

From: Mainguy, Timothy (US - Arlington)
Sent: Wednesday, May 01, 2013 4:59 PM
To: FASAB
Cc: Gorman, Louella (US - Arlington)
Subject: Deloitte Comment Letter on Proposed FASAB Technical Release - Implementation Guidance for G-PPE Cost Allocation

Good afternoon Ms. Payne,

Enclosed is Deloitte's response with comments to the subject exposure draft of proposed Federal Financial Accounting Technical Release, entitled *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*. Our response letter includes two appendices. In Appendix A, we respond to each of the questions posed by the AAPC in the proposed Technical Release's Questions for Respondents. Appendix B contains our editorial suggestions for the proposed Technical Release.

We appreciate the opportunity to comment on the proposed Technical Release. If you have any questions concerning our comments or require additional information, please contact Louella Gorman at +1 571 814 7340 or by email at lgorman@deloitte.com

Please confirm receipt of our letter.

Kind Regards,

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May 1, 2013

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RE: Proposed FASAB Technical Release: Implementation Guidance for General Property,
Plant, and Equipment Cost Accumulation, Assignment, and Allocation

Dear Ms. Payne:

Deloitte & Touche LLP is pleased to comment on the Accounting and Auditing Policy Committee (AAPC) of the Federal Accounting Standards Advisory Board's (FASAB or the Board's) exposure draft of a proposed Federal Financial Accounting Technical Release, entitled *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment, and Allocation* (the "proposed Technical Release").

We support the FASAB's objective to promote improved understanding of the flexibility in the application of FASAB Statements of Federal Financial Accounting Standards as they relate to (1) recognition requirements related to costs incurred during the G-PP&E lifecycle, (2) the concept of a cost accumulation decision framework, and (3) management's role in applying the cost accumulation, assignment, and allocation decision framework.

This letter includes two appendices. In Appendix A, we respond to each of the questions posed by the AAPC in the proposed Technical Release's Questions for Respondents. Appendix B contains our editorial suggestions for the proposed Technical Release.

We appreciate the opportunity to comment on the proposed Technical Release. If you have any questions concerning our comments or require additional information, please contact Louella Gorman at +1 571 814 7340.

Yours truly,

Deloitte & Touche LLP

cc: Louella Gorman, Partner

APPENDIX A
Deloitte & Touche LLP
Responses to Proposed Technical Release's Questions for Respondents

Q1. Do you agree or disagree with the concept that the current accounting standards provide entity management with both the responsibility and flexibility to design generally accepted accounting principles (GAAP) compliant policies and processes that align with the respective entity's operational environment (Paragraphs 3 – 4, 19 – 20, and 25)? Please provide the rationale for your answer.

We agree with the concept that the current accounting standards provide entity management with the responsibility and flexibility to design GAAP-compliant policies and processes that align with the respective entity's operational environment. Specifically, one of the core objectives of federal financial reporting is to provide information to federal program managers (in addition to external users). This implies strongly that the entity should select and implement financial reporting policies and processes which produce information that is inherently relevant to its internal needs and environment. In fact, the Board, in SFFAC 1, paragraph 25, stated that "The FASAB, on the other hand, considers the information needs of both *internal* and external users."

However, the tailoring of GAAP-compliant policies should be tempered by the need to meet the basic characteristic of comparability. As stated in SFFAC 1, paragraph 164 "Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions *or organizations* rather than by the mere selection of different alternatives in accounting procedures or practices." Accordingly, the Board should consider providing cautionary guidance emphasizing that organizations should be mindful of comparability when selecting GAAP-compliant policies and procedures, and avoid selecting policies which result in significant differences in financial reporting between similar organizations which are merely attributable to alternative accounting procedures or practices, rather than underlying transactions or organizational characteristics.

Q2. Do you agree or disagree that an entity's mission and operational environment impact the financial management information needs of the entity's stakeholders (Paragraph 9)? Please provide the rationale for your answer.

We agree that the financial management information produced by an entity should reflect the entity's mission and operational environment, as detailed in our response to Q1 above. As federal program managers are a primary user of financial reports and require relevant financial management information, entities should generally select and design accounting policies and procedures which produce information that reflects the mission and operations of the entity. Useful information for decision making purposes should be based on the mission, objectives and strategy of the entity. Additionally, the materiality of indirect costs, alongside cost-benefit analyses, must be considered when determining the needs of the entity's stakeholders. The wording and accompanying example in paragraph 9 that notes: "An entity's revenue source...significantly impacts the types of, and level of, cost detail required to be allocated to end assets" indicates the importance of materiality concerns within paragraphs 9 and 10.

Paragraph 9 does not currently reference Statement of Federal Financial Accounting Standards 35, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23 (SFFAS 35), in which the Board clarified and expanded on the ability to leverage a wide variety of information to establish reasonable, supportable estimates for PP&E asset values. Reasonable estimates of value for PP&E assets under SFFAS 35 often include more broadly-based estimates and allocations of indirect costs due to a lack of detailed information to support detailed cost assignments. The Board should consider making reference to the concepts invoked in SFFAS 35 related to materiality and reasonable estimates and allocations to promote consistency and further support the statements made in this paragraph. The Board may also refer to Statement of Federal Financial Accounting Standard 4 (SFFAS 4), paragraph 10, which states that “The full costs of resources that directly or indirectly contribute to the production of outputs should be assigned to outputs through costing methodologies or cost finding techniques that are *most appropriate to the segment’s operating environment* and should be followed consistently.”

Further, we believe that more granularity in actual indirect cost information would generally be indicated when the materiality of the indirect costs to be allocated is significant when compared to the financial statements presented as a whole, and when the amount of costs assigned to G-PP&E under more broad systems of allocation would differ substantially from those assigned using a more granular methodology.

Q3. If you agree with “Q2” above, do you agree or disagree with management’s use of the three principles identified in Paragraph 10 to determine their stakeholder’s financial management information needs? Please provide the rationale for your answer.

We agree with the overall concepts of the three principles presented in Paragraph 10 of the exposure draft. These principles reflect key aspects of the qualitative characteristics of effective financial reporting information detailed in Chapter 6 of SFFAC 1, and the consideration of balancing costs and benefits detailed in Chapter 5 of SFFAC 1. However, some readers may be confused by the use of different terminology in the principles described in Paragraph 10 as compared to the qualitative characteristics described in SFFAC 1. The Board should consider placing these principles explicitly into the context of overall federal financial reporting objectives, user information needs, cost-benefit constraints, and characteristics of effective financial reporting as laid out in its conceptual framework. Alternately, this connection could be more completely explained in the Basis for Conclusions, or with the proposed changes we suggest in the editorial section of this comment letter.

In addition, the use of the phrase “Cost-benefit of establishing and executing *intricate* cost assignment processes, methods and tools” may be unnecessarily prejudicial against the use of so-called “intricate” cost assignment processes. We suggest the Board consider rephrasing this principle or simply deleting the word “intricate” (suggestion made in editorial section) to avoid prejudicial over-selection towards simplified cost assignment methodologies by users of the framework. The Board should exercise caution in providing cost-benefit as a primary

consideration in selection and application of cost allocation methodologies, as some users may see this as an overriding concern to the important principles of relevance and precision. We suggest the insertion of clarifying language in paragraph 10 similar to that appearing in SFFAS 4, paragraph 142-143 (suggestion made in editorial section), which states: “Throughout the discussions of this section, it is stated that a cost accumulation and assignment method would be used when it is economically feasible. A method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users...However, they are preferable because they produce more reliable cost information than cost allocations.”

Q4. Do you agree or disagree with how direct costs are characterized as it relates to G-PP&E in paragraph 15? Please provide the rationale for your answer.

We agree with the characterization of direct costs based on the referenced citations to SFFAS 4 and Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant and Equipment (SFFAS 6).

Q5. Do you agree or disagree with how indirect costs are characterized as it relates to G-PP&E in paragraph 16? Please provide the rationale for your answer.

We agree with the characterization of indirect costs based on the referenced citations to SFFAS 6. As the proposed implementation guidance is primarily concerned with methods for accumulating and allocating indirect production costs, it may be helpful for readers if the Board were to provide additional guidance for determining whether an indirect cost contributes “to bring the G-PP&E to a form and location suitable for its intended use.” Specifically, there may be confusion among users of this guidance regarding the difference between administrative overhead which should not be capitalized and other, potentially similar, costs which should be allocated to G-PP&E and capitalized.

In providing guidance on the definition of capitalizable indirect production costs, it may be helpful to review standards set by the Financial Accounting Standards Board (FASB) on this topic. FASB Accounting Standards Codification (ASC) 360-970 Property, Plant and Equipment Real Estate – General can be referenced in order to provide additional guidance regarding the definition of indirect project costs. ASC 360-970-25-3 states “Indirect project costs that relate to several projects shall be capitalized and allocated to the projects to which the costs relate.” That standard spells out in its glossary definition of indirect project costs that such costs must be “clearly related” to the project under construction. Based on this guidance, it may be helpful to users if the Board defines capitalizable indirect costs to be those costs which ***can be clearly***

related to cost objects which include G-PP&E and relate to activities necessary to bring the G-PP&E to a form and location suitable for its intended use.

An additional definition for Indirect Project Costs that may be helpful for readers is found in the FASB Accounting Standards Codification's Master Glossary:

"Costs incurred after the acquisition of the property, such as construction administration (for example, the costs associated with a field office at a project site and the administrative personnel that staff the office), legal fees, and various office costs, that clearly relate to projects under development or construction. Examples of office costs that may be considered indirect project costs are cost accounting, design, and other departments providing services that are clearly related to real estate projects."

Although we believe that a principles-based standard is essential to the success of this guidance, examples are very helpful to help reinforce users' understanding in regards to this particular topic.

Q6. Do you agree or disagree with the financial reporting of certain indirect costs as unassigned costs on the Statement of Net Cost as described in Paragraph 22? Please provide the rationale for your answer.

We agree that management should consider general management and administrative support costs when identifying the costs to bring G-PP&E to a form and location suitable for its intended use. As noted in our response to Q5 above and per SFFAS 4 paragraphs 90 and 91, we believe that only indirect costs which are clearly related to, or can be specifically identified with, a G-PP&E cost object should be considered for capitalization. To the extent that the Board clarifies the definition of capitalizable indirect project costs per our suggestions in response to Q5, paragraph 22 of the proposed Technical Release may be unnecessary, since it appears that the Board's intention in including this paragraph is to further define indirect costs which are not capitalizable. Paragraph 16 of the proposed Technical Release also defines indirect costs and specifies their treatment, which appears to answer the question posed in paragraph 21 as to how indirect costs should be applied in considering the acquisition cost of G-PPE. Further, the paragraph, as written, is somewhat difficult to follow, overly general (e.g. "there will be differences in both methodologies and levels of allocation"), and unconnected with surrounding text. Accordingly, we recommend that the Board consider removing paragraph 22 and incorporating a reference to paragraph 16 of the proposed Technical Release as specified in the attached suggested editorial changes in Appendix B.

Q7. Do you agree or disagree with the financial reporting of non-production costs as described in Paragraph 24? Please provide the rationale for your answer.

We agree. The costs specified in the example are unusual and, if capitalized, would create significant variances. Such variances may limit the usefulness of the cost information.

Q8. Do you agree or disagree with the approach (e.g., decision points, application of GAAP, etc.) as outlined in the Decision Framework Flowchart (Appendix C)? Please provide the rationale for your answer.

We agree with the overall approach as outlined in the Decision Framework Flowchart, consistent with our responses in the previous sections above. We would suggest certain changes to align with our previous recommendations as detailed in the editorial section in Appendix B. Primarily, we suggest that the framework incorporate a clear definition stating that indirect project costs are clearly related to cost objects which include G-PP&E and relate to activities necessary to bring the G-PP&E to a form and location suitable for its intended use. We also suggest that limited examples of “Indirect Project Costs” be provided to clarify the types of costs which should be considered for capitalization, as detailed in our response to Q5 above.

APPENDIX B
Deloitte & Touche LLP
Editorial Comments

This appendix contains our suggested editorial changes to the proposed Statement. (Added text is underlined and deleted text is ~~struck out~~.)

Paragraph 10

~~10. The following three principles may be used by management to determine their stakeholder's financial management information needs:~~

- ~~a) Relevance/usefulness of information (both to internal and external stakeholders);~~
- ~~b) Level of precision (e.g., materiality) needed to properly manage and report costs; and~~
- ~~c) Cost-benefit of establishing and executing intricate cost assignment processes, methods, and tools.~~

10. The following principles may be used by management in conjunction with the definitions provided in SFFAC 1 to determine their stakeholder's financial management information needs:

- a) Relevance of information (logical relationship must exist between the information provided and the purpose for which it is needed, both to internal and external stakeholders)
- b) Reliability (e.g., nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions)
- c) Timeliness of information (e.g., benefits of more timely information can be more useful than precise information that takes longer to produce.) Note: a method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users. However, more precise methods are preferable, to the extent they are economically feasible, because they produce more reliable cost information.

OR

10. The following three principles may be used by management to determine their stakeholder's financial management information needs:

- a) Relevance/usefulness of information (both to internal and external stakeholders);
- b) Level of precision (e.g., materiality) needed to properly manage and report costs; and
- c) Cost-benefit of establishing and executing intricate cost assignment processes, methods, and tools. Note: a method is economically feasible if the benefits resulting from

implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users. However, more precise methods are preferable, to the extent they are economically feasible, because they produce more reliable cost information.

Paragraph 16

Indirect costs are costs that cannot be identified specifically with or traced to a given cost object in an economically feasible way [SFFAS 6, Glossary]. [For purposes of this guidance “cost object” is an item or items of G-PP&E.] The example of indirect costs noted in SFFAS 6 Paragraph 26 is indirect production costs (for assets produced or constructed). The indirect costs ~~identified as costs incurred to~~ which clearly relate to, or can be specifically identified with, cost objects which include G-PP&E and relate to activities necessary to “bring the G-PP&E to a form and location suitable for its intended use” should be accumulated, assigned or allocated to the cost of the G-PP&E item(s). If the accumulated indirect costs ~~are not identified as costs incurred to~~ do not clearly relate to, or cannot be specifically identified with, cost objects which include G-PP&E and relate to activities necessary to “bring the G-PP&E to a form and location suitable for its intended use” (for example, administrative overheads that do not contribute to bring the G-PP&E item to a form and location suitable for its intended use), then the costs should be expensed.

Paragraph 22

~~A2. SFFAS 4, paragraph 92, explains that: “A reporting entity and its responsibility segments may incur general management and administrative support costs that cannot be traced, assigned, or allocated to segments and their outputs. These unassigned costs are part of the organization costs, and they should be reported on the entity’s financial statements (such as the Statement of Net Costs) as costs not assigned to programs.” Management should consider general management and administrative support costs when identifying the costs to bring the G-PP&E to a form and location suitable for its intended use. Entities may incur indirect costs that cannot be reasonably allocated to programs, segments, or outputs including G-PP&E acquisition. Indirect production costs only apply to G-PP&E produced or constructed. When entities are allocating general management and administrative support costs to G-PP&E, there will be differences in both methodologies and levels of allocation.~~

Indirect costs which clearly relate to, or can be specifically identified with, cost objects which include G-PP&E and relate to activities necessary to bring the G-PP&E to a form and location suitable for its intended use should be accumulated, assigned or allocated to the cost of the G-PP&E item(s). If the indirect costs do not clearly relate to, or cannot be specifically identified with, cost objects which include G-PP&E and relate to activities necessary to bring the G-PP&E to a form and location suitable for its intended use (for example, administrative overheads benefitting several programs that do not contribute to bring the G-PP&E item to a form and location suitable for its intended use), then the costs should be expensed in the period incurred.

Appendix C: Decision Framework Flowchart

See changes suggested in Paragraph 10 above for page 1 of the flowchart as well as in the box which contains the text beginning with “Assign these costs to the item(s) or activities (outputs) they produce by:”

In the box containing the text “Was the indirect cost incurred for cost objects which include G-PP&E and needed to bring the G-PP&E to a form and location suitable for intended use?” (See SFFAS 6, par. 26):

Was the indirect cost incurred for cost objects which include G-PP&E and clearly relate to, or can be specifically identified with the cost objects which include G-PP&E, and was indirect cost related to activities needed to bring the G-PP&E to a form and location suitable for intended use? (See SFFAS 6, par. 26)