

Federal Accounting Standards Advisory Board

Request for comments on the Exposure Draft - Establishing Opening Balances for General Property, Plant, and Equipment: *Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*

Comments Requested by February 4, 2016

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Organization Represented: Department of Defense / Office of the Under Secretary of Defense (Comptroller)

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The Department of Defense (DoD) is pleased to submit comments to the Federal Accounting Standards Advisory Board (FASAB) on the Exposure Draft - *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* (the Exposure Draft). DoD acknowledges and appreciates the FASAB's efforts in addressing DoD's request for additional guidance on establishing opening balances for general property, plant and equipment in a cost effective and resource efficient manner. Our response to FASAB's request for comments, as set out below, is organized into two Sections: (1) Responses to the Exposure Draft questions; and, (2) Comments on other matters contained in the Exposure Draft. Thank you for considering DoD's responses and comments.

This response to the FASAB Exposure Draft is the official response of the DoD. The Department of the Army (Army) has differing views on several of the items included in DoD's response below and the Army has prepared their own response which is being submitted separately. Their response represents only the Army's opinion and should not be construed as the DoD view.

#### SECTION 1 – RESPONSES TO EXPOSURE DRAFT QUESTIONS

**Q1. The Board proposes a reporting entity be permitted to apply an alternative valuation method in establishing opening balances for general property, plant, and equipment (PP&E) when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.**

**The proposed Statement describes the alternative valuation method and related disclosures.**

**a) Do you agree or disagree with the proposal to permit opening balances of general PP&E to be valued based on deemed cost? Please provide your rationale.**

#### DoD Response

DoD agrees with the proposal to permit opening balances of general PP&E to be valued based on deemed cost. With the caveats noted in Section 2 below related to Plant Replacement Value, DoD believes that the deemed cost valuation methods set out in paragraph 12.e of the Exposure Draft provide an appropriate degree of flexibility while maintaining financial statement reporting integrity. The flexibility afforded by the deemed cost approach will allow DoD and other federal agencies to focus their efforts on improving and implementing processes and systems rather than trying to overcome an absence of transaction based historical cost

information. Improved accounting and reporting systems and the associated processes and internal controls will support recording of PP&E using historical costs in compliance with Statement of Federal Financial Accounting Standards (SFFAS) 6 – *Accounting for Property, Plant and Equipment* on a prospective basis.

**b) Do you agree or disagree that the related disclosures are appropriate? Please provide your rationale.**

DoD Response

DoD agrees that the related disclosure requirements are appropriate. Because most individuals reading and using federal financial statements will not be familiar with the concept of deemed cost the disclosures set out in the Exposure Draft are both necessary and appropriate in order for the reader to understand the basis of accounting used to record transactions. Disclosures will also be necessary to describe any resulting opening balance adjustments in accordance with SFFAS 21 – *Reporting Corrections of Errors and Changes in Accounting Principles*. Consequently, DoD agrees with the following disclosure requirements set out in the Exposure Draft, paragraph 12.g.ii:

- Disclose that a deemed cost methodology has been used to determine the opening balance of property, plant and equipment.
- Describe the specific deemed cost methodology used to determine the opening balances – e.g. replacement cost, estimated historical cost, or fair value.
- The disclosure requirements will apply only to the year in which the deemed cost was applied unless those balances are presented in subsequent year financial statements for comparative purposes. In this instance the disclosures would be repeated.

DoD also concurs that no disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required. This is an important element of the Exposure Draft because having to make this type of distinction would require additional effort and resources to separately track these balances in subsidiary property ledgers.

**Q2. The Board proposes to amend Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, so that land categorized as general PP&E may be excluded from the opening balances of general PP&E. Instead, disclosures would reveal the acres of land and changes in those acres over time. 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.**

Some members suggested valuing existing land holdings based on a set amount per acre of land or deemed cost. For example, one study estimated the land value in the United States at roughly \$4.5 trillion in the third quarter of 2009. Since the number of acres in the United States is almost 2.3 billion, this equates to approximately \$2,000 per acre. (Land values vary greatly based on location, potential use, and availability and cost of financing.) These members are interested in receiving comments on the usefulness of a general valuation approach that could be applied government-wide.

The Board intends to begin a project on land in the near future that would review existing standards and consider a consistent approach. Based on the results of that project, the decisions made for opening balances and future acquisitions of land in this Statement may be revised. Also, some members suggested deferring any

**changes in the historical basis for land acquired for use in operations until the Board completes a re-examination of the appropriate basis of accounting for land.**

**(See par. 12.d. and 12.g. for relevant standards and par. A27-A34 for a discussion of certain members' concerns and A55 in the Basis for Conclusions.)**

**a) Do you agree or disagree with the proposal to allow exclusion of land from the opening balances of general PP&E even though other component reporting entities will report the cost of certain land in general PP&E?**

**If you disagree, do you prefer (1) to value land holdings based on existing standards requiring historical cost of land acquired in connection with other general PP&E to be capitalized, a set amount per acre of land, deemed cost, or another valuation method, (2) to defer any changes in the current requirements until the Board completes a reexamination of the appropriate basis of accounting for land, or (3) to adopt another option? Please provide your rationale.**

#### DoD Response

DoD agrees with the proposal to allow exclusion of land from the opening balances of general PP&E (i.e. the opening balance for land will be zero on the balance sheet) even though other component reporting entities will report the cost of certain land in general PP&E. DoD's agreement is based primarily on:

- (i) A significant amount of land owned by the Federal Government (i.e. "Stewardship Land") is not recognized on the balance sheet under current FASAB accounting standards. Currently, only land acquired in connection with development or construction of an item of general PP&E is treated as general PP&E.
- (ii) DoD concurs with comment A32 in the Exposure Draft, Appendix A: Basis for Conclusions, that because land is not depreciated the benefit of capitalizing land and recognizing it in the financial statements is primarily in the period of acquisition (the majority of the DoD land would have been acquired in prior years as opposed to the current or future years). In future periods, the ongoing benefit is that of accountability for the asset which will be reflected in subsidiary property ledgers necessary to support the financial statement disclosure on the number of acres of land.

DoD does not support the deferral of any changes to the current FASAB requirements to record land at historical cost. This would impact the time frame in which DoD could achieve auditability. DoD does not have readily available sufficient documentation to support the opening land balances under current accounting standards (requiring land to be recorded at historical cost). DoD would have to expend significant financial and personnel resources in order to obtain sufficient supporting documentation (if even available) suitable for an audit. Many DoD land acquisitions date back more than a century and the acquisition price paid at that time would not be relevant to the current financial statements. The age of many of these land acquisitions make it virtually impossible to obtain records supporting historical cost.

**b) Do you agree or disagree that the related disclosures are appropriate? Please provide your rationale.**DoD Response

DoD agrees that the related disclosures are appropriate. These disclosures as set out in the Exposure Draft are:

- Disclose the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period.

These disclosure requirements are consistent with those currently required for Stewardship land. Having consistent disclosure requirements for these similar assets should provide the reader of the financial statements with more useful information regarding this property type.

**c) Do you agree or disagree that a reporting entity electing to exclude land from its general PP&E opening balances should continue to exclude future land acquisition amounts? Please provide your rationale.**DoD Response

DoD agrees that a reporting entity electing to exclude land from its general PP&E opening balances should continue to exclude future land acquisition amounts. Continuing to exclude acquisitions of land from recognition on the balance sheet subsequent to reporting a zero opening balance would provide a consistent methodology in accounting for land. This should be continued until such time as a different general valuation approach is determined by FASAB.

**d) The Board anticipates a project on land to review existing standards and to consider a consistent approach for all component reporting entities. Please provide any suggestions you have for improving current reporting on land.**DoD Response

DoD supports a federal government-wide general valuation approach based on the acreage of land that is a disclosure requirement for land under paragraph 12.g.i of the Exposure Draft. This valuation would be applied to all acres of land then being disclosed in an agency's financial statements. Determination of a price per acre could be the subject of a FASAB working group with participants from federal agencies, independent auditors and other interested parties. DoD would not support a future valuation methodology that would be applied retroactively if it requires additional information gathering other than what would have already been gathered to support the disclosure of land acreage.

DoD suggests when FASAB performs its project on land to review existing standards that it consider the following: (i) compare the total amount of Stewardship land/Heritage related land owned by the Federal Government compared to the non – Stewardship land/Heritage related land owned by the Federal Government, (ii) assess the importance of distinguishing between Stewardship land/Heritage related land and non-Stewardship land/Heritage related land based on the government's need to know this information for management and program purposes, and (iii) assess the importance to the Federal Government operations and budgeting process on having a dollar value assigned to the land it owns.

**Q3. The Board proposes to amend SFFAS 10, *Accounting for Internal Use Software*, to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The Statement provides for selecting between (1) an alternative valuation method of deemed cost that is consistent with that provided for all general PP&E and (2) prospective capitalization of internal use software.**

**The proposed Statement describes the alternatives and related disclosures. (See par. 13 – 14 for relevant standards and par. A35 – A39 and A56 in the Basis for Conclusions.)**

**a) Do you agree or disagree with the proposal to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software? Please provide your rationale.**

DoD Response

DoD agrees with the proposal to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software (IUS). DoD supports the conclusion in Appendix A: Basis for Conclusions of the Exposure Draft that it will be cost-beneficial to allow prospective treatment of IUS because it typically has a shorter useful life than other assets and is a “soft asset” that is harder to inventory when compared with other tangible assets. The flexibility that these alternatives provide to federal agencies will allow those agencies to focus their resources on improving systems and processes to be able to account for IUS in accordance with SFFAS 10: *Accounting for Internal Use Software* on a prospective basis rather than spending resources on supporting an opening balance.

**b) Do you agree or disagree that the related disclosures are appropriate? Please provide your rationale.**

DoD Response

DoD agrees that the related disclosures are appropriate; however, clarification on the disclosure requirements in paragraph 14.e and 14.d of the Exposure Draft would be beneficial as described below. Paragraph 14.e of the Exposure Draft sets out the following disclosure requirements:

- Disclose the election to apply alternative valuation methods for IUS opening balances.
- Describe the alternative valuation method(s) used in the first reporting period in which the entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP.
- If different alternatives are applied by component reporting entities consolidated into a large reporting entity, the alternative adopted by each significant component should be disclosed.
- The disclosure requirements will apply only to the year in which the deemed cost was applied unless those balances are presented in subsequent year financial statements for comparative purposes. In this instance the disclosures would be repeated.

DoD also concurs that no disclosure of the distinction or breakout of the amount of deemed cost of IUS included in the opening balance is required.

As noted above paragraph 14.e of the Exposure Draft relating to disclosures requires that “If different alternatives are applied by component reporting entities consolidated into a large reporting entity, the alternative adopted by each significant component should be disclosed.” Paragraph 14.d of the Exposure Draft states “Alternatives. A reporting entity 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 may establish an opening balance based on a combination of these alternatives. However, application of a particular alternative must be consistent within each of the component reporting entities prior to consolidation.” The last sentence of paragraph 14.d appears to require each component to select only one alternative valuation methodology to apply to all of its IUS even if that component is itself a reporting entity as well as being part of a consolidation in a larger reporting entity. For example the Department of the Navy is a component of the DoD overall consolidation but it is also a reporting entity on its own accord. The Department of the Navy is comprised of a number of Commands each of which have their own accounting and internal financial reporting systems. DoD seeks clarification from FASAB as to whether the individual Navy Commands, in this example, could select different alternative valuation methods for IUS and if they would then be required to change those valuations so that all Navy Commands applied a consistent alternative valuation method prior to consolidation of the Navy into the DoD wide financial statements.

**Q.4 The Board proposes to rescind SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23*, because this Statement would provide comprehensive guidance for establishing opening balances. The Board has incorporated the relevant components of SFFAS 35 in the proposed guidance in this Statement. The Board did not incorporate language from SFFAS 35 that explicitly allows for reasonable estimates on a go-forward basis to identify the cost of newly-acquired or constructed general PP&E.**

**Instead, the Board acknowledges that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35, and are acceptable without guidance from the Board. (See par.18 – 19 for relevant standards and par. A43 – A51 in the Basis for Conclusions.)**

**a) Do you agree or disagree with the proposal to rescind SFFAS 35? Please provide your rationale.**

DoD Response

DoD agrees with the proposal to rescind SFFAS 35, with the following caveat.

DoD has many lengthy and complex contracts for which it will be necessary to use estimates to allocate actual historical costs to newly acquired or constructed assets after establishment of the opening balances. Therefore, DoD suggests that paragraph 19 of the Exposure Draft should apply to both opening balances and to newly acquired or constructed assets after establishment of the opening balances. To avoid any confusion on the part of agencies and/or their auditors applying these accounting standards, DoD suggests that FASAB clarify paragraph 19 in the Exposure Draft to state that the use of estimates to arrive at indirect costs and the allocation of the direct and indirect components of the actual historical costs incurred, is permitted both in establishing opening balances for PP&E as well as for newly acquired or constructed assets after the establishment of the

opening balances. DoD further suggests that paragraph 19 should also state that the allocation of actual historical costs incurred is often a multi-step process involving the use of estimates in each of the steps. The allocation process steps often include: (i) evaluating the project direct costs incurred to determine which costs should be capitalized or expensed; (ii) estimating project indirect costs; (iii) accumulating project total cost in a construction in progress (CIP) account and relieving CIP as assets are placed in service. Allocation of costs on an estimated basis can be used to assign costs to assets when they are removed from CIP and placed in service.

In addition, DoD suggests that paragraph 19 of the Exposure Draft be an amendment to SFFAS 6 rather than remain in isolation within the new standard arising from the Exposure Draft. As a result, SFFAS 6 would then include all significant accounting policies for PP&E.

Although these concepts are set out in the Appendix A: Basis for Conclusions of the Exposure Draft, the preamble paragraph in the Appendix A states: “The standards enunciated in this Statement – not the material in this appendix – should govern accounting for specific transactions, events, or conditions.” Therefore, the DoD strongly believes that this matter needs to be more clearly addressed in the body of the Standard itself and as an amendment to SFFAS 6 (as described above) rather than just in the Appendix. This will help to avoid misinterpretations and misapplication of the Standard by both agencies and their auditors.

**Do you agree or disagree that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35? Please provide your rationale.**

#### DoD Response

DoD agrees that reasonable estimates are permitted in the preparation of financial statements with or without the existence of SFFAS 35. Based on discussions with many individuals, DoD believes that there are varying opinions on this by agencies and auditors, therefore to be sure there is no confusion or differing perspectives on this important concept, DoD requests additional clarifying language in the Standard as described in our response to Question 4 (a) above.

#### SECTION 2 – COMMENTS ON OTHER MATTERS CONTAINED IN THE EXPOSURE DRAFT

1. In numerous paragraphs throughout the Exposure Draft, for example in paragraph 7, the following statement is made: “This Statement may be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.” DoD requests that clarifying language be added in the Standard to address the following two points:
  - a) DoD currently reports General Property, Plant and Equipment, Net, as one line item on the balance sheet. However, in the footnotes, the major asset classes are reported separately (land; building, structures, and facilities; leasehold improvements; software; general equipment; assets under capital lease; construction in progress; and, other). DoD Components are most likely to make their unreserved assertions by major asset category rather than a one-time assertion for all General Property, Plant and Equipment taken as a whole. The phrase “one or more line items addressed by this Statement,” should be expanded to define line items as being line items on the financial statements or line items within the footnotes to the financial statements. This is consistent with the fundamental financial statement reporting concept that the footnotes are an integral part of the financial statements taken as a whole.

In addition, A13 in Appendix A: Basis for Conclusions of the Exposure Draft states:

“This Statement amends SFFAS 6 implementation guidance to include alternatives for establishing opening balances. A reporting entity may use deemed cost as an alternative 17 valuation method in establishing opening account balances for general PP&E for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The presentation of line items may be more or less detailed. For example, components of general PP&E, such as land, may be a separate line item, or there may be a single line item for all general PP&E.”

This statement appears to support DoD’s request for including footnote line items in the definition of a line item as set out above.

- b) While the Exposure Draft defines “an unreserved assertion” as an “unconditional statement”, it would be beneficial for the Standard to address, perhaps by way of an example, the narrative components that should be included in the assertion.
2. DoD recommends that “Plant Replacement Value” be explicitly added to the list of alternative valuation methods in paragraph 12.e of the Exposure Draft with the following footnote definition: “Plant Replacement Value is the current amount that would be required to replace the service capacity of an asset, inclusive of capital improvements.”

Although “Plant Replacement Value” is discussed in Appendix A: Basis For Conclusions in the Exposure Draft, DoD has the following concerns with the manner in which it is addressed in Appendix A and the fact that it is not in the body of the Standard:

- A16 in Appendix A states in part – “This Statement allows for PRV to be used in establishing the opening balance for property in current year dollars and not be deflated to the in-service year.” DoD supports that statement; however, A18 in Appendix A states in part “The Board cautions that although the PRV may qualify as replacement cost and be used in establishing the opening balance for real property, the PRV model and information supporting it would be subject to audit.”
- The phrase “may qualify” in A18 could be interpreted as contradictory to A16. DoD suggests changing this sentence in A18 to the following: “The Board cautions that although the PRV can be used in establishing the opening balance for property, the PRV model and information supporting it would be subject to audit.”
- A17 in Appendix A relates specifically to concerns raised by DoD over the definition for replacement cost from SFFAC 7 – *Measurement of the Elements of Accrual Basis Financial Statements in Periods After Initial Recording*. An excerpt of paragraph 47 from SFFAC 7 is included in A17. The examples in paragraph 47 from SFFAC 7 include the concept of discounting (reducing or adjusting) values for current cost or current fair value which is inconsistent with not deflating the PRV value. DoD is concerned that inclusion of this narrative and excerpt from SFFAC 7 in A17 may do more to confuse the issue than to clarify it. Consequently, DoD suggests that A17 be removed in its entirety.
- DoD is in agreement with the current narrative in A16 and the revised narrative suggested above for A18; however, it is important to note that the preamble paragraph in the Appendix A states “The standards enunciated in this Statement – not the material in this appendix – should govern accounting for specific transactions, events, or conditions.” Therefore, the DoD believes that this

matter needs to be more clearly addressed in the body of the Standard itself with the addition of the “plant replacement value” along with its definition in paragraph 12.e of the Exposure Draft rather than just in the Appendix. This will help to avoid misinterpretations and misapplication of the Standard by both federal entities and their auditors.

3. DoD suggests that paragraph A23 in Appendix A: Basis for Conclusions be revised to state the following: “The Board concluded that the current DoD process of including improved contract clauses in new or modified contracts should continue. As existing contracts expire or are modified, this issue should be resolved. Based on **preliminary estimated** information presented by the DoD, 77% of the current contracts expire in 2016 and 12% expire in 2017. Hence, **assuming that these estimates are reasonably accurate**, processes would be in place to capture government property in the hands of contactors by 2018 through issuance of new contracts with required clauses. Considering much of the information and data indicates the contracts for government property in the hands of contactors will expire soon and the assets may be immaterial or fully depreciated, with time the DoD may be in a position to support that this line item is not materially misstated. This supports that accounting treatment for government property in the hands of contactors should continue to be consistent with general PP&E.”

As previously discussed with the FASAB Staff, this information is based on very preliminary estimates and DoD suggests adding the words we highlighted in bold font above to emphasize that point in the final Standard. However, we are not suggesting that these edits be in bold font in the final version of the Standard.

4. Paragraph A52 in the Appendix A: Basis for Conclusions states: “A52. The disclosures required are also included in the amendments to the implementation guidance in SFFAS 6 and 10. Specifically, the election to apply the provisions of this Statement should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The first reporting period would be the first year-end financial statement that an unreserved assertion is made. The Board does not believe the first reporting period should be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures.”

DoD suggests that this narrative be clarified. For certain classes of PP&E, DoD has instructed its Components to establish their opening balances no later than March 31, 2017. As March 31, 2017 is an interim reporting period, would it be acceptable for the DoD Component to make the unreserved assertion with the “as of” date of September 30, 2017 since that is the year end during which the opening balances were established. Or, did FASAB intend to direct federal agencies only to establish opening balances at the end of a fiscal year?

5. If SFFAS 35 is rescinded, to prevent confusion in the future, DoD recommends that the FASAB either modify Technical Release 13 – Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment, by removing the references in the Technical Release to SFFAS 35 or incorporate the concepts from the Technical Release directly into SFFAS 6 as a further modification to SFFAS 6.
6. There is some confusion and differing opinions on whether or not corrections to opening balances valued based on deemed costs can be done in fiscal years subsequent to the fiscal year in which the opening balance was initially recorded. To clarify how such corrections should be recorded in accordance with

existing GAAP, DoD recommends the following changes to the amendment to paragraph 40 be included in paragraph 12 of the Exposure Draft:

- i) Re-letter paragraphs (d ) and (e) to (e) and (f), respectively.
- ii) Insert a new paragraph (e) that states the following:  
Reporting entities that find opening balance errors during a fiscal year subsequent to the fiscal year in which the opening balance was initially recorded based on deemed cost, and which need to be corrected, should record such adjustments subject to the reporting requirements under paragraph 10 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.