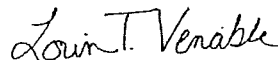


October 4, 2017

MEMORANDUM FOR EXECUTIVE DIRECTOR, FEDERAL ACCOUNTING STANDARDS
ADVISORY BOARDSUBJECT: Proposed Exposure Draft Technical Bulletin, 2017-1, "Intragovernmental Exchange
Transactions"

We appreciate the opportunity to respond to the proposed Exposure Draft Technical Bulletin, 2017-1, "Intragovernmental Exchange Transactions." We have reviewed the document as requested, below is our response to the "Questions for Respondents." Should you have any questions or require additional assistance, please contact me or Ms. Debie Alford at debra.alford@dodig.mil or 703-601-5396.



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Department of Defense Office of Inspector General Comments on the Draft Federal Accounting Standards Advisory Board Technical Bulletin 2017-1, "Intragovernmental Exchange Transactions"

- Q1. The proposed TB provides guidance to aid in determining whether intragovernmental arrangements are exchange transactions. **Do you agree or disagree with the proposed guidance? Please provide the rationale for your answer.**

The Department of Defense Office of Inspector General (DoD OIG) disagrees with the proposed guidance.

DoD OIG requests that the Board reassess the appropriateness of including the concepts and definition discussed in a technical bulletin, as opposed to a Statement of Federal Financial Accounting Standard. Specifically, in our opinion, this technical bulletin has the potential to cause a major change in accounting practice. In addition, as written, this technical bulletin conflicts in some areas with a broad fundamental principle and creates a novel accounting practice. Finally, as discussed below, the proposed guidance goes well beyond the scope of the stated DoD request, appears to conflict with other FASAB standards, and introduces new criteria for determining when accounting events occur. This will make it challenging for agencies and auditors to know what transactions this technical guidance applies to, and when to follow the FASAB standards.

First, this Technical Bulletin states it was proposed in response to DoD's request (Appendix A, paragraphs A.1. and A.2. of this proposed guidance) for guidance related to certain intragovernmental transactions – including transactions and balances among DoD components - that DoD performs throughout execution of its mission that DoD believes cannot be addressed effectively within the framework of existing accounting standards. DoD's request to FASAB states that their concern came through a DoD OIG Notice of Finding and Recommendation. The DoD OIG believes that the request from DoD did not accurately describe the DoD OIG concerns.

Therefore, we believe that the DoD requested examples could mislead readers and users of this proposed guidance. Specifically, DoD provided the request to FASAB without input from the DoD OIG and did not accurately represent the DoD OIG concerns. Specifically, for instances when a federal agency arranges for a third-party to perform services for another federal entity (for example, outsourcing such as arranging for an office lease for another federal entity), the DoD OIG agrees that the full amount of the requesting agencies' funding should be recorded as exchange revenue. To improve understanding and clarify our concerns, DoD OIG is willing to provide additional information to FASAB. DoD OIG respectfully requests that the Board remedy this concern.

Second, the statement that an entity could be considered the performing entity even if the entity only performs a minor role in the transaction could create inconsistencies in reporting. This guidance (page 4, paragraph 6, third sentence) specifically calls out that

one Federal agency can only play a minor service role, such as coordinating funding, facilitating transactions, negotiating contracts, and /or providing other related arrangements, but could then report the entire amount of the final goods or services. This type of accounting guidance could create very inconsistent applications for similar or the same types of transactions across the government. Specifically, these types of support roles occur throughout DoD and the Federal Government that are currently not recording the support role as value for the entire transaction. Instead, service organizations like the Defense Finance and Accounting Service, whose role is to coordinate funding, and facilitate transactions, do not report the entire amount of the requesting agencies' funding as revenue.

In addition, this broad flexibility in recording revenue and expenses appears to conflict with footnote 1 of the proposed guidance, which states that the providing entity incurs the costs of providing the service. These costs include paying the contractors, employees, and other resource providers. The receiving entity then pays the providing entity. However, there are situations in which the providing entity only plays a minor role, and does not incur any costs, such as paying the contractors, employees, or other resource providers, that would seem to conflict with the minor role a performer could play. In these circumstances, this guidance could cause confusion about the appropriate accounting for the revenue and expenses associated with the service being provided.

Finally, the scope of this guidance appears to far exceed the content of the DoD request, and conflict with existing standards. Because this guidance is unclear of the problem it is addressing, it will be difficult to allow both the entity and auditor to assess applicability for the particular transactions. Specifically, this technical guidance appears to adequately address the DoD question in paragraphs 5-7. Outside of these three paragraphs, it's very unclear what problem or situation FASAB is addressing, as the subject matter expands to questions related to value and sacrifice that DoD did not include in its original request.

Specific Concerns: Notwithstanding the purpose of the bulletin, the DoD OIG is concerned that this technical bulletin, as opposed to providing technical guidance, creates vague requirements that would make it extremely challenging to audit any intragovernmental transactions. In addition, the range of "value" items listed appear to be broad enough to support almost any transaction. This range would not allow for any meaningful distinctions between various types of evidence. Of particular concern is the technical bulletin conclusion that because these transactions are not market-based or arm's length, less rigor needs to apply for their application. In our opinion, these types of transactions are at higher risk for misstatements and abuse, and auditors would need to apply additional procedures to reduce that risk. See comments below for specifics:

1. **The intent of this technical bulletin appears to conflict with Statement of Federal Financial Accounting Standards 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," (SFFAS 7), Appendix B, "Guidance for the Classification of Transactions."** SFFAS 7, Appendix B provides guidance for the classification of specific transactions based on the accounting standards for revenues and other

financing sources, and the reasoning behind these standards as explained in the introduction and the basis for conclusions. To serve that purpose, SFFAS 7, Appendix B provides guidance for classifying all major transactions, including the financing transactions of the Federal government. It should be understood that while some classifications are unequivocal, others are the result of balancing different considerations.

This technical guidance appears to disregard SFFAS 7, Appendix B and instead allows entities to determine that a transaction could be recorded as an exchange transaction, versus another type of transaction (such as transfer out) without requiring any type of consideration as to which transaction would be more applicable, in light of each unique circumstance, and the substance of the transaction. Instead, the technical guidance states that determining “value” is challenging and allows transactions that might not be market-based or arms-length to be reported as an exchange transaction, instead of using the construct in SFFAS 7, Appendix B. SFFAS 7, Appendix B specifically defines intragovernmental exchange transactions as sales of goods and services, employer entity contributions, and interest of Treasury. This proposed document introduces “indirect” benefits as criteria for an exchange transaction, as opposed to providing or receiving goods and services. We believe that another type of financing listed in SFFAS 7, Appendix B could apply when considering how to record transactions where no goods or services are provided. Specifically, the transfer definition states that cash may be transferred without reimbursement from one government entity to another. The transferring entity does not **acquire** anything of value.¹ It would appear that having the ability to use someone else’s assets would accurately fit under a transfer, because the transferring entity did not acquire anything. To unilaterally allow that if each entity states that they receive value, without taking into account the true substance of each transaction does not appear to be in accordance with SFFAS 7, Appendix B. We recommend that FASAB reassess this technical bulletin with SFFAS 7, Appendix B compliance.

2. **The technical guidance appears to step outside the boundaries of SFFAS 4, “Managerial Cost Accounting Standards and Concepts,” (SFFAS 4) and SFFAS 7 by defining value so broadly.** This proposed technical guidance provides a definition of “value” that appears to encompass anything that could contribute to the entity’s goals, and goods or services made available for their use. In contrast, SFFAS 7 and SFFAS 4 focus on actual goods or services received, and how the goods and services specifically relate to individual programs that are under the control of the entity, not how the “value” might advance the overarching goal. Additional information would be helpful to determine how the FASAB working group determined that this guidance is needed or appropriate in light of the specificity in SFFAS 7, paragraph 18 that states that an exchange transaction occurs when one

¹ The Merriam-Webster definition of “acquire” is to get as one’s own or to come into possession of control of, often by unspecified means.

party sacrifices value and **receives a valuable good or service in return** (verses just value). Permitting entities to report expenses and revenue amounts that only indirectly contribute to the entity's goals does not appear supportable in current Federal accounting policies. This is clear when taking into account SFFAS 7 and SFFAS 4, as well as, the purpose of the entity financial statements, as defined in Statement of Federal Financial Accounting Concepts 1, "Objectives of Federal Financial Reporting," paragraph 11, that federal financial reporting should provide information that helps the reader to determine the costs of providing specific programs and activities and the composition of, and changes in, these costs.

3. **Additional guidance will be needed on timing of recognition because this guidance adds a new test of revenue by "contributing to the entity's goals" and "indirect goods or services made available to support their mission" as opposed to the Federal generally accepted accounting principles (GAAP) requirements that goods or services must be received.** Paragraph 18.b., page 6 needs additional clarity to highlight why it does not conflict with SFFAS 7, paragraphs 34 through 36. Specifically, SFFAS 7, paragraph 34 states that revenue should be recognized when goods or services are provided to the Government. The sub-bullets of paragraph 36 set specific recognition for the specific types of exchange transactions. Paragraph 36 states that (a) revenue should be recognized when the services are performed, (b) revenue should be recognized in proportion to the estimated total cost when goods and services are acquired to fulfill the contract, when goods (inventory) are delivered to the customer and, when services are rendered continuously over time, it should be recognized in proportion to the passage of time.

Paragraph 18.b. appears to introduce a new type of good or service, such as goods or services made available to support their mission as a result of the actions of the other party. Because this type of good or service is not included as a good or service that is delivered to the customer, entities will not be able to comply with SFFAS 7, paragraph 34, for the provider to determine when the good or service is provided to the entity. In addition, the receiving entity will not be able to appropriately identify when they should recognize their "appropriations used." SFFAS 7, paragraph 72 states that appropriations are used in operations when goods and services are received. It would be challenging for the entity, as well as the auditor, to confirm the appropriate recognition if the intent is the indirect availability to use goods or services.

In addition, SFFAS 7 is clear that recognition happens when goods or services are provided, not when "value" occurs. An argument could easily be made that "value" occurs as soon as another Federal entity agrees to perform work for the agency. The value received is that the receiving entity's operations do not need to absorb the time it takes to complete the work, and the value sacrificed is the commitment from the performing entity that they will absorb the work, at the expense of their own operations. However, SFFAS 7 is clear that the revenue and corresponding expense

does not occur until the specific good or service is received. Paragraph A7., page 9 of the proposed guidance states that the transaction does not qualify as a transfer-in/out because some value is identified by both parties, but neglects the “acquire” part of the transfer-in/out definition. It appears paragraph A7. is using only the more broad definition in SFFAS 5, “Accounting for Liabilities of the Federal Government,” but should also consider the more specific SFFAS 7 definition.

4. **Consideration should be given to describing when a non-exchange transfer would be appropriate.** In the current list of potential value described in paragraph 16, page 6, there does not appear to be any instance where an entity would ever record a non-exchange transfer. However, on the Treasury website, Treasury used an example to demonstrate when agencies would record a non-exchange transfer. The example related to the Department of Energy transferring money to the Environmental Protection Agency for the implementation of the Waste Isolation Pilot Plan Land Withdrawal Act of 1992 and the development of cleanup standards to guide the Department of Energy’s environmental restoration efforts. This example appears to clearly fit under several paragraphs in this technical guidance. Specifically:

- a. Paragraph 18.d., page 7, intangible, such as information systems, written materials, or information or 18.f. qualitative, such as guidance that may not be measurable.
- b. Paragraph 13.c., page 5, performing a service, such as advising or informing another party.
- c. Paragraph 14., page 6, which states that “the act of sacrificing value may provide value to both parties. For example, providing a consulting service may result in knowledge of benefit to both parties to the transaction as well as to others. The inability to measure the value sacrificed and the fact that the good or service is of continuing value to the provider, and possibly to others, does not mean the transaction is not an exchange transaction.”
- d. Paragraph 16., page 6, each party to a transaction should assess whether the transaction provides value.

The Treasury’s guidance is markedly different from this technical bulletin. Specifically, Treasury states that once the transfer has been accomplished, the appropriation making the transfer no longer has budgetary and proprietary control of the funds. We recommend specifically stating what would trigger a transaction to be considered a transfer, rather than an exchange.