effect on Net Position and that this error was a reclassification between components of Net Position. The funds were clearly accounted for in a responsible fashion, but were in the incorrect category of Net Position. There were adequate controls over these funds and total resources were fairly stated. The Cumulative Results of Operations ending balance for fiscal year 2003 increased by \$216 million (which includes \$186.2 million related to the

See comments 1 and 2.

See comments 1 and 2.

See comments 1 and 2.

See comment 3.

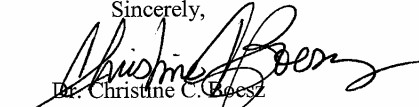
beginning balance) and the Unexpended Appropriations decreased by the same amount.

- 3 The report should clearly indicate that total net position was \$7.045 billion for fiscal year 2003, of which the special fund receipts represented 3.1 percent.
- 4 The statement that the IPA "...did not understand the proper accounting for these type of funds" is not accurate. Once these funds were identified, the IPA knew the appropriate accounting for the H-1B funds.

We have attached suggested changes to the report in order to address these issues.

We appreciate your consideration of our comments and if you have any questions, please contact me or Deborah Cureton, Associate Inspector General for Audit, on (703) 292-7100.

Sincerely,



Dr. Christine C. Boesz
Inspector General

Attachment

The following are GAO's comments on the November 30, 2005, letter from the National Science Foundation's Inspector General.

GAO Comments

1. See "Agency Comments and Our Evaluation" section.
2. See GAO comment 2 in Enclosure I.
3. We have clarified this point in our report by modifying the language to state that in our view, the IPA did not understand that the H-1B account funds are special funds, which are to be accounted for differently than certain other NSF receipts.

(198399)

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