AAPC SFFAS 50 Implementation Task Force
Meeting #4 Agenda
May 3, 9:30 a.m.

- Introductions

- Discussion of Draft Technical Release (TR)
  - Alternative methods
  - Deemed cost methods
    - Replacement cost
    - Estimated historical cost
    - Fair value
  - Land rights

- **Reschedule next Task Force meeting to Monday, June 5, 2017 9:30 a.m**. (The task force could determine a meeting is not necessary and reviews be done electronically.) Allows proposed TR to meet the following proposed milestones:
  - A pre-ballot exposure draft is forwarded to the AAPC for a June Meeting.
  - The AAPC would need to approve a **pre-ballot / ballot draft at the June Meeting—tentatively scheduled for June 15.** If there are changes, a ballot draft could be approved electronically after the meeting.
  - Short due process: **30 day exposure (estimate) June 21- July 21.**
  - Staff considers comment letters and prepares analysis for AAPC. (Reconvene or request feedback from AAPC Task Force if necessary.) AAPC approve proposed TR and forward to the Board. **July 22- August 22.**
  - Proposed TR provided to the Board for 45 day review, but must coincide with a FASAB Board meeting. Therefore, the draft must be provided for the **August 30- 31, 2017 Board meeting.**
  - Board approves Proposed Technical Release approximately 45 days later; it will be effective upon issuance. Based upon the above schedule, the **Proposed Technical Release will be issued in mid-October**.

  ****Any delays in information requests, significant changes to the proposed guidance or additional areas added to the scope will change the above schedule and delay the issuance. Alternatively, FASAB can issue a second guidance on the topics.**

Technical Release
Implementation Guidance for Establishing Opening Balances

Alternative Methods

This implementation guidance provides assistance in applying the alternative methods for opening balances. It explains the alternative valuation methods and describes the documentation that could be used to support the valuation as outlined in SFFAS 6, as amended. It does not address the need to validate existence and completeness.

In Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*, the Board points out accounting standards necessarily involve judgments about the cost and benefits of producing information or of reporting it differently. The standard setter must, to some extent, be aware of these potential effects when considering the costs and benefits of any given accounting alternative. The benefits from standards should exceed the cost of complying with them.

A premise for issuing SFFAS 50 was to consider the benefit and cost associated with establishing general PP&E opening balance information. As explained in the basis for conclusions of SFFAS 50:

> A6. The Board noted that while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when FASAB issued many of these standards, 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 proposed less costly alternatives that will support this objective.
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> A7. The Board believes assisting DoD with establishing a baseline benefits all parties. Providing a starting point will enable 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.

The alternative methods provided in SFFAS 50 are meant to be less costly options to implement Generally Accepted Accounting Principles (GAAP) for general PP&E. The alternative methods provide the needed flexibility for establishing opening balances because it is not practical or cost effective to determine the historical cost of general PP&E because of inadequate systems and/or insufficient documentation.

Determination of which method to use is a management decision. Any of the methods provided by SFFAS 6, as amended are acceptable. It appears management would apply cost–benefit considerations and other practical concerns under different alternatives. It is important to be mindful that the alternative methods for establishing opening balances do not seek precision and assessments of the materiality and benefit versus cost are guiding factors.

Cost-beneficial solutions are a major goal of SFAFS 50. The reporting entity is allowed to determine the point at which the costs of improving estimates outweighs the derived benefits, especially given that the usefulness of the information is limited to accountability. The reporting entity may select any method; there is no preferred method among the methods permitted. . Therefore, making comparisons among the methods or attempting to identify the most cost-effective method would be inappropriate. Management is not required to select the most cost-effective, the most precise, or the best method for any particular desired result.

Adoption of the various alternative valuation methods requires the use of estimates. Accounting estimates are an approximation of a monetary amount in the absence of a precise means of measurement. Estimation uncertainty is the susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement. Estimation uncertainty will be high in establishing opening balances under deemed cost methods. In estimating deemed cost, management should consider the reasonableness of the estimate and be mindful of decisions users make. This guidance provides a foundation for preparers to exercise judgment in formulating those estimates.

The Board expressed the view that use of opening balances of general PP&E would be limited to providing accountability and assessing the cost of service (SFFAS 50, par. A6). In making assessments regarding the potential for material[1] misstatements in estimates under the method selected, management should consider how the gross cost of service might be affected as well as any potential impact on accountability. Because deemed cost permits use of several measurement attributes in establishing opening balances, usefulness of the resulting depreciation expense is reduced in comparison to depreciation expense based on actual historical cost valuation. Management should consider this reduced usefulness when selecting methods, collecting data, and selecting amounts for recognition.

The alternative methods include (1) using deemed cost to establish opening balances of general property, plant, and equipment, (2) selecting between deemed cost and prospective capitalization of internal use software, and (3) allowing an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions.

Documentation

This implementation guidance also provides examples and additional detail regarding acceptable supporting documentation when the alternative methods of valuations are used to support the valuation for opening balances. As noted, management is not required to choose the best method and any of the methods provided in SFFAS 6, as amended are acceptable. Management is also responsible for maintaining adequate documentation of the sources of data and the application of methodologies.

Cost-beneficial solutions are a major goal of SFAFS 50. Based on the scope of applying SFFAS 50, it is reasonable to expect that sufficient relevant historical information may not be available for general PP&E when applying the alternatives. In the absence of sufficient relevant and reliable historical data on which to base reasonable estimates, reporting entities should maintain

[1] Whether an item is material depends on the degree to which omitting or misstating information about this 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. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user.

supporting documentation for the alternative method and data used to establish opening balances.

The documentation will provide an overview of the methodology, the reporting entity's review, a key internal control, and will also facilitate the auditor's testing of the alternative methods. While the documentation is somewhat different than what may be expected, it "should be complete and stand on its own." That is, a knowledgeable independent person could perform the same steps and replicate the same results. If the documentation were from a source that would normally be destroyed, then copies should be maintained in the file for the purpose of reconstructing the estimates.

Additional information, including specific examples of acceptable documentation, is included under each alternative method.

Deemed Cost

The primary focus of the guidance is on the application of deemed cost. Deemed cost is an acceptable valuation method for opening balances for general PP&E. Deemed cost may 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, as amended, at different times prior to establishing opening balances. Large and complex reporting entities such as DoD may have used a variety of valuation methods.

It is acceptable for the reporting entity to have multiple component or sub-component reporting entities that use various valuation methods simultaneously. Deemed cost should be based on one, or a combination, of the following three valuation methods permitted by SFFAS 6, as amended: (1) replacement cost, (2) estimated historical cost, or (3) fair value. No disclosure of the distinction or breakout of the amount of deemed cost of general PP&E included in the opening balance is required.

While flexibility is offered, some options require additional disclosures, such as when a reporting entity elects to apply an alternative besides deemed cost. Examples include when a reporting entity elects to exclude land and land rights or to apply prospective capitalization of internal use software. SFFAS 6, as amended, provides that in the event a different alternative method[2] is applied by a subcomponent reporting entity consolidated into a larger reporting entity, the alternative adopted by each significant subcomponent should be disclosed.

The methods are described more fully below and not listed in order of preference.

<u>I. Replacement cost</u>

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 receive from disposing of the asset at the end of its useful life.[3]

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[2] An alternative valuation method that is different than deemed cost to establish opening balances of general property, plant, and equipment.

[3] Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46.

Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording* explains replacement cost and that there may be several ways of arriving at an estimate:

> 47. 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.
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> 48. The relevance of replacement cost is high, especially for assessments of financial position and future resource needs. The level of understandability, reliability, and comparability across entities of reported replacement cost amounts may vary according to the data used and the complexity of the calculation.
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> 49. Reporting the replacement cost of capital assets used in providing services and related service costs can facilitate comparisons between program and activity costs and accomplishments related to the same period. An objection sometimes raised is that replacement cost is not an attribute of the asset that is actually owned. However, the asset being measured is not the physical asset but the services it can provide.

Generally, replacement cost is the amount that a reporting entity would pay to replace the service potential of an existing asset at current transaction prices with a similar asset. Replacement cost is different than reproduction cost. Reproduction cost is the cost to construct an exact duplicate of the subject structure at today's costs. Reproduction cost would result in reconstructing the item as is, using manufacturing/construction techniques and standards applicable at the time the asset (and any modifications) entered service. Replacement cost using today's materials and standards is typically lower than reproduction costs, as reproduction of older methods today is less efficient and more expensive. A managerial costing system employing replacement cost information that improves management's decision making could be considered an acceptable source for replacement cost data and consistent with the standards.

Plant Replacement Value (One Acceptable Replacement Cost Method for Real Property)

Estimated plant replacement value (PRV) represents the cost to design and construct a notional facility to current standards or to replace an existing facility at the same location. PRV was developed to support large-scale program-level estimates for planning purposes and is used in the Federal Real Property Profile (FRPP).[4] While not previously used for financial reporting purposes, PRV is used for decision making and management purposes. PRV may be an appropriate starting point in establishing replacement cost for real property.

FIGURE 1: Plant Replacement Cost Factors

PRV =	Facility Quantity	X	Replacement Unit Cost	X	Area Cost Factor	X	Historical Records Adjustment	X	Planning and Design Factor	X	Supervision Inspection and Overhead Factor	X	Contingency Factor

PRV is based on the factors identified in figure 1 above. The processes and methodology supporting the PRV model should be documented and maintained. The facility quantity (size or unit of measure, such as square footage) needs to be obtained for the real property asset in order to perform the calculation. The replacement unit cost factors are derived from multiple sources such as government contract awards and commercial estimating applications. Area cost factors are developed based on local conditions affecting construction costs. Actual contract award data may span multiple years due to the frequency of relevant awards. In collecting data for use in establishing area cost factors, timing issues will arise and some assets may take more than one year (often several) to plan, contract, and construct. Therefore, an averaging approach represents a trade-off. While more precision could be available it might require a broader search for relevant cost data that may or may not enhance the resulting valuation.

PRV also includes historical records adjustment, planning and design cost factors, supervision, inspection, and overheard cost factor, and contingency cost factor. Because PRV will lead to a replacement cost value, the asset characteristics and factors included in the model do not contain all possible attributes and factors. As noted in SFFAC 7 (par. 49), replacement cost is not an attribute of the actual asset; instead, it is the theoretical cost to replace the service potential embodied in the asset. Close alignment of the physical characteristics of the actual asset and the theoretical replacement asset is therefore not critical to arriving at a reasonable estimate.

Because of these inherent limitations, the PRV associated with a particular real property asset may not be indicative of all of the specific features of that asset. In fact, the specific features of the asset may not be consistent with current building codes or materials or methods. Further, the specific characteristics of the asset may not be catalogued in sufficient detail to establish highly granular cost factors.

Acceptable forms of supporting documentation for PRV and its underlying cost factors[5] or data elements may include some or all of the following:

- Physical inventory process and inventory verification sheet
- Geospatial data, space management systems, or as built blueprints and schematics
- Map with addresses or utilities maps,
- Designation Letter

[4] The FRPP is a "database of all real property under the custody and control of all executive branch agencies, except when otherwise required for reasons of national security,"
[5] PRV does not represent actual costs and is based on several factors that may be made up of different supporting documents, elements and formulas.

PRV is inclusive of capital improvements. For example, the primary sources of replacement unit costs are contract data and commercial estimating applications. Some of these factors are not explicitly addressed in PRV but are still embedded in the process. Further, the replacement unit costs are intended to estimate a notional amount for a large number of assets rather than a specific asset. This representative amount is then applied to individual assets.

If PRV is used in establishing the opening balance for real property in current year dollars, then accumulated depreciation should be recognized based on the remaining useful life compared to the original useful life.

Other Acceptable Methods of Replacement Cost for General Property Plant & Equipment (PP&E)

Replacement cost amounts for general PP&E may be obtained from the following current sources or methods:

- Published Price List- the basic price of an item as published in a catalog, price list, or advertisement before any discounts are taken. If the price is reasonably current, it may be used to establish a reasonable estimate of replacement cost. Sources of price lists include:
  - the original equipment manufacturer (OEM)
  - a vendor involved in the manufacture for the same or a similar asset
  - Federal Logistics Data (FED LOG) published by the Defense Logistics Agency (DLA) may be used for assets having a National Stock Number (NSN) or National Item Identification Number (NIIN). FED LOG would be an acceptable source for replacement cost estimates if the item remains available for purchase at the listed price. If not, the reasonableness of the estimate may be evaluated by qualified technical staff who can then attest to its reasonableness in light of any changes in circumstances since the item was last offered for sale. (Note that FED LOG prices may also serve as a basis to establish estimated historical cost.) **TO BE UPDATED- awaiting information from DoD, may affect other areas.**
- Published Industry Price Guide (Vehicles Only) - Examples of such price guides include the Kelley Blue Book, National Automotive Dealers Association (NADA) Guides, and Edmunds.com that provide prices for the same or similar asset.
- Estimates based on sales by the reporting entity of the same or similar assets to outside parties **Foreign Military Sales?**

Acceptable forms of documentation for this method would most often be the information from the above guides or lists.

II. Estimated historical cost (initial amount)

A reasonable estimate of historical cost may be based on the following methods:

1. cost of the same or similar assets at the time of acquisition;
2. current cost of the same or 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

3. other reasonable estimation 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.

This list of reasonable estimates is not intended to establish any hierarchy of methodologies. As noted in the earlier discussion regarding alternative methods, reasonable estimates of historical cost do not seek precision and assessments of the materiality and benefit versus cost are guiding factors.

Management is responsible for estimates included in the financial statements. Estimates are based on subjective as well as objective factors and, as a result, judgment is required to estimate opening balances. Although reasonable estimates are applicable to any general PP&E, certain special considerations would be applied when establishing opening balances. The following describes additional guidance that may assist in establishing opening balances based on a reasonable estimate of historical cost.

Cost-effective options

The alternative methods provided in SFFAS 50 are meant to be less costly options to implement Generally Accepted Accounting Principles (GAAP) for general PP&E thereby allowing reporting entities to focus on needed improvements to systems and controls to process transactions going forward. By establishing and maintaining reliable financial information, such reporting entities will be more informed about costs and regarding future general PP&E acquisitions.

Estimating historical cost of an asset is not the same as recreating the accounting records that would have been created had the reporting entity undertaken a GAAP accounting at the time the asset was acquired. It would be unreasonable to expend time or resources to recreate information or a history of information that does not exist. SFFAS 50 is intended to avoid 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.

While reporting entities must provide adequate supporting documentation to establish opening balances, the foundation and flexibility of SFFAS 50 encourage reporting entities to consider cost-benefit based on the availability of information or other practical considerations. This should be considered when developing assumptions (see the next section) and documenting reasonable estimates of historical cost methodology.

Assumptions

Assumptions[6] are basic beliefs about the future operating and functional characteristics. Generally, it is what is accepted to be true. For purposes of establishing opening balances of general PP&E, reasonable estimates may be based on sensible assumptions to make up for a lack of actual data. When reasonable assumptions and the associated reasonable estimates are made, they should be documented and used consistently. Reporting entities should ensure that the assumptions (and related supporting documentation) used are reasonable in the context of the asset.

[6] FASAB Handbook, Version 15 (06/16)

Estimated historical cost is an estimate of the costs incurred to bring the PP&E to a form and location suitable for its intended use. SFFAS 6 (as amended), par. 26, provides examples of the costs that may be included. This list is relevant only when management opts to use other reasonable estimation methods (alternative 3 on page 7) such as budget records to estimate historical cost because such costs would be inherent in methods 1 and 2.

Many of the examples (such as direct costs of inspection, supervisions, and administration of construction contracts and construction work) would require managerial cost accounting systems to calculate an appropriate capitalizable amount during the process of acquiring an asset. Including such costs in estimated historical cost would be especially challenging. The reporting entity may find that attempts to determine reasonable estimates result in critical data elements missing. For example, a reporting may utilize a contract for valuation of modifications and the contract is missing one or more critical elements to allow for proper cost allocation.

The reporting entity should consider whether including all such costs is necessary to arrive at a reasonable estimate. In doing so, the reporting entity may consider whether comparable costs today are material. If material, management may elect to use current cost accounting information to estimate historical costs of a similar nature. For example, if inspection and supervisions costs are approximate 6 % of contract costs today then that may be a reasonable and cost-beneficial assumption about past costs. Further, the reporting entity may use assumptions or items in conjunction with one another to develop a reasonable method. An example may be using depot labor rates set by a program in a reasonable estimate cost based on unique program rates.

The discussion below provides *examples (and are not required or expected, but should be considered acceptable)* of assumptions that may be appropriate for a reasonable estimate of historical cost in establishing opening balances. The list of assumptions below is not exhaustive and additional assumptions (even if not specifically identified in the list below) may have been used by a reporting entity.

Assumptions that may be appropriate for a reasonable estimate of historical cost in establishing opening balances include:

- It is a reasonable estimate; it does not seek precision.
- Assessments of the materiality and benefit versus cost are guiding factors.
- Multiple assumptions may be used to develop the reasonable estimate. This includes rates developed by other program offices, such as depot labor rates, maintenance or other unique program rates that would be used for labor.
- While conflicting documentation may exist regarding a particular item of general PP&E, the reasonableness of the estimate should be based primarily on the method selected. For example, deflating the current cost of a similar asset may result in an estimate that is contrary to a reasonable estimate based on budget records. Both estimates may be reasonable despite arriving at different amounts because neither represents a complete record of the transactions involved. The reporting entity is responsible for establishing a reasonable estimate and it is not necessary to validate the estimate against alternative ways of arriving at an estimate. The reporting entity should ensure its method is documented.

- The deemed cost approach does not anticipate that the full series of entries related to general PP&E be recreated. There is no compelling need for the increased cost or burden as benefits do not appear to justify costs.[7]
    - For example, it would not be cost-effective or beneficial to expect reporting entities to apply the full cost standard as it would have been applied[8] in establishing opening balances for general PP&E.
        - Reporting entities may develop assumptions to determine the capitalizable portion of contract costs or pooled costs. An analysis of current contract costs, looking at the amount of capitalizable and the non-capitalizable costs may provide a reasonable proxy for historical experience. An analysis may provide for a certain percentage or to capitalize all costs of certain programs.
        - Reporting entities may develop assumptions or methodologies to determine the capitalizable indirect costs for programs. An analysis of a few select programs may determine that a set indirect rate to all remaining programs is reasonable.
        - **end items?**

Documentation

In the absence of sufficient relevant and reliable historical data on which to base reasonable estimates, reporting entities should prepare reasonable estimates considering the goal of cost effective estimates established by SFFAS 50. However, it is important that reporting entities document and maintain support for the data and assumptions used to develop reasonable estimates.

Specific examples of acceptable documentation are included under each reasonable estimate method.

Estimates--budget based

The *Budget of the U.S. Government* (commonly referred to as the President's Budget) and related documentation for a program/asset has adequate detail to support a reasonable estimate. Specifically, the budget detail provides visibility of the various cost estimates for the asset as well as various cost estimates for the program/asset by year. To ensure the full program and funding amounts has been reviewed, it should be reconciled and documented at the appropriation level with Public Laws, and allocated to individual programs based on information provided in Congressional Conference, House and Senate committee reports, Congressional budget requests, Apportionment and Re-apportionment Schedule (SF-132) forms and Report on Budget Execution and Budgetary Resources (SF-133) forms, and other relevant documentation such as material supplemental appropriations, rescissions, or transfers.

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[7] The Technical Release provides examples of assumptions. The assumptions are not required or expected, but should be appropriate for a reasonable estimate of historical cost in establishing opening balances. Likewise, it is acceptable and appropriate for a reporting entity to perform the calculation and other SFFAS 4 and SFFAS 6 compliant calculations.

[8] Conditions remain that existed when FASAB issued many of these standards, 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 SFFAS 50 was 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 proposed less costly alternatives that will support this objective. (SFFAS par. A6.)

This method is relatively straight forward for individual assets being acquired. However it is much more complex when considering program or weapon systems that include a variety of assets and spare parts, logistics support, and support equipment that are being procured.

Acceptable forms of documentation for this method would most often be:

- Budget Justification Materials
- Appropriation Data
- Program Office Analysis
- Allocated Per Unit Cost Report
- Technical Specifications and Estimates
- Industry Estimates Reports of amounts to be expended

Estimates—contract based

The best case scenario is a "conformed contract" providing all the information available that needs to be allocated to a particular asset, including all the modifications and delivery orders associated with the contract. However, this is not normally the case because costs to be capitalized are included in multiple Contract Line Items and multiple contracts. This methodology involves valuing assets using the pricing data included in contracts. Although challenging, reasonable estimates based on contracts are still permitted.

Contracts contain specific Contract Line Item Numbers which delineate specific production and non-production activities (materials, installation, proposal prep, spare parts). Determination of whether to capitalize a particular cost as a cost of general PP&E should be based on general guidance in SFFAS 4 and SFFAS 6, as amended. While these standards are imperative for the go-forward approaches implemented, it is difficult to apply to these approaches in establishing opening balances under the alternative methods.

For example, SFFAS 4 provides that each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes and that costs should be assigned to outputs in one of the methods listed below in the order of preference: Directly tracing costs wherever economically feasible; Assigning costs on a cause-and-effect basis; and Allocating costs on a reasonable and consistent basis. A reporting entity eligible to apply the provisions of SFFAS 50 has not been in compliance with SFFAS 4 or SFFAS 6 in the past.

Therefore, the cost-benefit threshold of retrospectively establishing and executing cost assignment processes may not be met and methods to capture indirect costs for the purpose of establishing opening balances may not be feasible. A costing method is economically feasible if the benefits resulting from implementing the method outweigh its costs. It is not advantageous to use a costing method if it requires a large amount of resources and yet produces information of little value to users.

Given the intent of SFFAS 50, cost-benefit should be a major consideration. The reporting entity management should determine the point at which the costs of improving or providing financial information outweigh the derived benefits, especially given that the current use is limited to accountability.

Considering materiality and the fact many assets may be near fully depreciated, there may be an argument to expense indirect costs because of cost-benefit considerations and the risk of over-capitalization. Further, remaining cognizant of the goals of SFFAS 50 it would appear contradictory. The provisions of the standards were written to allow deemed cost to be flexible enough that it would not require incurring excessive cost to determine indirect costs that may be immaterial or insignificant.

As noted, while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when FASAB issued many of these standards, 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 SFFAS 50 is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past. Given the resources that have been devoted to resolving issues and the substantial efforts underway at DoD to modernize its systems, the greatest benefit would be for DoD to focus on the on the go-forward system.

Acceptable forms of documentation for this method would most often be:

- Acquisition Contracts
- Time Compliance and Technical Orders (TCTOs)
- Comprehensive Cost and Requirement System (CCAR) Reports
- Program office delivery schedule
- Maintenance delivery schedule
- DD Form -250, *Material Inspection and Receiving Report*
- Program office analyis

Estimates—engineering document based

Detailed technical and engineering documents lay out the assumptions, materials, and estimated cost to produce an asset. In these instances, the engineering documents can provide a sufficient basis for estimating deemed cost for opening balances.

Acceptable forms of documentation for this method would most often be:

- Technical specifications and estimates
- Maintenance delivery schedule
- Bill of material
- Vendor quotes on material costs/ sale rates
- Time Compliance and Technical Orders (TCTOs)
- Industry estimates

Estimate—deflation of current cost

SFFAS 6, as amended, provides that general PP&E may be estimated based on current cost of the same or 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. This method would be appropriate when a series of similar items are being acquired over time and there is a reliable value for a base asset.

Acceptable forms of documentation for this method would most often be:

- Current cost of similar asset
- Appropriate pricing index to discount the current asset cost to its estimated cost at the time of acquisition
    - Consumer Price Index
    - Other indices from the Department of Labor's Bureau of Labor Statistics

Cost Estimators

In certain instances, an informed opinion of an expert cost estimator may be used to support reasonable estimates in the absence of sufficient relevant and reliable historical data. Informed opinion refers to the judgment of others who make estimates based on their programmatic knowledge and/or experience without using a fully satisfactory information store and, in some cases, without using an econometric or other statistical model. If an expert cost estimator is used, the expert's credentials or qualifications should be articulated and documented in sufficient detail to allow review and validation by independent sources, including independent auditors. For example, reports and studies on relevant issues and other relevant communications describing the basis for any assumptions or changes in assumptions should be maintained in support of the expert's opinion.

Acceptable forms of documentation for this method would most often be:

- Reports and studies,
- Memos with outside experts, and minutes from internal meetings describing the basis for any assumptions or changes in assumptions, and
- Previous studies conducted by the expert, including industry studies, journal articles, and third party studies.

III. Fair value

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.[9] When determining the value of opening property balances, fair value is an acceptable valuation method to use in absence of actual cost data and associated supporting documents.

The FASAB has not developed detailed guidance regarding the approaches to use in establishing fair value. Other standards-setters have provided standards. For example, the Governmental Accounting Standards Board issued Statement No. 72, *Fair Value Measurement and Application*, which is summarized as follows:

> Fair value is described as an exit price. Fair value measurements assume a transaction takes place in a government's principal market, or a government's most advantageous market in the absence of a principal market. The fair value also should be measured

[9] SFFAC 7, par. 38

> assuming that general market participants would act in their economic best interest. Fair value should not be adjusted for transaction costs.
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> To determine a fair value measurement, a government should consider the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes as provided by the accounting standards. For example, the unit of account for investments held in a brokerage account is each individual security, whereas the unit of account for an investment in a mutual fund is each share in the mutual fund held by a government.
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> This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required to replace the present service capacity of an asset. The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques should be applied consistently, though a change may be appropriate in certain circumstances. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

SFFAS 6 as amended by SFFAS 50 permits use of fair value as one option for valuing opening balances and does not require that fair value be maintained through revaluation in the future. Generally, where fair value is applied in other circumstances it is maintained as a current value and updated each reporting period. Because SFFAS 50 seeks cost-effective approaches to a one-time valuation, the reporting entity should use fair value approaches that are cost-effective. The data available should be appropriate to the circumstances of establishing a cost-effective opening balance for unique assets.

In such cases, the markets may be inherently limited given the unique nature of government assets such as defense assets. In fact, many assets may be highly specialized; making fair value difficult to determine. For example, there may be few observable transactions and transactions may not be indicative of an active market between willing buyers and sellers.

For these reasons and to afford use of fair value in a cost-effective manner, opening balances at fair value may be determined based upon generally accepted approaches established by the GASB as well as:

1. market approaches where both the market and data are limited (hereafter “limited market approaches”)
2. desktop appraisals.

Limited market approaches may include transactions under the foreign military sales program, prices charged for sales between federal government agencies, and other transfer programs for which reimbursement occurs.

Fair Value can be established through an appraisal performed by an independent qualified professional. Appraisal must be performed in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP) to be considered compliant.

Although appraisals require the expenditure of resources, they may be justified for significant assets.

For the purpose of establishing deemed cost, desktop appraisals, which do not require physical inspection of the assets, are acceptable. Mass appraisals, which leverage systematic procedures and statistical testing techniques to value multiple assets concurrently, are also acceptable for establishing deemed cost.

Acceptable forms of documentation for this method would most often be:

- Appraisal documents from qualified professionals
- Methodology describing the fair value process
- Documentation showing a recent sales transaction and amount for a similar asset in similar condition
- Documentation showing a third party sales price for a similar asset in similar condition

Land Rights B Coffman sending edits

One alternative methods permitted under SFFAS 50 is an exclusion of land and land rights from opening balances with disclosure of acreage information and expensing of future acquisitions. Reporting entities may elect to exclude land and land rights in establishing opening balances of general PP&E (consistent with the alternative method established in SFFAS 6 (as amended), paragraph 40.f.i.) it is important to consider what information should be disclosed regarding land rights.

SFFAS 6, *Accounting for Property, Plant, and Equipment* (as amended), paragraph 40.h.ii. states that a component reporting entity electing to exclude land and land rights from its general PP&E opening balances "must disclose, with a reference on the balance sheet to the related disclosure, the number of acres 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 and land rights from its general PP&E opening balance should continue to exclude future land and land rights acquisition amounts and provide the disclosures." However, SFFAS 6 (as amended) and the basis for conclusions for SFFAS 50, acknowledge the diverse nature of land rights. For example, SFFAS 6 acknowledges that some land rights may be depreciable while others are not.

The reporting entity should consider quantitative and qualitative criteria in determining if land rights disclosures of acreage are appropriate. A reporting entity electing to exclude land rights from the opening balances and to expense subsequent acquisitions of land rights, would disclose acreage when a land right provides control of acreage. Generally, when a land right does not provide control of acreage, there would be no acreage to disclose. Therefore, there may not be land rights disclosures required by SFFAS 6 as amended by SFFAS 50.

In addition, materiality is an overarching consideration in financial reporting.