Federal Accounting Standards Advisory Board

**December 4, 2015**

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

*Wendy M. Payne*

Through: Wendy M. Payne, Executive Director

Subj: DoD Implementation Guidance Request - **Tab C**[1]

## MEETING OBJECTIVES

The objective of this session is to approve an exposure draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* for issuance immediately after the meeting.

## BRIEFING MATERIAL

The staff analysis is attached along with questions for the Board on page 13. The Staff Analysis at Attachment A also references DoD Implementation Guidance Request: **Land- Tab C2** that is provided under separate briefing sub-tab C2. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

**Attachment A**- Staff Analysis

**Attachment B**- Pre-ballot Exposure Draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* **(Marked Version)**

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

441 G Street NW, Mailstop 6K17V, Washington, DC 20548 ♦(202) 512-7350 ♦fax 202 512-7366

**Attachment C**- Air Force Meeting Summary

**Attachment D**- DoD Proposal – Prospective approach for GFE/CAP

**Attachment E**- Summary of Auditor Roundtable Meeting

**Attachment F**- DoD Proposed Language for Transition of Reasonable Estimates

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

**Attachment H**- Pre-ballot Exposure Draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* (**Clean Version)**

## BACKGROUND

As you may recall, at the October Board meeting staff provided the first draft of the exposure draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. After considering the draft exposure draft, the Board agreed to:

- The general approach to provide implementation guidance in SFFAS 6 to allow a reporting entity to apply alternative valuation methods in establishing opening balances for general PP&E.
- The alternatives (selecting between (1) an alternative valuation method of deemed cost that is consistent with that provided for all general PP&E and (2) prospective application) and related disclosure in establishing opening balances for internal use software.
- Propose rescinding SFFAS 35, *Estimating the Historical Cost of General Property, Plant and Equipment: Amending Statements of Federal Accounting Standards 6 and 23,* because this Statement incorporates the relevant portions and would provide comprehensive guidance in SFFAS 6 for establishing opening balances. The Board stated the question and basis for conclusions may need to be expanded to solicit the necessary information.

While the Board did not make a final decision regarding land, they agreed staff should focus efforts on further developing recommendations that would allow for a zero balance or an assigned value per acre. The Board did not make a decision regarding government property in the hands of contactors. Instead, they requested that staff consider other options (such as prospective treatment) and rationale based on information DoD may now have available.

It was agreed staff would develop a pre-ballot for the Board's consideration at the December 2015 meeting.

## NEXT STEPS

Staff will consider the Board member comments and determine if a ballot draft can be prepared for the second day of the December Board meeting or shortly after. However, staff believes the exposure draft would need to be approved for issuance by December 21st to meet previously discussed milestones. This also would include the exposure draft having a shorter (45-day) comment period with the intent to issue the Statement by September 30, 2016.

As explained, the CFO Act includes a requirement that accounting standards addressing capital assets be reviewed by Congress for 45-days of session prior to their issuance. While the 45-day period will run concurrently with the sponsor's 90-day review period, Congress is in recess during the month of August and for two weeks in July. Therefore, based on staff's review of the Congressional calendar, the Statement would have to be forwarded to Congress by **May 11, 2016**.

The Board would have to vote on the final by early May so staff could prepare the final package for distribution. Accordingly, staff would anticipate discussion of the comment letters and proposed recommendations at the February 2016 meeting. The Board would need to review a pre-ballot draft at the April 2016 meeting and approve a ballot draft electronically shortly after the April meeting. The timeline is summarized as follows:

| | |
|---|---|
| Discuss Pre-Ballot | **December 16, 2015** |
| Ballot- Day 2 or shortly thereafter | **December 17, 2015** |
| Issue ED with 45-day comment period | **December 21, 2015** |
| Comments due Date | **February 4, 2016** |
| February Board Meeting-<br>Discuss Comment Letters & Recommendations | **February 24-25, 2016** |
| April Board Meeting-<br>Discuss Revised Statement | **April 27-28, 2016** |
| Approve Ballot | **May 9, 2016** |
| Submit to Sponsors & Congress | **May 11, 2016** |

We will provide a ballot ED on the second day of the December Board meeting or shortly after the meeting. Staff has included the Ballot Forms at **Attachment G** so that you will have them available and to stress the importance of meeting the milestones established. **Members are encouraged to notify staff of any questions or wording suggestions before the Board meeting so they may be resolved prior to the meeting to meet milestone dates.** Any members considering an alternative view should notify staff as soon as possible because the ballot ED will be released when approved.

Staff cannot stress the importance of adhering to the proposed schedule because any delay would not allow the final Statement to be issued by September 30, 2016.

## MEMBER FEEDBACK

Please contact me as soon as possible to convey your questions or suggestions. Communication before the meeting will help make the meeting more productive. You can contact me by telephone at 202-512-5976 or by e-mail at batchelorm@fasab.gov with a cc to paynew@fasab.gov.

## Attachment A- Staff Analysis

*Land*

As you recall, when the Board discussed land in October, the Board did not make a final decision, they agreed staff should focus efforts on further developing recommendations that would allow for a zero balance or an assigned value per acre. Staff was asked to focus efforts in the following areas: (1) determining if there is information available by state or for the country, (2) further developing recommendations that would allow for a zero balance or an assigned value per acre, and (3) assisting the Board in determining if a DoD-centric approach should be applied to the government-wide level or if this issue should be deferred for a broader government-wide land project.

Certain members were concerned about the change for a single large department, its consequences on the government-wide statement, and whether this issue should be considered more broadly.[2] Meaning, the members suggested exploring options to improve reporting on land at the government-wide level that could be applied consistently across components.

In order to meet the target dates established and develop the pre-ballot for the Board's consideration at the December 2015 meeting, we asked Dom Savini to assist with performing the background and research work in the land area. This allowed me to address remaining areas and finalize the pre-ballot exposure draft.

See **DoD Implementation Guidance Request: Land Tab C2** for results of Mr. Savini's research regarding Board questions and concerns raised at the October 2015 meeting concerning land. The memo contains relevant statistics and information on DoD and government land holdings, followed by staff's preliminary research into questions and concerns raised by Board Members about consideration of land more broadly. It addresses whether the options under consideration should be applied to the government-wide level or if this issue should be deferred for a broader government-wide land project.

Available sources of information concerning land valuations along with pros and cons associated with each, definitions of elements and the recognition criteria, essential characteristics, and other considerations established in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements,* were considered in determining the best approach.

**Table 3.0 in Tab C2** provides an analysis of other recognition considerations mentioned in SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. SFFAC 5 explains that although an item may meet the basic recognition criteria it might not be recognized because of measurement, materiality, or cost versus benefit considerations. As such, unrecognized elements become

[2] Note that the Financial Report of the US Government, FY2014, indicates that Defense agencies account for 46% of the land and land rights reported by the federal government. (Note 7)

candidates for note disclosure or supplementary information. Staff believes when considering the two options—zero balance or assigned value—a zero balance is most practical for the proposed standard relating to DoD.

Staff believes a zero balance approach with adequate disclosures would provide more reliable and relevant information with benefits exceeding the cost. Efforts to assign monetary values (not symbolic or token) can be expected to exceed benefits. Further, given the tight timeframes and limited resources, one may question the benefit in diverting resources to determine the best value and then the associated audit cost. Additionally, a zero balance approach would better meet the qualitative characteristics of financial information as explained in **Table 4.0 Selecting an Appropriate Measurement Attribute of Tab C2.**

As noted, one reason for selecting a zero balance is the cost-benefit, but staff believes the issue of land needs to be considered broadly. Staff advises that further research is required before the Board can be fully equipped to answer what approach (or even if a similar approach) should be applied to the government-wide level. This would enable the needed research for applicability at the government-wide such as agency best practices that have evolved over time. See additional discussion at **Tab C2** page 22.

Staff believes the Board should move forward with this proposal and 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 proposed standard may be revisited. Staff recommends adding language to the ED to alert users of the Board's intent to revisit this area.

In summary, staff believes the proposed standard should provide for an exclusion of land from the opening balances of general PP&E with a note reference on the balance sheet that discloses acreage information. Disclosures would also reveal the changes in those acres over time. A reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude amounts for future land acquisitions and provide the note reference each year thereafter.

A question is also included for respondents on this topic.

**Questions for the Board:**

**Does the Board have any questions regarding the information presented or results of staff's research at Tab C2?**

**Does the Board agree with the staff recommendation that land categorized as general PP&E may be excluded from the opening balances of general PP&E with a note reference on the balance sheet that discloses acreage information?**

**Does the Board agree with the staff recommendation that a reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude future land acquisition amounts (i.e. expense future land acquisition amounts) and provide the note reference?**

**Does the Board agree with the staff proposed Question 2 and the discussion provided in the Basis for Conclusions regarding Land? [This includes that the Board intends to begin a project on Land and based on the results of that project, the decisions made for opening balances and future acquisitions of land may be revisited.]**

*Government Property in the Hands of Contactors*

Government property in the hands of contactors may include government furnished equipment and contractor acquired equipment. This is a longstanding issue area for DoD. Current accounting standards are consistent with general PP&E since there is no conceptual difference. Most would agree there should be accountability over government owned assets in the hands of others.

At the October meeting, DoD representatives provided a briefing on government property in the hands of contactors and described some of the challenges that DoD faces in this area. In summary, their briefing provided that:

- The majority of government property in the hands of contactors has not been recorded as general PP&E or in government accountability property records.
- Property in the hands of contractors has grown exponentially in the past 10 years due to the war. There is a bit of uncertainty as to what makes up much of this equipment as a large part of it is still in boxes and not inventoried. The equipment could be anything from a Jeep to a firetruck. The majority of army contracts during this time were Contractor Acquired Property (CAP).
- Previously, the majority of government property in the hands of contactors related to design, tool and test equipment. This type of equipment must be accounted for (mandate by Congress) and most remain in DoD custody at the end of the contract period.
- Previous contracting rules did not address how to get the property on the books of the federal government, but changes began in 2013 to correct this. The new rules require the contractor to report the equipment to the federal government, not only for capitalization but for property accountability. Some are reported at intervals while others are at contract close out.

The Board did not make a decision regarding government property in the hands of contactors. Instead, the Board requested that staff consider other options (such as prospective treatment) and rationale based on information DoD may now have available.

Staff notes that since the October Board meeting staff has held several meetings and teleconferences on this matter. In addition, staff has reviewed several GAO and DoD-OIG reports as well as GAO testimony specific to this area. While some of them were dated, it did confirm that DoD management, control, and accountability for government property in the hands of contactors has been a longstanding issue.

Meeting regarding Air Force work

At the October Board meeting, DoD representatives explained that the Air Force had shown the most success in resolving issues in this area. DoD had stated that the Air Force identified $8B in additional general PP&E through their work.

FASAB staff met with DoD representatives from the Air Force, DoD Property & Equipment Policy, Defense Contract Management Agency, DoD Procurement, and DoD FIAR to learn more about the work performed by the Air Force and consider other options based on information available. (See **Attachment C**- Air Force Meeting Summary)

While the work performed by the Air Force was comprehensive, staff did not believe the results obtained could provide specific data that could be used as a reliable basis for an alternative approach for government property in the hands of contactors for all of DoD.

DoD representatives also provided a slide that detailed information that led to their statements at the October Board meeting that the estimated useful life of government property in the hands of contractors is approximately 5.25 years. [Note: The slide presented during the meeting is included as the last page of **Attachment D**- DoD Proposal – Prospective approach for GFE/CAP.]

DoD cautioned that much of the information was incomplete, the data had known integrity and reliability issues and certain amounts were known to be best guesses. Staff finds it difficult to place much reliance on the numbers and relying on the useful life as a basis for prospective treatment is challenging.

However, two important points were gleamed from the information provided on the slide:

> 1. The issue with government property in the hands of contactors should correct itself within 2-3 years if DoD has implemented the procedures described. 77% of the current contracts expire in 2016 and 12% expire in 2017, so it would appear that processes would be in place to capture government property in the hands of contactors by 2018 through issuance of new contracts with required clauses.
>
> 2. Government property in the hands of contactors may be immaterial or fully depreciated based on the information provided. However, staff notes the caution with the information but still believes this may support a separate line item for contractor held GPP&E. With time DoD may be in a position to support that the line item is not materially misstated.

DoD also provided FASAB staff a proposal for consideration in this area, see **Attachment D**- DoD Proposal - Prospective approach for GFE/CAP. The proposal is to allow DoD to take a prospective approach for establishing completeness and accountability for GFE/CAP.

In summary, DoD's proposal is for all contracts which end prior to October 1, 2016:

1.) DoD will not remove GFE/CAP that is currently recorded from its accountability records and will not change their current financial reporting status.

2.) DoD will not execute any specific baselining activities to identify GFE/CAP not accounted for and record them in the financial statements. Instead, DoD will capture the GFE/CAP and record them at the end of the contract (i.e., prospective treatment).

All new contracts executed from October 1, 2016 forward, DoD will record GFE/CAP in accordance with current Generally Accepted Accounting Principles (GAAP).

Much of DoD's rationale is based on the belief that government property in the hands of contactors is immaterial and that the equipment has a short useful life. In addition, they explain that they would incur significant costs to bring these to record. This rationale also supports the notion that no special consideration be given to GFE/CAP since the problem assets may be immaterial, may have short useful lives, and will be recorded as contracts expire in the next few years.

When considering the "cost" to bring items to record, it is very important to note that FASAB cannot provide accountability relief nor assist with completeness issues. Staff notes that there are congressional mandates for tracking much of this equipment; some of which have more stringent requirements because of management issues. Therefore, DoD will still have to go through the "cost" to bring these items to record. Additional cost imposed would be for the financial statement audit valuation. As noted above, based on information provided it appears that time will allow for issues to resolve in this area but our proposal also offers certain provisions for valuation.

FASAB Roundtable with Auditors

FASAB staff also held an auditors roundtable meeting as a means to gather more information to inform the Board's response to the DoD's request for an alternative valuation method in establishing the opening balances for property in the hands of contactors. There were 12 participants, including representatives from a range of IPAs, GAO and DoD OIG.

The meeting was helpful and confirmed certain understandings. The summary is located at **Attachment E- Summary of Auditor Roundtable Meeting**, but key points were:

1.)  Many of the issues that DoD encounters with property in the hands of contactors are the same for all DoD property.

2.)  Establishing placed-in-service dates is a huge challenge for all DoD property.

3.)  The participants believed the DoD Proposal – Prospective approach for GFE/CAP would have significant audit challenges because there are too many gray areas, such as no firm cut-off date and the need for clarity with definitions.  In addition, the approach appears to add complexities as the implementation establishes multiple buckets of contracts that DoD would need to follow versus a clear baseline and go forward. Further, there were noted existence and completeness challenges.

4.)  Bottom line is contract improvements must occur at DoD to fix the issues and until these are implemented; there will be too many complexities that cause challenges. The group agreed FASAB should not make concessions in standards for areas such as this, that based on DoD's efforts in the contract area, time and ongoing improvements will allow for issues to be resolved.

Based on staff's additional research and meetings held, staff sees no reason to provide a different treatment than the application of the alternative valuation method (deemed cost) that is applicable to general PP&E in the ED.  If beneficial, DoD has the flexibility to display this as a separate line to enable deemed cost to be used until the opening balance is adequately established.

**Question for the Board:**

**Does the Board agree that government property in the hands of contactors should be treated consistently as general PP&E? (Therefore, the application of the alternative valuation method (deemed cost) would be applicable in establishing opening balances.)**

*Rescission of SFFAS 35*

At the October meeting, the Board agreed to propose rescinding SFFAS 35, *Estimating the Historical Cost of General Property, Plant and Equipment: Amending Statements of Federal Accounting Standards 6 and 23,* because this Statement incorporates the relevant portions and would provide comprehensive guidance in SFFAS 6 for establishing opening balances.  Certain board members believed that there may be more information that should be gathered; therefore, the Board agreed to expand the question for respondents on this topic and the basis for conclusions to solicit the necessary information.

Staff would like note that shortly after the October meeting, DoD provided draft language (See **Attachment F-DoD Proposed Language for Transition of Reasonable Estimates**) for consideration related to this issue that would allow for a transition period for reasonable accounting estimates while reporting entities (DoD) transition to a transaction-based accounting environment in accordance with SFFAS 6.

FASAB staff carefully considered the proposed language, but did not believe the proposed language would be appropriate to include in the proposed Statement. Staff believed the language would be in conflict with the Board's decision at the October meeting to rescind SFFAS 35, *Estimating the Historical Cost of General Property, Plant and Equipment: Amending Statements of Federal Accounting Standards 6 and 23* and could lead to further confusion regarding the use of estimates.

While the DoD proposal does not retain SFFAS 35, it does provide explicit language within a standard that a reporting entity may use reasonable estimates beyond establishing opening balances. Such wording has led to questions as to when estimates may or may not be used. In addition, FASAB staff believes that current standards provide some flexibility and 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 G-PP&E when there is not a detailed cost accounting system.

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 G-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.

Management has discretion in applying the cost assignment methods identified in SFFAS 4, *Managerial Cost Accounting Standards and Concepts* to accumulate acquisition costs. 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**.

In addition, SFFAS 4 recognizes that not all direct costs can be directly traced and provides for estimation where they are not. 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."

FASAB staff notes that the question for respondents and basis for conclusions was expanded to solicit comments from respondents about the potential impact or other information regarding the rescission of SFFAS 35. The tentative decision of the Board to rescind was based on several factors, but also because they would have the opportunity to consider responses during due process. The Board noted during deliberations in October that if other issues are brought to the Board's attention during due process, the Board could change this decision.

**Question for the Board:**

**Does the Board agree with Question 4 for respondents and the discussion provided in the basis for conclusions regarding the decision to rescind SFFAS 35?**

## Board Member Questions

1. **Does the Board have any questions regarding the information presented or results of staff's research at Tab C2?**

2. **Does the Board agree with the staff recommendation that land categorized as general PP&E may be excluded from the opening balances of general PP&E with a note reference on the balance sheet that discloses acreage information?**

3. **Does the Board agree with the staff recommendation that a reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude future land acquisition amounts (i.e. expense future land acquisition amounts) and provide the note reference?**

4. **Does the Board agree with the staff proposed Question 2 for respondents and the discussion provided in the Basis for Conclusions regarding Land? [This includes that the Board intends to begin a project on Land and based on the results of that project, the decisions made for opening balances and future acquisitions of land may be revisited.]**

5. **Does the Board agree that government property in the hands of contactors should be treated consistently as general PP&E? (Therefore, the application of the alternative valuation method (deemed cost) would be applicable in establishing opening balances.)**

6. **Does the Board agree with Question 4 for respondents and the discussion provided in the basis for conclusions regarding the decision to rescind SFFAS 35?**

7. **Does the Board have any other questions or comments regarding the draft exposure draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*?**

8. **Does the Board want to move to a <u>ballot</u> Draft Exposure Draft? Is the Board comfortable with the short comment period?**

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

**MARKED VERSION**

**Statement of Federal Financial Accounting Standards**

**Exposure Draft**

Written comments are requested by February 4, 2016

December 21, 2015

**Comment [MB1]:** 45 day review period – allows for issuance by Sept. 30, 2016

## 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, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. 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 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 FASAB's website at: www.fasab.gov.



**Contact us:**

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

Federal Accounting Standards Advisory Board

~~ISSUE DATE~~December 21, 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 ~~appear~~ 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 would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by ~~DUE DATE~~February 4, 2016.

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All comments received by the FASAB are considered public information. Those 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, 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 the comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not receive 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. ~~or A public hearing has been scheduled at 9:00 AM on Month Day, Year, in Room 7C13 at the GAO Building, 441 G Street, NW, Washington, D.C.~~

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 Statement provides 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 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.* The alternative methods include (1) use of deemed cost to establish opening balances of general PP&E (2) selecting between deemed cost and prospective treatment of ~~land and~~ internal use software and (3) exclusion of land from opening balances with disclosure of acreage information.

The alternative methods are 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 is 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 is intended to 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.

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# 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 also would welcome 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 Word file for your use at www.fasab.gov/exposure.html. 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
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by ~~[insert date]~~February 4, 2016.

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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 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~~ment~~ 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. ~~This proposal is based on the cost associated with establishing a deemed cost amount for existing land.~~ 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 note reference.

Some members suggested valuing existing land holdings based on a set amount per acre of land. 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 revisited.

(See paragraphs 12.d. and 12.g. for relevant standards and paragraphs A28 A1~~-~~ A30 and A51 in the Basis for Conclusions.)

**a) Do you agree or disagree with the proposal to exclude land from the opening balances of general PP&E? Please provide your rationale.**

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

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

**~~c)~~d) Do you believe the Board should ~~consider~~ revisit cost-effective options for valuing land on a government-wide basis? Please provide your rationale and any suggestions you have for improving current reporting on land.**

Q3. The Board proposes to amend~~ment~~ 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 application.

The proposed Statement describes the alternatives and related disclosures. (See paragraphs ~~11-12~~ 13-14 for relevant standards and paragraphs ~~A29-A33,~~ A31-A35 and A52 ~~A42-A45~~ 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. The Board believes it would be clearer if SFFAS 35 was rescinded. Rescission would avoid the implication that estimates may not be used absent an explicit provision in standards. (See paragraph ~~16~~18 for relevant standards and paragraphs ~~A37- A41~~ A39-A47 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.**
>
> ~~a)~~

**Comment [MB2]:** Board agreed to expand the question for respondents on this topic and basis for conclusions to solicit information.

# 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 in establishing opening balances for general PP&E 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. Through the amendments it also provides for selecting between an alternative valuation method of deemed cost that is consistent with that provided for all general PP&E and prospective application ~~the prospective treatment~~ of internal use software ~~and land~~ 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

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

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 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**[3] 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.[4]

~~9.~~10. **Unreserved Assertion-** An unconditional statement.

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

[2] Terms defined in the Glossary are shown in bold-face the first time they appear.
~~[3] An unreserved assertion is an unconditional statement. (See SFFAS 48.)~~
[4] Adopted from AU-C 510, Opening Balances – Initial Audit Engagements, Including Reaudit Engagements (AICPA Professional Standards).

~~10.~~11. This section amends the Implementation Guidance provided in SFFAS 6, *Accounting for Property, Plant, and Equipment* as described in the following paragraphs.

~~11.~~12. Paragraph 40 is replaced with:

40. Alternatives Available for Opening Balances.[5] 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 ~~applying the alternatives for~~ establishing ~~the~~ 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[6] 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 this opening balance that are discovered in later reporting periods.

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

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.

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]

[5] 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.
[6] An unreserved assertion is an unconditional statement.
[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.

i. Replacement cost[9]

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.

~~i.~~ 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.

~~f.~~ g. Disclosure requirements:

i. A reporting entity electing to exclude land from its general PP&E opening balances must ~~disclose this fact,~~ provide a note reference on the balance sheet that discloses 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. ~~, and the number of acres for which an amount is included in general PP&E.~~[11] Each year thereafter, a reporting entity electing to exclude land from its general PP&E opening balance should continue[12] to exclude future land acquisition amounts and provide the note reference.

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

[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 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)

~~[11] The amount will relate to acquisition of land subsequent to the date of the opening balance.~~

[12] 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 revisited.

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.

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

~~12.~~13. This section amends the Implementation Guidance provided in SFFAS 10, *Accounting for Internal Use Software,* as described in the following paragraphs.

~~13.~~14. Paragraph 36 is replaced with:

36. Alternatives for Establishing Opening Balances.[13] 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[14] 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

[13] 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.

[14] An unreserved assertion is an unconditional statement.

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 application. The reporting entity may choose prospective application of SFFAS 10. If the reporting entity elects prospective treatment, the reporting entity should choose between the following acceptable alternatives, ~~in~~to establish~~ing~~ the opening balance of ~~IUS~~internal use software under development 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 ~~IUS~~internal use software in service from the opening balance but include amounts related to ~~IUS~~internal use software under development at the opening balance date. ~~IUS~~Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 thru 27 or on the alternative valuation method provided in paragraph 36.d.ii.

ii. Alternative Valuation Method. Deemed cost[15] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40 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*

~~14.~~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.

~~15.~~16. Paragraph 10 is replaced with:

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

10. See SFFAS 6 for Implementation Guidance applicable to all ~~that applies to all~~ general PP&E.

~~16.~~17. Paragraphs 11- 18 of SFFAS 23 are rescinded. ~~(For implementation guidance, see SFFAS 6, as amended.)~~

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

~~17.~~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.

## EFFECTIVE DATE

~~18.~~19. 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'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 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, Board staff met with officials from DoD, as well as the audit community, to develop an understanding of the issues currently faced by 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~~s~~ not been in accordance with FASAB GAAP.
b. Many organizations that maintain several different accounting and property ~~and~~ systems are involved in acquiring general PP&E assets.
c. DoD has not had consistent procedures related to general PP&E acquisitions or documented processes for retaining source documentation.

d. All major systems ~~that~~ 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 establish a valuation baseline.
f. DoD has approximately 440,000 separate real property assets and many real property assets ~~facility built dates are beyond~~were built more than 40 years ago.
g. DoD records related to land values are not in a structured, searchable system~~manner~~. The records are not digitized and accessing them involves searching boxed records ~~in a warehouse~~. Also, source documents~~records~~ such as deeds may not be complete and court records often have gaps given the length of time involved.
h. DoD does not have a complete inventory of its internal use software (IUS) and costs of IUS have not ~~traditionally~~ been captured consistently.
i. General equipment is a broad category that includes military ~~type~~ equipment and consists of hundreds of thousands of assets.

A5. After considering the status of DoD's efforts and the fact 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 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 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 timely. The goal of this Statement is to avoid expending taxpayer dollars ~~on~~ recreating information that would have been of greater benefit in the ~~is long~~ past (for example, ~~its primary usefulness, which is~~to evaluat~~e~~ing major acquisition/construction programs as they ~~a~~were executed) but for which the current use is limited to accountability and assessing the cost of current services~~and avoiding overstatement of period expense by charging off the cost of acquiring assets as expenses~~. The Board has proposed less costly alternatives that will support this use.

Comment [MB3]: Based on SS suggestion

A7. The Board believes assisting DoD with establishing a baseline would benefit all parties. Providing a starting point may 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.

A8. The Board also acknowledged that other standard setters have provided guidance for organizations implementing an entire body of standards for a 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 ~~n~~similar approach ~~similar~~ 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 ~~the~~ 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. SFFAS 6 provides the accounting standards for general PP&E and implementation guidance. The implementation guidance for general PP&E currently resides in several Statements due to subsequent amendments to SFFAS 6. To provide implementation guidance allowing a reporting entity to apply alternative methods in establishing opening balances for general PP&E, this Statement amends existing standards to provide all implementation guidance for general PP&E, with the exception of certain provisions applicable to internal use software, in SFFAS 6.~~

~~A14. Having all the general PP&E implementation guidance within SFFAS 6 will provide a more complete guide for users when referencing the Statements versus considering several Statements that have amendments.~~

~~A15.~~A13. This Statement would amend 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 ~~in SFFAS 6~~ 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.

~~A16.~~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.

~~A17.~~A15. Using the DoD example, providing implementation guidance requires consideration of cost-benefit as well as the current resource constraints. For example, DoD has a dual challenge of establishing the baseline and ~~establishing~~~~still getting~~ a system capable of capturing the information to record~~capitalize~~ the acquisition or construction of new general PP&E~~,~~; thereby,~~and therefore~~ updating the information.

Comment [MB4]: HS suggestion

A16. 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 ~~that this~~ it is ~~a model~~ used for decision making and management purposes. This Statement would allow 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 would be recognized based on the remaining useful life compared to the original useful life. This would not systematically understate the historical cost since capital improvements would 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, 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*. 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 that 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, 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 the useful lives and is significant to all general PP&E.

~~A18.~~

A19. Government property in the hands of contactors has been ~~A~~a challenging ~~issue~~area for reporting entities~~ in establishing opening balances for general PP&E can be government property in the hands of contactors~~. 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 footnote 34) elaborates that PP&E should~~all~~ be recognized when 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 (e.g., the entity will ultimately hold title to the PP&E), PP&E sh~~all~~ould also be recognized upon delivery or constructive delivery whether to the contractor for use in performing contract services or to the entity.

A21. In 2003, ~~D~~during the due process deliberation of SFFAS 23, the issue also came up and a respondent unaware of existing standards encouraged the Board to develop standards that address this type of property because the respondent believed, “accounting control over this property is deplorable.” As discussed in the basis for conclusions to SFFAS 23, the previous Board found that “It is clear 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 DoD, to mitigate the cost of properly reporting on such PP&E were considered. DoD's proposal was intended to allow DoD to take a prospective approach for establishing completeness and accountability for government property in the hands of contactors. Much of 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, the data today have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. DoD also based the proposal on the fact they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. DoD has other accountability obligations and a management need for complete records to support decision making.[16]

A23. The Board believes 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 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 DoD may be in a position to support that this line item is not materially misstated. This supports the notion that no special consideration should be given to government property in the hands of contactors.

~~A22.~~A24. The Board conducted outreach on this issue prior to issuing the exposure draft. Feedback from the audit community conveyed that issues that DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to DoD's proposal, there were noted audit challenges due to gray areas, such as no firm cut-off date and 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.

~~A23.~~A25. There was not support for the Board to make concessions in GAAP standards for areas such as this, because it appears that time will allow for issues to resolve in this area. Therefore, the Board concluded the application of the alternative valuation method (deemed cost) would be appropriate and prospective treatment of government property in the hands of contactors would not. If beneficial, DoD has the flexibility to display this as a separate line

[16] 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."

to enable deemed cost to be used until the opening balance is adequately established. ~~**[placeholder – staff anticipates receiving a proposal from DoD regarding this matter on October 14th and will update this section based on Board deliberation].**~~

~~A24.~~A26. The Board recognizes that large and complex reporting entities such as 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 one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

~~A25.~~A27. 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 records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities such as 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.

~~A26.~~A28. 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 and 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 ~~it~~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 so the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

A29. The Board carefully considered those aspects ~~to~~ of the land category along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board ~~and~~ 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. Meaning this allows for ~~prospective treatment~~ land to be valued at $0 by excluding existing land from its general PP&E opening balance. However, the Board can support~~establish~~ accountability through disclosures. The Board proposed that the reporting entity ~~disclose the adoption of prospective reporting,~~ provide a note reference on the balance sheet that discloses 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. ~~, and the number of acres for which an amount is included in general PP&E (the amount will relate to acquisition of land subsequent to the date of the opening balance).~~ A reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude amounts for future land acquisitions. Instead, the reporting entity will provide the note reference each year thereafter.

~~A27.~~ Some members who supported ~~the prospective treatment of~~ excluding land suggested exploring options to improve reporting on land. ~~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 are not recognized on the balance sheet. Instead, they are disclosed in a note to the balance sheet.~~

~~A28.~~ These members would like to explore valuing existing land holdings based on a set amount per acre of land. For example, one study[17] 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 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 government-wide ~~to both~~ land classified as general PP&E ~~and stewardship land~~.

A30. 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, "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 Board plans to begin a project on land in the near future to 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 revisited.

*Amendments to SFFAS 10, Accounting for Internal Use Software*

~~A29.~~A31. SFFAS 10 provides accounting standards for internal use software (IUS) used by federal entities. Previously, IUS had been addressed in SFFAS 6, but certain questions remained regarding the issue and the Board decided to review the issue and develop a separate Statement.

~~A30.~~A32. 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 ~~and the definition and capitalizable costs for IUS were broadened~~. SFFAS 10 provided guidance regarding the

**Comment [MB5]:** HS suggestion

[17] 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.

definition of IUS, the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

~~A31.~~A33. 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."

~~A32.~~A34. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains some entities have not had or do not have systems that could provide the information necessary and the conditions remain that existed when many of these standards were issued. In regards to SFFAS 10, the Board considered certain unique aspects to this 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.

A35. 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 ~~some departments may be at different stages of auditability of component reporting entities and other factors that may need to be considered when implementing a Statement such as this~~the various stages of implementation within reporting entities, the Board determined that th~~e~~is Statement should provide flexibility. Therefore, the guidance ~~was~~ also ~~updated to~~ provides for an alternative valuation method ~~of deemed cost that is~~ consistent with general PP&E. Considering IUS are 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 ~~to report existing IUS based on deemed cost, to capitalize IUS prospectively, or to recognize IUS in development but not IUS in service.~~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

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

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

~~A33.~~A36. 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."

~~A34.~~A37. 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.

~~A35.~~A38. By rescinding the paragraphs in SFFAS 23, the Board ensured the appropriate relevant~~and pertinent~~ 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*

~~A36.~~A39. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data 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.

~~A37.~~A40. 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.

~~A38.~~A41. 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 historical data would be beneficial. 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.

A42. 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." ~~However, t~~The majority of the Board believes it would be clearer ~~and not misinterpreted by users~~ if SFFAS 35 was rescinded.

A43. However, at least one member noted 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.

A44. Prior to the issuance of the ED, DoD raised concerns with the Board's proposal to rescind SFFAS 35 based on the time it will take for DoD to become full cost compliant. DoD requested the Board consider retaining SFFAS 35 or provide transitional guidance in this area. The Board believes that current standards provide flexibility and 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 G-PP&E when there is not a detailed cost accounting system.

A45. 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 G-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.

A46. 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.

A47. 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."

~~A39.~~

~~A40. While rescinding SFFAS 35 in its entirety, the Board ensured any pertinent guidance was included in the amendments to the SFFAS 6 Implementation Guidance.~~

## DISCLOSURES

~~A41.~~A48. 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 financial statement year-end that an unreserved assertion is made. The Board does not believe th~~is~~e first reporting period would be an interim reporting period because interim financial statements ~~include interim financial statements that~~ presently are unaudited and do not include note disclosures.

~~A42.~~A49. The Board notes that the term "unreserved assertion" may be used in other contexts. For example, certain entities' management (such as DoD) may be required to make management assertions regarding its financial information and that DoD financial statements are validated as ready for audit by not 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.

~~A43.~~A50. 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.

~~A44.~~A51. 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,~~statements or one or more line items are presented fairly in accordance with GAAP and continue to do 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 provide a note reference on the balance sheet that discloses ~~also provide~~ 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. ~~, and the number of acres for which an amount is included in general PP&E.~~ The Board believes requiring these disclosures would meet accountability and ensure appropriate measures are continued for existence and completeness.

~~A45.~~A52. 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 application. 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

~~A46.~~A53. 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.

~~A47.~~A54. 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. 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 DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

~~A48.~~A55. 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 established 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. The importance of a reporting entity being prepared to make the unreserved assertion is critical because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the FY 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for FY 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 FY 2018, or
b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 6 (as amended), in all material respects.

~~A49.~~A56. Reporting entities that meet the conditions specified in paragraph ~~5~~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."

~~A50.~~A57. 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."

~~A51.~~A58. 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, briefly describe deemed cost, and indicate the effect of adoption on beginning net position.

~~A52.~~A59. 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

**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.[18]

**Unreserved Assertion-** An unconditional statement.

[18] 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

Mail Stop 6H19

Washington, DC 20548

Telephone 202-512-7350

FAX 202-512-7366

www.fasab.gov

# Government Furnished Equipment & Contractor Acquired Property
# Air Force Meeting- November 4, 2015

**Participants**

Air Force
*Contracting* - Kiel Anderson
*Financial Management* - Fred Carr
*Logistics*- Colquitt Lawrence
*Procurement* - Velvetta Black

Defense Contract Management Agency - Tom Ruckdaschel

DoD FIAR
Brian Sykes
Mobola Kadiri
Shaila McCall (contractor)
Steve Chad (contractor)

DoD Procurement - Carol Vigna

DoD Property & Equipment Policy (P&EP)
Steve Tkac
Bobby Garrett (contractor)
Joe Stossel
Jeannine Rogers (contractor)
Ken Schreier (contractor)

FASAB
Wendy Payne
Melissa Batchelor

**Discussion**

Steve Tkac provided a brief opening regarding the purpose of the meeting by explaining that DoD had requested the Board to consider other options for the treatment of government property in the hands of contactors because of the significant challenges in this area and rationale based on information DoD may now have available. He explained that he had noted the Air Force had shown the most success in this area and the Air Force identified $8B in additional general PP&E through the process thus far. Mr. Tkac explained that the FASAB staff was here to learn more about the work performed by the Air Force and consider other options (such as prospective treatment) and rationale based on information available.

[FASAB staff notes that government property in the hands of contactors includes government furnished equipment (GFE) and contractor acquired property (CAP). GFE includes equipment, special tooling equipment, and special test equipment. CAP includes items that are purchased within a cost reimbursable environment and is not normally a contract deliverable.]

Air Force representatives provided the following key points:

- The contract review began in response to the January 2010 Air Force Audit Agency report regarding government furnished equipment financial statement reporting. [Audit Report F2010-0005-FB3000[1]] The audit confirmed a problem that most knew existed. Air Force agreed that this was significant enough to be a Material Weakness in 2011 and has been reported as such since that time.
- Labor intensive effort [recent data showed that Air Force used over 500 individuals to review approximately 10,000 contracts since March 2015 and this equated to 1 contract per hour. They also modified approximately 1,200 contracts to add proper clauses during this time.]
- Required collaboration with Logistics, Contracts and Program Offices working together
- Primary goal for contract review and process improvement was accountability
- Focus was on "legacy" = equipment already in the hands of contractors
- Review resulted in changes, improved processed, and adding $8B assets "Gross acquisition value"
- Air Force could not provide any other specific data based on their work that could be used to assess useful lives of assets, contract lengths or any other specifics that may be a rational basis for use in an alternative approach.

The Air Force worked closely and continues to work closely with OSD and other offices to develop a proper go forward system and approach. It has been a cooperative approach with a work-group, including OSD and other components. The participants noted there is some concern about the commitment level of other components. OSD plans to issue guidance that will be implemented by all components. The updated policies are based on end-to-end business rules to ensure consistent policy and terminology across organizations. Policy changes ensure government furnished property will be recorded in Accountable Property Systems of Record as contracts are closed-out and new contracts are issued.

The changes that have been incorporated (documented in policy that will be issued in next few months) include new Federal Acquisition Regulations (FAR) requirement for property record accountability and new Defense Federal Acquisition Regulations Supplement (DFARS) requirements for reporting of government furnished property. The DFARS contain several key clauses, one of which is for establishing GFP reporting by the contractor. DoD monitors the implementation of each of these FAR requirement clause and GFP DFARS clauses in new contracts by components. There is not 100% implementation due to business shortcomings such as lack of training, legacy contracts are carried forward and occasionally push-back from contractors.

One issue that FASAB identified for further discussion relates to CAP because it appears that there may be a potential conflict with existing standards and the DoD's proposed guidance. Based on discussion, DoD does not take accountability (include in the government accountability property records) nor include any CAP that may be over the capitalization threshold. CAP is not recorded in the accountability system or recognized as general PP&E (if needed) until it is "delivered" which may result in the CAP becoming GFE, disposed or recognized as equipment. There is no plan for DoD to change this aspect of their policy. FASAB staff notes this may be in conflict with SFFAS 6 and suggests further discussion.

[1] The report indicated Air Force procedures and actions to improve the accounting and reporting of GFE in financial statements required significant improvements. Specifically the Air Force did not account for GFE in the Air Force equipment management system and lost fiscal accountability of GFE in excess of $22 billion acquisition value. Additionally, Air Force was unable to determine how much was financially reportable.

FASAB staff is a bit unclear as to why DoD views CAP differently than GFE. It was explained that often CAP had moved from one contract to another as it is issued and it has not been recorded in a government property book. The legacy CAP is often defacto GFE that rolls to the next contract and does not come back to DoD.

**[UPDATE:** FASAB staff held a follow-up teleconference with DoD representatives to discuss the CAP issue and DoD representatives explained that they would be revising policy to ensure that CAP treatment is also in accordance with SFFAS 6.]

Property & Equipment Policy (P&EP) provided a slide presentation (see attached) to support some of the information they had noted to the Board at the October FASAB meeting. Key points included the following:

- Data may be based on incomplete information
- Data has known integrity and reliability issues and certain amounts were known to be "SWAGS"
- The estimated useful life of 5.25 was based on information in the Defense Property Accountability System.
- The average length of contracts is 4 years. This was based on active Mechanization of Contract Administration Services (MOCAS) with potential for GFE and percentage of contracts would expire in:
  FY16: 77.4%
  FY17: 12.4%
  After FY17: 10.4%

FASAB staff inquired whether the accountability efforts relate solely to financial reporting. Logistics and acquisition representatives indicated a business need to establish accountability; that is, existence and completeness. Some noted the ability to use deemed cost to establish valuation would reduce the cost of accounting for GFP. The cost of the existence and completeness effort relates primarily to the need to accelerate the effort to meet the audit readiness goals.

Participants briefly discussed the timeline for audit readiness and subsequently obtaining an unmodified opinion. FASAB staff noted that given the estimated useful life of the GFP in DPAS and the average length of the contracts this problem was likely to substantially resolve itself. There was a brief discussion of the difference between asserting auditability and asserting fair presentation.

## Action Items

DoD planned to submit a revised DoD proposal on government property in the hands of contactors by November 18, 2015 for FASAB's consideration.

FASAB Staff

## Introduction

We want to thank you for allowing the Department of Defense (DoD) to participate in the October 2015 FASAB Board meeting and for considering our recommendations for addressing the beginning balances for Government Property in the Hands of Contractors (referred to as GFE/CAP). The FASAB staff's October 14, 2015 memorandum to the FASAB Board members included DoD's proposed three options for Board consideration to address our GFE/CAP issue. DoD's ability to analyze our current position on GFE/CAP and establishing a baseline is challenging. The data shown in Attachment A is an attempt to convey the scope of the issue. This data is from "best available" sources however we caution to not draw firm conclusions from this data as it is directional at best.

## Our Proposal

DoD recommends the Board consider including language in its draft standard for establishing opening balances for General Property, Plant and Equipment (GPP&E) which will allow DoD to take a prospective approach for establishing completeness and accountability for GFE/CAP. For all DoD contracts which end prior to October 1, 2016, DoD will not remove any assets from its accountability records and will not change their current financial reporting status. For GFE/CAP not accounted for; DoD will not execute any specific baselining activities to identify them and record them in the financial statements. We believe these assets are immaterial for financial reporting purposes. Our data, summarized in Attachment A, indicates over 90% of GFE/CAP is less than $100,000 (DoD's prior capitalization threshold). In addition, only 40% of the GFE/CAP has a remaining useful life and approximately 60% is fully depreciated. One data source showed an average useful life for the GFE/CAP to be 5.25 years. In our opinion, spending millions of dollars and thousands of man-hours to collect these items in an uncontrolled environment is not worth the cost. In the case of active contracts, where DoD has accountability records for GFE/CAP, DoD will not remove these accountability records and will continue to financially report them as appropriate. As these active contracts end, DoD will capture all GFE/CAP and record these assets at the end of the contract (i.e., prospective treatment). In addition, all new contracts executed from October 1, 2016 forward will record GFE/CAP in accordance with current Generally Accepted Accounting Principles (GAAP).

## Basis and Support for our Request

We continue to believe that significant costs associated with bringing these assets to record combined with their relative immaterial value justify prospective recognition. During the last FASAB Board meeting, several Board Members seemed to agree to consider a prospective approach even commenting that the discussions are very similar to those held for Land and Internal Use Software (IUS). According to the Board meeting notes, factors considered leading to the prospective treatment for IUS have application to GFE/CAP; such as shorter useful lives, difficult to inventory and an acquisition cost less than the capitalization threshold. Based upon the average useful life and our estimate that 90% of these assets are less than the capitalization threshold, we are of the opinion that the impact on the balance sheet using a prospective approach would not be significant. In addition, Defense Procurement and Acquisition Policy (DPAP) evaluated active contracts with the potential for having GFE/CAP and determined that 77% of active contracts will expire at the end of 2016 and approximately another 12% by the end of Fiscal Year 2017. As discussed in our last meeting, this may be considered a "self-correcting" condition as DoD has implemented several corrective action plans and installed improved controls (as outlined in our proposal to the Board included in the October 14, 2015 memorandum).

## Conclusion

We appreciate the opportunity to clarify our position and our recommendation for prospective treatment for GFE/CAP. Taking into consideration the data and other pertinent information presented in our Basis and Support for our Request, DoD would like to thank the Board for considering a prospective treatment for GFE/CAP and request the Board to include language in its draft standard for establishing opening balances for GPP&E.

**Attachment A – DoD GFE/CAP Data Points**

| | |
|---|---|
| Total Estimated Value of Equipment From DCMA Data (Equipment, Special Tooling & Special Test Equipment Only) | ~ $74 B |
| | |
| Rough Estimate of Value for Navy Self Administered Contracts (SWAG) | ~ $26 B |
| | |
| Rough Estimate of Value of GFE Problem (Sum of the two items above) | ~ $100 B |
| | |
| Estimates of Value Brought to Record (Based upon informtion provided by Air Force and Missile Defense Agency) | <$18 B> |
| | |
| Total Estimate Not Recorded | ~ $100 B less $18 B = $82 B |
| | |
| Percent to General Equipment FY14 Balance Sheet (Gross Acquisition Cost of estimated GFE compared to Gross Acquisition cost for GE from FY 2014 Note 10) | ~ 8.2% ($82 B / ~ $1 T) |

| | |
|---|---|
| Using Best Available Data - Average Cost Per Unit (Sources include: (1) all records in DPAS marked as "out to contractor" (2) 2012 Analysis of IUID Registry Data, for GFE at Contractors" (3) DCMA data (total value / total number of items) | Most < $100,000 below Prior Capitalization Threshold |
| | |
| Using Best Available Data - Average Useful Life (source is DPAS records for all items marked "out to contractor") | Most have Useful Life < 10 years Average - 5.25 Years |
| | |
| Percent of Items Estimated to be FULLY DEPRECIATED (Source: All DPAS records marked "out to contractors) | Approx. 60% |
| | |
| Percent of Items Estimated to have REMAINING Useful Life (Source: All DPAS records marked "out to contractors") | Approx. 40% |
| | |
| Average Period of Performance Active MOCAS Contracts w/ Potential Property (Source: DPAP) | 1609 Days 4.4 Years (1609 Days / 365 Days per Year) |
| | |
| Active MOCAS Contracts w/ Potential for GFE Percent when Contract Will End Aligned to Fiscal Year (Source: DPAP) | End FY 16 (77.4%) End FY 17 (12.4%) After FY17 (10.2%) |

Note: Data above is from “best available” sources, however, we caution to not draw firm conclusions from this data as it is directional at best.

# FASAB Auditor Roundtable
## Government Property in the Hands of Contractors
## December 1st 9 a.m.

FASAB staff held an auditors roundtable meeting as a means to gather more information to inform the Board's response to the DoD's request for an alternative valuation method in establishing the opening balances for property in the hands of contractors. FASAB staff explained government property in the hands of contactors is a longstanding issue area for DoD. Current accounting standards are consistent with general PP&E since there is no conceptual difference.

There were 12 participants, including representatives from a range of IPAs, GAO and DoD OIG. After brief introductions, FASAB staff explained the status of the DoD Implementation Guidance Request Project, the results from October 2015 Board Meeting, and that the government property in the hands of contractors issue is being considered in the Draft Exposure Draft, *Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*.

**Participants' observations regarding property in the hands of contactors at DoD:**

- DoD hasn't recognized or accounted for government equipment in the contractor's possession. This was a result of DoD not considering who actually had the title.
- Many of the issues that DoD encounters with this property are the same for all DoD property. Establishing records is challenging for all DoD property and no different for property in the hands of contactors. DoD will have the same issues when trying to get other property that existed before the conversion to DPAS. The challenges are documentation and valuation. A big challenge is getting the link from the contract and cost as well as the date in service.
- The contractors would like to satisfy the government needs but the issue is with the old contracts and clarity of requirements from DoD.
- Establishing placed-in-service dates is a huge challenge for all DoD property.
- Government property in the hands of contractors includes government furnished equipment, government furnished material, and contractor acquired property. A potential issue is confusion among these items and when the items come back to DoD. In addition, common understanding of what is "in the possession of the contractor" and should it be GFE in certain situations, such as co-located items.

**Participants' observations regarding property in the hands of contactors at other agencies:**

- NASA had similar issues with government equipment that was in contractor possession (some of the contracts were under DoD administrators) but they resolved the issue in 2004 or 2005. NASA changed their contracting and included monthly reporting requirements.
- FAA and US Coast Guard were also noted as agencies that had similar issues that had been corrected.
- Based on discussion, it was data call efforts that helped resolve but scope and volume were probably not as large.
- NOTE: When time permits, FASAB or DoD staff should contact the agencies noted above for further information about their processes. While it may not address the correct beginning balance, it would be of importance to DoD in improving their go-forward processes.

**Participants' observations regarding DoD Proposal – Prospective approach for GFE/CAP:**

- Appears to have significant audit challenges because too many gray areas, such as no real cut off. Existence and completeness challenges.

- The approach appears to add complexities as it establishes multiple buckets of contracts that DoD would need to follow versus a clear line when the baseline is established then go forward. In addition, the multiple stovepipes would be more challenging and most likely add to audit cost rather than reduce costs.
- Difficulties associated with using “contracts which end” because there are questions regarding task orders, modifications, and whether it would include passing to a new or extended contract that goes beyond October 1, 2016.
- There would need to be a clear set of established rules and processes and definitions that cover all issues to ensure it is implemented consistently across services.
- There would need to be rules to address entity issues such as who gets what at the end of the contract and when items are transferred between components.
- Bottom line is contracting needs improvement and until that is fully implemented; there will be too many complexities that cause challenges.

**The floor was open for discussion:**

- One participant suggested expensing it up front if it isn’t material. The group noted that management has discretion to address immaterial items through the capitalization threshold. The group also noted that not much weight could be placed on the information provided by DoD.
- The group agreed FASAB should not make concessions in standards for areas such as this, that based on DoD’s efforts in the contract area, time will allow for issues to resolve in this area.

FASAB staff also asked for the participants’ feedback regarding a separate issue related to DoD’s request to add “current replacement cost” as a deemed cost method in the Draft ED, *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*. After considering the issue, FASAB staff did not believe the proposed standards should be revised to include an additional category for current replacement cost. Replacement cost as defined in the SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording,* is the best source for the definition in the proposed standard because the standard is about valuation.

The group discussed the terms as two means to an estimated result. Therefore, logically both would be acceptable. FASAB staff explained that they may expand the basis for conclusions to explain the differences between fair value and replacement cost as well as in practice, it may be difficult to measure remaining service potential directly and several ways of arriving at an approximation. During this discussion, the participants stressed concern in understanding DoD’s PRV methodology because they will want to apply procedures to assess the reasonableness of the PRV, including the cost factors and if PRV is supported. The participants stressed the importance of reminding DoD that although the PRV may be used, the PRV model and information supporting that is subject to audit. In addition, the useful lives/ remaining useful lives is a critical matter that needs to be addressed.

DEPARTMENT OF DEFENSE – OUSD
SUGGESTED LANGUAGE FOR THE FASAB PROPOSED STANDARD (Establishing Opening Balances for General Property Plant and Equipment) TO AMEND SFFAS 6

SFFAS 6, 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 applying the alternatives for establishing the opening balance:

i) 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.

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

iii) 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*.

iv) Land. The reporting entity may exclude land from the opening balance of general PP&E.

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[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.

v) Alternative Valuation Method. Deemed cost:[6] 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:[7]

(1) Replacement cost[8]
(2) Asset replacement value[9]
(3) Estimated historical cost (initial amount)--Reasonable estimates may be based on:
i. cost of similar assets at the time of acquisition,
ii. 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
iii. 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.
(4) Fair value[10]

vi) Establishing in-service dates. 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.

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6 Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.
7 The methods are not listed in order of preference.
8 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. (SFFAC 7, par. 46)
9 Asset replacement value is the current amount that would be required to replace the service capacity of an asset, inclusive of capital improvements.
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)

vii) Use of estimates subsequent to establishing opening balances. For accounting periods subsequent to application of paragraph (v) above to establish opening balances, there may be a period of transition during which the reporting entity does not have adequate systems and processes in place to capture actual historical costs at the transaction level in accordance with this Standard. During such a period of transition leading to full implementation of this Standard, a reporting entity may use reasonable estimates to approximate actual costs of G-PP&E to be capitalized or expensed. Such estimates may be used when detail information needed has not been provided to the entity to appropriately record transactions which occurred during the accounting period. Reasonable estimates may rely on information such as, but not limited to, budget, appropriations, engineering documents, contracts or other reports reflecting amounts to be expended as the basis to allocate the actual costs to assets and/or expenses.

For example, an entity may be making periodic progress payments to a contractor. The invoices from the contractor do not provide specific information as to exactly what each progress payment represents. An estimate can be utilized to determine the amount to record to: work-in-process, an asset that should be capitalized and depreciated, or items that should be expensed such as training, overhead charges, or supplies. The estimate could be derived from contract documents such as work order schedules, receiving reports, or other documents that have information and/or financial data regarding part of, or the entire contract for which the payments are being made.

viii) Disclosure requirements:

(1) A reporting entity electing to exclude land from its general PP&E opening balances must disclose this fact, 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, the number of acres held at the end of each reporting period, and the number of acres for which an amount is included in general PP&E.[11]

(2) 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.

[11] The amount will relate to acquisition of land subsequent to the date of the opening balance.

**Federal Accounting Standards Advisory Board**

Date: December 4, 2015

To: Members of the Board

From: Wendy M. Payne, Executive Director

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

The following is a ballot for the Exposure Draft on the standard, *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.* Please enter your name in the space provided below and indicate your approval or disapproval. Please fax the ballot to us at 202 512-7366. If you wish to submit your ballot via e-mail, please e-mail to me at paynew@fasab.gov.

Ballots are due by **December 18, 2015**. If you wish to express an alternative view, please notify staff immediately and provide your alternative view as soon as possible but no later than **December 24, 2015**. **When staff receives five affirmative votes, we will publish the exposure draft unless a member has notified us that he or she is preparing an alternative view.**

Board Member: ________________________________________ Date__________

__________ I approve the subject Exposure Draft

__________ I do not approve the subject Exposure Draft

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 21, 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, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. 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 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 FASAB's website at: www.fasab.gov.



**Contact us:**

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

December 21, 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 would 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. Those 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, 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 the comments to (202) 512-7366. Alternatively, you may mail your comments to:

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

We will confirm receipt of your comments. If you do not receive 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 Statement provides 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 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.* The alternative methods include (1) use of deemed cost to establish opening balances of general PP&E (2) selecting between deemed cost and prospective treatment of internal use software and (3) exclusion of land from opening balances with disclosure of acreage information.

The alternative methods are 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 is 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 is intended to 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.

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# 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 also would welcome 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 Word file for your use at www.fasab.gov/exposure.html. 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<br>
Federal Accounting Standards Advisory Board<br>
Mailstop 6H19<br>
441 G Street, NW, Suite 6814<br>
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 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 note reference.

Some members suggested valuing existing land holdings based on a set amount per acre of land. 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 revisited.

(See paragraphs 12.d. and 12.g. for relevant standards and paragraphs A28 A30- A30 and A51 in the Basis for Conclusions.)

**a) Do you agree or disagree with the proposal to exclude land from the opening balances of general PP&E? Please provide your rationale.**

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

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

**d) Do you believe the Board should revisit cost-effective options for valuing land on a government-wide basis? Please provide your rationale and 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 application.

The proposed Statement describes the alternatives and related disclosures. (See paragraphs 13-14 for relevant standards and paragraphs A31-A35 and A52 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. The Board believes it would be clearer if SFFAS 35 was rescinded. Rescission would avoid the implication that estimates may not be used absent an explicit provision in standards. (See paragraph 18 for relevant standards and paragraphs A39-A47 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 in establishing opening balances for general PP&E 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. Through the amendments it also provides for selecting between an alternative valuation method of deemed cost that is consistent with that provided for all general PP&E and prospective application 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 paragraphs 21-39. For the definition, recognition, and measurement principles for internal use software see SFFAS 10 paragraphs 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 this opening balance that are discovered in later reporting periods.

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

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.

e. Alternative Valuation Method. Deemed cost[6] 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:[7]

    i. Replacement cost[8]

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

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

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

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[9]

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 provide a note reference on the balance sheet that discloses 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[10] to exclude future land acquisition amounts and provide the note reference.

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.

[9] 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)

[10] 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 revisited.

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

[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.

entity should choose between the following acceptable alternatives, to establish the opening balance of internal use software under development 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 thru 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 40 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.

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

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

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.

## EFFECTIVE DATE

19. 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. |
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# 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'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 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, Board staff met with officials from DoD, as well as the audit community, to develop an understanding of the issues currently faced by 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. 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 establish a valuation baseline.
f. 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. 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 DoD's efforts and the fact 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 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 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 timely. The goal of this Statement is to avoid expending taxpayer dollars 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 DoD with establishing a baseline would benefit all parties. Providing a starting point may 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.

A8. The Board also acknowledged that other standard setters have provided guidance for organizations implementing an entire body of standards for a 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 would amend 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.

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, 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. 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 would allow 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 would be recognized based on the remaining useful life compared to the original useful life. This would not systematically understate the historical cost since capital improvements would 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, 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.* 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 that 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, 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 the useful lives and is significant to all general PP&E.

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 footnote 34) elaborates that PP&E should be recognized when 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 (e.g., 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. In 2003, during the due process deliberation of SFFAS 23, the issue also came up and a respondent unaware of existing standards encouraged the Board to develop standards that address this type of property because the respondent believed, "accounting control over this property is deplorable." As discussed in the basis for conclusions to SFFAS 23, the previous Board found that "It is clear 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 DoD, to mitigate the cost of properly reporting on such PP&E were considered. DoD's proposal was intended to allow DoD to take a prospective approach for establishing completeness and accountability for government property in the hands of contactors. Much of 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, the data today have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. DoD also based the proposal on the fact they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. DoD has other accountability obligations and a management need for complete records to support decision making.[14]

A23. The Board believes 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 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 DoD may be in a position to support that this line item is not materially misstated. This supports the notion that no special consideration should be given to government property in the hands of contactors.

A24. The Board conducted outreach on this issue prior to issuing the exposure draft. Feedback from the audit community conveyed that issues that DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to DoD's proposal, there were noted audit challenges due to gray areas, such as no firm cut-off date and 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.

A25. There was not support for the Board to make concessions in GAAP standards for areas such as this, because it appears that time will allow for issues to resolve in this area. Therefore, the Board concluded the application of the alternative valuation method (deemed cost) would be appropriate and prospective treatment of government property in the hands of contactors would not. If beneficial, DoD has the flexibility to display this as a separate line to enable deemed cost to be used until the opening balance is adequately established.

A26. The Board recognizes that large and complex reporting entities such as 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 one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

A27. 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 records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities such as DoD finalize a sound GAAP compliant financial management system. All activity after the opening balances for general PP&E are

[14] 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."

established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

A28. 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 and 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 so the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

A29. 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. Meaning this allows for land to be valued at $0 by excluding existing land from its general PP&E opening balance. However, the Board can support accountability through disclosures. The Board proposed that the reporting entity provide a note reference on the balance sheet that discloses 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. Instead, the reporting entity will provide the note reference each year thereafter.

A30. Some members who supported excluding land suggested exploring options to improve reporting on land. These members would like to explore valuing existing land holdings based on a set amount per acre of land. For example, one study[15] 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 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 government-wide land classified as general PP&E. 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, "Stewardship Land" are not recognized on the balance sheet. Instead, reporting entities are required to reference a note on the balance sheet that discloses

[15] 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.

physical units by major land use. Because the reporting of land varies based on the intended use when land is acquired, the Board plans to begin a project on land in the near future to 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 revisited.

*Amendments to SFFAS 10, Accounting for Internal Use Software*

A31. SFFAS 10 provides accounting standards for internal use software (IUS) used by federal entities. Previously, IUS had been addressed in SFFAS 6, but certain questions remained regarding the issue and the Board decided to review the issue and develop a separate Statement.

A32. 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, and other guidance.

A33. 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."

A34. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains some entities have not had or do not have systems that could provide the information necessary and the conditions remain that existed when many of these standards were issued. In regards to SFFAS 10, the Board considered certain unique aspects to this 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.

A35. 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 IUS are 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, establish an opening balance of zero for IUS in service, and capitalize costs consistent with SFFAS 10 prospectively.

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

A36. 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."

A37. 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.

A38. 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*

A39. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data 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.

A40. 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.

A41. 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 historical data would be beneficial. 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.

A42. 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 was rescinded.

A43. However, at least one member noted 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.

A44. Prior to the issuance of the ED, DoD raised concerns with the Board’s proposal to rescind SFFAS 35 based on the time it will take for DoD to become full cost compliant. DoD requested the Board consider retaining SFFAS 35 or provide transitional guidance in this area. The Board believes that current standards provide flexibility and 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 G-PP&E when there is not a detailed cost accounting system.

A45. 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 G-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.

A46. 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.

A47. 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

A48. 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 financial statement year-end that an unreserved assertion is made. The Board does not believe the first reporting period would be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures.

A49. The Board notes that the term "unreserved assertion" may be used in other contexts. For example, certain entities' management (such as DoD) may be required to make management assertions regarding its financial information and that DoD financial statements are validated as ready for audit by not 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.

A50. 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.

A51. 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 do 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 provide a note reference on the balance sheet that discloses 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 and ensure appropriate measures are continued for existence and completeness.

A52. 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 application. 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

A53. 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.

A54. 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. 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 DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

A55. 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 established 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. The importance of a reporting entity being prepared to make the unreserved assertion is critical because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the FY 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for FY 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 FY 2018, or
b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 6 (as amended), in all material respects.

A56. 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."

A57. 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."

A58. 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, briefly describe deemed cost, and indicate the effect of adoption on beginning net position.

A59. 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

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|---|---|
| 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

**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.[16]

**Unreserved Assertion-** An unconditional statement.

[16] 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

Mail Stop 6H19

Washington, DC 20548

Telephone 202-512-7350

FAX 202-512-7366

www.fasab.gov