

On behalf of Carolyn Davis, Assistant Inspector General for Audit Policy and Oversight, attached are the DoD Office of Inspector General comments on the FASAB Exposure Draft "Estimating the Historical Cost of General property, Plant, and Equipment, Amending Statements of Federal Financial Accounting Standards 6 and 23". Thank you for the opportunity to comment on the Exposure Draft. Any questions please contact Carolyn Davis at (703) 604-8877.

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**DOD Office of Inspector General Comments on FASAB Exposure Draft
“Estimating Historical Cost of General Property, Plant, and Equipment,
Amending SFFAS 6 & 23”**

Overall Comment

The concept “reasonable estimate” is broad and subjective, and could be misleading in determining the asset value if there is no historical data to rely on. Additionally, this concept would make it very difficult for auditors to conduct an audit without a tremendous emphasis on guesswork. By allowing estimates, without establishing a definitive end date, organizations may take advantage and never provide factual data to support their numbers.

However, if the Board approves this concept, other accounting concepts such as consistency and conservatism should be considered to justify the reasonable estimation. These concepts should enhance asset value comparability in different accounting periods and minimize asset over estimation.

Answers to Request for Comments on Specific Topics

Q1. Do you agree or disagree that reasonably estimating the original transaction data historical cost and accumulated depreciation of G-PP&E upon initial capitalization is appropriate for entities that have not previously reported G-PP&E on their entity financial reports and for those who have not previously prepared financial reports, but who may be required or elect to do so in the future? Please provide the rationale for your answer.

Answer – We agree with allowing estimates of costs and depreciation of G-PP&E upon initial capitalization for entities that have not previously reported G-PP&E on their entity financial reports and for those who have not previously prepared financial reports, but may be required to in the future. We believe this will be a benefit to the entity because if an entity was not required to keep track of G-PP&E, most likely they will not have accurate historical information. Lacking historical records makes verifying historical costs difficult which questions the reliability of the information. Currently, entities are expending resources to generate historical cost data for G-PP&E based on inadequate accounting data. By letting the entity estimate the initial capitalization of G-PP&E, they have time to implement the new procedures and be prepared to report the following year. The use of estimates is a cost effective approach to getting historical costs. Using other information reflecting amounts expended or deriving from current replacement costs will help these entities reach a reasonable historical cost.

Q2. Do you agree or disagree that initial capitalization of G-PP&E based on reasonable estimation methods as provided in the SFFAS 23, as amended, is acceptable on a continuing basis? Please provide the rationale for your answer.

Answer – We do not agree with the use of reasonable estimates on a continuing basis. The use of estimates should not replace historical cost supported by original transactional data. Allowing Federal entities to estimate the historical costs of their G-PP&E on a continuing basis gives them an incentive to discard historical records instead of using these documents as support for the historical cost of the assets. The National Archives and Records Administration has published guidance addressing the retention of Federal records, thus Federal entities are required to retain their records in accordance with specific schedules. As a result, Federal entities should comply with the retention schedules the National Archives and Records Administration has published and retain supporting documents to support the historical cost of its assets. Furthermore allowing Federal entities to revise the historical cost of its assets on a continuing basis defies the point of using the historical costs to report an entity's assets. Constantly revising the estimate of the historical cost of assets will cause the Federal entities to constantly restate their financial statements.

Q3. Do you agree with the proposed amendment to SFFAS 6 that allows the use of reasonable estimates of the original transaction data historical cost and accumulated depreciation for G-PP&E? Please provide the rationale for your answer.

Answer – We neither agree nor disagree with the question. On the one hand, with the use of reasonable estimates of the original transaction data historical cost and accumulated depreciation for G-PP&E should be used only under specific circumstances. Because if estimates can be used when the entity deems it “impractical” to use historical data, the entity would not have motivation to improve their systems to make obtaining accurate historical data possible. On the other hand, we agree with the proposed amendment to SFFAS No. 6. We think entities should be able to use estimation methods, especially if lacking documentation. While historical cost is preferable, estimates are necessary in some cases. Using estimation methods will probably provide more timely historical costs than manually generating it.

Federal entities that have not previously reported G-PP&E on their entity financial reports and for the entities who have not previously prepared financial reports, but who may be required or elect to do so in the future should be allowed to use

reasonable estimates to report the historical cost of their assets upon initial capitalization of the G-PP&E. Once the entity either starts preparing financial statements or determines that it may have to do so, the entity should retain documentation that supports the cost of its assets and use that information to report the historical cost of the asset. Allowing Federal entities to revise their estimates of the historical cost of assets contradicts the purpose of using historical costs in the first place and puts into question the reliability of the financial statements.

Q4. Do you believe that the use of reasonable estimates to value G-PP&E should be permitted at any time (i.e., an open-ended option) or only permitted through a definitive end date (i.e., a date-certain option)? Please explain your preference.

Answer – We believe the use of reasonable estimates should be permitted only through a definitive end date. Given that G-PP&E be reported at historical costs, based on supporting documentation, entities should be working towards creating systems, processes, and internal controls to be able to do that. The use of estimates should be used only on G-PP&E items that do not have historical costs supported by original transactional data. Entities should keep all supporting documentation and original transactional data for new G-PP&E purchased in accordance with SFFAS No. 23. As G-PP&E items with estimated historical costs retire, the G-PP&E items remaining will be those with historical costs based on original transactional data, which is how G-PP&E should be reported on the financial statements.

Additionally, Statement of Federal Financial Accounting Concepts 1: *Objectives of Federal Financial Reporting*, states that the recommendation of accounting standards “necessarily involve[s] judgments about the costs and benefits of producing more information or of reporting it differently” [para. 151, 4th sentence]. SFFAC 1 continues by stating that accounting standards can have many different effects. Those effects include “the activities of agency accountants and the auditors who review reports prepared by those accountants” and an “influence [on] which physical assets are under accounting control and the extent of work the auditor does to provide assurance about those assets” [para. 152, 1st-3rd sentences]. An accounting standard that allows the continuing use of estimates, however reasonable, could result in some federal agencies continuing the use of estimates for an indefinite length of time [para. A20, 1st sentence].

Further, the exposure draft indicates that “initial application of this standard by an entity previously reporting G-PP&E should be treated as a correction of an error” [para. 16, 1st sentence]. According to SFFAS 21: *Reporting Correction of Errors and Changes in Accounting Principles*, “errors in financial statements 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” [para. 10, 1st sentence]. Presumably, the exposure draft is considering the reporting of G-PP&E as correcting an oversight of facts in existence when the financial statements were prepared. Allowing the continuing use of estimates, especially if it would result in some federal agencies not transitioning to actual G-PP&E historical cost, would continue to overlook facts in existence when preparing financial statements.

Q5. Do you agree with the views expressed in the Alternate View in the Basis for Conclusions? Please provide the rationale for your answer.

Answer – We agree with the view expressed in the Alternate View in the Basis for Conclusions. When cost information was not maintained the use of estimates would be an appropriate necessity to report G-PP&E acquired. Additionally, the use of a date-certain option would prevent agencies from continuing to use estimates indefinitely. Without an actual deadline of when to setup systems to capture actual acquisition costs, some entities will push off this responsibility. Granted, some reporting entities will still delay implementing this requirement; however, an actual timeline should lessen the number that does push off this necessity. Perhaps, it would be appropriate to address entities with a large volume of G-PP&E on a case-by-case basis to grant them additional time to implement the system.

Q6. Do you believe additional clarification is needed on the use of reasonable estimates when valuing the historical cost of G-PP&E? Please explain what areas require additional clarification and provide the rationale for your answer.

Answer – Yes, additional clarification is needed on the use of reasonable estimates when valuing the historical cost of G-PP&E. Paragraph A10- A13 is unclear about when estimates can be used. The way the paragraph reads, is that the agency gets to interpret what they consider impractical. We believe that the Board should consider identifying more requirements that are specific.

Furthermore, the Board should consider explaining those estimates developed using the estimating methods outlined in SFFAS 23 as reasonable. The standard should state that Federal entities could only use reasonable estimates

for historical cost of G-PP&E upon initial capitalization if they have not previously reported G-PP&E on their entity financial reports and for those who have not previously prepared financial reports, but may be required to in the future. In addition, the standard should state that once the entity starts preparing financial statements or determines that it may have to do so, it should report the historical cost its G-PP&E assets and retain transaction records that support the historical cost of the asset. If the Board does not add clarification to the standards, each Federal entity will implement the standards in a different way. This will make it difficult to prepare comparative and /or consolidated financial statements for the Federal government. Additionally, this will present a challenge to the audit community in determining if the entities are reporting assets in accordance with Generally Accepted Accounting Principles thus making it difficult to express an opinion on the financial statements.