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July 13, 2015

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

RE: Proposed Statement of Federal Financial Accounting Standards, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*

Dear Ms. Payne:

We appreciate the opportunity to respond to the proposed Statement of Federal Accounting Standards, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials* – the exposure draft (ED). We support the Board’s efforts to address alternative valuation methods for opening inventory, operating materials and supplies (OM&S), and stockpile materials. We agree, as discussed in the Basis for Conclusions, that there is a need within the Department of Defense (DoD) community for alternative valuation methods. However, there are certain aspects of the ED that are unclear, which will make implementation problematic, and in some instances will impact the auditability. Therefore, we provide the following comments, segregated between “key issues” and “other issues” for the Board’s consideration.

Key Issues:

1. Scope – Paragraph 4

The Basis for Conclusions (paragraphs A1-A4, A9, and A13-A16) implies that the Board developed the alternative valuation methods of inventory, OM&S, and stockpile materials for the DoD community. Therefore to avoid unintended application of this standard, we recommend adjusting paragraph 4 as follows (new content underscored):

This Statement applies when a Department of Defense 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 once per reporting entity.

If the scope is not restricted to DoD entities, we recommend that the Board incorporate guidance after paragraph 4 to further clarify when the Statement is not applicable, such as what is done in the International Public Sector Accounting Standard (IPSAS), No. 33, *First-Time Adoption of Accrual Basis International Public Sector Accounting Standards*, paragraph 3(a)-(c), as follows:

This Statement would not apply when a reporting entity:

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- a. Stops presenting financial statements in accordance with GAAP after having previously presented in accordance with GAAP;
- b. Presented financial statements in previous period(s) in accordance with GAAP; or
- c. Presented financial statements in previous period in accordance with GAAP, even if the auditors issued a modified opinion.

In addition, we believe it is unclear what is meant by the phrase “once per reporting entity” in the last sentence of paragraph 4. This could be interpreted to mean once per asset, once per asset type (inventory, OM&S, and stockpile materials), or once for the entity as a whole. Therefore, we recommend that the Board add an additional paragraph to explain the intent of this sentence.

2. Scope – Paragraph 5

Paragraph 5 uses the term “unreserved assertion” regarding the presentation of inventory, OM&S, and stockpile materials in accordance with GAAP. The concept of an “unreserved assertion” does not exist in the professional literature (auditing and/or accounting – AICPA, GAO, FASAB). Therefore, the term “unreserved assertion” should be defined with objective/measurable criteria.

In addition, the second sentence of paragraph 5 states that the alternative valuation methods may not be applied to transactions that increase the inventory, OM&S, and stockpile materials balance after the opening balances are established. However, the alternative valuation methods should not be applied to any transactions (increases and decreases) after the opening balances are established. Therefore we recommend that the second sentence in paragraph 5 be adjusted as follows (deleted content strike-through):

~~The alternative valuation methods permitted in this Statement may not be applied to transactions or events that increase the balance of inventory, OM&S, and stockpile materials after opening balances are established.~~

3. Alternative Valuation Method for Opening Balances – Paragraph 10

Paragraph 10 states, “...deemed cost may be based on one of a combination of any of the following valuation methods...” The term “may” presents an auditability challenge because a reporting entity could use any of the methods noted in paragraph 10 as well as any other method that may lack objectivity/measurability. Therefore, we recommend that paragraph 10 be adjusted as follows (new content underscored; deleted content strike-through):

Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost should ~~may~~ be based on one of or a combination of any of the following valuation methods, which are alternatives to the valuation methods allowable in SFFAS No. 3:

Further, paragraph 10 provides the following valuation methods:

- a. Standard price (selling price) or fair value
- b. Latest Acquisition Cost (LAC)
- c. Replacement cost
- d. Estimated historical cost (initial amount)
- e. Actual historical cost (initial amount)

Statement of Federal Accounting Standards (SFFAS) No. 3, *Inventory and Related Property*, provides that:

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- Inventory should be valued at historical cost or latest acquisition cost [paragraph 20];
- OM&S should be valued at historical cost [paragraph 42]; and
- Stockpile materials should be valued at historical cost [paragraph 53].

As a result, items “b” and “e” are already allowable as it relates to inventory and item “e” is already allowable as it relates to OM&S and stockpile materials. If the Board’s intent was for the list in paragraph 10 to be valuations methods alternative to what is allowable under SFFAS No. 3, we recommend deleting item “e” and adjusting item “b”. In addition, it is not clear why the term “initial amount” is provided in parenthesis in item “d” and, as a result, we recommend that the Board remove “initial amount” or explain its purpose. Therefore, we recommend the list provided in paragraph 10 be adjusted as follows (new content underscored; deleted content strike-through):

- a. Standard price (selling price) or fair value
- b. Latest Acquisition Cost (LAC) Method [expanded to OM&S and stockpile materials]
- c. Replacement cost
- d. Estimated historical cost ~~(initial amount)~~
- e. ~~Actual historical cost (initial amount)~~

In addition, footnote 4 in paragraph 10 provides a definition of standard price (selling price). We recommend that standard price (selling price) be added to the definitions section of the Statement instead of defined in a footnote.

Lastly, SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*, describes the concept of estimating historical cost regarding general property, plant, and equipment. We recommend that the Board incorporate guidance from SFFAS No. 35 or include a footnote reference to SFFAS No. 35 to provide a framework regarding estimating historical cost for inventory, OM&S, and stockpile materials.

4. Alternative Valuation Method for Opening Balances – Paragraph 11

The last sentence of paragraph 11 states, “No distinction of amounts arising from the opening balances is required.” We recommend that the Board clarify if this is meant to refer to opening balance in year of adoption, on a continuing basis, or both.

5. Disclosure Requirements – Paragraph 12

Paragraph 12 requires that the reporting entity disclose the application of deemed cost in the first reporting period without mention of subsequent year disclosure requirements. However, we believe that paragraph A18 of the basis for conclusions expresses a different intent regarding paragraph 12. The second sentence of paragraph A18 states, “If reporting entities are able to document that turnover rates for inventory, OM&S, and stockpile materials are such that the opening balance valuation is at historical cost, a reference to deemed cost would not be required.” This implies that it was the Board’s intent for a reporting entity to disclose the use of deemed cost in the first reporting period and subsequent periods until the valuation is at historical cost based upon the turnover rate. We have provided two example disclosures in appendix 1 to this letter that illustrate these two interpretations. Disclosure option 1 is based on paragraph 12 and disclosure option 2 is based on paragraph A18. We recommend that the Board consider these two options and adjust paragraphs 12 and/or A18 accordingly.

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6. Effect on Existing Standards – Amendments to SFFAS 3, *Accounting for Inventory and Related Property* – Paragraph 14

The information provided in paragraph 14 is not drafted as an amendment to SFFAS No. 3. Paragraph 14 adds a paragraph (56a) to SFFAS No. 3, which provides a reference to this proposed Statement and does not amend the guidance contained within SFFAS No. 3. If it was the Board's intent to amend SFFAS No. 3, as we believe it should be, we recommend that the Board revisit the guidance provided in paragraphs 9-12 and use this guidance to amend paragraphs 20, 22, 35, 42, 44, 50, 53, and 56 of SFFAS No. 3. Following this approach, would be consistent with the treatment of SFFAS No. 35, which amended SFFAS No. 6, *Accounting for Property, Plant, and Equipment*. If it is not the Board's intent to amend SFFAS No. 3, we recommend deleting this section from the Statement.

Other Issues:

1. Definitions – Paragraphs 7 and 8

The definition of deemed cost (paragraph 7) should not include the phrase “as used in this Statement” because once a term is defined in FASAB literature it should be considered a universal term that could be used in future Statements. Therefore, we recommend deleting the phrase, “as used in this Statement.”

The definition of opening balances (paragraph 8) contains a footnote that states that the definition is “adapted” from U.S. Auditing Standards-American Institute of CPAs (Clarified). The definition in paragraph 8 of the ED is identical to the definition provided in AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements*. Therefore, instead of implying that the definition was changed (“adapted”), we recommend that footnote 2 state, “Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).”

2. Basis for Conclusions

We recommend that the Board clearly explain that the purpose of this Statement is to provide alternative valuation methods for opening balances, however, it does not eliminate the reporting entity's responsibility to maintain evidential matter to support the valuation method(s) selected.

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

Sincerely,

KPMG LLP

**Disclosure Option 1** – Disclose use of deemed cost only in first reporting period (Paragraph 12)

First year:

During FY 201X, [Name of Entity] adopted Statement of Federal Accounting Standards (SFFAS) No. XX, *Opening Balances for Inventory, Operating Materials and Supplies and Stockpile Materials*. The opening balances of inventory, operating materials and supplies, and stockpile materials are valued at deemed cost. The methods used to determine deemed cost was *[describe method using one or a combination of the methods from paragraph 10]*. Current year transactions are recorded at historical cost and/or latest acquisition cost.

Subsequent years:

Inventory, operating materials and supplies, and stockpile materials are recorded at historical cost and/or latest acquisition cost.

Disclosure Option 2 – Disclose use of deemed cost in first reporting period and each subsequent year until inventory is valued at historical cost based upon turnover rate (Paragraphs 12 and A18).

First year:

During FY 201X, [Name of Entity] adopted Statement of Federal Accounting Standards (SFFAS) No. XX, *Opening Balances for Inventory, Operating Materials and Supplies and Stockpile Materials*. The opening balances of inventory, operating materials and supplies, and stockpile materials are valued at deemed cost. The methods used to determine deemed cost was *[describe method using one or a combination of the methods from paragraph 10]*. Current year transactions are recorded at historical cost and/or latest acquisition cost.

Subsequent years (turnover such that inventory value still based on deemed cost):

During FY 201X, [Name of Entity] adopted Statement of Federal Accounting Standards (SFFAS) No. XX, *Opening Balances for Inventory, Operating Materials and Supplies and Stockpile Materials*. Certain balances of inventory, operating materials and supplies, and stockpile materials are valued at deemed cost. The methods used to determine deemed cost was *[describe method using one or a combination of the methods from paragraph 10]*. FY 201X and 201Y transactions are recorded at historical cost and/or latest acquisition cost.

Subsequent years (turnover such that inventory is valued at historical cost):

Inventory, operating materials and supplies, and stockpile materials are recorded at historical cost and/or latest acquisition cost.