KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Telephone +1 212 758 9700
Fax +1 212 758 9819
kpmg.com

March 5, 2018

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548

RE: Proposed Statement of Federal Financial Accounting Standards, *Classified Activities*

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Financial Accounting Standards, *Classified Activities* (the Exposure Draft or ED). We support the Board's efforts to address the challenges posed by the financial statement presentation of classified activities.

We believe there are certain aspects of the ED that are unclear, which will make implementation difficult. Therefore we provide the following comments segregated between "key issues" and "other comments" for the Board's consideration.

Key issues

Link to Underlying Concepts

Statement of Federal Financial Accounting Concepts (SFFAC) 8, *Federal Financial Reporting*, describes overall federal financial reporting objectives. Specifically, paragraph 16b of SFFAC 8 describes the objective of reporting operating performance as follows:

> "Operating Performance. Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities."

The objective of the guidance proposed in the ED appears to be contrary to this objective for reasons that we understand and that we believe most financial statement users will understand as well. However, we believe the Board should be explicit about the fact that the ED's proposed guidance represents an exception to the objective of reporting operating performance as described in SFFAC 8 that is being undertaken for reasons of national security.

Complexity

The brevity of the standard implies a simplicity in its application. As we considered several possible scenarios under this proposal, we realized that each masking decision leads to other decisions that take the preparer further away from the stated objectives in SFFAC 8. We provide an example in Appendix 1 to illustrate a possible chain of decisions. We encourage the Board to include an illustrative example in the final standard.

In light of the potential complexity, we encourage the Board to reconsider whether a simple omission of classified information from the general purpose federal financial report (GPFFR) with disclosure that certain financial statement presentations and/or disclosures have been omitted to protect classified information would be more true to the reporting objectives of SFFAC 8 than the potentially numerous modifications of financial statement presentations and omissions of disclosures/required supplementary information.

Disclosure

We believe that component reporting entities should be required to disclose that modifications of presentations and omissions of disclosures were made. We recognize that the Board has put forward this proposal in the interest of national security; however, allowing entities to modify presentation and disclosures of the GPFFR without alerting the user impedes a user's ability to assess how much weight to place on reported results in evaluating an entity's operating performance.

We recommend that the Board replace paragraphs 10 and 11 with the following: "When financial statement presentations have been modified, or required disclosures have been omitted, to protect classified information, component reporting entities (CREs) should disclose that such modifications and/or omissions occurred. The disclosure should state that the financial statement presentations have been omitted and/or related disclosures have been modified to protect classified information."

Paragraph A11 indicates that classified (not publicly available) GPFFR will conform to U.S. GAAP without the application of this standard. However, unclassified (publicly available) GPFFR also will conform to U.S. GAAP with the application of this standard. We are concerned that an entity could present two dramatically different GPFFRs that conform to U.S. GAAP yet not disclose why they are different.

Future Interpretations

The forward to the FASAB Handbook indicates that "Interpretations clarify original meaning, add definitions, and provide other guidance for existing SFFAS." Previous interpretations have been linked to specific standards. If the Board's intent is for future interpretations to modify the proposed requirements of paragraph 6 of the ED, we are unclear how such interpretations could override a requirement of a standard. We suggest further consideration be given to whether additional standards are needed in place of interpretations.

Appendix A indicates that future interpretations could be classified. It is not clear how management of each federal entity will be able to assert that their GPFFR have been prepared in accordance with GAAP when management does not have access to all of GAAP.

Other Comments

Paragraph 6

1. Paragraph 6 states: "Therefore, unclassified reports should be presented in a manner that protects the classified information." We are concerned that the inclusion of this statement as a GAAP requirement is, in essence, asking the auditor to opine on whether the entity protected its classified information from disclosure, which seems beyond the scope of forming an opinion

about whether the financial statements are free from material misstatement. Perhaps this sentence would be more appropriate in the introduction.

2. Paragraph 6 discusses changes to presentation and disclosure. We recommend that the Board clarify that these modifications do not extend to the underlying accounting or valuation. For example, if Asset X is presented as Asset Y in the financial statements, Asset X retains the accounting for the type of asset it is.
3. We recognize that required supplementary stewardship information (RSSI) may be eliminated as a result of one of the Board's ongoing projects, but we recommend that until such determination is made, the Board amend paragraph 6 to address whether RSSI may or may not be modified.
4. We recommend that the Board insert "classified" as follows (added text underlined): "…to protect the classified information if the modification…"

Paragraphs 10 and 11

If the Board does not require disclosure and continues with these paragraphs:

1. It is unclear if there was an intended difference between the modifications referenced in these two paragraphs. Paragraph 10 only refers to presentations while paragraph 11 covers all modifications. If both paragraphs were intended to cover all modifications, we do not believe paragraph 11 is necessary because the use of "may choose" in paragraph 10 already provides an entity the options of including or omitting a disclosure that the presentation of financial information was modified to prevent disclosure of classified information.
2. The use of "consistently" in paragraph 10 is unclear. We recommend that the Board amend this paragraph to clarify the meaning. For example, is "consistently" referring to consistency of disclosure between years for a given entity, or is it referring to consistency of disclosure among all entities' GPFFRs?
3. We recommend that the Board revise these paragraphs as follows to clarify the applicability of the disclosure (added text underlined): "component reporting entities with classified information may".

Paragraphs 9 and 12

We do not believe these paragraphs are necessary.

Paragraph 9. We do not believe it is necessary to indicate that management must maintain supporting books and records. Making that statement in this standard could indicate that such records are not required when not mentioned in other standards.

Paragraph 12. We believe this paragraph is duplicative of paragraph 6b. If the Board intended a meaning distinct from paragraph 6b, we recommend that the language be clarified.

Footnotes

1. Footnote 2: It is unclear as to whether this ED requires approval from OMB for the exclusion of a CRE. If so, it is also unclear whether the receiving CRE also needs approval for its inclusion.

2. Footnote 3: It is unclear what an “associating organization” is. It is not defined in SFFAS 47.
3. Footnote 4: The paragraph references should be 6 through 8.

If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or aenelson@kpmg.com.

Sincerely,

KPMG LLP

Appendix 1

Application of Paragraph 6

Entity A has classified inventory in the amount of $100 million, and unclassified general property, plant and equipment (PP&E) of $200 million.

Decision No. 1 – *Financial statement presentation*

Entity A decides to modify its financial statement presentation following the proposed guidance in paragraph 6a of the ED. It decides to present the balance of classified inventory in the general PP&E balance sheet line item because that is already a large financial statement balance:

Current GAAP (SFFAS 3, 6):		*Exposure Draft:*	
Inventory	$100,000,000		
General PP&E	$200,000,000	General PP&E	$300,000,000

Decision No. 2 – *Inventory disclosures*

After electing to modify its financial statement presentation, Entity A evaluates the disclosures for inventory.

Entity A decides to omit the inventory disclosures following the proposed guidance in paragraph 6b of the ED because Entity A no longer presents an inventory balance in its GPFFR.

Decision No. 3 – *General PP&E disclosures*

After electing to modify its financial statement presentation and omit the inventory disclosures, Entity A evaluates the required disclosures for general PP&E. These disclosures include, among other items:

- Cost, accumulated depreciation and net book value by major class
- Estimated useful lives

Entity A determines that it will be challenging to have a list of balances by major class that reconciles to the total financial statement line item. So Entity A needs to decide whether to omit some or all of the required general PP&E disclosures.

Decision No. 4 – *General PP&E RSI*

After making the above decisions Entity A evaluates the RSI related to deferred maintenance and repair for general PP&E. This decision will be influenced by the decision on the general PP&E disclosure.