Federal Accounting Standards Advisory Board

June 1, 2017

Memorandum

MEMBER ACTIONS REQUESTED:
• Respond to staff question (p.4) by June 12th • Prepare to approve staff recommendation or provide alternatives

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: New Proposed Flexibilities for Department of Defense– **Tab I** [1]

OBJECTIVE

The objective of this session is to consider a request from the Department of Defense (DoD) related to DoD Intragovernmental activities/costs. Specifically, DoD requested the assistance of the Federal Accounting Standards Advisory Board (FASAB) to provide guidance related to certain intragovernmental transactions – including transactions and balances among DoD components - that DoD performs.

DoD provided example scenarios (see ***Appendix B of the Draft Exposure Draft***) from across the DoD entities. In some of these cases, SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* would require calculation of imputed cost when there is no reimbursement or reimbursement at less than full cost. Given the complexities of the DoD's organization and the many standalone audits, the application of SFFAS 4 would be challenging and costly.

BRIEFING MATERIAL

The staff analysis is attached along with questions for the Board on page 4. You may electronically access the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

Attachment 1- *Draft Exposure Draft*

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

441 G Street NW, Mailstop 6K17V, Washington, DC 20548 ♦ (202) 512-7350 ♦ fax (202) 512-7366

MEMBER FEEDBACK

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at batchelorm@fasab.gov with a cc to paynew@fasab.gov.

BACKGROUND

The DoD Implementation Guidance Request Project was initiated in December 2014 because the Department of Defense (DoD) identified areas of concern for the FASAB's consideration. FASAB agreed to assist DoD by providing practical guidance to resolve long-standing issues identified by DoD. The Board agreed the primary objectives will be to resolve the issues within the framework of existing accounting standards and where necessary provide the appropriate guidance to address remaining issues.

STAFF ANALYSIS

The Department of Defense (DoD) requested guidance related to certain intragovernmental transactions that DoD performs throughout execution of its mission. DoD provided example scenarios (see ***Appendix B of the Draft Exposure Draft***) from across the DoD entities.

SFFAS 4, *Managerial Cost Accounting Standards and Concepts* likely would require calculation of imputed cost when there is no reimbursement or reimbursement at less than full cost. Given the complexities of the DoD's organization and the many standalone DoD component audits, the application of SFFAS 4 has been challenging and will be costly as well as pose an audit obstacle.

While DoD is continuing its efforts to comply with the Chief Financial Officers Act of 1990 (as amended), they continue to note certain challenges in meeting existing standards. As noted above, SFFAS 4 is one of such existing standards through its goals to associate elements of financial statements such as assets and costs with the related operating activities. That association may be different than the legal associations established by elected officials through laws establishing budgetary and management practices.

Staff notes that there are many complex relationships among the components of DoD, such as the military services, as well as between DoD and other related departments such as the US Coast Guard. The effort to assign elements based on the current standards and concepts is especially challenging. Many specialized components provide services to other components of DoD. In addition, law may prohibit one component from owning assets; instead another component owns the assets and hosts the component using the assets. In such cases, there may or may not be a financial transaction related to use of the assets.

Considering these factors, staff suggests certain flexibilities be permitted to classify transactions among and between components of the Department of Defense and other departments. In addition, staff suggests limiting the scope of imputed costs under SFFAS 4.

Draft Proposed Flexibilities for DoD:

The following flexibilities are proposed for component reporting entities, other than those conducting business-type activities that are consolidated in the Department of Defense financial statements:

1. Inter-entity, including intra-departmental, costs addressed in SFFAS 4 (including Interpretation 6), except for the following two items, need not be imputed.

   a. Costs of employee benefits addressed in par. 93 of SFFAS 4 and par. 74-76 of SFFAS 5
   b. Treasury Judgment Fund Transactions addressed in Interpretation 2

2. Concepts state that an asset would be recognized by the component entity having a comprehensive relationship to it. This may be different than the component reporting entity that has legal title to or funded the asset. There should be a process to ensure all assets of the DoD are assigned to a component reporting entity. Assets may be assigned to component reporting entities on any basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, or using the asset in its operations.
3. SFFAS 5, *Accounting for Liabilities of the Federal Government,* defines a liability as "a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS 6, *Accounting for Property, Plant, and Equipment,* provides guidance for recognizing liabilities for cleanup costs and SFFAS 5 provides guidance for recognizing liabilities from government-related events such as cleanup of environmental damage. Within DoD, one component reporting entity may operate the item of general PP&E that resulted in a cleanup cost liability but another component reporting entity may settle the liability. With the exception of cleanup costs intended to be covered by rates charged in a business-type activity, DoD may assign cleanup cost liabilities to component reporting entities on any basis. For example, the cleanup cost liability may be assigned to the component reporting entity that reports the asset or to another entity. A business-type activity required or expected to recover cleanup costs through rates should recognize those cleanup costs per SFFASs 5 and 6.

4. The option to classify intragovernmental transactions as transfers-out (SFFAS 7, par. 70) or as a cost. This flexibility is necessary because it can be difficult to determine whether an exchange has occurred between the federal components, departments or agencies involved. Notwithstanding this flexibility, the two parties should attempt to agree to the nature of the transaction so that treatment of the transaction is parallel for purposes of elimination. For example, a transaction classified as a transfer-out by the paying entity ideally would be classified as a transfer-in by the receiving entity.

Staff Recommendation:

Staff recommends that the above flexibilities be provided in a Statement of Federal Financial Accounting Standards (SFFAS). The flexibilities would be restricted through the scope paragraphs of the SFFAS so that it only applies to the Department of Defense (DoD) and its component reporting entities presenting general purpose federal financial reports.

Questions for the Board:

Does the Board agree with the staff recommendation to issue a Statement that would provide flexibilities to the Department of Defense? (If the Board agrees, staff has presented a Draft for the Board's initial thoughts and feedback.)

Or alternatively, does the Board prefer another course of action?

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at batchelorm@fasab.gov with a cc to paynew@fasab.gov.

NEXT STEPS

If the Board agrees with the staff recommendation, staff will present an updated Draft Exposure Draft (based on the feedback received) at the August 2017 Board meeting.

ATTACHMENT - 1

Federal Accounting Standards Advisory Board

SELECTED PROVISIONS APPLICABLE TO THE DEPARTMENT OF DEFENSE

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by [date 90 days after issuance]

Month day, year

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Accounting standards are typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standards with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *Selected Provisions Applicable to the Department of Defense,* are requested. Specific questions for your consideration appear on page 4 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by DUE DATE.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

The Board's rules of procedure provide one or more public hearings may be held on any exposure draft. No hearing has yet been scheduled for this exposure draft. or A public hearing has been scheduled at 9:00 AM on Month Day, Year, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.

Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

D. Scott Showalter

Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

The Department of Defense (DoD) is continuing its efforts to comply with the Chief Financial Officers Act of 1990 (as amended). Existing standards strive to associate elements of financial statements such as assets and costs with the related operating activities. That association may differ from the legal associations established by elected officials through laws establishing budgetary and management practices.

Because of the complex relationships among the components of DoD, such as the military services, as well as between DoD and other related departments such as the US Coast Guard, the effort to assign elements based on the current standards and concepts is especially challenging. Many specialized components provide services to other components of DoD. In addition, law may prohibit one component from owning assets; instead another component owns the assets and hosts the component using the assets. In such cases, there may or may not be a financial transaction related to use of the assets.

The Board is proposing to allow flexibility in assigning elements to component reporting entities within the Department. In addition, the Board is proposing flexibility in classifying transactions among and between components of the Department of Defense and other departments. The following flexibilities are provided to component reporting entities, other than those conducting business-type activities, consolidated in the Department of Defense financial statements:

1. Inter-entity, including intra-departmental, costs addressed in Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standards and Concepts* (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4*), except for the following two items, need not be imputed
   a. Costs of employee benefits addressed in par. 93 of SFFAS 4 and par. 74-76 of SFFAS 5, *Accounting for Liabilities of the Federal Government*
   b. Treasury Judgment Fund Transactions addressed in Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*
2. Concepts state that an asset would be recognized by the component entity having a comprehensive relationship to it. This may be different than the component reporting entity that has legal title to or funded the asset. There should be a process to ensure all assets of the DoD are assigned to a component reporting entity. Assets may be assigned to component reporting entities on any basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, or using the asset in its operations.
3. SFFAS 5, *Accounting for Liabilities of the Federal Government,* defines a liability as "a probable future outflow or other sacrifice of resources as a result of past transactions or events. SFFAS 6, *Accounting for Property, Plant, and Equipment,* provides guidance for recognizing liabilities for cleanup costs and SFFAS 5 provides guidance for recognizing liabilities from government-related events such as cleanup of environmental damage. Within DoD, one component reporting entity may operate the item of general PP&E that resulted in a cleanup cost liability but another component reporting entity may settle the

liability. With the exception of cleanup costs intended to be covered by rates charged in a business-type activity,[1] DoD may assign cleanup cost liabilities to component reporting entities on any basis. For example, the cleanup cost liability may be assigned to the component reporting entity that reports the asset or to another entity.

4. The option to classify intragovernmental transactions as transfers-out (SFFAS 7, par. 70) or as a cost. This flexibility is necessary because it can be difficult to determine whether an exchange has occurred between the federal components, departments or agencies involved. Notwithstanding this flexibility, the two parties should attempt to agree to the nature of the transaction so that treatment of the transaction is parallel for purposes of elimination. For example, a transaction classified as a transfer-out by the paying entity ideally would be classified as a transfer-in by the receiving entity.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

Federal financial reporting should support the assessment of operating performance. To this end, SFFAS 4, *Managerial Cost Accounting*, provides that:

> **Reporting entities should report the full costs of outputs** in general purpose financial reports. The full cost of an output produced by a responsibility segment is the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities. (Emphasis added.)

Existing concepts and standards support this goal. However, the Department of Defense comprises many component reporting entities and it is not always possible to distinguish the outputs of one reporting entity from another reporting entity. Instead, DoD components – and some related agencies such as the US Coast Guard – share responsibility for the nation's defense.

This proposal facilitates reporting based on the complex decisions made by elected officials regarding funding flows, specialized functions (such as security or transportation), and managerial responsibilities (such as property management). Given the complex responsibilities and relationships among the components charged with national defense, this proposal will result in less costly financial reporting by allowing DoD to align reporting with established funding and governance structures.

The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

[1] A business-type activity required or expected to recover cleanup costs through rates should recognize those cleanup costs per SFFASs 5 and 6.

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QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at http://www.fasab.gov/documents-for-comment/. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

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

All responses are requested by [insert date].

Q1. The Board is proposing certain provisions for the Department of Defense (DoD) and its component reporting entities, such as flexibility in in assigning elements to component reporting entities within the DoD and flexibility in classifying transactions among and between components of the DoD and other departments. The flexibilities are being provided because the DoD comprises many component reporting entities where it may not always be possible to distinguish the outputs of one reporting entity from another reporting entity. Considering the complex structures and shared responsibility for the nation’s defense among the components within the DoD, this proposal will result in less costly financial reporting by allowing DoD to align reporting with established funding and governance structures.

Do you agree or disagree with the Board’s proposed provisions for the Department of Defense (DoD) and its component reporting entities? Please provide the rationale for your answers.

Do you agree or disagree with the specific provisions (see paragraphs 2-5 of this Statement) permitted by this Statement? Please provide the rationale for your answers.

Q2. The Board proposes to require component reporting entities that apply this Statement to provide information describing significant services received for which no cost is recognized and policies used to assign significant assets and liabilities, if applicable.

Do you agree or disagree with the component reporting entity disclosure requirements (see paragraph 6 of this Statement)? Please provide the rationale for your answers.

PROPOSED STANDARDS

SCOPE

1. This Statement applies to the Department of Defense (DoD) and its component reporting entities presenting general purpose federal financial reports in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

PROVISIONS

2. Inter-entity costs addressed in SFFAS 4, *Managerial Cost Accounting Standards and Concepts,* (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4*) need not be imputed unless the costs relate to a business-type activity as defined in SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraph 23, footnote 27. The inter-entity costs exception does not apply to:

    a. Costs of employee benefits addressed in par. 93 of SFFAS 4 and par. 74-76 of SFFAS 5, *Accounting for Liabilities of the Federal Government*

    b. Treasury Judgment Fund Transactions addressed in Interpretation 2, *Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS 4 and SFFAS 5*

3. Assets may be assigned to component reporting entities on any basis. There should be a process to ensure all assets of the DoD are assigned to a component reporting entity. Individual standards addressing asset recognition and related reporting may not provide detailed guidance useful to resolving the question of what entity should report the asset as well as related amounts such as deferred maintenance and repair. Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, paragraphs 10 through 16 provide concepts for associating elements with an entity. Based on these concepts, an asset would be recognized by the component reporting entity having a comprehensive relationship to it. If there is no component entity having a comprehensive relationship, then the asset should be reported by the component reporting entity most responsible for managing it. Notwithstanding these concepts, so long as the DoD consolidated financial report includes all the appropriate assets, the DoD may assign assets to component reporting entities on any basis. For example, an asset may be assigned to the component reporting entity holding legal title, funding the asset, or using the asset in its operations.

4. With the exception of liabilities covered in rates charged by business-type activities[2], liabilities for cleanup costs (SFFAS 6, par. 85-111) and government-related events (SFFAS

[2] The liability for cleanup costs may be assigned to the component reporting entity that reports the asset or to another entity.

5, par. 27-29) may be assigned to component reporting entities on any basis so long as all such liabilities are assigned.

5. The option to classify intragovernmental transactions as transfers-out on the statement of changes in net position or as a cost on the statement of net cost. SFFAS 7, par. 70 describes transfers-out as follows “financing outflows may result from transfers of the reporting entity’s assets to other Government entities or from exchange revenues earned by the entity but required to be transferred to the General Fund or another Government entity.” Paragraph 74 further provides that: “An intragovernmental transfer of cash or of another capitalized asset without reimbursement changes the resources available to both the receiving entity and the transferring entity. The receiving entity should recognize a transfer-in as an additional financing source in its result of operations for the period. Similarly, the transferring entity should recognize the transfer-out as a decrease in its result of operations.” In practice, it can be difficult to determine whether reimbursement occurred. Notwithstanding this flexibility, the two parties should attempt to agree to the nature of the transaction so that treatment of the transaction is parallel for purposes of elimination. For example, a transaction classified as a transfer-out by the paying entity ideally would be classified as a transfer-in by the receiving entity.

DISCLOSURE REQUIREMENTS

COMPONENT REPORTING ENTITY DISCLOSURES

6. Each component reporting entity that applies this Statement should provide the following, if applicable:

    a. A concise statement describing significant services received for which no cost is recognized based on SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, (including Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS 4*.)

    b. The policies used to assign significant assets and liabilities based on the provisions of this Statement.

EFFECTIVE DATE

7. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In 2014, the Department of Defense (DoD) requested FASAB's consideration of a project after identifying several areas of concern and audit challenges. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, by providing the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is issued in response to DoD's request for guidance related to certain intragovernmental transactions – including transactions and balances among DoD components - that DoD performs throughout execution of its mission.

Scope

A3. The guidance will provide certain flexibilities classifying transactions among and between components of the DoD and other departments. The flexibilities are restricted through the scope paragraphs of the Statement by reference that it only applies to the DoD and its component reporting entities presenting general purpose federal financial reports.

A4. SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board,* paragraphs 6-7 provides that reporting entities may apply an accounting principle established within categories (a)-(d) for an analogous transaction or event on the basis of its substance.[3]

A5. Therefore, although not said explicitly, this Statement may be applied by reporting entities facing analogous circumstances. For example, there may be a non-DoD reporting entity assigned national defense responsibilities for which any output cannot be clearly related to a single reporting entity. Instead, complex relationships among many reporting entities have

[3] Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. Consideration should be given to whether the substance of transactions or events differs materially from their form.

been established that facilitate national defense goals through cross-agency cooperation. Under such circumstances, it may be appropriate to apply this Statement.

Provisions

A6. While DoD is continuing its efforts to comply with the Chief Financial Officers Act of 1990 (as amended), they continue to note certain challenges in meeting existing standards. SFFAS 4, *Managerial Cost Accounting Standards and Concepts* is one of such existing standards. Through its goals to associate elements of financial statements such as assets and costs with the related operating activities, it creates special challenges to a large complex organization such as DoD. That association may be differ from the legal associations established by elected officials through laws establishing budgetary and management practices.

A7. There are many complex relationships among the components of DoD, such as the military services, as well as between DoD and other related departments such as the US Coast Guard. The effort to assign elements based on the current standards and concepts is especially challenging. Many specialized components provide services to other components of DoD. In addition, law may prohibit one component from owning assets; instead another component owns the assets and hosts the component using the assets. In such cases, there may or may not be a financial transaction related to use of the assets.

A8. Therefore, certain provisions and flexibilities are offered in this Statement to classify transactions among and between components of the DoD and to limit the scope of imputed costs under SFFAS 4.

APPENDIX B: EXAMPLES OF DEPARTMENT OF DEFENSE ARRANGEMENTS

The Department of Defense (DoD) requested assistance by submitting the following on May 27, 2017. This Statement would address many but not all of the challenges noted in following existing accounting policies.

> "Given the complexities of the Department of Defense (DoD)'s organization, DoD is requesting the assistance of the Federal Accounting Standards Advisory Board (FASAB) to provide further clarity and guidance related to certain intragovernmental transactions that DoD performs throughout execution of its mission. Specific examples of DoD's intragovernmental transactional challenges are detailed below.

A. Recording of Transfers Versus Costs

Recording of Transfers Versus Costs		
Scenario: One DoD Reporting Entity conducts an expenditure exchange transaction with another DoD Reporting Entity. How should the purchasing DoD Component record these transactions – as a transfer-out or as costs of operations (e.g., expense)?		
Example		**Challenges in Following Accounting Policies**
1	WHS provides and manages office space for all of the various organizations within DoD. WHS obtains this office space through lease agreements with GSA and commercial vendors. Currently, the WHS records exchange revenue for the full amount billed ($105) and collected from its customers, and those billings include both the cost of the rental space ($100) that is provided by third parties (GSA/commercial vendors), as well as an administrative fee ($5) to recover the cost of managing that contractual and interagency relationships.	In this example, the DoD OIG believes WHS should only record $5 as exchange revenue, and the remaining $100 should be reported as a transfer-in (at the time of collection) and transfer-out (at the time of payment to GSA). Per response to Letter of Technical Inquiry from FASAB, dated February 6, 2017, it is appropriate to recognize the full amount billed to customers as revenue in accordance with the following SFFAS paragraphs: SFFAS 4, paras. 108-109, and SFFAS 7, paras. 38 and 166. Also, SFFAS 7, paragraph 43 states that "The exchange revenue should be recognized regardless of whether the entity retains the revenue for its own use or transfers it to other entities. Gross and net cost should be calculated as appropriate to determine the costs of outputs and the total net cost of operations of the reporting entity".

B. Appropriating Costs into One Reporting Entity

<table>
<tr><th colspan="3">Appropriating Costs into One Reporting Entity</th></tr>
<tr><td colspan="3">Scenario: Congress purposely appropriates funding to one Reporting Entity to perform services for multiple Reporting Entities as its core mission. As a result, the Reporting Entity who is appropriated the funding incurs all of the costs related to that service. How do the other Reporting Entities who receive the benefit from that service record the costs – as imputed costs or as an expense?</td></tr>
<tr><td colspan="2">Example</td><td>Challenges in Following Accounting Policies</td></tr>
<tr><td>1</td><td>DCMA's mission is to provide "a broad range of contract-procurement management services for America's Warfighters." DCMA receives appropriations to fund the services it provides to all of its DoD customers (i.e., DCMA's customers do not reimburse or pay for the services). Do DCMA's customers need to record imputed costs?</td><td>Per SFFAS 4, para. 112, if the services provided by DCMA are considered "broad, general support," the receiving entities should not recognize the costs of those services, unless those services are considered integral to the operations of the receiving entities. If so, the receiving entities should recognize the costs.

SFFAS 4, para. 244 states that when non-reimbursed or under-reimbursed inter-entity costs are recognized, the receiving entity should recognize the full costs of the goods or services received as an expense and, if the reimbursement is less than full cost, the difference is recognized as a financing source.

Per SFFAS 4, para. 112, the receiving entities would have to impute the costs of the services they are receiving from DCMA if the receiving entities are not reimbursing DCMA, if the costs are: (1) Significant (material) to the receiving entity; (2) form an integral or necessary part of the receiving entity's mission (output), <u>and;</u> (3) can be identified or matched to the receiving entity with reasonable precision.</td></tr>
<tr><td colspan="3">Scenario: Congress purposely appropriates funding primarily to one Reporting Entity to pay another agency to provide services for a group of Reporting Entities. As a result, the Reporting Entity who is appropriated the funding incurs all of the costs related to that service. How do the other Reporting Entities who receive the benefit from that service record the costs – as imputed costs or as an expense?</td></tr>
<tr><td colspan="2">Example</td><td>Challenges in Following Accounting Policies</td></tr>
<tr><td>1</td><td>The Defense Security Service's (DSS) mission includes a variety of security functions for the Department of Defense (issuing security requirements, assessing and issuing facility clearances). DSS is also appropriated funds to reimburse the OPM for performing background investigations for all DoD civilians. This cost is primarily (but not always) paid by DSS for</td><td>SFFAS 4, para. 244 states that when non-reimbursed or under-reimbursed inter-entity costs are recognized, the receiving entity should recognize the full costs of the goods or services received as an expense and, if the reimbursement is less than full cost, the difference is to be recognized as a financing source.

Is it appropriate for DSS to record the full cost of its payments to OPM in its Statement of Net Cost? DSS is not paying less than the full cost of clearances for its own personnel--it's paying significantly more than its share of the costs, to the benefit of all other DoD Reporting Entities. The Department believes it is important to note that DSS is purposefully appropriated funding to cover the majority of these costs for all of the DoD Reporting Entities.

Secondarily, in this scenario if it is appropriate for DSS to report these costs (because it's mission and appropriations include funding clearances for all DoD Reporting Entities), is it necessary or appropriate</td></tr>
</table>

	benefit of DoD Reporting Entities.	for other DoD Reporting Entities to record imputed financing for their share of the costs paid by DSS?

C. Sharing the Use of Assets

<table>
<tr><th colspan="3">Shared Use of Equipment</th></tr>
<tr><td colspan="3">Scenario: One DoD Component uses the equipment owned by another Component. Who should record the asset and/or should imputed cost be recorded?</td></tr>
<tr><td colspan="2">Examples</td><td>Challenges in Following Accounting Policies</td></tr>
<tr><td>1</td><td>SOCOM uses a Navy Helicopter but does not alter the state of the equipment for their use. Asset is not transferred to SOCOM.</td><td>Per SFFAS 4 para. 112, SOCOM should impute the cost/value of using the assets which would be the depreciation and associated maintenance cost for the period if the un- reimbursed costs are: (1) are significant (material) to the SOCOM, (2) form an integral or necessary part of the SOCOM's mission (output), <u>and</u> (3) can be identified or matched to SOCOM with reasonable precision.

Challenges:
1. Identify ALL shared equipment between the components and <u>ownership</u> of the equipment
2. Logistics system - Identifying all maintenance cost associated with equipment
3. Identify or determine a method for allocating maintenance costs (Hours, % based on time period.
4. Identify cost that were reimbursed and compare to actual costs

The Navy would need to identify all costs associated with the use of the equipment.
1) If capital equipment, calculate the depreciation for the period
2) Identify all maintenance cost associated with the equipment and prorate the value for the period of time the asset was used by SOCOM.
a. For example, if the service life is determined by hours, the Navy should determine a rate for annual maintenance (e.g. svc hrs/annual maintenance).
b. The rate would be multiplied by the # hours used by SOCOM.

SOCOM would need to:
1) Track in a logistic system the # of hours used. This information would be provided to the Navy for calculation of imputed cost.
2) Develop criteria for determining the significance of the equipment to the mission. Would the exclusion of the cost of the equipment from the program costs influence decision makers?
3) Establish the materiality threshold.
4) Document decision made that the equipment was an integral part of the SOCOM's specific mission for which the equipment is used.</td></tr>
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2	SOCOM uses a US Navy helicopter. In using the equipment, they alter the state of the equipment by adding their "bells and whistles."	If the equipment stays on the military service balance sheet: Assuming the "improvements" extended the useful life or increased the capability or capacity (e.g. lifts more weight), then the improvements would need to be recorded by SOCOM as an asset." Challenges will include tracking the maintenance dollars associated with the equipment and allocating a portion of the cost to SOCOM. This will require tracking in the logistics system. More likely than not, this will not be traceable to the asset in the Financial system. The challenges in example #1 will also apply to this example, however the components would also have to identify any costs associated with improvements - are the improvements due to the shared use/ directly associated with the other component such as improvement to increase capacity?
	One Reporting Entity purchases equipment as part of an Economy Act reimbursable customer order and funded by multiple Reporting Entities. There is generally no clear determination as to who "owns" the assets and which Reporting Entity is responsible for the financial reporting of the assets.	The Reporting Entity that has primary economic benefit of the asset is responsible for the financial reporting of the asset. If other Federal entities provide funds to the "joint venture," those entities would record an imputed costs for the amount paid.

Shared Use of Software Licenses and IUS		
Scenario: One DoD Component shares software licenses or owned IUS with another DoD component		
Examples		**Challenges in Following Accounting Policies**
1	The Air Force developed an IUS asset (e.g. aviation guiding system) that is also used by the Army.	Per SFFAS 4 para 112, if the Army reimburses Air Force for the license usage, the agreed-upon payment needs to be reconciled to the share of costs that were incurred. Otherwise the Army may have an additional imputed cost, if the un-reimbursed costs are: (1) are significant to the Army, (2) form an integral or necessary part of the Army's mission (output), and (3) can be identified or matched to the Army with reasonable precision.

		If there is no exchange of funds, Army must impute its share of the licenses acquired through AF's enterprise-wide agreement Challenges: 1. Identifying software used by the AF 2. Identifying Rights to software (owned vs annual subscription) 3. Identifying with whom the software is shared and determining # licenses shared with users. 4. Air Force ERP – **<u>If the asset was capitalized</u>** identifying depreciation costs and allocating a % to the Army. 5. Identifying any overhead cost associated with operating the software. (a rate could be assigned, but establishing the method for applying an OVH rate must be documented and repeatable) 6. Identify cost that were reimbursed and compare to actual costs 7. Document decision made that the equipment was an integral part of the Army's specific mission for which the asset is used.
2	The AF makes a perpetual acquisition of enterprise-wide licenses of Adobe, which are used by multiple entities. Annually, the AF makes an acquisition for maintenance services.	Challenges: 1. Identifying software licenses used by the each component 2. Identifying Rights to software (perpetual ownership or annual subscription) 3. Identifying if and with whom the licenses are shared and determining # licenses shared with users. 4. Identifying any associated cost of operating/maintaining the license. 5. Air Force ERP – **<u>If the license was capitalized</u>** identifying depreciation costs and allocating a % to the Army. 6. Allocating annual maintenance and services costs 7. Identify cost that were reimbursed and compare to actual costs 8. Document the decision made that the equipment was an integral part of the Army's specific mission for which the asset is used.

Shared Use of Real Property and Leases

Scenario: One DoD Component uses the building owned by another Component. Who should record the asset and/or should imputed cost be recorded?

Examples		Challenges in Following Accounting Policies
1	Navy enters into a use agreement with the Air Force to occupy a building on an Air Force installation. The Navy is responsible for services such as utilities, maintenance, and security.	Per SFFAS 4 para 112, if the AF owns the building, the AF records the asset and Navy records a leasehold improvement for any capital improvements. The AF calculates the Navy's share of building depreciation, associated maintenance and costs associated with building services such as cleaning and utilities for the period. If the AF subleases the building to the Navy, the AF will not report costs associated with depreciation. The costs are reconciled to the agreed upon reimbursements and any un-reimbursed costs reported to the Navy. The Navy records a program expense if the un- reimbursed costs are:
2	Navy enters into a use	

	agreement with the Air Force to share space in a building (25%) with AF personnel on an Air Force installation. The AF is responsible for all services such as utilities, maintenance, and security.	(1) are significant to the Army, (2) form an integral or necessary part of the Army's mission (output), and (3) can be identified or matched to the Army with reasonable precision. Challenges: 1. Identify all shared space owned by each DoD component. 2. Identify all tenants and % of space 3. Identify the associated agreements (written and oral) 4. Identify reimbursements made by each tenant a. Is tenant billed for share of utilities, trash removal, security, etc) b. IF this is a sublease, what is the reimbursement rate?? What is reimbursed? 5. Identify OVH costs associated with the building such as maintenance cost 6. Does the shared space include parking 7. IF the shared space is a sublease in an occupancy agreement, identify % of annual executory cost associated with OA. 8. Identify cost that were reimbursed and compare to actual costs
3	The Air Force has an occupancy agreement with GSA for an office building. The Air Force enters into a use agreement to share the leased space with the Navy.	
4	One Reporting Entity contributes to assets that are funded by multiple Reporting Entities. There is generally no clear determination as to who "owns" the assets and which Reporting Entity is responsible for the financial reporting of the assets.	The Reporting Entity that has primary economic benefit of the asset is responsible for the financial reporting of the asset. If other Federal entities provide funds to the "joint venture," those entities would record an imputed costs for the amount paid.

D. Environmental Liability Cleanup

Ownership of Environmental Liabilities		
Scenario: Real Property assets that exist on Service installations and where responsibilities related to the maintenance, sustainment, and operation of those assets (e.g., fuel tanks) are shared or varied.		
Examples		**Challenges in Following Accounting Policies**
1	A fuel tank farm is on an Army base where DLA provides the fuel and services but Army provides sustainment, restoration, and modernization funding to maintain the physical tanks over time. While the Army receives funding for the maintenance and sustainment of the	The challenge is determining who would report the liability for the clean-up if the equipment is owned by one entity and the using entity receives appropriations for environmental clean-up costs. If the Army reports the liability, the subsequent clean-up expenditures made by DLA would not liquidate Army's liability. FASAB / FMR references: No FASAB references

	tanks, DLA receives the appropriation for the clean-up cost related to environmental spills. Several examples include: (1) Both DLA and Army report the assets on their financial statements, both DLA and Army report the Environmental Closure Requirement E&DL on their financial statements, but (if and when) a spill occurs, DLA would report the cleanup E&DL on their financial statements; (2) neither organization reports the asset or ECR E&DL on their financial statements, assuming the other is doing so, and; (3) Army or DLA report the asset and associated ECR E&DL on their financial statements, inconsistently.	currently exist to specifically deal with this scenario – FASAB E&DL references deal with whether or not an E&DL exists and the requirements related to timing for when these E&DL need to be recorded on DoD consolidated financial statements. However, DoD has interpreted various relevant pronouncements (SFFAS 4, SFFAS 5, FASAB TR2, SFFAC 5) when developing the memo below on Reporting for Real Property Assets, which includes a provision for imputing E&DL costs in these 'shared' scenarios. The memo will be codified in Volume 4, Chapter 24 of the FMR but is still at the informal coordination phase. § OUSD(C) Policy Memo entitled, *Accounting Policy Update for Financial Statement Reporting for Real Property Assets* issued on September 30, 2015
2	Fuel tank farm is on an Army base where DLA provides the fuel and services associated with fueling vehicles but Army provides sustainment, restoration, and modernization funding to maintain the physical tanks over time. The Army receives appropriations for sustainment of the tanks and any clean-up cost.	SFFAS 4 para 244 of the Basis for Conclusion, states that when non-reimbursed or under-reimbursed inter-entity costs are recognized, the receiving entity should recognize the full costs of the goods or services received as an expense and, to the extent that reimbursement is less than full cost, the difference is to be recognized as a financing source. Per SFFAS 4 para 112, DLA records a program expense if the un- reimbursed costs are: (1) are significant to the DLA, (2) form an integral or necessary part of the DLA's mission (output), and (3) can be identified or matched to DLA with reasonable precision.

E. Sharing the Use of Military Personnel

Shared Use of Personnel		
Scenario: Military Personnel are lent out to other entities, or non-DoD personnel assist the DoD with a mission. Who should capture and report the military pay costs?		
Examples		**Challenges in Following Accounting Policies**
1	The Navy borrows USCG military personnel to carry out a mission. The Navy	Per SFFAS 4, para 112, the Navy should impute the cost of the benefits received by utilizing the USCG military personnel. A share of the military pay and benefits for the USCG service members should be recorded as program expenses by the Navy. If there is an exchange in funds, the USCG should analyze any additional costs that have not be reimbursed and provide Navy with the amount of costs above and beyond what was reimbursed through the agreement with the USCG. The under-reimbursed costs should be imputed by the Navy; (i.e. recorded as

	does not pay for the USCG personnel pay.	program expenses) if the un- reimbursed costs are: (1) are significant to the Army, (2) form an integral or necessary part of the Army's mission (output)**, and** (3) can be identified or matched to the Army with reasonable precision. Challenges: 1. Identify all of the "oral" or written agreements where personnel are shared between services 2. Identify if the services are sharing the mission (e.g. combat teams in a deployed environment) or if the mission is associated with the specific service and the service required additional/specific resources 3. Identify specific personnel or FTEs shared between services and the period of time 4. Identify total costs for FTEs and allocation rate a. Pay b. Benefits 5. Identify cost that were reimbursed and compare to actual costs

F. Pooling of Assets

Shared Use of Program		
Scenario: How should the costs and associated assets be accounted for in a scenario where the assets are funded through a pool of contributions or the assets are held in a pool?		
Examples		**Challenges in Following Accounting Policies**
1	F-35 Joint Strike Fighter – U.S. and several allies pool funds for the R&D. At some point, the F-35s will be "in-service." The costs are currently expensed as R&D, but should some be capitalized as CIP and depreciated once placed in service. The costs to date will exceed (by several hundred million) the costs per unit expected for future purchases.	1) Value of the aircraft -- Each partner nation in the JSF program is paying for the specific planes it has ordered. Each had unique requirements added to the basic F-35 aircraft, and the price for each of these planes is known. The DoD military service will capitalize the actual cost of each aircraft and depreciate it over its estimated useful life. 2) Value of Support Equipment - Support equipment for the maintenance of the fleet of aircraft is required to be at each of the bases that will service the aircraft. Each nation and military service specifically orders the support equipment it anticipates needing. The support equipment will be recorded at its actual cost and depreciated over its estimated useful life. The title/ownership of support equipment ordered by another nation will stay with the U.S. 3) Value of Pooled Operating Materials and Supplies (OM&S)-OM&S will be ordered for all entities, held at a U.S. warehouse. Title/ownership of the OM&S transfers to the nation or military service that takes possession of it. Unused OM&S DoD-wide will be reviewed and, if

		material to the consolidated financial statement, will be recorded on the consolidated balance sheet through an entry made in consolidation.
2	DLA Managed Assets - The Army, Navy, and AF orders inventory through DLA and advances the money for payment to DLA. DLA acquires the inventory using the funds provided by the Services, and maintains custody of the inventory on their behalf. This inventory is reported as assets by the Services, not DLA. The challenge is that DLA comingles certain inventory regardless of the Service owning the items—therefore, DLA is not able to distinguish what assets belong to which Military Service.	As part of the audit process, DoD reporting entities need to satisfy auditor requests to provide evidence supporting relevant financial statement assertions. For certain comingled assets, DoD is challenged to demonstrate the Rights assertion (entity has rights to the reported assets) because DLA does not track individual inventory items by unique identifier, physically segregate assets by customer or otherwise label its inventory by customer. As a result, DoD reporting entity auditors are unable to confirm their auditee has the rights to certain comingled assets held in DLA custody as there is no way to differentiate one DoD reporting entity's assets from another.

G. Transportation

Transportation		
Scenario: The Army charters a vessel from MSC to transport cargo between CONUS to OCONUS.		
Examples		**Challenges in Following Accounting Policies**
1	The Army charters a vessel for a new mission with MSC. A rate has not been established by the Working Capital Fund. MSC sets up a reimbursable agreement for direct costs and a burdened rate for overhead costs.	In accordance with SFFAS 4 para. 112, if there is an exchange in funds, MSC would have to analyze if any additional costs were incurred on behalf of the Army. The under-reimbursed costs would have to be imputed by the Army; (i.e. recorded as program expenses) *if* the un-reimbursed costs are: (1) are significant to the Army, (2) form an integral or necessary part of the Army's mission (output), **<u>and</u>** (3) can be identified or matched to the Army with reasonable precision. Systems impacted: MSCs ERP, N Code logistics systems Challenges: Identify all direct and indirect cost associated with charter vessel and crew. a. Identify maintenance costs b. Direct cost for Crew, vessel improvements c. Share of OVH

H. Shared Services

Shared Services		
Scenario: Multiple Reporting Entities receive benefits from a shared service provided by another Reporting Entity. How does the Reporting Entity receiving the benefit report costs?		
Examples		**Challenges in Following Accounting Policies**
1	The Military Treatment Facility operated by the Service Medical Activity (DHA) is mission funded to provide medical services to active duty and retired military personnel across the globe, along with the building, maintenance, and sustainment of medical facilities. These services are provided without reimbursement from the Military Departments directly to active duty and retired Military personnel.	USMC's IPA observed that USMC needs to record an imputed costs for cost of military hospitals that provide services to the Marines and their families, per SFFAS 4.

I. Contingent Legal Liabilities

Imputed Cost for Contingent Legal Liabilities		
Scenario: In accordance with DoD Instruction 5515.08 each DoD Service has responsibility for adjudicating legal claims by OCONUS region on behalf of the department. The responsible service for a specific OCONUS region will make payment without reimbursement for any adverse decisions or judgments regardless of responsible offending service member.		
Examples		**Challenges in Following Accounting Policies**
1	A Navy service member is sued for damages he caused to a home in a government vehicle within Afghanistan. The Army has OCONUS geographic responsibility for Afghanistan thus will manage the claim and pay out any judgment resulting from the case on behalf of Navy using Army funds.	Under current standards, Army is reporting the contingent liability and full costs on their books. Navy would have to recognize an imputed cost.

APPENDIX C: ABBREVIATIONS

CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
OMB	Office of Management and Budget
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

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