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COMPTROLLER

FEB 19 2009

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board (FASAB)
441 G. Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548

Dear Ms. Payne:

The Department of Defense (DoD) comments on the Exposure Draft (ED) entitled: *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Federal Accounting Standards Board (FASB)* are attached. Overall, we agree with the proposals outlined in this ED. We appreciate the opportunity to comment on federal financial reporting by entities that use FASAB and FASB standards.

My point of contact is Ms. Audrea M. Nelson. She can be reached at (703) 602-0199 or by e-mail at Audrea.Nelson@osd.mil.

Sincerely,

David P. Smith
Acting Deputy Chief Financial Officer

Attachment:
As stated

U.S. Department of Defense (DoD)
Response to Request for Comments
FASAB Exposure Draft (ED): *The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

Hierarchy of Generally Accepted Accounting Principles

Q1. The Board proposes to incorporate the hierarchy of generally accepted accounting principles (GAAP) that currently resides in the professional auditing literature into the FASAB's authoritative literature.

Do you agree or disagree with the hierarchy presented in the Exposure Draft (reference pages 12-13 ED)? Please explain the reasons for your position in as much detail as possible.

A1. DoD agrees with the hierarchy as proposed and its incorporation within FASAB's authoritative literature. Including the hierarchy in the FASAB literature promotes: 1) ownership over its structure and applicability, and 2) FASAB's role in ensuring pronouncements and sources address accounting issues in a timely manner. Also, the proposed hierarchy should direct users to use their respective financial and accounting reporting guidance. For example, DoD Components would seek the DoD Financial Management Regulation (FMR) as the authoritative financial and reporting guidance to obtain additional financial and accounting reporting guidance not covered under the FASAB standards and interpretations.

Introducing the proposed hierarchy into FASAB's literature reemphasizes FASABs deliberative role and accountability which may be unclear if the following practices apply:

(a) Auditors, rather than management, maintain authority over GAAP sources to determine whether financial statements 'fairly' present the organization's financial position. Allowing the hierarchy to remain in the Auditing authoritative literature (Statement of Auditing Standards (SAS) 91) implies auditors determine the guidance hierarchy rather than management.

(b) GAAP hierarchy issued by other regulatory authorities could result in unclear guidance. For example, FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* resulted in significant concerns about the applicability of Statement 162 to federal financial reporting entities and financial statements preparation .

Application of Standards Issued by the Financial Accounting Standards Board

Q2. The Board proposes to regard general purpose financial reports prepared in conformity with accounting standards issued by the Financial Accounting Standards Board (FASB) as being in conformity with GAAP for those federal entities that have in the past issued such reports (reference pages 14-15 of the ED).

Do you agree or disagree with the Board's position? Please explain the reasons for your position in as much detail as possible.

A2. The DoD agrees with the Board's position that the general purpose financial reports prepared in conformity with accounting standards issued by the FASB are in conformity with GAAP for those federal entities that have in the past issued such reports.

Entities should be allowed to continue to apply the standards that more fairly present their financial position, results of operations, and cash flows with a focus on improving financial statements usefulness.

Inconsistent FASAB and FASB rulings or interpretations should not be issued. To avoid any conflicts, we recommend FASAB require the federal reporting entity include a reconciliation of the impact in applying different principles in its financial statement presentation.

Q3. The Board proposes to clarify that a federal entity that is preparing GAAP-based financial statements for the first time is required to implement FASAB standards unless the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards. While the application of standards issued by the FASB may be acceptable for a limited number of federal entities, those entities that have already implemented standards issued by FASAB should continue to apply the federal standards, as FASAB is the preferred method of reporting.

A3. The DoD agrees with the Board's position. A federal entity preparing GAAP-based financial statements for the first time should be required to implement FASAB standards **unless** the entity clearly demonstrates that the needs of its primary users would be best met through the application of FASB standards.

Within the DoD, Nonappropriated Fund Instrumentalities (NAFIs) entities such as the Army, Air Force Exchange Service (AAFES), and Navy Exchange Service, derive revenues from the sale of goods and services similar to commercial retailers and entrepreneurs. Considering the DoD NAFIs unique business operations, the NAFI financial transactions and financial statements are prepared in accordance with GAAP standards issued by FASB and DoD guidance.

Should DoD establish new operations under the NAFIs, all financial transactions should conform with GAAP and any newly prepared financial statements should continue to be prepared using FASB standards and DoD guidance. This practice would continue to enhance the DoD NAFI's (e.g., the AAFES) ability to borrow money from commercial entities based on financial statements prepared in accordance with GAAP/FASB standards and industry-based credit ratings.

Entities should be allowed to apply standards that more fairly present their financial position, results of operations, and cash flows. In addition, standards used should improve financial statements usefulness. However, any exceptions to FASAB reporting should be approved by the AICPA governing Board for federal entities (e.g., FASAB) and disclosed in the financial statements notes.

The FASAB should be the preferred reporting method unless FASB standards presents data more meaningful to the primary financial statement users.

Application to the Legislative and Judicial Branches

The Board believes that the FASAB standards, including the guidance listed under Q2 and outlined at pages 14-15 of the ED relative to applicable use of FASAB vs FASB standards, would be appropriate for use by both the Legislative Judicial Branches should they prepare GAAP-based financial statements.

The DoD agrees that the FASAB standards, including the guidance covered in Questions 2 related to the application of FASAB vs. FASB standards, would be appropriate for the Legislative and Judicial Branches of government provided they are required to prepare GAAP-based financial statements.

Separate Project on Reporting By Federal Entities That Primarily Apply Standards Issued By the FASB

The Board would greatly appreciate your responses to the following questions to aid in the Board's future deliberations on its companion project on reporting by federal entities that primarily apply standards issued by the FASB. Further information on this project may be found in paragraphs A7 through A16 of Appendix A: Basis for Conclusions and on the FASAB website at http://www.fasab.gov/projectsgaap.html.

Q4. The Board has tentatively decided that no federal entities will be required to convert to FASAB standards for their stand-alone general purpose financial reports at this time; however, the Board is considering whether additional reporting may be required in order to meet the objectives of federal financial reporting (e.g., budgetary reporting, cost accounting, management's discussion and analysis).

What FASAB reporting requirements are you aware of that would complement or enhance current reporting by federal entities following FASB standards (see paragraphs A8 through A12 of Appendix A: Basis for Conclusions)? Please explain the reasons for your position in as much detail as possible.

A4. The DoD agrees with the Board's position that no federal entities should be required to convert to FASAB standards for preparing stand-alone general purpose financial reports.

Currently, DoD entities are required to report "Required Supplemental Information (RSI)" with the Annual Financial Statements. This RSI contains information on General Property, Plant, and Equipment Deferred Maintenance (Real Property) and Heritage Assets and Stewardship Land. This supplemental reporting is not a FASAB requirement but provides additional information that may complement FASAB and FASB financial reporting.

If the Board decides a more structured or uniformed approach be taken for all reports, DoD suggests one reporting standard be defined, adopted, and provided to the Department of Treasury (DoT) for the consolidated financial report of the United States Government.

Q5. As noted in the previous question, the Board has tentatively decided that no federal entities will be required to convert to FASAB standards for their stand-alone general purpose financial reports at this time; however, the Board is considering whether information provided by these entities to a parent agency or the U.S. Department of the Treasury for the consolidated financial report (CFR) of the U.S. Government (USG) should conform with accounting and reporting principles issued by the FASAB where there are material differences between the two sources (see paragraphs A13 through A15 of Appendix A: Basis for Conclusions).

Do you agree or disagree that the information provided for consolidated financial reports should conform to FASAB accounting and reporting standards? Please explain the reasons for your position in as much detail as possible.

A5. DoD agrees that the information provided for consolidated financial reports should conform to FASAB accounting and reporting standards where there are material differences between the two sources.

As noted in A4, one common reporting standard should be defined, adopted, and provided to the DoT for the consolidated financial report of the USG. However, this concept should not apply to non-appropriated fund entities such as the Nonappropriated Fund Instrumentalities (NAFIs) in DoD or other federal entities that derive funds from the sale of goods or services rather than by means of a direct appropriation of funds from the DoT. Consolidated financial reports prepared by these business entities should

remain consistent with FASB standards or related guidelines adopted (e.g., IFRS guidelines).

Prior to implementing this proposal, the FASAB should further assess the material differences that currently exists in reporting parent/child relationship in the CFR of the USG.

Q6. The Board requests input relative to Federal Entities converting from using FASB standards to International Financial Reporting Standards (IFRS).

Do you have a current opinion on whether federal entities that report in conformance with FASB standards should be permitted to convert to International Financial Reporting Standards (IFRS), given the discussions regarding whether public companies should use IFRS (see paragraph A16 of Appendix A: Basis for Conclusions)? Please explain the reasons for your position in as much detail as possible.

A6. The DoD does not agree that federal entities that report in conformance with FASB standards should convert to IFRS unless these standards are more conducive to fairly presenting the financial position, results of operations, and cash flows and will result in improved financial statements usefulness.

Overall, should the FASB and International Accounting Standards Board (IASB) agree to converge international and U.S. generally accepted accounting principles, the DoD believes federal entities that prepare financial statements based on FASB standards should convert to IFRS when all other US public companies/industries are required to apply or convert to such standards.

The Board should assess FASAB, FASB, and IFRS before making a final decision to allow any federal entity to convert to IFRS. The assessment may be conducted via a 'pilot' program using IFRS vs. FASAB/ FASB standards.