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COMPTROLLER

JAN 30 2009

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

Dear Ms. Payne:

The Department of Defense's (DoD) comments on the Exposure Draft, *Estimating the Historical Cost of General Property, Plant, and Equipment, Amending Statements of Federal Financial Accounting Standards 6 and 23* are attached. Overall, we agree with the exposure draft. We believe the proposed changes will permit reasonable estimates of historical cost now and in the future that will improve financial information reported to the public.

My point of contact is Ms. Donjette L. Gilmore. She can be reached at (703) 697-0537.

Sincerely,

David P. Smith
Acting, Deputy Chief Financial Officer

Attachment
As stated

U.S. Department of Defense
Response to Request for Comments
FASAB Exposure Draft: *Estimating the Historical Cost of General Property, Plant, and Equipment -- Amending Statements of Federal Financial Accounting Standards 6 and 23.*

Q1. The Board proposes that reasonable estimates may be used upon initial capitalization by entities implementing G-PP&E accounting for the first time. See paragraphs 7 and A9.

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.

A1. DoD agrees with this proposal. This is a practical response to the challenges faced by some agencies as they work to establish sound financial systems and controls. The use of estimates is a more cost effective means of implementing new requirements than reconstructing actual historical amounts based on inadequate or non-existent accounting records. DoD has one general comment. The Executive Summary clearly presents the guidance intentions, therefore, we suggest this guidance be included in the Standards section along with the proposed paragraph revisions in SFFAS 6 and 23.

Q2. The Board proposes that initial capitalization of G-PP&E based on reasonable estimation methods as provided in the SFFAS 23, as amended, be considered acceptable on a continuing basis. See SFFAS 23 amended paragraphs [10.] – [13A.].

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.

A2. DoD agrees that capitalization of G-PP&E based on reasonable estimation methods as provided in the SFFAS 23, as amended, is acceptable on a continuing basis.

Additional guidance is needed to confirm that estimates are allowed for those entities that have been reporting General Property, Plant, and Equipment (G-PP&E) assets in financial reports but are unable to validate the historical acquisition cost of those capitalized assets due to the lack of historical documentation and system deficiencies. In these cases, estimations of the historical cost of property already capitalized may be necessary.

This would be the case when existing property has been recognized in the financial statements, but the historical cost records are not reliable, resulting in a qualification or disclaimer. It appears that the intent of this document is to permit use of estimates for this type of existing property. However, selected statements in the document imply that use of estimations for historical cost applies only when initially capitalizing the underlying property. For example, the proposed revision to SFFAS 23, paragraph 12, states, "When *establishing* the historical cost of G-PP&E…." Additional clarification of this point would be helpful.

Q3. The Board proposes to allow the use of reasonable estimates of the original transaction data historical cost and accumulated depreciation for G-PP&E. See paragraphs 7 and A10 – A13A.

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.

A3. DoD agrees 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. However, the DoD requests specific language be added to the standard to communicate that there is no preference among the three methodologies to prevent the interpretation that the estimates have to be based on a hierarchy of the methodologies provided in the standard. This could be accomplished by adding "or" after each methodology in paragraph 40 of SFFAS 6 or by inclusion of a sentence that the options are presented in no particular order. The additional language would resolve any confusion between agency and auditors in their review/audit of financial statements for the purpose of rendering an opinion.

Q4. The Board proposes that reasonable estimates be permitted at any time. One member has expressed concern regarding the open-ended time period for the use of estimates. See paragraphs 7 [SFFAS 6 amended paragraph 40], A5., A14., A15., A19. and A20

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.

A4. DoD agrees that reasonable estimates to value G-PP&E should be permitted at any time (i.e., an open-ended opinion). DoD believes that this will enable Federal agencies to focus accounting resources on long-term, system based solutions. There is wide acknowledgement of both the value and the long-term cost-effectiveness of capturing financial data at the transaction level. The ongoing availability of the use of estimates supports the goal of establishing reliable and cost-effective financial systems.

Agencies should be encouraged to move towards systems that will support transaction based valuation of assets since the ability to link specific transaction values with individual assets demonstrates that an Agency has effective internal controls in place to support financial reporting. However, reporting accurate financial information to the public is also important and should be facilitated while transaction-based systems are developed.

Further, DoD believes that this guidance should be placed as an amendment to SFFAS No. 6 rather than as an amendment to SFFAS No. 23, since the guidance applies to all G-PP&E, not just that property formerly classified as National Defense PP&E.

Q5. As noted above, one member, Mr. James Patton, has expressed views different from the majority view regarding this proposal. See paragraphs A18 through A20.

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

A5. DoD **does not** agree with the Alternative View. As noted in response to Question 4, cost estimations and other cost finding techniques are more costly over time than effective financial systems that capture real-time transaction data. The ability to estimate historical cost data when necessary will not detract from the long-term goal. Rather, this flexibility will enable agencies to focus accounting resources on long-term solutions.

The Board's position is that reasonable estimates should be open-ended. The alternative view sets a time limit which is inconsistent with the Board's view. Further, the alternative view states concerns that without substantial constraints some federal agencies will defer and delay the creation of systems for a considerable period of time. DoD places a high priority on establishing and maintaining high-quality financial management systems.

Q6. The Board has proposed clarifications regarding when reasonable estimates are permitted.

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.

A6. DoD believes that clarification would be helpful in the following areas.

First, as noted in DoD's response to Question 4, the location of the guidance may create confusion. The estimation instructions, including guidance for estimating the in-service date, are currently proposed as amendments to SFFAS 23, *Eliminating the Category*

National Defense Property, Plant, and Equipment. However, since this guidance applies to all G-PP&E we suggest that the guidance be placed as an amendment to SFFAS 6.

Second, as discussed in DoD's response to Question 2, estimations of historical cost for property already capitalized may be necessary. This should be expressly permitted.

Third, DoD believes that additional clarification of "other reasonable methods" is needed. The amendments to SFFAS No. 23 indicate that estimates of historical cost may be based on information such as, but not limited to, budget, appropriation, engineering documents, contracts, or other reports reflecting amounts to be expensed. DoD suggests that one or more bullets be added to SFFAS 6 to specifically permit these sources of information.

In addition, guidance on how to determine whether an estimate is reasonable should be added either in the Standards or the Basis for Conclusions. This is likely an area where disagreements between auditors and Agencies will arise. For example, the guidance could state that the estimated value of an asset might vary depending on whether it was established using budgets (the original estimate submitted to Congress), appropriations (the amount provided by Congress in response to the budget request), contracts (the amount obligated for the items), or other reports reflecting amounts to be expensed (or reflecting amounts expensed). These alternate methods would not be expected to result in identical estimated values. The FASAB exposure draft indicates that for Federal financial reporting purposes all of the referenced types of information would be acceptable for establishing asset values. This point should be emphasized.

Fourth, to improve consistent application of the Standards, the Department of Defense recommends that the Board include examples in the Basis for Conclusion. The examples might specify that estimating values based on the Congressional appropriation provided to acquire a group of assets or estimating the values using reports that track expenditures against these appropriations would meet the "reasonableness" criteria included in the standard and would be acceptable. DoD provides the following examples of information that could be presented in the Basis for Conclusions.

> The estimated value of an asset might vary depending on whether it was established using budgets (the original estimate submitted to Congress), appropriations (the amount provided by Congress in response to the budget request), contracts (the amount obligated for the items), or other reports reflecting amounts to be expensed (or reflecting amounts expensed). For Federal financial reporting purposes, any of these sources of information would be acceptable for establishing asset values.
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> Federal entities evolved a detailed process for developing budgets, tracking appropriated funds, recognizing obligations and tracking expenditures against appropriations. Throughout this process various internal and external reviews are

performed to ensure that the amounts requested and ultimately appropriated are reasonable. Further, all Federal Agencies provide reports to Congress on the status of expenditures by appropriation line. This control ensures that Agency expenditures do not exceed the related appropriations and this level of oversight and continuing reporting is somewhat unique to the Federal reporting environment. This control process supports FASAB's decision to accept budget and appropriation data for establishing the historical cost of assets.

A problem that Agencies frequently must address when using accounting system data is systems may not associate program expenditures with individual assets. In this situation, estimates must be applied to program level total cost to determine what should be reported for individual assets. As long as these estimated allocations are based on data included in budgets, appropriations, or contracts, the associated estimates should be deemed reasonable.

Additional considerations when determining the reasonableness of an estimate might include:

- Ensuring the total amount capitalized does not exceed the amount appropriated,
- Determining the extent to which the estimates and related financial reporting meet the needs of internal and external users, and,
- Ensuring the efforts required to value the assets are commensurate with the usefulness of the related financial data.

Fifth, the Department of Defense recommends that additional guidance be added to the Basis for Conclusions indicating that use of estimates should be considered as a secondary approach, used if historical cost data cannot be obtained and maintained cost effectively. Establishing information systems, internal controls, and business practices for obtaining actual transaction value costs for accounting and reporting of G-PP&E should be encouraged.