

U.S. Department of Labor

Office of the Chief Financial Officer
Washington, D.C. 20210

JUN 24 2010

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548

Dear Ms. Payne:

On behalf of the U.S. Department of Labor, Office of the Chief Financial Officer, enclosed please find our comments on Statement of Federal Financial Accounting Standards, "Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment (Exposure Draft)," dated May 4, 2010.

We believe that the revised definitions will provide important guidance for the proper accounting, presentation, and disclosure of Deferred Maintenance and Property, Plant, and Equipment in Federal financial statements. Thank you for the opportunity to provide comments. If there are any questions, please contact Cynthia Simpson at simpson.cynthia@dol.gov or (202) 693-6807.

Sincerely,

A handwritten signature in black ink, appearing to read "Stanley Karczewski", with a long horizontal flourish extending to the right.

Stanley Karczewski
Office of Financial Policy

Enclosure

cc: Yoko Albayrak, OCFO

**U.S. Department of Labor
Office of the Chief Financial Officer
Comments on Federal Accounting Standards Advisory Board
Statement of Federal Financial Accounting Standards,
"Definitional Changes Related to Deferred Maintenance and Repairs:
Amending Statement of Federal Financial Accounting Standards 6,
Accounting for Property, Plant, and Equipment (Exposure Draft),"
Dated May 4, 2010**

Q1. The Board proposes adding "repairs" to the title and body of the revised definition in order to clarify that deferred "repairs" as well as deferred "maintenance" need to be reported.

Do you agree or disagree that the maintenance definition (title and body) should be changed to explicitly include "repairs" (refer to paragraphs A8 – A27 for a detailed discussion and related explanations)? Please provide the rationale for your answer.

In general, the U.S. Department of Labor (DOL) agrees that repairs may be added to the title and body of the revised definition in order to clarify that deferred repairs as well as deferred maintenance need to be reported. Maintenance work may invariably involve some degree of repairs. Repairs are a known lifecycle cost; reporting the deferral of repairs may provide information about items that may adversely affect assets. The proposed language in the last sentence of the definition is:

"Maintenance and repairs exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use."

The language could be clearer about the accounting treatment, such as, "Maintenance and repair costs exclude activities that would be treated as capitalized costs."

Various Reasons Why Maintenance and Repair Costs may not be Capitalized. There are various reasons why maintenance and repair costs may not be capitalized even though the costs expand the capacity of an asset or otherwise upgrade it, but are still treated as expenses. The reasons may include (1) costs do not meet the Agency's current capitalization threshold or (2) management determines it is more appropriate to treat the costs as expenses versus increases to assets. It may be more appropriate to treat the costs as expenses because (1) management may be unable to determine the probability or timing of future benefits (e.g., whether the repairs will result in the intended benefits or how long the benefits may last), (2) the future benefits may not last long enough to justify capitalization, or (3) repairs are made to items which the Agency did not capitalize.

We suggest that FASAB consider in its deliberations the various reasons why maintenance and repair costs may not be capitalized.

Matching Principle and Periodicity. Statement of Federal Financial Accounting Concepts No. 1 (SFFAC 1), Operating Performance Objective, states, "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;"

Implied in this objective are the principles of matching and periodicity, that ". . . expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results." (SFFAC 1, Paragraph 124, FASAB: Pronouncements as Amended, Version 8, 06/2009), Page 40)

If maintenance and repairs are limited to costs that are expensed and that would have been expensed if they had been incurred, the reader of the financial statements would be better able to ascertain these costs in comparison to the achievement of program results.

This does not preclude the recognition of costs that would be capitalized if they were incurred, because this would then lead to depreciation expense and would extend the expenses over multiple periods.

We suggest that FASAB consider in its deliberations the matching principle and periodicity.

Benefits to Future Periods. Paragraph 37 of SFFAS 6 states:

"37. Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E." (FASAB: Pronouncements as Amended, Version 8 (06/2009), Page 584)

Capitalization of costs which extend the useful life or enlarge or improve the capacity of existing PP&E is still subject to (1) meeting the capitalization threshold and (2) management's determination that expenditures will benefit future periods. Implied in paragraph 37's requirement to depreciate/amortize the capitalized cost over the remaining useful life of the PP&E is that the expenditures will benefit future periods and costs must be matched to services provided in that period. The standard implies that the remaining useful life is the future periods benefited, but does not provide a minimum number of periods.

Paragraph 17 of SFFAS 6 requires PP&E to have a useful life of 2 years or more, but management must decide whether or not this 2-year threshold is applicable to these types of costs. (FASAB: Pronouncements As Amended, Version 8, (06/2009), Page 577) If the 2-year threshold is applicable, then management must decide whether to apply it at the component level (useful life for that component) or to the PP&E item as a whole (additional useful life for the PP&E).

We suggest that FASAB consider in its deliberations the benefits to future periods.

Confusion Over Using the Term "Normal" to Describe Repairs. Paragraph A17.a. of the Exposure Draft (ED) states that the term "normal repairs" may cause confusion and "... could lead to the exclusion of repair activities (e.g. repairs brought about by injury or damage) that would ordinarily fall under deferred maintenance reporting. . . ."

Injury or damage may be caused by casualty, weather, man-made or natural disasters, or other events; the Agency may consider these events to be unusual, infrequent, or both. DOL agrees that activities to restore functionality in these fixed assets could also be considered repairs. Therefore, DOL agrees that the term "normal" should not be used to describe the repairs.

We suggest that FASAB consider in its deliberations: the reasons for the repairs, the extent of the repairs, and whether the repairs would restore the asset to its previous state or significantly improve the asset's productivity or extend its useful life.

Unmet Capital Needs, New Assets, Capital Improvements and/or Enhancements.

Paragraphs A22 and A23 of the ED state:

"A22. . . . While unmet capital needs (i.e. capital improvements and new acquisitions) are relevant to decision makers, they do not as clearly relate to reporting on past transactions and events as DM&R does. As such unmet capital needs should not be accounted for and included in the calculation of DM&R. DM&R arises because an asset exists and it is not maintained in accordance with an agency's established M&R policy; this is an event that has financial consequences for the entity and is relevant to decision makers."

"A23. . . . Rather, that agencies should not include new asset, capital improvement and/or enhancement needs in DM&R and should treat alike circumstances similarly over time since a consistently followed practice that is well described will assist decision makers."

We agree that unmet capital needs, new assets, capital improvements and/or enhancements, whether capitalized or expensed and whether for fixed assets or PP&E, should be excluded from deferred maintenance and repairs. With regard to consistently followed practices, the change in a capitalization threshold may change the how the Agency views maintenance and repairs as compared to capital improvements and/or enhancements.

We suggest that FASAB consider in its deliberations the effect of a change in capitalization threshold. If the capitalization threshold is increased, then expenditures may be more likely considered as maintenance and repairs; if the capitalization threshold is decreased, then expenditures may be more likely considered as capital improvements and enhancements. We also suggest that FASAB consider in its deliberations the effect of a change in the unit of account: group, composite, asset, or component level. If the unit of account is increased to a higher level, the expenditures may be more likely considered as maintenance and repairs. If the unit of account is decreased to a lower level, the expenditures may be more likely considered as capital improvements and enhancements.

Q2. The second sentence of the existing standard provides (1) an illustrative list of activities which are not meant to be all inclusive and (2) the terms "acceptable services" and "expected life." First, the Board proposes that the list of activities contained in the second sentence of the existing definition be updated to better reflect current federal and industry practices as well as encompass maintenance and repair (M&R) activities related to equipment and other personal property in addition to buildings, building components, or service systems. Second, the Board believes that the terms "acceptable services" and "expected life" should be eliminated from the definition. The second sentence would read as follows:

"Activities include preventive maintenance, replacement of parts, systems, or components, and other activities needed to preserve or maintain the asset."¹

¹ Note: The current SFFAS 6 language states in part that maintenance is "...needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life."

a. Do you agree or disagree with each change to the list of activities (refer to paragraph A16 through A17 for a list of changes and related explanations)? Please provide the rationale for your answer to each change.

b. Do you agree or disagree with the elimination of the phrase "so that it continues to provide acceptable services and achieves its expected life" (refer to paragraphs A18, A19, and A27 for detailed discussions and related explanations)? Please provide the rationale for your answer to each reference/phrase.

a. **Use of the Term "Systems."** The proposed definition states, "Activities include preventive maintenance, replacement of parts, systems, or components, and other activities needed to preserve or maintain the asset."

Paragraph A17.b of the ED states, "...because complete system replacements can be part of a routine M&R program, they should not be excluded from the definition of M&R. For example, it is not uncommon for real property to be viewed in terms of building service systems such as electrical, plumbing, HVAC, fire protection, and elevators." The term "asset" in the definition refers to the real property in the context of the systems example, but some Agencies may account for the systems separately from the real property. DOL believes that an Agency that overhauls or replaces a system may capitalize these costs as a separate asset, assuming that the costs meet the capitalization threshold and benefit future periods, even though these costs may not expand the capacity of the system or real property or otherwise upgrade it to serve different needs. Therefore, DOL disagrees with including the term "systems" in the definition.

¹ Note: The current SFFAS 6 language states in part that maintenance is "...needed to preserve the asset so that it continues to provide acceptable services and achieves its expected life."

Information Technology. Paragraph A17.b of the ED also states, "Second, like other assets, Information Technology (IT) systems also are subject to routine maintenance and repair (e.g. version releases commonly referred to as 'maintenance fixes') and consequently, should be included in the list of M&R activities."

In reference to the IT systems, we made inquiries of FASAB staff on whether the proposed definition of maintenance and repairs applied to internal use software. FASAB staff replied to us that, "SFFAS 10 classifies internal use software as PP&E. As such, DM&R [*deferred maintenance and repairs*] would apply." (E-mail from FASAB Staff dated June 7, 2010).

We recommend that any discussion regarding IT systems and maintenance and repairs also include a reference to internal use software. Except for the term "systems," DOL agrees with the other items in the list of activities.

b. DOL agrees with the elimination of the phrase "so that it continues to provide acceptable services and achieves its expected life" as long as the maintenance and repair activities are treated as expenses in the current period and not capitalized. We believe that acceptable services are implied and that life expectancy may vary even with the best maintenance and that there may be different expectations regarding life expectancy.

One DOL Agency suggested alternative wording, such as "to ensure asset full end use functionality." Paragraph A.14 of the ED states, ". . . the Board acknowledges the view that maintenance generally retains an asset's functionality whereas repair generally restores an asset's functionality." The Agency believed that this phrase in paragraph A.14 of the ED emphasizes the functionality of the asset and its usefulness in serving the current environment and not an arbitrary sub-component use. The alternative wording also emphasizes the use of the asset in the current environment and is not limited to the one originally intended.

Q3. The Board proposes changing the last sentence of the definition to exclude the reference to needs "originally intended" to be met by the asset. Instead, "*activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use*" is proposed (underscoring added for emphasis).

As such, the proposed revised last sentence would read as follows:

"Maintenance and repairs exclude activities directed towards expanding the capacity of an asset or otherwise upgrading it to serve needs different from, or significantly greater than, its current use."

Do you agree or disagree with the aforementioned change (refer to paragraph A20 for a detailed discussion and related explanation)? Please provide the rationale for your answer.

DOL agrees with the aforementioned change to this wording. Excluded activities may be those activities whose costs would have otherwise been capitalized. Please refer to our response to Question 1 for our discussion regarding the various reasons why maintenance and repair costs may not be capitalized.

Q4. The Board is not proposing a change at this time but rather, is seeking input on the impact that agency capitalization thresholds might have in the reporting of deferred maintenance and repairs. Because PP&E is subject to various capitalization thresholds and actual maintenance requirements are not, some believe it is more appropriate to report deferred maintenance and repairs (DM&R) in the broader context of fixed assets rather than only for capitalized PP&E.

Do you believe Deferred Maintenance and Repair (DM&R) reporting should be limited to DM&R related to capitalized PP&E or directed broadly to fixed assets? Please provide the rationale for your answer. Refer to paragraph A21(c) and A24 for a detailed discussion and related explanation.

DOL believes that, because PP&E is subject to various capitalization thresholds, deferred maintenance and repairs should be directed broadly to fixed assets; deferred maintenance and repairs should not be limited to capitalized PP&E. If deferred maintenance and repairs were to exclude activity related to non-capitalized PP&E, then Agencies would have to distinguish between capitalized versus non-capitalized PP&E. DOL's capitalization policy is as follows:

"DOL's capitalization thresholds are displayed in the following table.

Property classification	Prior to FY 1996	FY 1996 through		Useful life
		FY 2001	FY 2002 and thereafter	
Equipment — WCF	> \$5,000	> \$5,000	≥ \$50,000	≥ 2 years
Equipment — Non WCF	> \$5,000	> \$25,000	≥ \$50,000	≥ 2 years
Real Property Purchases or Improvements	> \$5,000	> \$25,000	> \$500,000	≥ 2 years
Leasehold Improvements	> \$5,000	> \$25,000	> \$500,000	≥ 2 years
Internal Use Software — WCF	> \$5,000	> \$5,000	> \$300,000	≥ 2 years
Internal Use Software — Non WCF	> \$5,000	> \$300,000	> \$300,000	≥ 2 years

PP&E purchases and additions are stated at cost. Normal repairs and maintenance are charged to expense as incurred. PP&E are depreciated over their estimated useful lives using the straight-line method of depreciation." (DOL Performance and Accountability Report (PAR) for FY 2009, Page 185, Note 1, Summary of Significant Accounting Policies, F. Property, Plant and Equipment, Net of Accumulated Depreciation)

In FY 2010, DOL raised the capitalization threshold for internal use software to \$500,000 for both WCF and non-WCF items.

In accordance with the above capitalization threshold policy, the same type of item may have been capitalized or expensed depending on (1) the year of purchase and (2) the source of funds, Working Capital Fund (WCF) or non-WCF. For this reason, deferred maintenance and repairs should apply to all fixed assets and not just capitalized PP&E.

One of DOL's Agencies has considerable amounts of facilities, structures, and equipment that are below the current capitalization threshold. Excluding deferred maintenance and repairs on the non-capitalized property may skew the data and misrepresent the situation for deferred maintenance and repairs.

Q5. The Board encourages respondents to not only provide input concerning any and all aspects of the proposed changes thus far discussed, but also other changes, points, issues and/or considerations which may not have been specifically addressed in this exposure draft. In addition, the basis for conclusions explains the Board's goals for this project (see comments beginning at par.A8) and also discusses other issues raised by task force members (as an example, see paragraphs A11 through A13).

Please provide any comments or suggestions you have regarding the goals for this project, other issues identified in the basis for conclusions, or areas which have not been addressed.

Heritage Assets and Multi-Use Heritage Assets. SFFAS No. 29, paragraph 26, states:

"26. Entities should report the condition¹¹ *[footnote omitted]* of the heritage assets (which may be reported with the deferred maintenance information¹²) *[footnote omitted]* as required supplementary information. Entities should include a reference to the condition and deferred maintenance information¹³ *[footnote omitted]* if reported elsewhere in the report containing the basic financial statements." (FASAB: Pronouncements as Amended, Version 8 (06/2009), Page 1181)

SFFAS No 29, paragraph 22, states:

"Multi-use Heritage Assets

22. The cost of acquisition, improvement, reconstruction, or renovation of multi-use heritage assets should be capitalized as general PP&E and depreciated over its estimated useful life." (FASAB: Pronouncements as Amended, Version 8 (06/2009), Page 1179)

Other than a couple of references to museum collections in paragraph A17.d of the ED, we could not find any discussion regarding heritage assets. Please clarify whether the scope of the ED excludes heritage assets and multi-use heritage assets treated as general PP&E.

Normal versus Major Repairs, Paragraph A17.a. Paragraph A17.a of the ED states that the term "normal repairs" may cause confusion because it ". . . implies that there are abnormal or extraordinary repairs." The difference between normal and major repairs is described in

intermediate accounting textbooks and taught in intermediate accounting courses on U.S. Generally Accepted Accounting Principles for non-governmental entities. Under U.S. GAAP for non-governmental entities, the accounting entry for a major repair (a repair that extends the useful life of an asset) may decrease accumulated depreciation and increase to the carrying value of the asset. (Kieso, Weygandt, and Warfield's *Intermediate Accounting*, 13th edition, Pages 510-511, John Wiley & Sons, 2010)

We suggest that FASAB consider distinguishing the different types of repairs.

In this document, DOL has offered a number of suggestions for the Board to consider in its deliberations. We hope that our suggestions assist you in your efforts to complete this standard and in the follow up project to improve comparability and standardize measurement and reporting for deferred maintenance.

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Suggested edits are as follows:

1. Paragraph 3, Page 12. Remove the comma after *resulting in*.
2. Paragraph A17.a, Page 21. Place a comma after *e.g.*
3. Paragraph A18., Page 21. Change *crisp* to *concise* or *brief* and place a comma after *e.g.*
4. Paragraphs A22 and A24, Pages 23 and 24. Place a comma after *i.e.*