INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

November 30, 2017

MEMORANDUM FOR EXECUTIVE DIRECTOR, FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

SUBJECT: Proposed Exposure Draft Statement of Federal Financial Accounting Standards, "Amending Inter-Entity Cost Provisions"

We appreciate the opportunity to respond to the proposed Exposure Draft Statement of Federal Financial Accounting Standards, "Amending Inter-Entity Cost Provisions." 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 of my staff at debra.alford@dodig.mil or 703-601-5396.

Lorin T. Venable
Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

Department of Defense Office of Inspector General Comments on the Draft Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards

"Amending Inter-Entity Cost Provisions"

Q1. The provisions of Statement of Federal Financial Accounting Standards (SFFAS) 4, *Managerial Cost Accounting Standard and Concepts*, as amended, require all reporting entities to recognize the full costs of services received from other federal reporting entities even if there is no requirement to reimburse the providing entity for the full cost.

Component reporting entities that have implemented the inter-entity cost provisions of SFFAS 4 typically show less than one percent increase in gross costs attributable to imputed costs other than those associated with personnel benefits and the Treasury Judgment Fund. The proposal would revise SFFAS 4 to provide for recognition of inter-entity costs by business-type activities and rescind the following:

a. SFFAS 30, *Inter-entity Cost Implementation: Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts*
b. Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4*

Do you agree or disagree? Please provide the rationale for your answer.

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

As stated in the exposure draft, if SFFAS 30 is rescinded in its' entirety, then the previous version of SFFAS 4 (with the proposed revisions to paragraphs 110 and 111) will be required again. Our main concerns relate to paragraph 110 which provided the Office of Management and Budget (OMB) the authority to recognize which inter-entity costs should be recognized, and paragraph 111 which states that "ideally" all significant entity costs should be recognized.

The DoD OIG is concerned that giving OMB the authority to determine which costs should be recognized might conflict with the auditor's own materiality judgment of the significance of inter-entity costs. In addition, when applying auditing standards, there could be instances in which auditors may request disclosures related to inter-entity transactions that the auditor determines fundamental to user's understanding of the financial statements. The proposed guidance may create circumstances in which the OMB's decisions conflict with the judgment of financial statement auditors.

The proposed paragraph 111 states that ideally, all "significant" inter-entity costs should be recognized, and then concludes that recognition of inter-entity costs that specifically support business-type activities should be recognized. Footnote 33 further defines a business-type activity as a significantly self-sustaining activity that finances its continuing cycle of operations through collection of exchange revenue. The DoD OIG is concerned that recognizing inter-entity costs from only business-type activities as defined by the footnote would require an entity auditor to review the other entity's financial information to assess whether significant exchange transactions occurred between the entities. The DoD OIG recommends that the wording of the Standard clearly require entities to recognize material amounts of inter-entity costs, including "business-type" and "non-business-type" activities.

Finally, the DoD OIG is concerned that the basis behind this decision is based on known reported amounts. Although the exposure draft acknowledges that the proposed policy changes are based on unaudited amounts provided to the Board, we question the reliance on this data for the conclusions reached. If there are significant unknown amounts that would be material to the financial statements, removing the requirement could prevent those from being accurately reported.

Q2. The Board is proposing that component reporting entities provide a concise statement to acknowledge significant services received for which no cost is recognized.
a) **Do you agree or disagree? Please provide the rationale for your answer.**
b) **Do you believe the proposed disclosure would impose a greater cost or burden when compared to existing requirements? Please consider implementation challenges for both the preparer and auditor in formulating your opinion. Please provide the rationale for your answer.**

DoD OIG Response:

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

We are concerned that the vagueness of what a "concise" statement would be could result in wide-ranging applications of this requirement and potentially cause disagreements between entities and auditors about how to apply the guidance properly. We believe that FASAB could improve this requirement if it required the entity to form a conclusion regarding the materiality of the services received and provide a description of the services. In addition, requiring that entities prepare a blanket statement of a "concise" "acknowledgment" would not necessarily remove the need for auditors to obtain additional information and apply audit tests to the associated transactions. If auditors could not apply procedures, it could be considered a scope limitation. Each auditor needs to work with the entity to determine how much disclosure is needed so that readers have a fundamental understanding of the financial statements. In addition, auditors would determine the level of procedures necessary to confirm statements from the entity related to the materiality of services received.