ACCOUNTING AND AUDIT POLICY COMMITTEE MEETING
FINAL MINUTES
January 20, 2011

The meeting was convened at 1:00 PM in room 7C13 of the GAO Building, 441 G St., NW, Washington, DC.

ADMINISTRATIVE MATTERS

- **Attendance**

Present: Ms. Payne (chairperson), Ms. Carey, Mr. Bragg, Ms. Julie Edwards (substituting for Mr. Rebich), Ms. Gilmore, Ms. Kearney, Mr. Marchowsky, and Mr. Synowiec.
FASAB/AAPC project director, Ms. Valentine and general counsel, Mr. Dymond were present at the meeting.

Absent: Mr. Brewer and Mr. Rebich

- **Minutes**

The minutes of November 18, 2010 were previously approved as final, having been circulated by E-mail to members.

- **Administrative**

Ms. Payne noted that both Ms. Gilmore and Mr. Brewer had just been re-appointed to a second 3-year term on the AAPC.

PROJECT MATTERS

Project Agenda

MD&A

Ms. Valentine gave a brief overview of the background of the project. She first noted that FASAB staff member Rich Fontenrose had been managing the work of the task force; however he retired from federal service on 9/30. She stated that staff worked with Ms. Kearney, MD&A task force chair, and the task force to finalize the guide. The draft guide provides examples of "best practices" from current federal MD&A; this report is intended to help preparers of federal MD&As achieve the objectives of the standards. Ms. Kearney continued and noted that the guide highlights good examples currently in practice and is meant to address issues of MD&A presentation. The guide is to provide useful information and how to best format that information.

Ms. Valentine asked the Committee for comments on the draft guide, specifically focusing on whether the guide is extensive enough and fully covers the objectives of the standards. Ms. Payne noted that one of the decision factors for the guide is what vehicle should be used to issue the guide. As a best practices guide it does not flesh out GAAP and does not provide implementation guidance as options. She noted that staff is looking at issuing best

practices guide as a report from the AAPC; as such it would not go through the public comment process.
Mr. Synowiec asked if the Guide could also include examples of the following areas:

- High-risk,
- Trend data greater than 2 years (both performance and financial), and
- Improper payments.

Mr. Dymond and Mr. Bragg both noted that the narrative before each example should indicate how that example aligns with the MD&A requirements outlined previously.

Ms. Payne asked members to read through the draft guide again and provide any additional significant comments to staff by February 11, 2011. Staff's plan is to have a revised draft for review and discussion at the March AAPC meeting.

General PP&E

Ms. Gilmore gave an update on the current work of the general PP&E (G-PP&E) task force. She noted that the task force was very active in its work and was progressing towards providing implementation guidance on several G-PP&E issues. The Acquisition subgroup was working on three implementation issues: estimating historical cost (currently out for comment as an exposure draft), capitalization thresholds, and capital leases. The Disposal subgroup's third project on triggering events for the disposal of equipment was currently out for comment as an exposure draft. The Use subgroup is still working the contractor financing payments issue (being presented today as a draft discussion paper) and is beginning discussions on both the deployed assets and group/composite depreciation issues. The Record retention subgroup recommendations have now been folded into the estimating historical cost guide and will move forward as recommendations to NARA once the ED comment period has ended and final deliberations have taken place for final issuance of the estimating historical cost guidance. She also noted that the task force will begin its work on the new project on G-PP&E cost accounting issues presented by the Agenda committee at the September 2010 meeting.

- **Update on the two Exposure Drafts (EDs) – "Implementation Guide on SFFAS 35, Estimating the Historical Cost of G-PP&E" and "Implementation Guide on the Accounting for the Disposal of G-PP&E"**

Ms. Valentine noted that the EDs were released for comment on December 10, 2010 and the comment period will end on February 11, 2011. She noted that thus far, only one comment letter for each ED had been received.

- **Review of Discussion Paper: Construction Work in Process and Contract Financing Payments**

Ms. Valentine gave an overview of the latest issue prepared by the Use Subgroup of the AAPC G-PP&E Task Force. The subgroup has met several times over the last year discussing this issue. She noted that the objective of today's discussion is to review a draft discussion paper on the use of the "Construction Work in Process" (CWIP) account as it relates to the contract vehicle, "Contract Financing Payments" (CFP), in the acquisition of G-PP&E capital assets. Currently in the Department of Defense (DoD) financial statements, certain contract financing payments are reported as Advances and Prepayments under the title "Outstanding Contract Financing Payments" in the Other Assets line item on the Balance Sheet. Audits completed by the Office of the Inspector General, DoD (OIG, DoD), have taken exception to this accounting treatment and have recommended that contract financing payments be recorded as Construction Work in Progress (CWIP) and presented in that manner on the financial statements.

Ms. Valentine noted that the paper is setup in a question/answer format and then opened the discussion up to the members. Ms. Payne noted that in her read of the discussion paper her primary comment was to ensure that as many related issues as possible be resolved through this guidance. Due to the long history of this issue it is important to fully resolve all related issues. She also suggested that the subgroup provide guidance on entities analyzing the contractor costs at the time of payment to determine how the costs should be allocated (i.e., CWIP, inventory, expense, advance, etc.).

Mr. Synowiec asked if the Standard General Ledger (SGL) addressed how CWIP should be accounted for. Ms. Payne noted that SGL definition described what costs should be in a CWIP account but not what the account represents, which is appropriate for an SGL account. [SGL CWIP account definition: " includes costs of direct labor, direct material, and overhead incurred in the construction of general property, plant, and equipment (except information technology software) for which the agency will be accountable. Upon completion, these costs will be transferred to the proper capital asset account as the acquisition cost of the item."]

Mr. Synowiec asked if the guidance should allow CFP to just be grouped into one asset account with its own characteristics until the G-PP&E is ready to be placed in service. He asked if this option would satisfy the concerns of the OIG. Ms. Carey noted that this option was suggested during the subgroup discussions, but was not viewed as a viable option. She commented that from an audit standpoint, such an account would not allow for the assurance of the accuracy and completeness of the PP&E account. Ms. Kearney asked if there was any different treatment of the asset if it is classified as an other asset vs. CWIP (a PP&E account) or if cost would be affected (e.g., depreciation). Ms. Valentine responded that the asset account treatment would not be different and that cost would not be affected from the standpoint of depreciation. Ms. Kearney stated that it would be a matter of having PP&E "whole."

Ms. Kearney also wanted to further explore the option of one unique account to record all CFP. She stressed that she was sympathetic to an entity having to perform a lot of work on a valuation method of an asset account and whether the cost of precisely valuing PP&E was worth the benefit of the valuation. Ms. Payne asked if some of the CFP included costs that would be expensed, such as training costs. Ms. Gilmore responded that some of those costs could be expense items. Ms. Carey responded that it would vary depending on the contract. Ms. Payne stated that the Board does not normally base its standards on the possible significance of a cost. In practice, that can be done through management's materiality assessment. The standards are not flexible based on the ease or difficulty of implementation but do permit estimates and application to only material items. Ms. Carey noted that SFFAS 35, *Estimating the Historical Cost of G-PP&E*, should assist with estimating the costs to be allocated.

Ms. Payne asked Ms. Gilmore and Ms. Carey if they both were comfortable the recommendations presented were the best options developed by the subgroup. They both agreed and also noted that adding DFAS to the subgroup now would be beneficial given that DoD's financial statement preparation has now been delegated to DFAS. Ms. Payne suggested that the guidance could possibly develop factors to assist the entity to assess the level of possible risk of a contract with significant expense-type costs and making a judgment call as to when a contract may only have immaterial expense-type costs and allocate all of the CFP to CWIP.

Ms. Kearney asked if this issue was isolated to DoD. Ms. Carey noted that when the subgroup discussions began other agencies where involved, but soon dropped off because they did not have the same concerns as DoD and most had processes in place to allocate CFP costs into the appropriate "buckets" including CWIP. The subgroup also talked with other agencies about how they accounted for CFP related CWIP and it appeared that the others were allocating the costs to CWIP when deemed appropriate. Ms. Gilmore acknowledged that some of DoD's difficulties with this issue lie in their system problems and the contract coding involved in allocating those costs. Ms. Carey noted that DoD is currently recording progress payments as advances.

Ms. Kearney noted that in one of the slides it stated that there were certain limitations to the rights of the property paid using CFP and therefore did not allow DoD to record CFP as CWIP. She asked what was meant by that statement. Ms. Valentine explained that DoD's interpretation was that CFP related to property being acquired from a contractor was not legally the property of DoD until the asset was completed and DoD had accepted the property. Mr. Dymond noted that from a legal standpoint the government's rights to property contracted for can be interpreted differently depending on the jurisdiction involved. Ms. Payne noted that in developing accounting standards FASAB looks at the economic perspective over the legal perspective (i.e., substance over form) to determine the proper accounting treatment. However, if there are significant legal implications they should be disclosed in the notes to the financial statements.

Mr. Dymond asked if this issue was specific to the federal government. Ms. Valentine noted that large commercial entities use the account CWIP to allocate the cost of constructed assets, but there was no indication of the use of advance payments to contractors as opposed to progress payments.

Ms. Carey stated that financial management should be an important premise behind how these costs are reported. She emphasized that if all CFP were just reported in one account and not allocated appropriately at the time of payment, managing those costs, as well as auditing them, would be challenging. Mr. Synowiec asked what the recommendations of the DOD OIG were on this issue. Ms. Carey noted that the OIG recommendations centered on the appropriate accounting for the CFP costs (i.e., advances vs. progress payments). Ms. Payne also suggested that the subgroup talk again to some of the non-DoD agencies originally involved in the discussion to ask them about some of the tools and methodologies they use to allocate CFP payments. Ms. Kearney stressed that it is important for the eventual guidance to not disrupt or cause unnecessary changes in accounting for those entities currently interpreting the standards appropriately.

Ms. Valentine assured the Committee that the subgroup would further explore their options and suggestions and make the necessary revisions to the discussion paper. Some of the specific areas to consider are:

- Developing factors to allocate the CFP costs into the appropriate accounts at the time the CFP payments are made and considering the cost benefit factors as it relates to the allocation of those costs.
- The discussion guide should take a broad enough perspective in order to capture any related issues.
- Stress the use of estimating methodologies (as outlined in SFFAS 35).
- Allow the subgroup to further develop those other implementation areas noted in the discussion paper as educational sections.

- **Agenda Committee Report**

None

- **New Business**

Ms. Gilmore asked Ms. Payne if the FASAB had any intentions of re-evaluating the current standards on internal use software (IUS). Ms. Payne noted that FASAB staff held a roundtable a few months ago with several preparers from the federal financial community to discuss issues surrounding IUS. In a similar issue to the CFP/CWIP issue – cost allocation, one option suggested was to expense all IUS cost as opposed to allocating the costs between capitalization and expensing. She also mentioned that the FASAB will be evaluating its technical agenda at its February meeting and IUS will be presented as possible topic to be added as a project.

The meeting adjourned at 2:20 pm.