INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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October 13, 2017

MEMORANDUM FOR EXECUTIVE DIRECTOR, FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

SUBJECT: Proposed Exposure Draft Technical Bulletin, 2017-2, "Assigning Assets to Component Reporting Entities"

We appreciate the opportunity to respond to the proposed Exposure Draft Technical Bulletin, 2017-2, "Assigning Assets to Component Reporting Entities." 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.

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Department of Defense Office of Inspector General Comments on the Exposure Draft Federal Accounting Standards Advisory Board Technical Bulletin 2017-2, "Assigning Assets to Component Reporting Entities"

Q1. The proposed Technical Bulletin (TB) provides that assets may be assigned by a reporting entity to its component reporting entities on a rational and consistent basis. For example, an asset may be assigned to a component reporting entity holding legal title, funding the asset, using the asset in its operations, or another rational and consistent basis. However, assets may only be assigned by a component reporting entity to its own sub-component reporting entities (such as bureaus, components, or responsibility segments within the same larger reporting entity or department). **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 Technical Bulletin.

Overall Comments. The proposed technical guidance states that Federal Accounting Standards Advisory Board (FASAB) intends for the bulletin to provide guidance to address areas not directly covered in existing Statements and to clarify existing standards. Specifically, in our opinion, this technical bulletin has the potential to cause a major change in accounting practice. This bulletin also conflicts with a broad fundamental principle and creates an unconventional accounting practice.

In addition, the proposed technical bulletin would increase audit risk and require additional auditing procedures to address the increased risk. We further believe the implementation of this proposed bulletin would result in increased audit costs because of the increased coordination needed to confirm asset ownership, costs, location, and quantity. We respectfully request that FASAB re-consider the need for this technical bulletin or revise the proposed guidance so that it fully addresses the concerns stated below.

1. **FASAB Already Issued Guidance About Reporting Assets for Component Entities.** The proposed technical bulletin creates a novel accounting practice and conflicts with the broad fundamental concepts FASAB provided in Statement of Federal Financial Accounting Concepts (SFFAC) 5, "Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements." Further, Statement of Federal Financial Accounting Standards (SFFAS) 47, "Reporting Entity," paragraph 92 outlines the importance of SFFAC 5 regarding the definition of a reporting entity. SFFAC 5 already provides guidance concerning which entity should report assets. Specifically, SFFAC 5, paragraph 12 states that "the component entity is responsible and accountable for receiving, controlling, managing, and utilizing government assets or incurring liabilities on behalf of the government in performing operations related to the program or activity. When a component entity has such a comprehensive relationship, the assets and other elements involved should be reported by that component entity." Additionally, SFFAC 5, paragraph 13 provides further guidance stating that "when no component entity has a comprehensive relationship to a government program or activity, the assets and other elements involved should be reported by the component entity most responsible for managing them." SFFAC 5, paragraph 13 even provides an example: assume that two component entities support a single program to which neither has a comprehensive relationship. If one of the component entities has acquired and has some control over a

government asset but the other component entity presently manages and utilizes the asset as part of its routine operations, the second component entity should report the asset.

As written, the proposed technical bulletin allows for the unconventional accounting practice of two entities reporting different capitalized costs relating to a single asset. The specific guidance provided in SFFAC 5 appears to outline how entities would report the example that FASAB provided in paragraph A4 of the proposed bulletin. The proposed wording of the bulletin appears to conflict with the fundamental principles of SFFAC 5. FASAB's proposed guidance would allow one component entity to report an asset and allow another component entity to report capital improvements and other costs for the same asset. While SFFAC 5 does allow management judgement when two component entities have a relationship with an asset but neither have a comprehensive relationship, it does not allow for both entities to report the asset or the other elements involved. In this proposed bulletin, FASAB does not appear to consider where the significant risks of asset ownership lie and whether or not the entity maintains either a continuing managerial involvement or control over the asset. For example, the proposed treatment would make recording operating costs associated with the asset complicated, which would increase program costs. In our opinion, FASAB should not issue the proposed technical bulletin. Instead, we request that the board consider clarifying the current SFFAC 5 guidance instead of creating unconventional accounting treatments.

2. **The Proposed Bulletin Would Raise Audit Risk.** As proposed, the current technical wording would impose barriers to asset testing that do not currently exist, if current standards are followed. The proposed guidance would allow the Air Force to own an asset and the Navy to make capital improvements to the same asset and carry the improvement in its records. This novel accounting practice would increase audit risk and require additional planning procedures and testing for the component auditors. For example, an auditor performing tests of an asset reported by both the Air Force and the Navy would need to confirm that the Air Force and Navy are in fact carrying the improvement in their records. This would involve increased planning costs as well as increased audit testing costs. The auditor would have to plan for additional auditing procedures, request documentation from the other services supporting the capitalized costs, and in some cases would need to travel to a different location to verify the existence of the asset. We do not believe it would be appropriate for two components to report the improvement costs. Instead, one component should report all of the costs associated with the asset. One entity reporting all of the costs would not decrease financial reporting accuracy and would result in lower audit risks and costs. Further, a one-entity approach would decrease the risk that both agencies would report the same costs or neither agency would report the appropriate costs.

   The unintended consequence of allowing for more flexibility could also result in the auditor of one component not being able to obtain sufficient, appropriate evidence about the existence and correct valuation of the other capitalized piece of the asset. If the auditor's requests for additional documentation or onsite visits are not fulfilled timely by the auditee, the auditor would not be able to adequately test the asset. This could impose a scope restriction on the audit, increase costs, and result in a qualification to an opinion or a disclaimer of opinion. FASAB should consider the other impacts that issuing the proposed guidance would cause. It may be harder, instead of easier, for a reporting entity to pass asset testing if FASAB issues the proposed bulletin.

Q2. The proposed TB requires reporting entities to disclose the policies used to assign significant assets. **Do you agree or disagree? Please provide the rationale for your answer.**

DoD OIG agrees that reporting entities should disclose how they assign assets. However, we believe that the reporting entities should follow the current SFFAC 5 guidance instead of creating a novel accounting practice.

Q3. Staff plans to develop guidance regarding assignment of liabilities to components within a larger reporting entity. Thus far, the specific types of liabilities identified where it may be helpful to provide additional guidance are liabilities related to assets such as clean-up costs and possibly all government related events. **Should such guidance be limited to liabilities related to assets such as clean-up costs or also address all government-related events? Are there other types of liabilities for which guidance would be helpful? Please provide the rationale for your answer.**

DoD OIG has no comment at this time.