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

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## Status

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| <b>Issued</b>                                 | October 14, 2009   |
| <b>Effective Date</b>                         | Upon issuance  |
| <b>Interpretations and Technical Releases</b> | TR 13, <i>Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment</i>          |
| <b>Affects</b>                                | <ul style="list-style-type: none"><li>• SFFAS 6, paragraphs 40 and 45.</li><li>• SFFAS 23, paragraphs 10 – 18.</li></ul> |
| <b>Affected by</b>                            | None.  |

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## Summary

This standard amends Statement of Federal Financial Accounting Standard (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, which was issued in November 1995. SFFAS 6 provides implementation guidance and permits estimation of the amount to be capitalized but is not specific regarding allowable methods of estimation.

This standard also amends SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, which was issued in May 2003. SFFAS 23 provides guidance for estimating historical cost and accumulated depreciation consistent with SFFAS 6, as amended, but offers more detail regarding permissible documentation and methods.

This standard clarifies that reasonable estimates of original transaction data historical cost may be used to value general property, plant, and equipment (G-PP&E). The use of reasonable estimates is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities have decided to use estimates to determine the historical cost values of G-PP&E.

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## Introduction

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### Purpose

1. Statement of Federal Financial Accounting Standard (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, was effective for periods beginning after September 30, 1997. SFFAS 6 provides implementation guidance and permits estimation of the amount to be capitalized but is not specific regarding allowable methods of estimation. SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, provides guidance for estimating historical cost and accumulated depreciation consistent with SFFAS 6, as amended, but offers more detail regarding permissible documentation and methods. SFFAS 23 was issued May 8, 2003, and became effective in fiscal year 2003.
2. This standard amends SFFAS 6 and 23 to clarify that reasonable estimates of original transaction data historical cost may be used to value G-PP&E. The objective of this amendment is to establish a cost effective method to comply with SFFAS 6. The use of reasonable estimates is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities have decided to use estimates to determine the historical cost values of general property, plant, and equipment (G-PP&E).
3. Note that this amendment will not extend the effective date<sup>1</sup> of SFFAS 6 as amended, but will clarify that methods deemed acceptable by SFFAS 23 continue to be acceptable. This amendment to SFFAS 6 clarifies that it is acceptable to use estimates to approximate the historical cost values of G-PP&E.
4. The Board encourages those federal entities that use estimates to approximate the historical cost values of G-PP&E to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the G-PP&E historical cost valuation requirements.

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<sup>1</sup> Thus, entities must comply with the provisions of SFFAS 6 as amended in order to obtain an unqualified audit opinion. This ensures comparability among federal reporting entities receiving unqualified audit opinions.

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## 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 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.

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## Effective Date

6. The Statement will be effective upon issuance to ensure that any cost savings available are realized as soon as possible.

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## Accounting Standard

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### Scope

7. This Statement amends SFFAS 6 and 23 to provide for reasonably estimating the historical cost and accumulated depreciation of G-PP&E.
8. This Statement is also applicable to internal use software when the software meets the criteria for G-PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software*, and provides for reasonably estimating the historical cost and accumulated amortization of that G-PP&E.

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### Estimation of G-PP&E Historical Cost

9. This standard amends SFFAS 6 and 23 to clarify that reasonable estimates of original transaction data historical cost may be used to value G-PP&E. Reasonable estimates may be used upon initial capitalization as entities implement G-PP&E accounting for the first time, as well as by those entities who previously implemented G-PP&E accounting.
10. This standard clarifies that federal entities should report their G-PP&E based on historical cost information in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended. However, reasonable estimates of historical cost may be used to value G-PP&E assets.
11. This standard also allows the use of reasonable estimates when an entity determines it is necessary to revalue G-PP&E assets previously reported.
12. The text of SFFAS 6, par. 40 and 45, and SFFAS 23, par. 10 through 18, is amended as shown below (original paragraph numbers are retained).

#### (SFFAS 6)

[40.] Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of existing G-PP&E, in accordance with the asset recognition and measurement provisions herein. For existing general PP&E, if historical cost information necessary to comply with the above recognition and measurement provisions has not been maintained, estimates of historical cost are required. Estimates may shall be based on:

- cost of similar assets at the time of acquisition, ~~or~~
- current cost of similar assets discounted for inflation since the time of acquisition (i.e., deflating current costs to costs at the time of acquisition by general price index), or
- other reasonable methods, including those estimation methods specified in SFFAS 23 paragraph 12.

### Disclosure Requirements

[45.] The following are minimum ~~general~~ G-PP&E disclosure requirements:

- the cost, associated accumulated depreciation, and book value by major class;
- the use and general basis of any estimates used;
- the estimated useful lives for each major class;
- the method(s) of depreciation for each major class;
- capitalization threshold(s) including any changes in threshold(s) during the period; and
- restrictions on the use or convertability of ~~general~~ G-PP&E.

### **(SFFAS 23)**

[10.] The ~~initial~~ capitalization amount for G-PP&E assets previously considered ND PP&E should be based on historical cost in accordance with the ~~asset recognition~~ provisions of SFFAS 6, as amended, and should be the initial historical cost for the base unit<sup>4A</sup> ~~items~~, including any major improvements or modifications.

~~[11.] This standard recognizes that determining initial historical cost for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate not be reasonable or practical.~~

~~[12.] When establishing the historical cost of existing G-PP&E, in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended, reasonable estimates may be used. If obtaining initial historical cost is not practical, estimated historical cost may be used. Estimates may be based on Other information such as, but not limited to, budget, appropriations, ~~or~~ engineering documents, contracts, or ~~and~~ other reports reflecting amounts to be expended may be used as the basis for reasonably estimating historical cost.~~

[13.] Alternatively, estimates of historical cost may be derived by estimating the current replacement costs of similar items and deflating those costs, through the use of price-level indexes, to the in-service ~~acquisition~~ year or estimated in-service ~~acquisition~~ year if the actual in-service year is unknown. Other reasonable approaches for estimating historical cost may also be utilized. For example, latest acquisition cost may be substituted for current replacement cost in some situations.

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[13A.] 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.

[14.] A contra asset account--accumulated depreciation--for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS 6, as amended.

[15.] For military equipment that is eligible for capitalization ~~in service upon implementation of under~~ this standard, cleanup cost liabilities should be adjusted, as needed.<sup>5</sup>

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## Adjustment to Cumulative Results of Operations

[16.] ~~Initial application~~ Changes to previously reported G-PP&E amounts resulting from the application of this standard by an entity previously reporting G-PP&E should be treated as a corrections of an error in accordance with SFFAS 21. The cumulative effect of adopting this accounting standard 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 the change is made.

[17.] ~~Prior year financial statements presented for comparative purposes should be presented as previously reported.~~

[18.] ~~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 disclosures.~~<sup>6</sup>

[Footnotes:]

<sup>4A</sup>"Base unit" refers to the level of detail considered in categorizing PP&E. Generally, the base unit is the smallest or least expensive item of property to be categorized. The term "base unit" may be used by others to have a different meaning--the meaning intended in this standard is limited to that specified above [from SFFAS 6 fn 25].

<sup>5</sup> Under the provisions of SFFAS 6, paragraph 97, a portion of the estimated total cleanup costs shall be recognized as expense during each period that ~~general G-~~G-PP&E is in operation and a liability accumulated over time as expense is recognized. This adjustment may be needed because the DoD may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS 6, as amended.

<sup>6</sup>~~SFFAS 21, Reporting Corrections of Errors and Changes in Accounting Principles, paragraphs 12 and 13. Recognition and Measurement~~

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## Appendix A: Basis for Conclusions

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### Project History

- A1. At the FASAB September 2007 meeting, the Board discussed technical agenda options. During the discussion, members expressed support for an effort to reduce the cost expected to be incurred at the Department of Defense (DoD) as it establishes the historical cost for G-PP&E during the coming years.
- A2. The discussion documented a number of concerns relating to DoD accounting. In addition, concerns regarding group and composite depreciation have been raised since the meeting. Collectively, concerns regarding G-PP&E were summarized as follows:
- a. Continued use of estimates in the absence of a system
  - b. Options for group/composite depreciation
  - c. Accounting for assets deployed to a war zone
  - d. Cost accounting (assignment of R&D, support and overhead to G-PP&E)
  - e. Evaluation of existing standards and the potential for adopting fair value as the measurement basis
- A3. In considering these issues, the Board agreed that issues a. through d., can and should be addressed quickly due to the potential that more costly solutions will be used in the absence of guidance. The Board agreed that these issues could be addressed without significantly affecting the Board's ongoing projects.
- A4. With respect to issue e., evaluation of existing standards, the Board agreed that this issue should be considered when the Board makes decisions on its technical agenda. As noted by one of the members, considerable time has been devoted to the question of G-PP&E accounting. A project on this topic is likely to be controversial and demand staff and Board time. Therefore, undertaking the project should be considered in the broad context of agenda setting. In August 2008, the Board agreed to add a project regarding evaluation of existing standards and plans to address the PP&E standards as one component of that project.

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## Initial Proposal for Implementation Guidance

- A5. Regarding the permissibility of estimates (issue a), the Board agreed that it should consider amending the standards. It is not unreasonable to read SFFAS 6, as amended, to provide for the use of the SFFAS 23 initial capitalization methods only when assigning cost to G-PP&E acquired before the effective dates of SFFAS 6 or 23. The Board agreed to clarify this through a relatively narrow amendment of SFFAS 23. A draft exposure draft (omitting the Board's basis for conclusions) was presented at the December 2007 FASAB meeting. The draft (1) provided an additional five year window for the Department of Defense and a rolling five year window for agencies not previously producing financial reports to rely on SFFAS 23 methods and (2) provided new guidance regarding estimation of the in-service date. Subsequent Board discussions discouraged a proposal that would establish a date-certain timeframe for the use of reasonable estimates when determining the historical cost values of G-PP&E.
- A6. Staff did not request immediate action by the Board on the draft ED. The Board generally supported the proposal so staff's next steps were to inquire with selected agencies and members of the audit community to confirm that the guidance is needed. In addition, staff reviewed fiscal year 2007 agency reports to determine if agencies other than the Department of Defense face similar challenges with respect to developing G-PP&E systems, using SFFAS 23 methods, and could be expected to incur significant costs to arrive at acceptable estimates absent explicit guidance.
- A7. With respect to the three remaining issues noted in par. A3., (group/composite depreciation, deployed assets, and cost accounting), staff recommended and the Board agreed to request that the Accounting and Auditing Policy Committee (AAPC) consider these issues. Staff suggested that a task force develop implementation guidance within the boundaries of the current standards. The AAPC has accepted the project and a task force is actively engaged in developing guidance.

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## Member Views

- A8. SFFAS 6 was issued in November 1995 and was effective in fiscal year 1998. In addition, SFFAS 23, *Eliminating the Category National Defense PP&E*, was issued in May 2003 and was effective in fiscal year 2003. In 2002, the Accountability of Tax Dollars Act established a requirement for many agencies that did not previously produce audited financial statements to do so. As a result, in fiscal year 2003 many agencies were required to comply with SFFAS 6 for the first time. Therefore, certain entities were not afforded an implementation period because they began preparing financial statements after the effective date of SFFAS 6.

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- A9. This Statement permits continued application of the SFFAS 23 initial capitalization guidance. The Statement's primary objective is a cost effective method for attaining compliance with SFFAS 6 as amended. This method is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities decide to use estimates to determine the historical cost values of G-PP&E.
- A10. An entity may find that it is not practical to determine the historical cost of G-PP&E based on the original transaction data because it is either not cost effective to do so or documentation is inadequate. Cost effectiveness may be based on an analysis of various cost factors associated with determining those historical cost values. An entity may also determine it impractical when the original transaction data historical cost documentation has not been maintained or when the historical cost data has been maintained but not in a manner that facilitates the timely valuation of G-PP&E. An entity's inadequate systems and/or processes that do not facilitate the ready and timely collection of data for the valuation of G-PP&E may lead to an assessment that valuation based on original transaction data is not cost effective.
- A11. The Board initially included "cost effectiveness" and "practical" as the basic criteria to be met before the use of reasonable estimates when valuing G-PP&E in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended, would be permitted. The Board later decided against including the above basic criteria. Such criteria are open to interpretation and likely to lead to subjective and inconsistent application.
- 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.
- A13. The Board is aware that these amendments will not resolve all the concerns surrounding accounting for G-PP&E. However, allowing estimates as entities are working towards implementing systems and processes that can capture historical data would be beneficial. The Board is also relying on other means, such as laws and regulations relating to systems and controls, to encourage entities to continue to develop adequate systems and processes.
- A14. The Board also debated at length whether to establish a date-certain time frame or have an open-ended approach for the use of reasonable estimates when determining the historical cost values of G-PP&E. The debate included both pros and cons to a date-certain approach. One of the pros to the date-certain approach is that entities will have a specific goal (i.e.,

time frame) to work towards. The con to the date-certain approach is that there is a risk that the benefits of the standard could be voided if the entity does not or cannot meet the date-certain time frame. The debate also included pros and cons to an open-ended approach. The pros include flexibility and the opportunity to test various methodologies when determining the best estimation method. The cons include the prolonged use of estimates when not appropriate.

A15. The Board decided against a proposal that would establish a date-certain time frame for the use of reasonable estimates when determining the historical cost values of G-PP&E. The Board does not want to penalize an entity simply because it may take the entity longer to implement the necessary systems and processes to ensure the adequate capture of historical cost values. In addition, the Board believes that the use of reasonable estimates is proper given the appropriate disciplines surrounding the use of estimates.

A16. The Board encourages those federal entities that use estimates to approximate the historical cost values of G-PP&E to establish processes and practices (i.e., adequate systems and internal control practices) for future acquisitions that will capture and sustain transaction based data that meet the G-PP&E historical cost valuation requirements.

A17. The Board believes that acknowledging the continuing appropriateness of estimates based on non-traditional documentation as provided by SFFAS 23 is prudent under the current circumstances. Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

## Exposure Draft

A18. FASAB published the exposure draft (ED), *Estimating the Historical Cost of General Property, Plant, and Equipment -- Amending Statements of Federal Financial Accounting Standards 6 and 23* on November 14, 2008. Upon release of the ED, notices and/or press releases were provided to: The Federal Register, the *FASAB News*, the *Journal of Accountancy*, *AGA Today*, the *CPA Journal*, *Government Executive*, the *CPA Letter*, *Government Accounting and Auditing Update*, the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations commenting on past exposure drafts.

A19. Thirty-one comment letters were received from the following sources:

|                          | FEDERAL<br>(Internal) | NON-<br>FEDERAL<br>(External) |
|--------------------------|-----------------------|-------------------------------|
| Users, academics, others |                       | 7                             |

|                                  |    |   |
|----------------------------------|----|---|
| Auditors                         | 3  | 1 |
| Preparers and financial managers | 20 |   |

A20. A majority of the respondents agreed with the Board that reasonable estimates may be used upon initial capitalization as entities implement G-PP&E accounting for the first time, as well as by those entities who previously implemented G-PP&E accounting.

A21. Based on comments received on the exposure draft, the Board agreed that internal use software, when the software meets the criteria for G-PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software*, should also be included in the scope of this standard. SFFAS 10 specifies that if internal use software meets the criteria for G-PP&E it should be classified as G-PP&E and the costs should be capitalized.

A22. Some ED respondents raised questions about the revaluing of G-PP&E that has previously been reported. The Board believes that there may be instances when the documentation for the original valuation is no longer available or it is not practical to revalue the reported cost of G-PP&E based on the original data because it is either not cost effective to do so or the documentation is inadequate. An entity may also determine it impractical when the original documentation has not been maintained or when the data has been maintained but not in a manner that facilitates the ready and timely valuation of G-PP&E. Therefore the Board agreed to allow the use of reasonable estimates when an entity determines it is necessary to revalue G-PP&E assets previously reported.

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## Board Approval

A23. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.