Federal Accounting Standards Advisory Board

ESTABLISHING OPENING BALANCES FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT:

AMENDING STATEMENT OF FEDERAL FINANICAL ACCOUNTING STANDARDS (SFFAS) 6, SFFAS 10, SFFAS 23, AND RESCINDING SFFAS 35

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by February 4, 2016

December 22, 2015

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the Government Accountability Office (GAO), established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. The FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor the FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board," exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on the FASAB's website at www.fasab.gov .

Contact us:

Federal Accounting Standards Advisory Board
441 G. Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone (202) 512-7350
FAX (202) 512-7366
www.fasab.gov

Federal Accounting Standards Advisory Board

December 22, 2015

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Statement of Federal Financial Accounting Standards, entitled *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*, are requested. Specific questions for your consideration begin on page 3, but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response will be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by February 4, 2016.

All comments received by the FASAB are considered public information. These comments may be posted to the FASAB's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, we ask that you please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax your comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not get a confirmation, please contact our office at (202) 512-7350 to determine if your comments were received.

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

Tom L. Allen

Chairman

EXECUTIVE SUMMARY

WHAT IS THE BOARD PROPOSING?

This proposed Statement would provide implementation guidance to allow a reporting entity to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E). To do so, it would amend Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and would rescind SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23.* The alternative methods include (1) using deemed cost to establish opening balances of general PP&E, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) excluding land from opening balances with disclosure of acreage information.

The alternative methods would be permitted 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 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 application of this Statement based on the second condition would be available to each reporting entity only once per line item addressed in this Statement.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This Statement would provide alternative methods when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 6, 10, 23, and 35. The alternatives are intended to reduce the barriers to and cost of adopting GAAP.

TABLE OF CONTENTS

QUESTIONS FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board welcomes your comments on other aspects of the proposed Statement. Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Board believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Microsoft Word file for your use at http://www.fasab.gov/board-activities/documents-for-comment/exposure-drafts-and-documents-for-comment/. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

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

All responses are requested by February 4, 2016.

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.

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

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.

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

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.

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.

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.**

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

Q4. 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.**

b) **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.**

INTRODUCTION

PURPOSE

1. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6 *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23* by providing implementation guidance to allow a reporting entity to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods or services.[1]

2. The alternative methods permitted by this Statement may be applied when a reporting entity is 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 application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

3. This Statement provides implementation guidance to allow a reporting entity to apply an alternative valuation method (deemed cost) in establishing opening balances for general PP&E and to allow an exclusion of land from the opening balances 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. It also provides for selecting between deemed cost and prospective capitalization of internal use software 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.

4. As a result of these amendments and rescission, all implementation guidance for general PP&E, with the exception of certain provisions applicable to internal use software, will be in SFFAS 6. The Board believes providing implementation guidance for general PP&E other than internal use software in SFFAS 6 will provide a comprehensive guide for users in a single Statement.

MATERIALITY

5. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating

[1] For a complete discussion of the definition, characteristics, recognition, and measurement principles for general PP&E, see SFFAS 6 par. 21-39. For the definition, recognition, and measurement principles for internal use software, see SFFAS 10 par.9-34.

information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

PROPOSED STANDARDS

SCOPE

6. This Statement applies when a reporting entity is 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 application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

7. This Statement may be applied in establishing **opening balances**[2] 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.

8. Reporting entities that meet either condition in paragraph 6 and elect to apply the alternative valuation method in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21, *Reporting Corrections of Errors and Changes in Accounting Principles*.

DEFINITIONS

9. **Opening Balances-** Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

10. **Unreserved Assertion-** An unconditional statement.

AMENDMENTS TO SFFAS 6, *ACCOUNTING FOR PROPERTY, PLANT, AND EQUIPMENT*

11. This section amends the implementation guidance provided in SFFAS 6, *Accounting for Property, Plant, and Equipment* as described in the following paragraphs.

[2] Terms defined in the Glossary are shown in bold-face the first time they appear.
[3] Adopted from AU-C 510, Opening Balances – Initial Audit Engagements, Including Reaudit Engagements (AICPA Professional Standards).

12. Paragraph 40 is replaced with:

40. Alternatives Available for Opening Balances.[4] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the 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 following should be considered in establishing opening balances:

a. The alternatives for establishing opening balances may only be applied for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[5] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP and for periods during which it is necessary to correct errors in the opening balances that are discovered in later reporting periods.

b. The application of these alternatives based on the second condition specified in paragraph 40 is available to each reporting entity only once per line item.

c. Reporting entities that meet either condition in paragraph 40 and elect to apply any of the alternatives available in establishing opening balances are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.

d. Land and land rights. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative is applied, the reporting entity should expense future land and land right acquisitions.[6]

e. Alternative Valuation Method. Deemed cost[7] is an acceptable valuation method for opening balances of general PP&E. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[8]

    i. Replacement cost[9]

[4] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[5] An unreserved assertion is an unconditional statement.

[6] 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.

[7] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

[8] The methods are not listed in order of preference.

[9] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would

ii. Estimated historical cost (initial amount). Reasonable estimates may be based on:
   a) cost of similar assets at the time of acquisition,
   b) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index), or
   c) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

iii. Fair value[10]

f. Establishing in-service dates.
   i. In some cases, the in-service date must be estimated. In estimating the year that the base unit 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. Disclosure requirements.
   i. A reporting entity electing to exclude land from its general PP&E opening balances must disclose, with a reference on the balance sheet, 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. 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.
   ii. A reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the method 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 general PP&E included in the opening balance is required.

---

receive from disposing of the asset at the end of its useful life. (Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46)

[10] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)

AMENDMENTS TO SFFAS 10, *ACCOUNTING FOR INTERNAL USE SOFTWARE*

13. This section amends the implementation guidance provided in SFFAS 10, *Accounting for Internal Use Software,* as described in the following paragraphs.

14. Paragraph 36 is replaced with:

36. Alternatives for Establishing Opening Balances.[11] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or the line item addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the 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 following should be considered in applying an alternative:

a. Alternatives for establishing opening balances may only be applied for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[12] that its financial statements, or the line item addressed by this Statement, are presented fairly in accordance with GAAP and for periods during which it is necessary to correct errors in this opening balance that are discovered in later reporting periods.

b. The application of this method based on the second condition specified in paragraph 36 is available only once to each reporting entity. 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.

c. Reporting entities that meet either condition in paragraph 36 and elect to apply any of the alternatives available in establishing opening balances are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21: *Reporting Corrections of Errors and Changes in Accounting Principles*.

d. 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.

    i. Prospective capitalization. The reporting entity may choose prospective application of SFFAS 10. If the reporting entity elects prospective treatment, the

[11] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[12] An unreserved assertion is an unconditional statement.

reporting entity should choose between the following acceptable alternatives at the opening balance date:

(a) Exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance.

(b) Exclude internal use software in service from the opening balance but include amounts related to internal use software under development at the opening balance date. Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 through 27 or on the alternative valuation method provided in paragraph 36.d.ii.

ii. Alternative Valuation Method. Deemed cost[13] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40e for implementation guidance regarding deemed cost.

e. Disclosure requirements: A reporting entity electing to apply the alternative methods 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 of amount of deemed cost of internal use software included in the opening balance is required.

AMENDMENTS TO SFFAS 23, *ELIMINATING THE CATEGORY NATIONAL DEFENSE PROPERTY, PLANT, AND EQUIPMENT*

15. This section amends the implementation guidance provided in SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* as described in the following paragraphs.

16. Paragraph 10 is replaced with:

    10. See SFFAS 6 for implementation guidance applicable to all general PP&E.

17. Paragraphs 11-18 of SFFAS 23 are rescinded.

RESCISSION OF SFFAS 35, *ESTIMATING THE HISTORICAL COST OF GENERAL PROPERTY, PLANT, AND EQUIPMENT: AMENDING STATEMENTS OF FEDERAL ACCOUNTING STANDARDS 6 AND 23*

[13] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

18. This paragraph rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23* in its entirety. Provisions from SFFAS 35 were incorporated into the implementation guidance of SFFAS 6 as needed.

19. Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35.

EFFECTIVE DATE

20. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for the Federal Accounting Standards Advisory Board (FASAB)'s consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, provide the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request from the DoD for guidance on establishing opening balances for general property, plant, and equipment (PP&E). Accounting for the federal government's general PP&E is complex and continues to be a challenge for large federal departments. This topic has been addressed in numerous Statements of Federal Financial Accounting Standards (SFFAS) and Interpretations as well as guidance issued by the Accounting and Auditing Policy Committee. SFFAS 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software*, SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23* address the accounting and reporting requirements for general PP&E.

A3. During the project, the Board's staff met with officials from the DoD, as well as the audit community, to develop an understanding of the issues currently faced by the DoD in establishing their baseline for general PP&E. This included discussing valuation methodologies currently employed, difficulties relevant to management assertions and the completion of audits, and the status of implementation of a generally accepted accounting principles (GAAP) compliant system for the DoD component.

A4. Based on the meetings and information provided it was determined that:

a. DoD financial systems and many aspects of DoD accounting policy for general PP&E have not been in accordance with FASAB GAAP.
b. Many organizations that maintain several different accounting and property systems are involved in acquiring general PP&E assets.
c. The DoD has not had consistent procedures related to general PP&E acquisitions or documented processes for retaining source documentation.

d. All major systems the DoD has utilized for acquisitions of general PP&E have either never been audited, or when audited had significant deficiencies or material weaknesses related to them.
e. Capital improvement projects have not been reliably tracked in systems so it is difficult to determine the date they were placed in service or to establish a valuation baseline.
f. The DoD has approximately 440,000 separate real property assets, and many real property assets were built more than 40 years ago.
g. DoD records related to land values are not in a structured, searchable system. The records are not digitized and accessing them involves searching boxed records. Also, source documents, such as deeds, may not be complete, and court records often have gaps given the length of time involved.
h. The DoD does not have a complete inventory of its internal use software (IUS) and costs of IUS have not been captured consistently.
i. General equipment is a broad category that includes military equipment and consists of hundreds of thousands of assets.

A5. After considering the status of the DoD's efforts and the fact that the DoD has had numerous years to implement the standards and has shown little progress, the Board discussed the merits of the project. Specifically, one member had concern regarding what the Board's role was and that the Board may be undermining its own credibility by acting to offer relief to the DoD because it has been unable to adopt GAAP requirements. The Board acknowledges that appearance is a concern. However, the Board has been tasked with establishing standards for which the benefits exceed the cost.

A6. The Board noted that while the DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when many of these standards were issued, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of this Statement is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed) but for which the current use is limited to accountability and assessing the cost of current services. The Board has proposed less costly alternatives that will support this use.

A7. The Board believes assisting the DoD with establishing a baseline would benefit all parties. Providing a starting point may enable the DoD to focus on needed improvements to systems and controls to process transactions going forward and thereby establish and maintain reliable financial information regarding future PP&E acquisitions. Establishing a sound financial management system is of primary importance.

A8. The Board also acknowledges that other standard-setters have provided guidance for organizations implementing an entire body of standards for the first time. The challenge of establishing opening balances for large public sector entities warrants the flexibilities proposed in this Statement.

ALTERNATIVE VALUATION METHOD AND IMPLEMENTATION GUIDANCE

A9. During deliberation on the project, the Board considered the recently approved SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.* SFFAS 48 permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. Deemed cost, or the amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances, was the alternative valuation method for valuation of opening balances in accordance with SFFAS 3, *Accounting for Inventory and Related Property* in SFFAS 48.

A10. The Board based part of its decision to select deemed cost in SFFAS 48 on International Public Sector Accounting Standards (IPSAS) No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board (IPSASB) reached several relevant conclusions with IPSAS No. 33:

a. Use of deemed cost facilitates the introduction of IPSASs in a cost effective way.
b. Multiple options for deemed cost are appropriate.
c. The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.
d. Use of deemed cost does not affect fair presentation.

A11. Consistent with the decisions in SFFAS 48, the Board believes a similar approach is appropriate in this project. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for general PP&E. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 6, as amended where historical records and systems do not support such balances.

A12. The Board determined permitting a reporting entity to apply alternative valuation methods in establishing opening balances for general PP&E would be most appropriate through implementation guidance. The implementation guidance for general PP&E currently resides in several Statements. Accordingly, this Statement amends SFFAS 6, SFFAS 10, and SFFAS 23, and rescinds SFFAS 35 by providing implementation guidance to allow a reporting entity to apply an alternative valuation method in establishing opening balances for general PP&E. Further, based on these amendments and rescission, all implementation guidance for general PP&E, with the exception of certain provisions applicable to internal use software, will be in SFFAS 6. The Board believes providing implementation guidance for all general PP&E in SFFAS 6 will provide a more inclusive approach and comprehensive guide for users versus reviewing multiple Statements that relate to this topic.

AMENDMENTS TO STATEMENT OF FEDERAL FINANCIAL ACCOUNTING STANDARDS

Amendments to SFFAS 6, Accounting for Property, Plant, and Equipment

A13. This Statement amends SFFAS 6 implementation guidance to include alternatives for establishing opening balances. A reporting entity may use deemed cost as an alternative 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.

A14. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 6, where historical records and systems do not support such balances. Accordingly, this Statement provides flexibility by permitting use of several measurement attributes and estimates. Deemed costs should be based on one, or a combination, of the following valuation methods: replacement cost, estimated historical cost, reasonable estimates, or fair value. The Board believes this is the most cost-effective option.

A15. Using the DoD example, providing implementation guidance requires consideration of cost-benefit as well as the current resource constraints. For example, the DoD has a dual challenge of establishing the baseline and a system capable of capturing the information to record the acquisition or construction of new general PP&E, thereby updating the information.

A16. The DoD currently uses plant replacement value (PRV) which is based on cost factors, such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. While PRV (a replacement cost model) has not been used for financial reporting purposes, DoD officials have stated it is used for decision-making and management purposes. 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. PRV is inclusive of capital improvements. Accumulated depreciation will be recognized based on the remaining useful life compared to the original useful life. This will not systematically understate the historical cost since capital improvements will not be deflated. However, by allowing current year costs, it may overstate the historical cost and subsequent years' depreciation expense.

A17. Prior to issuing the ED, the DoD raised concern regarding the definition of "replacement cost" from SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording.* The DoD questioned whether the PRV method would qualify as replacement cost. As explained in paragraph 47 of SFFAC 7 there may be several ways of arriving at an estimate:

> Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in

age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

A18. The Board cautions that although the PRV method 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. Allowing PRV for opening balances does not provide assurance that the data and supporting information will be acceptable for audit. At the issuance of the ED, the DoD was in the process of developing an approach to estimate the remaining useful life of real property assets, which is a key component to establishing the opening balances for real property. The Board stresses the importance of establishing useful lives and its significance to all general PP&E.

Government property in the hands of contactors

A19. Government property in the hands of contactors has been a challenging area for reporting entities. This may include government furnished equipment and contractor acquired equipment. Previous Boards believed the accounting treatment for such assets should be consistent with that of other assets since there is no conceptual difference. Further, most would agree there should be accountability over government owned assets in the hands of others.

A20. SFFAS 6 paragraph 18 provides that PP&E includes “property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors)” and paragraph 34 (along with note 34) elaborates that PP&E should be recognized when a title passes or is delivered to the acquiring entity or to an agent of the entity. For PP&E acquired by a contractor on behalf of the entity (for example, the entity will ultimately hold title to the PP&E), PP&E should also be recognized upon delivery, or constructive delivery, whether to the contractor for use in performing contract services or to the entity.

A21. During the due process deliberation of SFFAS 23 in 2003, this issue also came up. A respondent, unaware of existing standards, encouraged the Board to develop standards that address this type of property because the respondent believed that “accounting control over this property is deplorable.” As discussed in the Basis for Conclusions to SFFAS 23, the previous Board found that “despite the existence of standards for contractor held assets since late 1995, little progress has been made in resolving the issue. The Board does not believe that deferral of standards related to vast amounts of PP&E will facilitate resolution of the contractual and administrative details needed to reasonably comply with generally accepted accounting principles.”

A22. The Board understands that certain reporting entities may have long-standing contracts lacking contractual terms and systems needed to accumulate the necessary information. The alternative valuation method—deemed cost—is applicable to general PP&E in the hands of others. Other alternatives, including those proposed by the DoD, to mitigate the cost of properly reporting on such PP&E were considered. The DoD’s proposal was intended to allow the DoD to take a prospective approach[14] for establishing completeness

[14] The DoD’s proposed approach was for those contracts which end prior to October 1, 2016. The DoD would not perform procedures to identify property in the hands of contractors not accounted for to

and accountability for government property in the hands of contactors. Much of the DoD's rationale was based on the belief that government property in the hands of contactors is immaterial and that the equipment has a short useful life. However, existing data have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. The DoD also based the proposal on the fact that they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. The DoD has other accountability obligations and a management need for complete records to support decision making.[15]

A23. 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 information presented by the DoD, 77% of the current contracts expire in 2016 and 12% expire in 2017. Hence, 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.

A24. The Board conducted outreach on this issue prior to issuing the exposure draft. Feedback from the audit community conveyed that the issues the DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to the DoD's proposal, there were noted audit challenges due to gray areas, such as no firm cut-off date, the need for clarity with definitions, and complexities with implementation. In addition, there were noted existence and completeness challenges. There was also a belief that challenges would remain until the necessary contractual improvements were fully implemented.

Combination of valuation methods permitted

A25. 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 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.

A26. The purpose of this Statement is to provide an alternative valuation method for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of

---

establish an opening balance. However, they also would not remove property in the hands of contractors currently recorded. The DoD proposed recording the property prospectively at the end of the contract. The DoD will record all new contracts from October 1, 2016 forward in accordance with GAAP.

[15] In a May 13, 2014 statement to the U. S. Senate Committee on Homeland Security and Governmental Affairs, then DoD Comptroller Robert Hale acknowledged the importance of completeness when he explained, "Our audit strategy focuses first on the elements of our business that most often influence our decision making—namely budgetary dollars and the existence and completeness of property records."

records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities, such as the DoD, finalize a sound GAAP compliant financial management system. All activity after the opening balances for general PP&E are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

Land deliberations

A27. When deliberating general PP&E, the Board considered land somewhat differently from general PP&E. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance, both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information. Because land is not depreciated, the benefits of capitalizing land are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and capitalized. In doing so, the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

A28. The Board carefully considered those aspects of the land category along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board determined the most practical and cost-beneficial approach to establishing an opening balance for land was to permit the reporting entity to exclude land from the opening balance of general PP&E. However, the Board can support accountability through disclosures. The Board proposed that the reporting entity disclose, with a note reference on the balance sheet, 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. A reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude amounts for future land acquisitions. Accordingly, the reporting entity will provide the disclosures each year thereafter.

A29. Some members who supported excluding land expressed concern regarding the resulting inconsistency in reporting and suggested the Board begin a project on land in the near future to review existing standards and consider a consistent approach. In addition, the members suggested exploring options to improve reporting on land. Other members would like to explore valuing existing land holdings based on deemed cost (consistent with general PP&E) or on a set amount per acre of land.

A30. For example, one study[16] 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. Challenges in applying this method are many. Land values vary greatly based on location, potential use, and

[16]Joseph B. Nichols, Stephen D. Oliner, and Michael R. Mulhall. Commercial and Residential Land Prices Across the United States. *Finance and Economics Discussion Series.* Federal Reserve Board. Divisions of Research & Statistics and Monetary Affairs. 2010-16.

availability and cost of financing. In addition to establishing a relevant initial valuation, members would need to consider whether the valuation should be updated and, if so, how often. Nonetheless, these members are interested in receiving comments on the usefulness of a general valuation approach that could be applied to government-wide land classified as general PP&E.

A31. Two members do not believe that it is appropriate to revise current standards to allow write-off of all land acquired in connection with other general PP&E by selected federal entities for several reasons, including:

a. It is conceptually inconsistent to establish differing bases of accounting between two components for like assets; in this case land acquired for use in operations. Reporting land at zero cost is also inconsistent with the accounting for other general PP&E.
b. Reporting some land classified as general PP&E at zero cost and disclosing acreage for other land does not provide complete, consistent information across government concerning land.
c. Developing a "temporary" change in the basis for accounting until the Board completes a broader reconsideration of accounting for land, which may be different, does not support consistent application of the qualitative characteristics.
d. There is insufficient time to adequately research, consider, and develop proposals for alternative valuation bases for land based on the Board's desired timeframes for revisions to standards for other property, plant, and equipment.

These members support either (1) adopting alternative valuation methodologies for land included in general PP&E, such as deemed cost (similar to other general PP&E) or a set amount per acre, or (2) deferring any changes to the current historical cost basis for land classified as general PP&E for certain entities until the proposed Board project to re-examine the appropriate basis of accounting for all land is completed.

A32. The Board agrees that there is a need for a land project to review existing standards and consider a consistent approach, but it does not resolve the immediate request for assistance with opening balances. The DoD has made resolving general PP&E issues a priority area and requested guidance to avoid diverting DoD resources or taxpayer dollars in these areas to meet requirements. As noted, land is not depreciated so the benefits of capitalizing land are primarily in the period of acquisition. In future periods, the ongoing benefit is that of accountability for the asset.

A33. The Bard notes that current standards provide that only land acquired in connection with development or construction of an item of general PP&E should be treated as general PP&E. As a result, vast amounts of land owned by the federal government, also known as "Stewardship Land," are not recognized on the balance sheet. Instead, reporting entities are required to reference a note on the balance sheet that discloses physical units by major land use. Because the reporting of land varies based on the intended use when land is acquired, the project will 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.

A34. Therefore, the Board believes the proposal to allow exclusion of land for opening balances with disclosure of acreage information is the least costly approach, while also ensuring accountability, until the Board completes the land project.

Amendments to SFFAS 10, Accounting for Internal Use Software

A35. SFFAS 10 provides accounting standards for internal use software (IUS) used by federal entities. Previously, IUS had been addressed in SFFAS 6. Because certain questions remained, the Board decided to review the issue and to develop a separate Statement.

A36. IUS addressed by SFFAS 10 includes purchased commercial "off-the-shelf" software, contractor-developed software, and internally-developed software. Under the provisions of SFFAS 10, IUS is classified as general PP&E as defined in SFFAS 6. With the issuance of SFFAS 10, the section on IUS in SFFAS 6 was rescinded. SFFAS 10 provided guidance regarding the definition of IUS, the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, as well as other guidance.

A37. When SFFAS 10 was issued, the previous Board in effect provided for prospective implementation of SFFAS 10 in paragraph 36 by stating that "cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred."

A38. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains that some entities have not had or do not have systems that can provide the information necessary; therefore, the conditions remain that existed when many of these standards were issued. The Board considered certain unique aspects to the category of general PP&E that justify a similar treatment that was provided when SFFAS 10 was established. Specifically, the Board believes it would 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 to tangible assets. These facts make the cost of implementation higher than for other general PP&E and the benefit lower due to the shorter time the IUS would be reported as an asset that would be amortized to expenses.

A39. Therefore, the Board believes the most appropriate path is to amend the implementation guidance provided in SFFAS 10 to provide for prospective application of IUS if the reporting entity elects to do so. Considering the various stages of implementation within reporting entities, the Board determined that this Statement should provide flexibility. Therefore, the guidance also provides for an alternative valuation method consistent with general PP&E. Considering that IUS is classified as general PP&E, the Board believes it appropriate to allow use of deemed cost and to refer users to the deemed cost implementation guidance in SFFAS 6. Together, these amendments allow the preparer to elect from these three options:

a. to establish opening balances for existing IUS based on deemed cost,

b. to establish an opening balance of zero and capitalize costs consistent with SFFAS 10 prospectively, or

c. to establish an opening balance for IUS in development based on deemed cost, to establish an opening balance of zero for IUS in service, and to capitalize costs consistent with SFFAS 10 prospectively.

Amendments to SFFAS 23, Eliminating the Category National Defense Property, Plant, and Equipment

A40. The purpose of SFFAS 23 was to amend certain standards with regard to national defense (ND) PP&E. More specifically, SFFAS 23 rescinded the term “ND PP&E.”

A41. SFFAS 23 also provided implementation guidance for assets reclassified as general PP&E. Much of that guidance referred to the requirements in the implementation guidance provided in SFFAS 6. SFFAS 23 was effective for periods beginning after September 30, 2002, with earlier implementation encouraged. The Board believes it appropriate to rescind the implementation guidance in SFFAS 23 and refer users to the implementation guidance in SFFAS 6 that applies to all general PP&E, including general PP&E assets previously considered ND PP&E.

A42. By rescinding the paragraphs in SFFAS 23, the Board ensured the appropriate relevant guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board chose not to rescind SFFAS 23 in its entirety because the standards provide other amendments, such as rescinding the term ND PP&E as discussed above, that must be maintained.

Rescission of SFFAS 35, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Accounting Standards 6 and 23

A43. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data’s historical cost may be used to value general PP&E. It was to establish a cost-effective method to comply with SFFAS 6 by allowing reasonable estimates that were in accordance with SFFAS 6, as amended. While rescinding SFFAS 35 in its entirety, the Board ensured any pertinent guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board did not incorporate language from SFFAS 35 that explicitly allowed for reasonable estimates on a go-forward basis to value general PP&E. Such wording has led to questions as to when estimates may or may not be used.

A44. As explained in SFFAS 35, Basis for Conclusion paragraph A12:

> The Board stresses to federal entities that the measurement basis for G-PP&E remains historical cost; however, reasonable estimates are allowed. The Board believes entities should use judgment regarding the decision to use estimated historical cost in lieu of original transaction based data. The Board also notes that estimates are widely used throughout the financial statements. In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.

A45. When SFFAS 35 was issued, the Board believed that allowing or encouraging estimates as reporting entities worked towards implementing systems and processes that could capture beneficial historical data. However, it appears that this has not occurred at all Departments, and there has been an overreliance that was unintended. The language in SFFAS 35 has often been misinterpreted to be something other than reasonable estimates that are in accordance with SFFAS 6.

A46. Therefore, the Board believes it appropriate to rescind SFFAS 35. The Board acknowledges that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35. As noted in paragraph A17 of SFFAS 35, “estimates that do not lead to material misstatements are acceptable without guidance from the Board.” The majority of the Board believes it would be clearer if SFFAS 35 were rescinded.

A47. However, at least one member expressed concern with rescinding SFFAS 35 before soliciting input from the financial management community about (1) whether the rescission would send a signal that the Board no longer believes reasonable estimates are acceptable and (2) how other departments may be interpreting SFFAS 35 and the potential impact of the rescission of SFFAS 35. Therefore, the Board agreed to ask a detailed question for respondents on this topic.

A48. Prior to the issuance of the ED, the DoD raised concerns with the Board’s proposal to rescind SFFAS 35 based on the time it will take for the DoD to become full cost compliant. The DoD requested the Board consider retaining SFFAS 35 or provide transitional guidance in this area. The Board believes that current standards provide flexibility and that there are resources other than SFFAS 35 within the GAAP hierarchy to assist in this area. For example, there is guidance (Technical Releases) to assist in accumulating, allocating, and reporting the cost of general PP&E when there is not a detailed cost accounting system.

A49. Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the general PP&E lifecycle, decisions regarding the granularity of cost information, and acceptable methods for recognizing those costs. This implementation guidance is not dependent on SFAFS 35 and would remain applicable even if SFFAS 35 is rescinded.

A50. Additionally, SFFAS 4 established a requirement for cost accounting that acknowledged the use of cost finding techniques. The requirement is:

> Each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

A51. Management has discretion in applying the cost assignment methods identified in SFFAS 4, *Managerial Cost Accounting Standards and Concepts* to accumulate acquisition costs. Of particular importance is the emphasis on economic feasibility with regard to direct tracing of costs to outputs. SFFAS 4, paragraph 124, provides that "[in] principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

a. Directly tracing costs wherever economically feasible;
b. Assigning costs on a cause-and-effect basis; and
c. Allocating costs on a reasonable and consistent basis."

DISCLOSURES

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.

A53. The Board notes that the term “unreserved assertion” may be used in other contexts. For example, certain entities’ management (such as the DoD) may be required to make management assertions regarding its financial information and that DoD financial statements are validated as ready for audit by no later than September 30, 2017. This Statement refers to an unreserved assertion that the reporting entity’s “financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.” Other assertions – such as being ready for an audit - may or may not accompany such an assertion.

A54. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required. This disclosure need not be repeated unless the financial statements or, as applicable, reports on line items are presented for comparative purposes.

A55. A reporting entity electing to exclude land should disclose this fact 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 and continue to be so as long as an amount is not reported on the balance sheet. In addition, those reporting entities electing to exclude an amount for land on the balance sheet should disclose, with a note reference on the balance sheet, 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. The Board believes requiring these disclosures would meet accountability requirements and ensure appropriate measures continue to be taken for existence and completeness requirements.

A56. The disclosure requirements included in the amendments to SFFAS 10 are broader because the reporting entity may choose among alternatives for establishing an opening balance for internal use software. It provides for an alternative valuation method of deemed cost that is consistent with general PP&E and prospective capitalization of internal use software. A reporting entity electing to apply the alternative methods 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.

APPLICATION OF THIS STATEMENT

A57. A component reporting entity that is in the process of implementing systems that are GAAP compliant is permitted to apply this Statement at the time it 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. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A58. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP compliant systems; this allows them to assert independently of the larger DoD. The DoD would make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be the DoD's opening balance deemed cost at the beginning of the period the DoD was able to make an unreserved assertion on its financial statements, or one or more line items, addressed by this Statement.

A59. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election, since it may only be made once. A complex entity should work with its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities should ensure issues such as supporting documentation for opening balances are addressed and validated through sampling or other means, including consideration of any audit findings or conclusion affecting the reliability of the valuation, prior to making the unreserved assertion. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for fiscal year 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to:

a. continue in subsequent years to correct or support the valuation as of the beginning of fiscal year 2018, or
b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 6 (as amended), in all material respects.

A60. Reporting entities that meet the conditions specified in paragraph 6 and elect to apply the alternative valuation method in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles*. Specifically, paragraph 12 of SFFAS 21 states "…for the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards."

A61. Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13(a) – (c) for all changes in accounting principles:

(a) The cumulative effect of the change on prior periods should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made.
(b) Prior period financial statements presented for comparative purposes should be presented as previously reported; and
(c) The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosure."

A62. SFFAS 21 provides that the adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position for the period that the change is made. Thus, no change would be made to the ending net position of the previous year. The disclosures should be at a high level and explain that opening balances of a particular line item or group of line items were valued at deemed cost under this Statement, then briefly describe deemed cost and indicate the effect of adoption on beginning net position.

A63. In addition, alternative valuation methods provided in this Statement may be applied in correcting errors related to the opening balances discovered in later reporting periods if needed.

APPENDIX B: ABBREVIATIONS

DoD	Department of Defense
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
IUS	Internal Use Software
PP&E	Property, Plant, and Equipment
PRV	Plant Replacement Value
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

<u>Opening Balances</u>- Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[17]

<u>Unreserved Assertion</u>- An unconditional statement.

[17] Adopted from AU-C 510, Opening Balances – Initial Audit Engagements, Including Reaudit Engagements (AICPA Professional Standards).

FASAB Board Members

Tom L. Allen, Chair

Robert F. Dacey

Michael H. Granof

Christina Ho

Sam M. McCall

Mark Reger

D. Scott Showalter

Graylin E. Smith

Harold I. Steinberg

FASAB Staff

Wendy M. Payne, Executive Director

Melissa L. Batchelor

Federal Accounting Standards Advisory Board

441 G. Street, NW, Suite 6814

Mailstop 6H19

Washington, DC 20548

Telephone (202) 512-7350

FAX (202) 512-7366

www.fasab.gov