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February 4, 2016

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

RE: Proposed Statement of Federal Financial Accounting Standards, *Establishing Opening Balances for General Property, Plant, and Equipment*

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Financial Accounting Standards, *Establishing Opening Balances for General Property, Plant, and Equipment* – the exposure draft (ED). We support the Board's efforts to address alternative valuation methods for opening balances of general property, plant, and equipment (PP&E). We agree, as discussed in the Basis for Conclusions, that there is a need within the Department of Defense (DoD) community for alternative valuation methods. However, we believe there are certain aspects of the ED that are unclear, which will make implementation problematic, and in some instances will impact the auditability. Therefore, we provide the following comments for the Board's consideration.

1. Accounting for Parent-Child Allocation Transfers

We encourage the Board to collaborate with the Office of Management and Budget to consider the potential challenges a "parent account" reporting entity will face in ensuring the transactions and balances of its "child account" are properly recorded, reported, and disclosed in the "parent account" reporting entity's financial statements (or one or more line items addressed by the proposed Statement) in accordance with the proposed Statement when both the "parent account" and the "child account" establish opening balances based on the proposed Statement.

2. Application of Proposed Statements at Complex Reporting Entities

A complex reporting entity (level A) may have multiple component reporting entities (level B), each of which may be a reporting entity with its own component reporting entities (level C). We recommend that the Board clearly state at which level (A, B, or C) within a complex reporting entity the Board intends there to be consistency in accounting treatment when providing alternatives such as the proposed amendments to SFFAS 6, paragraph 40(d) and SFFAS 10, paragraph 36(d).

3. Amendments to SFFAS 6, *Accounting for Property, Plant, and Equipment* – Paragraph 12

- a. Footnotes 4, 5, 7, and 9 through 10 provide various definitions of terms. We recommend that the Board not repeat definitions within the footnotes if the term is already defined within the

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Statement, and that for those terms previously defined outside the proposed Statement, the Board either consistently repeat the definition or reference to where the term is previously defined.

- b. The proposed amendment to SFFAS 6, paragraph 40(d) states “The reporting entity may exclude land and land rights...” We recommend that the Board clarify in paragraph 40(d) whether the decision to exclude land and land rights is made by the reporting entity or made individually by the multiple component reporting entities that may exist within a given reporting entity. A similar clarification was made for the use of the alternative valuation methods in paragraph 40(e).
- c. The proposed amendment to SFFAS 6, paragraph 40(d) states “If this alternative is applied, the reporting entity should expense future land and land right acquisitions.” This sentence addresses accounting for transactions beyond the opening balances; however, it is included in the section on opening balances. We recommend that the Board consider amending SFFAS 6, paragraph 25 to include this proposed ongoing accounting treatment.
- d. We recommend that the Board add a footnote reference to SFFAS No. 47, *Reporting Entity*, for the definition of a component reporting entity in the proposed amendment to SFFAS 6, paragraph 40(e).
- e. The proposed amendment to SFFAS 6, paragraph 40(f)(ii), uses the term “material improvements”. We recommend that the Board replace the term “material improvements” with language from SFFAS 6, paragraph 37, which uses the phrase “Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity...”
- f. The proposed amendment to SFFAS 6, paragraph 40(f)(ii), states “It is not necessary to separately identify the in-service date for material improvements to a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.” We believe the proposed amendment could distort an asset’s net book value as described in the following examples.

	Cost	Estimated in-service date of material improvement	Estimated in-service date of base unit	Useful life*	Years in service at 10/1/16	Accumulated depreciation at 10/1/16	Net book value at 10/1/16
<i>Example 1: Base unit depreciated using estimated in-service date of base unit; Material improvement depreciated using estimated in-service date of material improvement</i>							
Base unit	\$120,000,000	-	10/1/1996	40	20	\$60,000,000	\$60,000,000
Material improvement	\$ 20,000,000	10/1/2011	-	25	5	\$ 4,000,000	\$16,000,000

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<i>Example 2: Base unit depreciated using estimated in-service date of base unit; Material improvement depreciated using estimated in-service date of base unit</i>							
Base unit	\$120,000,000	-	10/1/1996	40	20	\$60,000,000	\$60,000,000
Material improvement	\$ 20,000,000	10/1/2011	10/1/1996	40	20	\$10,000,000	\$10,000,000

*SFFAS 6, paragraph 37 states “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.”

Therefore, we recommend adjusting the proposed amendment to SFFAS 6, paragraphs 40(f)(i) and (ii) as follows (new content underscored; deleted content struck-through):

- ~~f.i.~~ In some cases, the in-service date must be estimated. In estimating the year that the base unit or costs which either extend the useful life of existing general PP&E or enlarge or improve its capacity was placed in service, if only a range of years can be identified then the mid-point of the range is an acceptable estimate of the in-service date.
- ~~ii. It is not necessary to separately identify the in-service date for material improvements to a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in service at the date the base unit was placed in service.~~
- g. The proposed amendment to SFFAS 6, paragraph 40(g)(i) does not address the disclosure requirements for a reporting entity electing to exclude land rights from its general PP&E opening balances. We recommend that the Board add additional language to discuss the disclosure requirements related to land rights. We also recommend the Board consider whether the expensing of future land and land right acquisitions in lieu of capitalizing such acquisitions is a significant accounting policy that warrants ongoing disclosure.
- h. Certain language from the second sentence in the proposed paragraph 40(g)(i) repeats language from the proposed paragraph 40(d) and thus we recommend that the Board adjust the second sentence in paragraph 40(g)(i) as follows (deleted content struck-through):
- Each year thereafter, a reporting entity ~~electing to exclude land from its general PP&E opening balance~~ should ~~continue to exclude future land acquisition amounts~~ and provide the disclosures.
- i. We recommend that the Board adjust the proposed amendment to SFFAS 6, paragraph 40(g)(ii), as follows (new content underscored):

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A reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the methods used in the first reporting period...

- j. SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, states “Once established using deemed cost, opening balances are to be considered consistent with GAAP.” We recommend that the Board add this clarification to the proposed amendments to SFFAS 6.

4. Amendments to SFFAS 10, *Accounting for Internal use Software* – Paragraph 14

- a. Footnotes 11 through 13 provide various definitions of terms. We recommend that the Board not repeat definitions within the footnotes if the term is already defined within the Statement, and that for those terms previously defined outside the proposed Statement, the Board either consistently repeat the definition or reference to where the term is previously defined.
- b. We recommend that the Board adjust the proposed amendment to SFFAS 10, paragraph 36(b) as follows (new content underscored; deleted content struck-through):

The application of ~~this method~~ these alternatives based on the second condition....

- c. The proposed amendment to SFFAS 10, paragraph 36(b) states “Application of the recognition, measurement, and disclosure requirements of this Statement is required during the reporting period when the reporting entity makes an unreserved assertion.” We recommend that the Board reconsider whether this language is necessary given the proposed amendment to paragraphs 36(a) and 36(e).
- d. We recommend that the Board add a footnote reference to SFFAS No. 47, *Reporting Entity*, for the definition of a component reporting entity in the proposed amendment to SFFAS 10, paragraph 36(d).
- e. The proposed amendment to SFFAS 10, paragraph 36(d), states “A reporting entity may choose among the following alternatives...” and “a reporting entity may establish an opening balance based on a combination of these alternatives...” The term “may” presents an auditability challenge because a reporting entity could use any of the methods noted in the proposed paragraph 36(d) as well as any other method that may lack objectivity/measurability. Therefore we recommend that proposed paragraph 36(d) be adjusted as follows (new content underscored; deleted content struck-through):

Alternatives: A reporting entity should ~~may~~ choose among the following alternatives for establishing an opening balance for internal use software. Because a reporting entity may have multiple component reporting entities selecting different alternatives, a reporting entity should ~~may~~ establish an opening balance based on one, or a combination, of these alternatives. However, application of a

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- particular alternative must be consistent within each of the component reporting entities prior to consolidation.
- f. We recommend that the Board adjust the proposed amendment to SFFAS 10, paragraph 36(e), to require a reporting entity that elected to apply deemed cost in establishing opening balances for internal use software to disclose such election and the methods used, as follows (new content underscored; deleted content struck-through):

e(i). Disclosure requirements: A reporting entity electing to apply the alternative methods in establishing opening balances for internal use software should disclose this fact and describe the alternatives used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternatives are applied by component reporting entities consolidated into a larger reporting entity, the alternative adopted by each significant component should be disclosed. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which the alternative for establishing opening balances was applied are presented for comparative purposes. No disclosure of the distinction or breakout by alternative method of amount of ~~deemed cost~~ of internal use software included in the opening balance is required.

e(ii). A reporting entity electing to apply deemed cost in establishing opening balances for internal use software should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of internal use software included in the opening balance is required.

- g. SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, states “Once established using deemed cost, opening balances are to be considered consistent with GAAP.” We recommend that the Board add this clarification to the proposed amendments to SFFAS 10.

5. Amendments to SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment* – Paragraphs 15 through 17

We support the Board for taking steps to combine implementation guidance for general property, plant, and equipment, with the exception of certain provisions applicable to internal use software, in SFFAS 6. We recommend that the Board combine the remaining ‘Amendments to Existing

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Standards' section from SFFAS 23 into the appropriate SFFAS and rescind SFFAS 23 in its entirety.

6. Paragraph 19

Paragraph 19 states "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35." It is unclear whether the Board intends for paragraph 19 to be included within the subheading "Rescission of SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23*" section of the proposed standard, or whether the Board intends for the paragraph to stand on its own. Readers could interpret this paragraph as applicable to opening balances for general PP&E discussed within the proposed standard, applicable to any general PP&E, or applicable to any financial statement balance. We recommend that the Board adjust the proposed standard to clarify its intent. If the Board intended this concept to be limited to opening balances, we do not believe paragraph 19 is needed as the thought is already captured in the amendments to paragraph 40 of SFFAS 6. If the Board intended this concept to be applicable to any general PP&E, we recommend moving the first sentence from the deleted language in paragraph 40 of SFFAS 6 and inserting it in paragraph 26 as follows (new content underscored):

All general PP&E shall be recorded at cost. Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

7. Basis for Conclusions – Amendments to SFFAS 6, Accounting for Property, Plant, and Equipment

- a. Paragraph A16 states "This Statement allows for PRV [plant replacement value] to be used in establishing the opening balance for real property in current year dollars and not be deflated to the in-service year." The use of "real property" in paragraph A16 is inconsistent and we recommend that the Board replace "real property" with "general property, plant, and equipment" or clarify its intent.
- b. Paragraph A16 states "This Statement allows for PRV to be used in establishing the opening balance for real property in current year dollars and not be deflated to the in-service year..." and paragraph A18 states "...although the PRV method may qualify as replacement cost..." The Board's use of "may" in paragraph A18 appears inconsistent with paragraph A16 and we recommend the Board amend paragraph A16 and/or A18 such that they are consistent.
- c. Paragraph A25 states "Deemed cost may be based on one, or a combination, of the accepted valuation methods". However, within paragraph 12, the proposed amendment to SFFAS 6, paragraph 40(e) states "...deemed cost should be based on one, or a combination, of the

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following valuation methods.” We recommend that the Board revise paragraph A25 to agree with paragraph 12 of the standard as follows (new content underscored; deleted content struck-through):

The Board recognizes that large and complex reporting entities such as the DoD may have used a variety of valuation methods prior to the adoption of a GAAP compliant method. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6 at different times prior to establishing opening balances. Deemed cost should ~~may~~ be based on one, or a combination, of the accepted valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

If you have questions about our response, please contact Ms. Amanda Nelson at 202-533-5560 or aenelson@kpmg.com.

Sincerely,

Handwritten signature of KPMG LLP in black ink.

KPMG LLP