



Federal Accounting Standards Advisory Board

OPENING BALANCES FOR
INVENTORY, OPERATING
MATERIALS AND SUPPLIES (OM&S)
AND STOCKPILE MATERIALS

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by July 20, 2015

June 2, 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.

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Federal Accounting Standards Advisory Board

June 2, 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 *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials* are requested. A specific question for your consideration appears 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 July 20, 2015.

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 response, 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 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 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.

HOW WOULD THIS PROPOSAL IMPROVE FEDERAL FINANCIAL REPORTING AND CONTRIBUTE TO MEETING THE FEDERAL FINANCIAL REPORTING OBJECTIVES?

This Statement is intended to provide a cost-effective approach 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*.

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QUESTION FOR RESPONDENTS

The Board encourages you to become familiar with all proposals in the Statement before responding to the question in this section. In addition to the question below, the Board also welcomes 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 question in this section is available in a Word file for your use at www.fasab.gov/exposure.html. Your response should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your response to (202) 512-7366. Alternatively, you may mail your response 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 July 20, 2015.

- Q1. The Board proposes a reporting entity be permitted to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials 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, disclosures, and amendments to SFFAS 3, *Accounting for Inventory and Related Property*.

Do you agree or disagree with the proposed standards? Please provide your rationale.

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*.
2. While SFFAS 3 addresses six types of tangible property, only inventory, operating materials and supplies (OM&S), and stockpile materials are required to be valued using the “initial amount” measurement approach. An opening balance consistent with this requirement may not be available when a reporting entity begins 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). This Statement is intended to provide a cost-effective approach to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3.

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.

PROPOSED 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 be applied in establishing **opening balances**¹ 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. 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. Thus, a reporting entity applying this Statement must be prepared to comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.
6. This Statement does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are the subject of:
 - a. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and
 - b. Specific transitional requirements in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by the FASAB.

DEFINITIONS

7. **Deemed Cost**— As used in this Statement, “deemed cost” is an 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.²

¹ Terms defined in the Glossary are shown in bold-face the first time they appear.

² Adapted from U.S. Auditing Standards-American Institute of CPAs (Clarified), AU-C Glossary- Glossary of Terms.

ALTERNATIVE VALUATION METHOD FOR OPENING BALANCES

9. Deemed cost is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials for the reporting period that 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.
10. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of any of the following valuation methods:³
 - a. Standard price (selling price)⁴ or fair value⁵
 - b. Latest Acquisition Cost (LAC) Method⁶
 - c. Replacement cost⁷
 - d. Estimated historical cost (initial amount)
 - e. Actual historical cost (initial amount)
11. Once established using deemed cost, opening balances are to be considered consistent with SFFAS 3 requirements. Opening balances should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had an SFFAS 3 valuation method been used. No distinction of amounts arising from the opening balances is required.

DISCLOSURE REQUIREMENTS

12. 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 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. No disclosure of the amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

³ The methods are not listed in any order of preference.

⁴ 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.

⁵ 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)

⁶ 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*

⁷ 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)

EFFECT ON EXISTING STANDARDS- AMENDMENTS TO SFFAS 3, *ACCOUNTING FOR INVENTORY AND RELATED PROPERTY*

13. This section amends Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property* as described in the following paragraph.
14. The following heading and paragraph are inserted after paragraph 56:

Implementation Guidance

56a. Refer to SFFAS XX, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials* for implementation guidance in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials when presenting financial statements or line items of financial statements 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.

EFFECTIVE DATE

15. 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 legacy inventory, operating materials and supplies (OM&S), and stockpile materials. 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 (MAC)) will be cleansed 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 that it is not practical or cost effective to develop models for revaluation.

Consideration of Other Accounting Standards

- A5. 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:
- Use of deemed cost facilitates the introduction of IPSASs in a cost effective way.
 - Multiple options for deemed cost are appropriate.
 - The use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available.
 - Use of deemed cost does not affect fair presentation.
- A6. 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

- A7. 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.
- A8. 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.
- A9. 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 approaches to valuation because the reporting entity may have components (1) using different approaches simultaneously and/or (2) adopting an approach 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.
- A10. 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.

- A11. 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 an SFFAS 3 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 (FIFO) approach. The purpose of this Statement is to provide a cost effective approach 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.
- A12. 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

- A13. 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 10 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.
- A14. 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 (that is, DoD components) to make the assertion at different times. The DoD reporting entity may make the assertion after a sufficient number of DoD 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 (that is, DoD) when its assertion is made.
- A15. With 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.
- A16. 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. Complex entities such as DoD should work with DoD components to ensure the most appropriate method allowed by this Statement is selected. Further, DoD should ensure issues such as supporting documentation are addressed and validated through sampling or other means prior to making the unreserved assertion.

Disclosure Requirements

- A17. 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.
- A18. 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 will 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, 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.

APPENDIX B: ABBREVIATIONS

CFR	Consolidated financial report of the U.S. government
ED	Exposure draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GASB	Governmental Accounting Standards Board
IPSASB	International Public Sector Accounting Standards Board
OMB	Office of Management and Budget
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

Deemed Cost—As used in this Statement, “deemed cost” is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

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.⁸

⁸ Adapted from U.S. Auditing Standards-American Institute of CPAs (Clarified), AU-C Glossary- Glossary of Terms.

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