
Statement of Federal Financial Accounting Standards 48: Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials

Status

Issued	January 27, 2016
Effective Date	For periods beginning after September 30, 2016. Earlier implementation is encouraged.
Interpretations and Technical Releases	None.
Affects	SFFAC 3, par. 20, 22, 23-25, 26, 42, 44, and 53.
Affected by	None.

Summary

This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. This method is 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.

This Statement is intended to provide an alternative valuation method to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3, *Accounting for Inventory and Related Property*.

Table Of Contents

	Page
Summary	1
Introduction	3
Standards	4
Scope	4
Definitions	4
Disclosure Requirements	6
Effect on Existing Standards-Amendments to SFFAS 3, <i>Accounting for Inventory and Related Property</i>	6
Effective Date	9
Appendix A: Basis for Conclusions	10
Appendix B: Abbreviations	19
Appendix C: Amendments to SFFAS 3	20

Introduction

Purpose

1. This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials. These assets are addressed in Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*. While SFFAS 3 addresses six types of tangible property, only inventory, OM&S, and stockpile materials are required to be valued using the "initial amount" measurement approach.¹
2. The alternative valuation method 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.

Materiality

3. 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.

¹ The *measurement approach* is how an asset or liability is measured in periods after initial recording-i.e., at the historical cost or initial transaction amount (with subsequent adjustments for amortization, depreciation, or depletion, if applicable) or at an amount, such as fair value, measured at each financial statement date. A different measurement approach may be appropriate for different assets and liabilities. Amounts initially recorded are referred to as the "initial amount" and amounts measured at each subsequent financial statement date are "remeasured amounts." [Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 7a]

Standards

Scope

4. 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 once per reporting entity.
5. This Statement may only 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.
6. Reporting entities that meet either condition in paragraph 4 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

7. **Deemed Cost**—Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.
8. **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

²Terms defined in the Glossary are shown in bold-face the first time they appear.

³Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).

-
9. **Unreserved Assertion**—An unconditional statement.

Alternative Valuation Method for Opening Balances

10. **Deemed cost** is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials for the reporting period when 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.
11. 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:⁴
- a. Standard price (selling price)⁵ or fair value⁶
 - b. Latest Acquisition Cost⁷
 - c. Replacement cost⁸
 - d. Estimated historical cost (initial amount)
 - e. Actual historical cost (initial amount)

⁴ The methods are not listed in order of preference.

⁵ The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

⁶ 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).

⁷ The Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*

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)

-
12. Once established using deemed cost, opening balances are to be considered consistent with GAAP. No distinction or breakout of the deemed cost amount in the opening balances is required.

Disclosure Requirements

13. A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials 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 addressed by this Statement, 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 inventory, OM&S, or stockpile materials included in the opening balance is required.

Effect on Existing Standards - Amendments to SFFAS 3, *Accounting for Inventory and Related Property*

14. This section amends SFFAS 3, *Accounting for Inventory and Related Property*, as described in the following paragraphs.
15. Paragraph 20 is replaced with the following paragraph: “**Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost.”
16. Paragraph 22, the last sentence is amended by removing “(e.g., a standard cost system).”
17. Paragraphs 23-25 are rescinded to remove the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance).
18. Paragraph 26 is replaced by the following paragraph which expands the exception to valuation in SFFAS 3 to incorporate the Alternative Valuation Method for Opening Balances provided in this Statement.

"26. Valuation Method for Opening Balances and Exceptions to Valuation.

- a. **Alternative Valuation Method for Opening Balances.**⁹ Deemed cost¹⁰ is an acceptable valuation method for opening balances of inventory, operating materials and supplies (OM&S), and stockpile materials when a reporting entity is presenting financial statements, or one or more line items addressed by Statement of Federal Financial Accounting Standards (SFFAS) 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*, 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 valuation method:
- i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion¹¹ that its financial statements, or one or more line items addressed by SFFAS 48, are presented fairly in accordance with GAAP.
 - ii. The application of this method based on the second condition specified above is available once per reporting entity.
 - iii. Reporting entities that meet either condition in paragraph 26a. and elect to apply the alternative valuation method in establishing opening balances permitted by SFFAS 48 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. 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:¹²

⁹Opening 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.

¹⁰Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

¹¹ An unreserved assertion is an unconditional statement.

¹² The methods are not listed in order of preference.

-
- (1) Standard price (selling price)¹³ or fair value¹⁴
 - (2) Latest Acquisition Cost¹⁵
 - (3) Replacement cost¹⁶
 - (4) Estimated historical cost (initial amount)
 - (5) Actual historical cost (initial amount)
- v. Disclosure requirements-A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials 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 inventory, OM&S, or stockpile materials included in the opening balance is required.
- b. **Exceptions to Valuation.** An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:
- i. Units of which are interchangeable,
 - ii. Units of which have immediate marketability,
 - iii. Units for which appropriate costs may be difficult to obtain."

¹³The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.

¹⁴ 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)

¹⁵ The Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*

¹⁶ 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)

-
19. Paragraph 42 is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Operating Material and Supplies."
 20. Paragraph 44 is amended by deleting the last sentence: "In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system)."
 21. Paragraph 53, the first sentence is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Method for Opening Balances, extend to Stockpile Materials." Paragraph 53 is also amended by deleting the last sentence: In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system)."

Effective Date

22. 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 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 for guidance on the use of reasonable baseline estimates on the valuation of inventory, operating materials and supplies (OM&S), and stockpile materials from non-GAAP legacy systems. Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, requires valuation at historical cost (initial amounts).
- A3. In the initial phase of the project, Board staff met with senior officials from DoD to develop a comprehensive list of inventory valuation methodologies in place and the status of implementation of an SFFAS 3 compliant system for each DoD component.
- A4. Based on the meetings and information provided it was determined that:
 - a. Most DoD component legacy systems have valued inventory, OM&S, and stockpile materials at latest acquisition cost or standard cost (selling price) rather than historical cost. These legacy systems do not maintain a record of the cost of previous purchases. Therefore, DoD does not have the data necessary for revaluing inventory, OM&S, and stockpile materials at transition from a non-GAAP to a GAAP valuation (that is, historical cost).
 - b. DoD components transitioned from non-GAAP legacy systems to SFFAS 3 compliant systems at different times. While DoD has implemented systems that are SFFAS 3

compliant, it is difficult to determine at what point DoD inventory valuation using a historical cost methodology (for example, moving average cost) will be cleansed (eliminated through turnover) of non-GAAP values derived from legacy systems.

- c. DoD components advised that they do not have the information to provide historical turnover rates for the purpose of identifying items that have turnover rates such that the non-GAAP valuation method used prior to the adoption of SFFAS 3 would approximate historical cost.
- d. DoD does not have the information for revaluation and it is not practical or cost effective to develop models for revaluation.

Summary of Outreach Efforts and Responses

- A5. The Exposure Draft (ED), *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, was issued on June 2, 2015 with comments requested by July 20, 2015.
- A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, FASAB News, the Journal of Accountancy, Association of Government Accountants Today, the CPA Journal, Government Executive, and the CPA Letter, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board.)
- A7. This broad announcement was followed by direct mailings of the ED to the following relevant congressional committees:
 - a. House Appropriations- Sub-Committee on Defense
 - b. House Committee on Armed Services
 - c. House Committee on Oversight and Government Reform
 - d. House Committee on the Budget
 - e. House Committee on Veterans' Affairs
 - f. Senate Appropriations- Sub-Committee on Defense

- g. Senate Committee on Armed Services
- h. Senate Committee on Finance
- i. Senate Committee on Homeland Security and Governmental Affairs
- j. Senate Committee on the Budget
- k. Senate Committee on Veterans' Affairs

A8. The DoD also received the ED.

A9. Twelve responses were received from preparers, auditors, and professional associations. All respondents (with the exception of one respondent that did not specify agreement or disagreement) agreed with the proposal. The respondents identified certain issues that could be clarified within the Statement or addressed in the Basis for conclusions.

A10. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.

A11. Two respondents requested that aspects of the scope be clarified. After considering the comments, the Board considered options and decided to state consistently the conditions that entities must meet in order to apply the provisions of this Statement rather than attempting to describe the many conditions for which the Statement does not apply. Additionally, the Board believed it should address the applicability of Statement of Federal Financial Accounting Standards (SFFAS) 21: *Reporting Corrections of Errors and Changes in Accounting Principles* to those reporting entities that meet the conditions and elect to apply the provisions of this Statement. Specifically, paragraph 12 states "...For the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards." 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."

- A12. 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.
- A13. In addition, changes to the basis for conclusions were made so it did not appear that references to DoD in the basis for conclusions were intended to limit the applicability of deemed cost. While the Statement resulted from a request from DoD, it may be applied to any reporting entity that falls within the scope of the Statement.
- A14. During due process, two respondents noted potential confusion due to the similarities between the valuation methods identified for use in arriving at deemed cost for opening balances and with methods identified for use in SFFAS 3. Respondents questioned how the alternative valuation method differs from other valuation methods which approximate historical cost such as latest acquisition cost. They asked whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods.
- A15. The Board believes all reasonable methods should be allowed for opening balances. Therefore, the list of potential deemed cost methods remains expansive. This list includes historical cost because deemed cost may be a consolidation of amounts based on historical cost methods and other methods that do not approximate historical cost. Further, some respondents were confused by the references to latest acquisition cost. The Board's intends that latest acquisition cost, without adjustment for unrealized holding gains and losses needed to approximate historical cost, be permitted under the deemed cost method; thus, this method was not a method that approximates historical cost as provided by SFFAS 3.
- A16. The Board believes that amending SFFAS 3 to incorporate the alternative valuation approach for opening balances would clarify the intended application and address the concerns raised by respondents. Specifically, removing the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC is equivalent to historical cost (inclusive of the valuation allowance) will avoid potential misunderstandings. The Board believes removing this discussion of LAC will prevent confusion regarding the use of LAC adjusted to approximate historical cost through an allowance for unrealized holding gains or losses

as a deemed cost method (not adjusted to approximate historical cost) as provided in this Statement. To assist users, the Board is providing Appendix C: Amendments to SFFAS 3, a marked version of the relevant sections (Inventory, Operating Materials and Supplies, and Stockpile Materials) of SFFAS 3.

- A17. In addition, it was suggested the term "may" as used in paragraph 11 regarding the use of valuation methods presents an auditability challenge and respondents recommended it be changed to "should." The Board's intent was to be permissive regarding methods; however, after considering the suggestion that an unacceptable method could be used the language was changed. The Board still believes the standards should provide for all methods, including those that are allowable under SFFAS 3, because this provides flexibility and a cost-effective approach for large and complex organizations to include several valuation methods because the reporting entity may have components using different methods and/or adopting methods permitted under SFFAS 3 at different times.
- A18. In addition, four respondents requested clarification on the disclosure requirements. Based on the comments, language was added to the disclosure paragraph to clarify that financial statements of subsequent periods need not repeat this disclosure unless the statements to which deemed cost was applied in establishing opening balances are presented for comparative purposes. One respondent requested clarification on what is meant by first reporting period in relation to interim reporting. The first reporting period would be the first financial statement year end that an unreserved assertion is made. The Board does not believe this would include interim financial statements that presently are unaudited and do not include note disclosures. One respondent requested that the Board consider adding a requirement for the amount of the deemed cost to be disclosed. The Board considered carefully the disclosures that would provide the most meaningful information when developing the Statement. Considering the intent and purpose of this Statement, the Board does not believe such a disclosure would add sufficient value to warrant the significant effort and costs.
- A19. During due process, three respondents requested the term "unreserved assertion" be defined. The Board revised the Statement to include a definition of the term. Additionally, a respondent suggested that certain entities' management (such as DoD) may be required to make assertions regarding its financial information. An example is management assertions 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. Other minor changes were made to the Statement as suggested by respondents that improved the clarity of the document and terms.

Alternative Valuation Method

Consideration of Other Accounting Standards

- A20. During deliberation on the project, the Board considered the recently issued 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.
- A21. The Board believes that it should take an approach similar to the IPSASB standard. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for inventory, OM&S, and stockpile materials. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances.

Alternative Valuation Method for Opening Balances

- A22. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for inventory, OM&S, and stockpile materials addressed in SFFAS 3 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.
- A23. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances. Therefore, most often deemed cost will be based on the reporting entity's valuation method or system used for managing inventory, OM&S, and stockpile materials prior to the adoption of SFFAS 3.
- A24. Large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. 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 3 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 3.

- A25. Opening balances in this Statement are the balances at the beginning of the first reporting period when the entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are fairly presented in accordance with GAAP. Once established using deemed cost, opening balances are to be considered consistent with historical cost requirements of SFFAS 3.
- A26. Opening balances, established by application of this Statement, should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had a GAAP valuation method been used. Further, no distinction or segregation of amounts arising from the opening balances is required. For example, cost of goods sold using deemed cost need not be distinguished from cost of goods sold at historical cost under a first-in first-out approach. 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 individual types of inventory, OM&S, and stockpile materials, acceptance of non-GAAP values at the transition point to SFFAS 3 compliant systems is the most cost-effective approach.
- A27. However, all activity after the opening balances for inventory, OM&S, and stockpile materials are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.

Implementation by Component Reporting Entities

- A28. As stated above, complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Further, reporting entity components may have transitioned to an SFFAS 3 valuation method at different times; however, some components established balances for existing inventory, OM&S, and stockpile materials at the time of transition using methods that were not in accord with SFFAS 3. Therefore, given the timing of the transition to an SFFAS 3 valuation methodology, opening balances for the reporting entity may be based on transitional values based on one of the other methods listed in paragraph 11 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.
- A29. A component reporting entity that is in the process of implementing systems that are SFFAS 3 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.

- A30. Using the DoD example, certain DoD components may have transitioned at an earlier date to SFFAS 3 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.
- A31. 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 3 (as amended), in all material respects.

Disclosure Requirements

- A32. The election to apply the provisions of this Statement (deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials) 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 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.
- A33. The Board discussed that, with time, the valuation of inventory, OM&S, and stockpile materials will not be materially different than historical cost because the older inventory may be consumed. 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 Statement, however, does not impose a requirement that reporting entities engage in an effort to conclude that the use of deemed cost is no longer necessary.

Board Approval

- A34. This Statement was approved unanimously. Written ballots are available for public inspection at the FASAB's offices.

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
LAC	Latest Acquisition Cost
OM&S	Operating materials and supplies
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: AMENDMENTS TO SFFAS 3

Appendix C was provided to assist users. It provides a marked version of relevant sections of SFFAS 3. Because the FASAB Handbook presents texts as amended, SFFAS 3 has been updated. Users may view Appendix C as presented in SFFAS 48 on the Original Standards Webpage at <http://fasab.gov/standards>.