Federal Accounting Standards Advisory Board

February 17, 2016

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne /s/

Through: Wendy M. Payne, Executive Director

Subj: ***Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*- Tab C2**[1]

MEETING OBJECTIVES

To make decisions on issues regarding the exposure draft and review the Draft Statement, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*.

BRIEFING MATERIAL

This is Tab C2 that accompanies Tab C that was distributed to the Board on Friday, February 12th. The staff analysis is attached along with questions for the Board on page 35. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

Attachment 2- Staff Analysis and Recommendations

Attachment 3- Draft Statement, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35* (Marked Version)

NOTE- Also attached are 2 additional comment letters received.

QUESTIONS FOR THE BOARD

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

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

Attachment 2- Staff Analysis and Recommendations

Summary of Results

After considering the comments, staff notes the majority of respondents agreed with these proposals to:

- Permit opening balances of general PP&E to be valued based on deemed cost [15 agreed, 1disagreed, 1 partially agreed and 2 did not provide an answer] and require the related disclosures [15 agreed, 1 disagreed, and 3 did not provide an answer].
- Allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software [10 agreed, 2 disagreed, 5 partially agreed and 2 did not provide an answer] and require the related disclosures [14 agreed, 1 disagreed, 1 partially agreed and 3 did not provide an answer].

- Rescind SFFAS 35 [11 agreed, 2 disagreed, 3 partially agreed and 3 did not provide an answer] and permit reasonable estimates in the preparation of financial statements, with or without the existence of SFFAS 35 [15 agreed, 2 partially agreed and 2 did not provide an answer].

One area that respondents noted disagreement was in the area of land. Specifically, based on the responses the majority of respondents disagreed with the proposals to:

- Allow exclusion of land from the opening balances of general PP&E even though other component reporting entities will report the cost of certain land in general PP&E. [6 agreed, 10 disagreed, 1 partially agreed and 2 did not provide an answer]
- Require a reporting entity electing to exclude land from its general PP&E opening balances to exclude future land acquisition amounts. [4 agreed, 11 disagreed, 1 partially agreed and 3 did not provide an answer]
- However, the majority of respondents agreed that the related disclosures are appropriate. [8 agreed, 2 disagreed, 2 partially agreed and 7 did not provide an answer]

Issues for the Board's Consideration

Certain issues identified by respondents resulted in areas that need to be revised and /or clarified within the Statement. However, most of the issues could be addressed by adding additional language in the Basis for conclusions. Similar comments from respondents are grouped by issue below, along with the staff recommendation.

1. Land

As noted in the summary of results, the majority of respondents disagreed with the proposal to allow exclusion of land from the opening balances of general PP&E. Specific reasons provided for disagreeing with the proposal to allow exclusion of land were:

- inconsistencies in the treatment land and lack of comparability across the entire Federal Government
- exclusion could result in a potentially material misstatement for entities who own significant amounts of land and disclosing only the acreage does not provide enough information regarding the value of the land associated with general PP&E
- temporary change may lead to confusion and added cost
- optional exclusion of land undermines the integrity of and a primary purpose of a reporting entity's financial statements; that is, to present a reporting entity's financial condition as of the balance sheet date (in this case, proper presentation of land and land rights assets), and the results of operations for the specified timeframe
- not recording land acquisition cost may impact requirements to recoup full repayment of construction costs
- reporting only acres or a set amount may distort the entity's service efforts, costs, and accomplishments
- although the government may not plan on selling the land in the near future, holding onto the land ties up resources and is part of the inherent cost of operations
- does not meet operating performance objective in SFFAC 1
- disposals of land would not record the gain or loss required by SFFAS 6 and 7
- the impact of excluding land from the opening balances and future balances on the overall government-wide financial statements
- approach in the ED appears to contradict the treatment of land as general PP&E versus stewardship land
- For one group letter – it noted the respondents were split in responding to this aspect of the proposal

Most respondents (13 of 19) preferred that the Board defer any change to land for opening balances. Those respondents believed that no action should be taken until the project on land is completed. Even certain respondents that agreed with the proposal suggested that if the Board intends to begin a project on land in the near future, consideration should be given to delaying the land aspect of the ED until such time as the Board's project on land is completed.

In addition, as noted in the summary, the majority of respondents disagreed that a reporting entity electing to exclude land from its general PP&E opening balances should continue to exclude future land acquisition amounts. One respondent explained that going forward, the entity should make every effort to obtain valid cost information and capitalize new land acquisitions as they occur, which would ensure better financial reporting and the recording of the most complete information on the financial statements. Another respondent stated future land acquisition amounts should be capitalized because the historical cost is known. Again, most respondents noted that the Board should defer any changes in the accounting treatment of land pending completion of the land project. Most respondents believed that subsequent land acquisition amounts under this scenario should be recorded under existing standards and provide a more accurate reflection of costs incurred during the reporting period.

It should be noted that one respondent that didn't object to the proposal (they agreed to allow exclusion of land from the opening balances of general PP&E) disagreed with continuing to exclude future land acquisition amounts. The respondent explained that this proposed practice is inconsistent with the Basis for Conclusions which notes in several places that "land is not depreciated so the benefits of capitalizing land are primarily in the period of acquisition." The respondent added that the Board can appropriately provide relief to a reporting entity when establishing its opening balance for land without distorting the reporting of expenses in future years that would occur if future land acquisitions are expensed by one component of the Federal reporting entity but treated as capital acquisitions by other components of the Federal reporting entity.

Staff believed it important to note that while the majority disagreed—6 respondents' agreed. DoD and Army were respondents that supported the proposal to allow exclusion of land. Important feedback to consider from these respondents likely to elect to use the proposed standard:

- DoD does not support the deferral of any changes to the current FASAB requirements to record land at historical cost. This would impact the time frame in which DoD could achieve auditability.
- DoD would have to expend significant financial and personnel resources in order to obtain sufficient supporting documentation (if even available) suitable for an audit.
- Many DoD land acquisitions date back more than a century and the acquisition price paid at that time would not be relevant to the current financial statements. The age of many of these land acquisitions make it virtually impossible to obtain records supporting historical cost.
- Reporting land at its cost, either estimated or based on transaction detail, does not appear to provide much benefit to readers of the financial statements relative to the cost to develop and maintain the values.
- DoD would not support a future valuation methodology that would be applied retroactively if it requires additional information gathering other than what would have already been gathered to support the disclosure of land acreage.
- If standards require land to be reported in financial statements, consider whether it should only be reported on the financial statements of the United States and not on the statements of each reporting entity.

While the majority of respondents agreed that the related disclosures are appropriate, staff notes that there a substantial number of respondents that did not provide a comment or chose not to answer based on the fact they disagreed. There were also several comments regarding land disclosures:

- Disclosing only the acreage does not provide enough information regarding the value of the land associated with general PP&E. When historical costs are not available, estimating these costs more accurately depicts the value of the assets. Not recording land acquisition cost may impact Reclamation's requirement to recoup full repayment of construction costs. Reporting only acres or a set amount may distort the entity's service efforts, costs, and accomplishments. Although the government may not plan on selling the land in the near future, holding onto the land ties up resources and is part of the inherent cost of operations.
- One respondent suggested additional disclosure requirements for a reporting entity with long-lived, non-depreciating assets. The suggested disclosures address control, condition, policies, and use of such assets. The suggestion references the GASB Statement 34 modified approach for reporting infrastructure.
- Another respondent explained paragraph 40(g)(i) of the ED does not address the disclosure requirements for a reporting entity electing to exclude land rights from its general PP&E opening balances. We recommend that the Board add additional language to discuss the disclosure requirements related to land rights. We also recommend the Board consider whether the expensing of future land and land right acquisitions in lieu of capitalizing such acquisitions is a significant accounting policy that warrants ongoing disclosure.
- Staff believed it important to note DOI's comments regarding stewardship land and disclosures due to their significant holdings. DOI explained the Land Project should maintain the distinction between general PP&E land and Stewardship land. Any value assigned to the Stewardship land would be arbitrary and meaningless to the readers of DOI's financial statements. Stewardship information is specifically not measured, or measurable, in financial terms. DOI's current reporting of Stewardship land is based on Land Management Categories. If the Board were to require that Stewardship land now be reported in acres the costs of the annual financial audit would increase dramatically. In addition, this non-financial data is not captured in financial systems and the cost of developing auditable support for Stewardship land reported in acres would be prohibitive.
- Other disclosure suggestions included categories of land based on how the land is used and costs associated with the future land acquisition.

In summary, staff believes the key point is respondents showed an overwhelming support for the land project. However, there was a strong preference that the project should be concluded before an action, such as allowing an exclusion of land from the balance sheet, or actions that may affect future accounting acquisitions are considered. Consistent with this, fellow staff member Dom Savini has provided the Board with the Proposed Project Plan for Land for approval at the February meeting. Staff has also shared all letters so that the comments received on the Land portion of this proposal can be considered in the project.

Staff notes that several respondents that disagreed with the proposal to allow exclusion of land, indicated that they preferred deemed cost and/or existing standards. Staff also recognizes that not all respondents addressed this aspect of question 2 and it may not have been worded in the best manner to gather the appropriate feedback. However, question 1 of the ED addresses the broad proposal to permit opening balances of general PP&E to be valued based on deemed cost. As noted on page 3, the majority [15 agreed, 1 disagreed, and 3 did not provide an answer] of respondents agreed with the proposal to permit opening balances of general PP&E to be valued based on deemed cost and agreed with the related disclosures. Therefore staff sees no objection to the use of deemed cost in establishing opening balances for land consistent with that for general PP&E.

Staff Recommendation: Staff recommends removing the option for allowing an exclusion of land from the opening balances from the Statement and the related disclosure requirements paragraph. Specifically, paragraph 12.40.d. and paragraph 12.40.g.i. of the ED would be deleted. Staff has included the two paragraphs below that would be removed:

> d. Land and land rights. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative is applied, the reporting entity should expense future land and land right acquisitions.
>
> g. Disclosure requirements.
> i. A reporting entity electing to exclude land from its general PP&E opening balances must disclose, with a reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. Each year thereafter, a reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude future land acquisition amounts and provide the disclosures.

Staff notes that the removal of these two paragraphs also takes care of removing the reference to future land acquisitions and there is no need to address future land and land right acquisitions as they would be accounted for in accordance with current accounting requirements until the new land project is completed.

Deemed cost would still apply and be an acceptable valuation method for opening balances of land as described in paragraph 12.40.e. of the current proposal.

Staff also recommends adding the following paragraph to the basis for conclusions:

> The majority of respondents disagreed with the exposure draft to allow exclusion of land from the opening balances of general PP&E. The respondents showed an overwhelming support for a land[2] project to reexamine standards for reporting on

[2] The Board [approved] the project plan for the Accounting and Reporting of Government Land at the February 2016 meeting.

land. There was a strong preference that the Board defer any changes to the current requirements, such as allowing an exclusion of land from the balance sheet or actions that may affect future accounting acquisitions, until the Board completes the re-examination. The respondents provided reasons such as: inconsistent accounting treatment, potential material misstatement for entities who own significant amounts of land, and confusion and added cost from a temporary change. However, consistent with the support for permitting opening balances of general PP&E to be valued based on deemed cost, respondents preferred that deemed cost and/or existing standards be used to value beginning balances of land. Therefore, the Board sees no objection to the use of deemed cost in establishing opening balances for land consistent with that for general PP&E as provided in paragraph 12.40.e. of the Statement.

Based on the respondents' comments, the Board determined it was best to defer exclusion of land from the balance sheet, until the Board completes the land project. Therefore the Statement was revised to remove the option for allowing an exclusion of land from the opening balances and the related disclosure requirements paragraph. The removal of these paragraphs also removes the reference to future land acquisitions and land right acquisitions.

Staff notes that all other appropriate language in the Summary and Introduction in the Statement would be updated to reflect this change by removing any reference to the option of allowing a reporting entity to exclude land from opening balances with disclosure of acreage information.

The Board is also encouraged to expedite the land project to review existing standards and to issue new standards as soon as possible addressing land. Staff did not believe the comments on the disclosure requirements needed to be pursued further since most relate to if the Board allowed the exclusion. Staff has provided these, along with the other suggestions and comments to the Mr. Savini for consideration on the land project.

Question for the Board: Does the Board agree with the staff recommendations regarding land?

2. Disclosure Requirements

The majority of respondents agreed with the related disclosures for establishing opening balances for general PP&E as provided in the proposed standards.

However, certain respondents that agreed with the related disclosures provided comments for consideration:

- Several respondents commented on clarification of consistency in accounting treatment when providing whether a reporting entity at a higher level of consolidation may elect a different alternative in applying the standards. It was recommend that the Board clearly state at which level within a complex reporting entity there needs to be consistency in accounting treatment when providing alternatives such as the proposed amendments to SFFAS 6, paragraph 40(d) and SFFAS 10, paragraph 36(d).

  - A complex reporting entity (level A) may have multiple component reporting entities (level B), each of which may be a reporting entity with its own component reporting entities (level C). For example, this could be a complex reporting entity such as DoD as follows: A= DoD, B=Army, and C=unit within the Army.
  - It was suggested that additional clarification should be provided for this area in IUS
  - It is unclear at what level a combination of alternatives may be used, e.g., whether a significant component may use multiple alternatives to estimate deemed cost. Clarification about the level at which multiple alternatives may be used; examples would be helpful.
  - Need to consider if similar provision that's made in par. 36(d) and related disclosure should be made for land alternatives (if Board determines to keep options)

- One respondent suggested the disclosures include a reference to the applicable scope condition met : (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 the use of the alternate valuation method.
- One respondent suggested that the use of deemed cost as a valuation method should be disclosed until such point as assets valued at deemed cost become immaterial.
- Another respondent disagreed with the statement that "subsequent periods need not repeat this disclosure." They believed the disclosures should be included in all periods where alternate valuation methods are used because many reporting entities will use alternate methods in subsequent reporting periods.
- One respondent suggested that when the opening balance is based on replacement cost or fair value, then it seems reasonable that the values should be discounted to the time of acquisition. The respondent believe that if alternative methods of asset valuation or deemed cost are used, these alternative methods must be consistently applied and fully disclosed in the notes to the financial statements. However, if discounting the values is not a cost effective solution, then this fact should also be disclosed in the notes to the financial statements.

Staff carefully considered the suggestions and believes the first suggestion regarding consistency in accounting treatment and combination of alternatives for complex reporting entities may warrant further elaboration in the basis for conclusions. Authoritative guidance – if needed – could be provided through the AAPC or Staff Implementation Guidance.

It's important to consider the potential scenarios permitted by the Statement:

General PP&E (except IUS)

- Deemed cost to include several valuation methods
- Component reporting entities using different methods simultaneously and/or adopting a method permitted under SFFAS 6 at different times
- Components may make assertions at different times thereby affecting when a Consolidated (DoD) would make its assertion

IUS

- Alternatives for establishing opening balance of IUS
    - Alternatives - must be consistent within the component reporting entity prior to consolidation
        - Deemed cost to include several valuation methods
        - Prospective Capitalization (0 or include under development)
- Component reporting entities using different methods simultaneously and/or adopting a method permitted under SFFAS 10 at different times
- Components may make assertions at different times thereby affecting when a Consolidated (DoD) would make its assertion

Staff notes that paragraph A25. of the basis for conclusions addresses combination of methods for deemed cost and paragraphs A57-A59 (under application of this statement) addresses the fact that component reporting entities may make assertions at different time. However, the basis for conclusion did not include additional narrative or detail regarding consistency in accounting treatment and combination of alternatives for IUS under the section “Amendments to SFFAS 10” in the basis for conclusion. Staff has included the relevant portions from the BFC mentioned above that address some of the concerns raised by respondents. With additional language to the BfC IUS section, staff believes it will resolve concerns.

> A25. The Board recognizes that large and complex reporting entities such as the DoD may have used a variety of valuation methods prior to the adoption of a GAAP compliant method. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6 at different times prior to establishing opening balances. Deemed cost may be based on one, or a combination, of the accepted valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

> A57. A component reporting entity that is in the process of implementing systems that are GAAP compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A58. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP compliant systems; this allows them to assert independently of the larger DoD. The 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 the DoD's opening balance deemed cost at the beginning of the period the DoD was able to make an unreserved assertion on its financial statements, or one or more line items, addressed by this Statement.

A59. 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 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. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for fiscal year 2018 determines that the valuation does not comply with the alternative valuation in all material respects, the reporting entity then would need to……

Staff does not believe the other suggestions require further action. These topics or very similar ideas were researched, discussed, and/or deliberated as part of the due process in finalizing SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. For example, in August 2015, the Board discussed "Disclosure Requirements" in response to the comment letters for SFFAS 48 where the Board decided to clarify subsequent year reporting and comparative year reporting. In addition, staff notes that much time has been spent by the Board deliberating the disclosures for the opening balance standards, including the decision of no disclosure of amounts, and it would be preferred that the Statements remain consistent.

Staff Recommendation: Staff recommends adding the following paragraph to the basis for conclusions; it would be inserted after paragraph A39. of the Statement. Paragraph A39 is included below for reference.

A39. Therefore, the Board believes the most appropriate path is to amend the implementation guidance provided in SFFAS 10 to provide for prospective application of IUS if the reporting entity elects to do so. Considering the various stages of implementation within reporting entities, the Board determined that this Statement should provide flexibility. Therefore, the guidance also provides for an alternative valuation method consistent with general PP&E. Considering that IUS is classified as general PP&E, the Board believes it appropriate to allow use of deemed cost and to refer users to the deemed cost implementation guidance in SFFAS 6. Together, these amendments allow the preparer to elect from these three options:

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

A39b. Based on the flexibility offered for establishing opening balances IUS, a larger reporting entity may establish an opening balance for IUS based on a combination of multiple component reporting entities' alternatives, which may or may not be the same. Therefore, a larger reporting entity may have multiple component reporting entities[3] that selected different alternatives. This is permitted by the Statement; a larger reporting entity may establish an opening balance based on a combination of these alternatives, but application of a particular alternative must be consistent within each of the component reporting entities prior to consolidation.

Question for the Board: Does the Board agree with the staff recommendation addressing disclosures?

3. SFFAS 35 Rescission

The majority of respondents agreed with the proposal to rescind SFFAS 35 and the majority agreed that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35.

In fact, respondents appeared very supportive by noting that:

- integrating the opening balance approach into SFFAS 6 and 10 could be easier to apply
- preparation of financial statements in conformity with GAAP requires management to make reasonable estimates and assumptions that affect reported amounts presented and disclosed in agency consolidated financial statements
- estimates in accounting, statistics or other professional work are assumed to be done with due professional care

[3] SFFAS 47, *Reporting Entity,* provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

While there was agreement, there were common suggestions provided by several respondents, including those that agreed or partially agreed with the proposal to rescind SFFAS 35.

- Reporting entities would benefit from the inclusion of paragraph 19 of the proposal into both SFFAS 6 and SFFAS 10 in conjunction with the effort to consolidate standards.
- There were several suggestions on keeping the first sentence of the current SFFAS 6 paragraph 40 which states, "although the measurement for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein." It was noted that this clarification is essential. If the Board intended reasonable estimates to be applicable to any general PP&E (versus just opening balances) it was recommend moving the first sentence from the deleted language in paragraph 40 of SFFAS 6 and inserting it in paragraph 26 as follows:

  All general PP&E shall be recorded at cost. <u>Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein.</u> Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:
- Consolidation of the guidance, including providing a clearer definition of reasonable estimates for use in the financial statements, not just opening balances, would be helpful. Maintaining language in the standards that clarifies what makes a "reasonable estimate" would prove beneficial to reporting entities to ensure consistent and repeatable compliance across federal entities.

Further, some that agreed or partially agreed, appeared to be on the fence as to whether they preferred to maintain SFFAS 35 or if it was contingent on the revisions being clearer. For example, one respondent stated they both agreed and disagreed—because they supported the proposal, but suggested that SFFAS 35 provides important guidance that could be retained and clarified if it has been misinterpreted or misapplied. Another respondent explained that they agreed only if it is clear in the revised SFFAS 6 that all of the permitted uses of estimates for valuing general PP&E found in the present SFFAS 23 and SFFAS 35 remain in effect. The respondent was concerned that a lack of clarity could lead to disparate treatment and unproductive disagreements between agencies and their auditors over estimation. There was concern regarding external auditors absent the clarity of SFFAS 35 and potential confusion concerning the permitted use of estimated historical cost to value general PP&E when the original documents are no longer available.

Audit concern and that SFFAS 35 provides valuable guidance were the most prevalent reasons cited by respondents that disagreed with the proposal to rescind SFFAS 35.

Staff notes that some respondents seemed unaware that Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment*, would remain in effect after these amendments and that each significant provision of SFFAS 35 was incorporated in the proposed amendments – including the ability to use estimates in the future. It also appeared that respondents were not clear or aware of the provision regarding the use of deemed cost to correct errors in the opening balances as provided in paragraph 12.40.a. and elaborated upon further in the basis for conclusions paragraph A63. Respondents indicated:

- SFFAS 35 and Technical Release 13 are valuable to reporting entities by providing additional needed clarifications to the standards for use of estimation methods. Independent auditors rely on these documents to inform their judgment on the reasonableness of estimation methodologies. Specifically, an auditor can safely determine that an estimation approach listed in the standards and technical release is more than likely reasonable.
- Before the issuance of SFFAS 35, some auditors would insist on obtaining original documentation, even beyond the contractual requirements of record retention. While the respondent agreed that SFFAS 35 should not be needed, there was concern regarding the audit community and their interpretation of what is not explicitly written. When documents are withdrawn, many believe that all of the concepts and requirements contained therein no longer apply.
- SFFAS 35 clarifies the option of using estimates and the requirements for doing so. Entities relied on SFFAS 35 in the past. The rescission of SFFAS 35 removes necessary guidance and may leave the entity open to consequences due to changes in interpretation.   Without the specifics in the original guidance, auditors may interpret the new guidance differently from the guidance the entity relied on when making past decisions. Paragraph 9 and 10 of SFFAS 35 specifies that entities who previously implemented general PP&E accounting may use estimates. Paragraph 11 allows estimates when an entity finds revaluing general PP&E assets is necessary.
- SFFAS 35 should be retained until the issues included in the exposure draft are resolved. The Board may want to expand on and explain when reasonable estimates are appropriate and when they are not.
- Current standards explicitly support methodologies for the estimation of historical cost based on “amounts to be expended.” SFFAS 35 does not require transaction based data but rather “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.”
- SFFAS 35 is necessary to permit reasonable estimates in the financial statements. The proposed paragraph 40 only applies to opening balances or a one-time adjustment to a line item. Loss of the guidance to use reasonable estimates when historical costs are not available could leave entities vulnerable to their auditor’s interpretation for existing balances where they have used estimates to establish costs for PP&E.

DoD (agreed with proposal) and Army (disagreed with proposal) provided other feedback that was a bit more detailed. Again, staff believed it was important to include because the DoD Implementation Project is what began the proposed statement and likely to elect to use the proposed standard. Staff would also like to point out that their comments included:

- Paragraph 19 of the ED should be clarified to state that the use of estimates to arrive at indirect costs and the allocation of the direct and indirect components of the actual historical costs incurred, is permitted both in establishing opening balances for PP&E as well as for newly acquired or constructed assets after the establishment of the opening balances.
- Paragraph 19 of the ED should be clarified to explain that the allocation of actual historical costs incurred is often a multi-step process involving the use of estimates in each of the steps. The allocation process steps often include: (i) evaluating the project direct costs incurred to determine which costs should be capitalized or expensed; (ii) estimating project indirect costs; (iii) accumulating project total cost in a construction in progress (CIP) account and relieving CIP as assets are placed in service. Allocation of costs on an estimated basis can be used to assign costs to assets when they are removed from CIP and placed in service.
- If SFFAS 35 is rescinded, to prevent confusion in the future, Technical Release 13 – *Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment*, should be modified by removing the references to SFFAS 35 or incorporate the concepts from the TR 13 directly into SFFAS 6.
- Revised paragraph 40 explicitly applies to opening balances and only allows an entity to apply condition (2) once per line item. Seeing as how financial system modernization efforts are both complicated and time consuming, the revised standard would prevent reporting entities from applying any alternate valuation procedures, and thus valuing impacted assets, in the interim (after opening balances are established).

As noted above, there may be some questions regarding whether TR 13 would remain in effect after these amendments and that each significant provision of SFFAS 35 was incorporated in the proposed amendments – including the ability to use estimates in the future. The exposure draft paragraphs A49-A51. addressed this and the fact that SFFAS 4 established a requirement for cost accounting that acknowledged the use of cost finding techniques. Of particular importance is SFFAS 4, paragraph 124, provides that included coverage of the use of "Allocating costs on a reasonable and consistent basis."

Based on the comments and concerns, staff believes it appropriate to incorporate the provisions of paragraph 19 of the exposure draft in the amended text of SFFASs 6 and 10. This will address the primary concerns of most respondents and staff believes it can be accomplished while remaining consistent with the Board's intent.

Staff believes reporting entities should consider all available standards and technical releases when considering the application of GAAP. The Statement provides direction on those that may assist in this area. Any other necessary guidance would be best addressed through lower level or staff guidance.

Staff Recommendation: Staff recommends that it is still appropriate to rescind SFFAS 35. However, staff recommends including the provisions of paragraph 19 of the exposure draft in SFFASs 6 and 10 by incorporating the following paragraphs in the Statement.

> Paragraph 26 of SFFAS 6 is amended by adding the following second sentence: "Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein."
>
> The new paragraph 26 of SFFAS 6:
> 26. All general PP&E shall be recorded at cost. <u>Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein.</u> Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include…..:
>
> Paragraph 16 of SFFAS 10 is amended by adding the following first sentence: "Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein."
>
> The new paragraph 16 of SFFAS 10:
> 16. <u>Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein.</u> For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.[4] Such cost should be limited to costs incurred after….

Staff also recommends included the following explanation in the basis for conclusions.

> Although the majority of respondents agreed with the proposal to rescind SFFAS 35 and that reasonable estimates are permitted in the preparation of financial statements, this provision of the Statement generated many comments from respondents—including those respondents that were supportive.

[4] For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995), pars. 90-92. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, Entity and Display.

A common suggestion provided by many respondents was that reporting entities would benefit from the inclusion of paragraph 19[5] of the exposure draft in SFFAS 6 and SFFAS 10 to clarify that the Board intended reasonable estimates to be applicable to any general PP&E versus just opening balances. Although the Board believes the broad statement provided in paragraph 19 should be sufficient to address the matter, members agreed that including the provisions of paragraph 19 of the exposure draft in SFFASs 6 and 10 may be clearer. Specifically, SFFAS 6 paragraph 26 and SFFAS 10 paragraph 16 were amended to include language specifying that although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used.

Audit concern and that SFFAS 35 provides valuable guidance were the most prevalent reasons cited by respondents that disagreed with the proposal to rescind SFFAS 35. However, many of the detailed concerns expressed by respondents are addressed through existing guidance. The Board reiterates (as explained in the exposure draft) that Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment*, would remain in effect after these amendments and that each significant provision of SFFAS 35 was incorporated in the proposed amendments – including the ability to use estimates in the future. In addition, the Board echoes the language provided in the exposure draft that reminded users that SFFAS 4, *Managerial Cost Accounting Standards and Concepts* established a requirement for cost accounting that acknowledged the use of cost finding techniques and included coverage of the use of allocating costs on a reasonable and consistent basis. The Board also believes it important to point out the Statement provides for the use of deemed cost to correct errors in the opening balances. Reporting entities are reminded that they should consider all available GAAP guidance when implementing new accounting standards.

Question for the Board: Does the Board agree with the staff recommendations regarding SFFAS 35?

4. Internal Use Software

The majority of respondents agreed with the proposal to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software (IUS). The alternatives are:

[5] "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35."

1. Prospective capitalization with zero opening balance (exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance)
2. Prospective capitalization with IUS under development included in the opening balance based on deemed cost or actual cost
3. Alternative Valuation Method wherein deemed cost is used to establish opening balances of internal use software

However, of the respondents that partially agreed, staff noted:

- 4 respondents noted disagreement or concern with prospective capitalization of IUS, but agreed with deemed cost as an alternative method for IUS. Key points included (1) this “will promote inconsistencies with other reporting entities,” (2) SFFAS 10 has been effective since FY 2001, providing numerous years for implementation, and (3) this undermines the integrity of and a primary purpose of a reporting entity's financial statements. Also, one respondent noted that DoD has spent billions of dollars to implement financial accounting Enterprise Resource Planning systems (ERPs) for the last decade and this proposal could mean that most of these costs will not be included. These respondents supported the valuation method of deemed cost that is consistent with that provided for all general PP&E.
- One respondent (Army) believed prospective capitalization of IUS should be the only option. The respondent noted removal of the alternate valuation method deemed cost would enhance consistency while also appropriately balancing the value of the information in the financial statements with the cost of reporting that information.
- There was concern that allowing different alternatives would create inconsistencies within the different financial statements.
- Similarly, one respondent (a component within DOI) that agreed with the proposal explained that they disagreed with paragraph 36 section d.i.(a) which allowed the exclusion of software under development but agreed with the remaining alternatives. They explained costs associated with software under development should be readily available and thus should be included in the opening balance.

2 respondents disagreed with the proposal explained:

- IUS has a short useful life and the NBV of most would be $0. From a materiality standpoint, there is little reason to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software.
- The reporting of software as an intangible asset should be limited. The benefits of placing software on the balance sheet may not be sufficient to justify the administrative cost of obtaining separate reliable capital cost from operating expenses.

While staff understands the views submitted by respondents, staff believes these were considered during the Board deliberations related to this topic. While DoD has had numerous years to implement this and other standards, the fact remains they have not and the conditions remain that existed when many of these standards were issued. Staff notes the Board's goal is the project is propose less costly alternatives in establishing opening balances. Therefore, the Board was supportive of prospective capitalization of IUS to provide similar relief to DoD that was initially provided when SFFAS 10 was implemented.

As far as the inconsistency in treatment, the Board recognizes this concern. In fact, staff notes the Board *initially agreed* to only allow for prospective treatment of IUS. However, based on additional research and discussions with DoD, it was determined that it would be best to provide optimum flexibility within the proposed language. Considering that DoD is a large and complex Department, there might be component reporting entities that currently receive clean audit opinions, charge rates, or *may not want to apply the prospective treatment*. For example, within DoD, there may be a working capital funds or an intelligence agencies that have been audited and may want to apply deemed cost to this area. In addition, staff notes that this Statement would also be for new reporting entities that may have IUS so the Statement should provide for an alternative valuation method of deemed cost that is consistent with general PP&E. Therefore, the Board agreed the Statement should allow for the alternatives in establishing opening balances for internal use software.

In summary, staff believes the Board has deliberated many of the concerns identified by respondents and provided the best option within the Statement that would be both cost-beneficial while not forcing application of prospective treatment. Staff believes any inconsistencies will resolve quickly due to the fact IUS has a short useful life.

Staff Recommendation: Staff recommends adding language to the Basis for Conclusion to acknowledge the concerns raised by respondents as follows:

> While the majority of respondents agreed with the exposure draft to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software (IUS), there were several concerns expressed to the Board. Four respondents expressed concern with prospective capitalization of IUS, but agreed with deemed cost as an alternative method for IUS. The respondents did not believe component reporting entities should be able to adopt inconsistent alternatives when establishing an opening balance for IUS. In contrast, one respondent believed prospective capitalization of IUS should be the only option because this would enhance consistency while also appropriately balancing the value and cost of the information in the financial statements.
>
> The Board recognizes the concerns raised by respondents and considered them during the development of the Statement. While the Board understands the importance of consistency and comparability in financial reporting, the Board believes users of federal financial statements often have different objectives and do not necessarily compare asset values among various reporting entities in the way that users of financial statements do in a commercial setting.

The Board considered the fact that there may be component reporting entities that currently receive clean audit opinions (such as working capital funds that that charge rates or others such as intelligence agencies) for which the prospective treatment would be undesirable. The Board determined that it would be best to provide optimum flexibility by providing for the option of deemed cost for IUS. Therefore, the Board agreed the Statement should allow for the alternatives in establishing opening balances for internal use software.

The Statement requires that the application of a particular alternative must be consistent within each of the component reporting entities prior to consolidation and the disclosures of alternatives (if different) adopted by each significant component reporting entity. The Board believes the disclosure requirements required by the Statement regarding the different alternative methods for establishing opening balances for IUS, if applicable, will allow sufficient comparability for users of federal financial statements.

The Board believes allowing a reporting entity to choose among alternatives in establishing an opening balance for IUS remains the best option. Concerns regarding inconsistencies will resolve quickly due to the short useful life of IUS.

Question for the Board: Does the Board agree with the staff recommendation to address the IUS concerns?

5. Line Item

There were a few comments regarding what was meant by the term line item. Specifically it was suggested that the definition of a “line item”; e.g., whether or not the standard may be applied to the individual line items (but not all line items) as presented in the PP&E notes to the financial statements. If the standard may be applied for each item separately (as presented in the notes), then this should be made clearer in the standard. A respondent explained that in the past, DoD has asserted to the audit readiness of sub-sets of assets. The proposed standard should clearly state whether it applies only to the line items as reported on the financial statements (i.e., General Property, Plant, and Equipment) or to the categories broken out in the footnotes. The proposed standard needs to clarify the definition of “line item” so entities do not apply the standards in a piece-meal fashion.

Another respondent (DoD) also requested that clarifying language be added to the Statement to expand upon the phrase “one or more line items addressed by this Statement,” to define line items as being line items on the financial statements or line items within the footnotes to the financial statements. DoD explained that they currently report General Property, Plant and Equipment, Net, as one line item on the balance sheet but the major asset classes separately (land; building, structures, and facilities; leasehold improvements; software; general equipment; assets under capital lease;

construction in progress; and, other) are reported separately in the footnotes. DoD explained that component reporting entities are most likely to make their unreserved assertions by major asset category rather than a one-time assertion for all General Property, Plant and Equipment taken as a whole.

Staff notes that the Board discussed this issue as reported in the excerpt from the December 2015 minutes:

> Ms. Batchelor explained that there was one other item that needed to be discussed. She explained that she included it in the marked ballot draft as it relates to feedback from Mr. Dacey and whether the Board wants to elaborate on what the term “line item” means when used. Mr. Dacey noted that in SFFAS 48 the decision was made that it was an all or nothing for inventory. Ms. Batchelor explained that line item is used in the Statement because it is much broader than inventory, and one could elect for software or a type of PP&E by a particular year. Mr. Allen explained that it is difficult to clarify line items because we do not have standards that dictate categories for PP&E.
>
> Mr. Dacey explained that he believed it was important to be clear what the Board’s intent is -- whether it is the total general PP&E or the components one may find in the footnote.
>
> The Board discussed the issue and came to the conclusion that the preparer decides which line items he or she wishes to consistently define and to present. For example, DoD may wish to show disaggregated information to show progress in the general PP&E area. Mr. Dacey suggested if there is confusion, it may warrant a sentence in the basis for conclusions that explains the reporting entity can determine components of general PP&E. The Board agreed it does not warrant an explanation in the standard.
>
> The following sentence was added to the basis for conclusions: “The presentation of line items may be more or less detailed. For example, components of GPP&E such as land may be a separate line item or there may be a single line item for all GPP&E.”
>
> Mr. Granof asked if an auditor could present an opinion on a single line item, particularly plant and equipment. Mr. Dacey explained that they can and do because the auditing standards allow it. Mr. Dacey explained that DoD’s Financial Improvement and Audit Readiness (FIAR) Plan dictates that each assessable unit would follow a progression from identifying issues, resolving the issues, determining whether this assessable unit is auditable, and then proceeding to an audit. Mr. Dacey also explained that the schedule of public debt, which is a line item on the government-wide financial statements, is separately audited.

Paragraph A13 of the Basis for Conclusions states:

This Statement amends SFFAS 6 implementation guidance to include alternatives for establishing opening balances. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for general PP&E for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The presentation of line items may be more or less detailed. For example, components of general PP&E, such as land, may be a separate line item, or there may be a single line item for all general PP&E.

Staff believes that the basis for conclusion is clear regarding the issue, but considering there appears to be question, additional language could be added.

Staff recommendation: Staff recommends adding the following paragraph to the basis for conclusions:

Certain respondents requested that clarifying language be added to the Statement to expand upon the phrase "one or more line items addressed by this Statement," to define line items as being line items on the financial statements or line items within the footnotes to the financial statements. The exposure draft addressed this point in the basis for conclusions. The Board acknowledges the term line item is quite broad, especially in relation to general PP&E. The preparer can use judgment to decide which line items he or she wishes to consistently present on the face of a financial statement and that is not something that should be specified within this Statement. In establishing opening account balances for general PP&E for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, the presentation of line items on the face of the balance sheet may be at a detail selected by the preparer. For example, line items may be based on class of general PP&E, such as those included in the disclosures or a single line item for all of general PP&E.

Question for the Board: Does the Board agree with the staff recommendation to address the "line item" concerns?

6. Scope issues

There were several issues relative to scope that were raised:

- Clarify whether the reporting entity is supposed to have systems in place that can provide the information necessary to produce financial statements that are based on generally accepted accounting principles (GAAP) before using the alternative valuation method. Since this alternative method is only supposed to be used one-time, if the systems cannot provide the necessary information after implementation of the alternative method, then the entity will still be unable to comply with the standards.

- Scope of assets to apply deemed cost - The proposal should specifically state that the use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available. As currently written, the proposed guidance is allowing entities to use deemed cost for all of its assets instead of only for those assets for which it does not have supporting documentation.

- Consider providing examples of the two scope conditions

While staff acknowledges that the concerns, staff believes the Statement addresses these topics to the point most appropriate for a principles based standard or what would be appropriate. For example, the scope explains the two conditions which the Statement may be applied. Staff believes that the scope conditions are straight forward and the Board would not want to say more. As for the comment regarding whether the reporting entity is supposed to have systems in place that can provide the information necessary to produce financial statements that are based GAAP before using the alternative valuation method, staff believes the Statement is clear that the line items must be in accordance with GAAP.

However, the importance of having the system in place is reiterated throughout the basis for conclusions. For example, paragraph A26. states:

> The purpose of this Statement is to provide an alternative valuation method for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities, such as the DoD, finalize a sound GAAP compliant financial management system. All activity after the opening balances for general PP&E are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

Further, paragraphs A57.-A59. states:

> A57. A component reporting entity that is in the process of implementing systems that are GAAP compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.
>
> A58. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP compliant systems; this allows them to assert independently of

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

A59. 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 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. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for fiscal year 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 fiscal year 2018, or
b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 6 (as amended), in all material respects.

And the comment regarding the proposal should specifically state that the use of deemed cost should be restricted to those circumstances where reliable information about the historical cost of the asset is not available. Staff believes this a common theme also embedded throughout the entire Statement but not one that should be part of the deemed cost definition. The deemed cost definition is the same as used for SFFAS 48.

- Applicability to the government-wide

Prior to receipt of the comment letters, an issue that came up was if the CFR contained an unreserved assertion? Along these lines is that some may question if the proposed standards apply to the government-wide reporting entity. *(Note: Staff believes that inventory would be immaterial at the government-wide but PP&E would not.)* One respondent also asked for clarification that the standards apply to both the component reporting entities and the government-wide reporting entity.

Staff believes it is the intention of the Board that all standards apply to any entity – component or government-wide unless otherwise stated. SFFAS 24 *Selected Standards for the Consolidated Financial Report of the United States Government* states that SFFASs "apply to all federal entities, that is, to the Government as a whole and to component entities …, unless provision is made for different accounting treatment in a current or subsequent SFFAS."

With that said, staff believes that based on the current proposal, the standards would apply to any entity – component or government-wide – that satisfies the conditions in the scope paragraph. The Scope paragraph of the proposal states:

> This Statement applies when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

Note 1 of FY 2014 Financial Report of the United States Government provides the following:

Financial Report of the United States Government – 2014
<u>Basis of Accounting</u>

> These financial statements were prepared using U.S. GAAP, primarily based on Statement of Federal Financial Accounting Standards (SFFAS). Under these principles:
>
> - Expenses are generally recognized when incurred.
> - Nonexchange revenue, including taxes, duties, fines, and penalties, are recognized when collected and adjusted for the change in net measurable and legally collectible amounts receivable. Related refunds and other offsets, including those that are measurable and legally payable, are netted against nonexchange revenue.
> - Exchange (earned) revenue are recognized when the government provides goods and services to the public for a price. Exchange revenue include user charges such as admission to federal parks and premiums for certain federal insurance.
>
> The basis of accounting used for budgetary purposes, which is primarily on a cash and obligation basis and follows budgetary concepts and policies, differs from the basis of accounting used for the financial statements which follow U.S. GAAP. See the Reconciliations of Net Operating Cost and Unified Budget Deficit in the Financial Statements section.

> The basis of accounting used and the detail of the basis for the Statement of Social Insurance (SOSI) and the Statement of Changes in Social Insurance Amounts (SCSIA) are covered in Note 24—Social Insurance.

Staff notes that we are not technically in a position to assess whether they have or have not made an unconditional assertion. Staff notes the wording is different from component reports as they don't use the word "primarily" and that some may interpret a reservation by the use of the word "primarily." However, staff believes it is more likely the "primarily" may relate to GAAP – as in US GAAP is primarily based on SFFAS – rather than that these financial statements are primarily based on SFFAS.

Staff believes it's not clear that the CFR assertion has a reservation based on: "These financial statements were prepared using U.S. GAAP, primarily based on Statement of Federal Financial Accounting Standards (SFFAS)." This raises the question of whether the relevant assertion is the summary of significant accounting policies (Note 1) or the management representation letter provided to the auditor.

Staff requests the Board's thoughts on this matter.

Staff Recommendation: Staff recommends that the Board mention the comment regarding applicability to the government-wide report in the basis for conclusions and refer to the SFFAS 24 provision as follows:

> A respondent asked for clarification whether the standards apply to the government-wide reporting entity. It is the intention of the Board that all standards apply to any entity – component or government-wide unless otherwise stated. SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government* states that SFFASs "apply to all federal entities, that is, to the Government as a whole and to component entities …, unless provision is made for different accounting treatment in a current or subsequent SFFAS."

If the Board believes that the factual question of whether the CFR has previously presented an unreserved assertion should be addressed, staff recommends that the basis for conclusions discussion be expanded, but will await further direction.

Question for the Board: Does the Board agree with the staff recommendation regarding the scope issues?

7. In-service dates

Three respondents provided comments regarding "in-service dates" as provided in paragraph 40.12.f. Comments included the following:

- Paragraph 12f "states that there is no requirement for in-service dates to be separately identified for material improvements and that all material improvements should be treated as if they were placed in-service at the date the base unit was placed in-service." The respondent requested clarification if the in-service dates for material improvements are the same as the base unit when establishing asset value. Further, they requested clarification on the approach if the in-service dates for material improvements is known but the in-service date for the base unit is not known? Should the agency disregard the in-service dates for material improvements?
- One respondent explained they did not agree with paragraph 12 (40)f.ii. and believed that identifying in-service dates on material improvements separately from the base unit is essential to minimizing the distortion of depreciation and future year expenses. Also, using the in-service date of just the base unit distorts the comparability between entities and does not comply with the concept of operating performance in SFAC 1.
- One respondent suggested that the term "material improvements" paragraph 12 (40)f.ii be replaced with the language from SFFAS 6 paragraph 37, which uses the phrase "Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E." The same respondent also recommended combining paragraphs 40(f)(i) and (ii) as follows (new content underscored; deleted content struck-through):

    fi. In some cases, the in-service date must be estimated. In estimating the year that the base unit <u>or costs which either extend the useful life of existing general PP&E</u> <u>or enlarge or improve its capacity</u> was placed in service, if only a range of years can be identified then the mid-point of the range is an acceptable estimate of the in-service date.

    ~~ii. It is not necessary to separately identify the in-service date for material improvements to a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.~~

Based on the comments, there appears there may be some misinterpretation that the material improvements had to be treated as if they were placed in service at the date the base unit was placed in-service. Therefore, a paragraph may be helpful in the basis for conclusions.

Staff Recommendation: Staff recommends that following paragraph be added to the basis for conclusions:

> Several respondents provided comments regarding "in-service dates." There appeared to be questions if the in-service dates for material improvements are the same as the base unit and if reporting entities should disregard the in-service dates for material improvements. The Board notes that the Statement is permissive.

Material improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service but this treatment is not necessary.

Staff also believes the wording of the Statement could be clarified by slightly revising ii as follows:

f.i. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified then the mid-point of the range is an acceptable estimate of the in-service date.

ii. It is not necessary to separately identify the in-service date for material improvements[6] included in the opening balances of ~~to~~ a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.

Question for the Board: Does the Board agree with the staff recommendation regarding "in-service dates"?

8. Other comments- Staff recommends no further action

a. Unreserved assertion

Two respondents commented about "unreserved assertion" and suggested:

- The term "unreserved assertion" is unclear. The concept does not exist in the professional literature (AICPA, GAO, FASAB). Thus, the term should be defined with objective criteria.
- While the ED defines "an unreserved assertion" as an "unconditional statement", it would be beneficial for the Standard to address, perhaps by way of an example, the narrative components that should be included in the assertion.

These topics or very similar issues were researched, discussed and/or deliberated as part of the due process in finalizing SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials*. For example, in August 2015, the Board discussed "Terminology" in response to the comment letters for SFFAS 48 where the Board decided to add the definition of "unreserved assertion' which is also included in this Statement and clarify discussion in the basis for conclusions. The definition is included at paragraph 10 and a similar paragraph in the basis for conclusions is included in this statement at A53:

[6] Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity.

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

A53. The Board notes that the term "unreserved assertion" may be used in other contexts. For example, certain entities' management (such as the DoD) may be required to make management assertions regarding its financial information and that DoD financial statements are validated as ready for audit by no 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.

Staff notes that much time has been spent by the Board deliberating this issue and it would be preferred that the Statements remain consistent or some may question if there was an intended difference.

Staff Recommendation: *Staff does not recommend further action.*

b. Plant Replacement Value (PRV)

In their response, DoD requested that PRV be explicitly added to the list of alternative valuation methods in paragraph 12.e , along with the following footnote definition: "Plant Replacement Value is the current amount that would be required to replace the service capacity of an asset, inclusive of capital improvements." DoD explained that this would help to avoid misinterpretations by both reporting entities and their auditors.

DoD acknowledged that the Basis For Conclusions explained that "This Statement allows for PRV to be used in establishing the opening balance for property in current year dollars and not be deflated to the in-service year." However it would have been preferred it had been in the body of the standards. DoD also noted some concerns with the manner in which it was addressed in the basis for conclusions. For example, there was concern with the sentence in A18. "The Board cautions that although the PRV may qualify as replacement cost and be used in establishing the opening balance for real property, the PRV model and information supporting it would be subject to audit." DoD explained the phrase "may qualify" in A18 could be interpreted as contradictory and suggested changing it to "The Board cautions that although the PRV can be used in establishing the opening balance for property, the PRV model and information supporting it would be subject to audit."

DoD also expressed concern with inclusion of paragraph A17 in the basis for conclusions. DoD acknowledged paragraph A17. relates to concerns raised by DoD over the definition for replacement cost from SFFAC 7 – *Measurement of the Elements of Accrual Basis Financial Statements in Periods After Initial Recording*. DoD is concerned that inclusion of this narrative may do more to confuse the issue than to clarify it. Consequently, DoD suggested that paragraph A17 be removed in its entirety.

Staff notes that during December 2015, DoD submitted a similar request that was carefully considered. The request was similar because the request was phrased in a slightly different manner as it was to add "current replacement cost" and a definition as an additional deemed cost method in the ED. In their submission, DoD explained that they can calculate a current replacement cost, i.e. a plant replacement value using its current PRV model and that this approach would need to be added as a method for deemed cost.

As explained previously, staff does not believe the Statement should be revised to include an additional category—whether for PRV or current replacement cost. This decision is based on staff does not believe new terms such as these should be used or defined for purposes of this standard in establishing opening balances. Staff believes the explanatory language that was added to the basis for conclusions, not only to address that the Statement allows for PRV to be used in establishing deemed cost but also to address the concern regarding current replacement cost should be sufficient in addressing any concern. Staff has included the language from the basis for conclusion regarding this topic below for the Board's reference:

> A16. The DoD currently uses plant replacement value (PRV) which is based on cost factors, such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. While PRV (a replacement cost model) has not been used for financial reporting purposes, DoD officials have stated it is used for decision-making and management purposes. This Statement allows for PRV to be used in establishing the opening balance for real property in current year dollars and not be deflated to the in-service year. PRV is inclusive of capital improvements. Accumulated depreciation will be recognized based on the remaining useful life compared to the original useful life. This will not systematically understate the historical cost since capital improvements will not be deflated. However, by allowing current year costs, it may overstate the historical cost and subsequent years' depreciation expense.
>
> A17. Prior to issuing the ED, the DoD raised concern regarding the definition of "replacement cost" from SFFAC 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording.* The DoD questioned whether the PRV method would qualify as replacement cost. As explained in paragraph 47 of SFFAC 7 there may be several ways of arriving at an estimate:
>
>> Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an

equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

A18. The Board cautions that although the PRV method may qualify as replacement cost and be used in establishing the opening balance for real property, the PRV model and information supporting it would be subject to audit. Allowing PRV for opening balances does not provide assurance that the data and supporting information will be acceptable for audit. At the issuance of the ED, the DoD was in the process of developing an approach to estimate the remaining useful life of real property assets, which is a key component to establishing the opening balances for real property. The Board stresses the importance of establishing useful lives and its significance to all general PP&E.

Staff also notes that this topic was discussed at the December 5 Audit Roundtable on the draft guidance and they concurred. See Excerpt from Dec. 5 Audit Roundtable Summary:

FASAB staff also asked for the participants' feedback regarding a separate issue related to DoD's request to add "current replacement cost" as a deemed cost method in the Draft ED, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. After considering the issue, FASAB staff did not believe the proposed standards should be revised to include an additional category for current replacement cost. Replacement cost as defined in the SFFAC 7, Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording, is the best source for the definition in the proposed standard because the standard is about valuation.

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

Staff Recommendation: *Staff does not recommend further action.*

c. Accumulated Depreciation

One respondent noted the Statement is unclear regarding the treatment for opening balances for accumulated depreciation and suggested a disclosure regarding how accumulated depreciation was derived.

Staff notes the Statement provides implementation guidance to allow a reporting entity to apply an alternative valuation method in establishing opening balances for general PP&E. As a result of the amendments and rescissions in the Statement, all implementation guidance for general PP&E, with the exception of IUS, will be in SFFAS 6.

Staff notes that SFFAS 6 implementation guidance, paragraphs 41-42 addresses accumulated depreciation:

> 41. Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost[7] and depreciation/amortization charged over the remaining life based on that net remaining cost.
>
> 42. For general PP&E that would be substantially depreciated/amortized had it been recorded upon acquisition based on these standards, materiality and cost-benefit should be weighed heavily in determining estimates. Consideration should be given to:
> • recording only improvements made during the period beyond the initial expected useful life of general PP&E, and
> • making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building by building estimate).

Staff Recommendation: *Staff does not recommend further action.*

d. Accounting for Parent-Child Allocation Transfers

One respondent suggested the Board collaborate with the Office of Management and Budget to consider the potential challenges a "parent account" reporting entity will face in ensuring the transactions and balances of its "child account" are properly recorded, reported, and disclosed in the "parent account" reporting entity's financial statements (or one or more line items addressed by the proposed Statement) in accordance with the proposed Statement when both the "parent account" and the "child account" establish opening balances based on the proposed Statement. (Note that the broad challenge of

[7] Net remaining cost is the original cost of the asset less any accumulated depreciation/amortization to date.

parent-child relationships was also raised during the IPA Roundtables on the three-year plan.)

Staff acknowledges the challenges, but does not see an immediate action for the Board or believe that this issue needs to be addressed in the Statement. Staff notes that the Board briefly discussed the issue of parent-child accounts during the deliberation of *SFFAS 47, Reporting Entity*. It was determined that the standards were not the venue to address guidance for parent-child accounts. Below is an excerpt from June 2010 Board meeting:

> He asked if OMB had issue with "all accounts" and how it relates to guidance on the parent and child accounts. Ms. Kearney explained the guidance is in Circular A-136 and it relates to accounts where in practice there was confusion as to which agency was going to report it. The guidance ensured the parent account picked it up to avoid double counting.[8]
>
> Ms. Kearney didn't see a specific reason for this to be addressed in the entity standard. Ms. Kearney explained the parent is in control -- the child is merely executing on behalf of the parent because it is in support of the parent's mission, the parent gets appropriated funds. Ultimately the parent is responsible for that money.

As always, the Board (and FASAB staff) will collaborate with OMB as necessary to ensure guidance is in accordance with the Statement as necessary.

Staff Recommendation: *Staff does not recommend further action.*

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[8] OMB Circular A-136 provides the following: 5. What are the financial reporting requirements for transferring budget authority to another agency (Parent/Child Reporting)? Some laws require departments (or agencies) to allocate budget authority to another Federal entity within the same department or in another department. Allocation means a delegation, authorized in law, by one department of its authority to obligate budget authority and outlay funds to another department. While the department receives budget authority in accordance with law, the same law requires the department (i.e., referred to as the parent) to allocate some or even all of the budget authority to another Federal entity ['child']. … In the child account, the receiving Federal entity receives the budget authority, and then obligates and outlays sums up to the amount included in the allocation. Except for the object class schedule, the Budget does not separately show the allocations, but rather shows all financial activity (e.g. budget authority, obligations, outlays) in the parent account. In essence, the parent is accountable for and maintains the responsibility for reporting while the child performs on behalf of the parent and controls how the funds are expended.
… The parent is responsible for the program's overall performance and may decide to reallocate funds if the parent is not satisfied with the child's performance. The various children responsible for carrying out the different parts of the program report their costs to the parent for the activities they perform. All costs are then consolidated in the parent's financial statements in order to provide a complete cost of the parent's program.

e. Other issues- interim reporting & correction of errors

There were comments regarding other reporting issues related to the Statement.

- DoD requested clarification regarding paragraph A52. in the basis for conclusions. They noted that paragraph A52. states that "The disclosures required are also included …The first reporting period would be the first year-end financial statement that an unreserved assertion is made. The Board does not believe the first reporting period should be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures." DoD noted that for certain classes of PP&E, DoD has instructed its components to establish their opening balances no later than March 31, 2017. DoD asked if it would it be acceptable for the DoD component to make the unreserved assertion with the "as of" date of September 30, 2017 since that is the year end during which the opening balances were established or did FASAB intend to direct federal agencies only to establish opening balances at the end of a fiscal year?

- One respondent noted that paragraphs A60-A61, prescribe entities to treat the conditions specified in this exposure draft as a change in accounting principle. They requested clarification on whether the change to the beginning balance of Cumulative Results of Operations to reflect a change in accounting principle must be shown in the quarterly financial statements as well.

- DoD explained that there is some confusion and differing opinions on whether or not corrections to opening balances valued based on deemed costs can be done in fiscal years subsequent to the fiscal year in which the opening balance was initially recorded. To clarify how such corrections should be recorded in accordance with existing GAAP, they suggested the following changes to the amendment to paragraph 40 be included:
    i) Re-letter paragraphs (d) and (e) to (e) and (f), respectively.
    ii) Insert a new paragraph (e) that states the following:
    Reporting entities that find opening balance errors during a fiscal year subsequent to the fiscal year in which the opening balance was initially recorded based on deemed cost, and which need to be corrected, should record such adjustments subject to the reporting requirements under paragraph 10 of Statement of Federal Financial Accounting Standards 21: Reporting Corrections of Errors and Changes in Accounting Principles.

Staff believes these points are more practical/application and something that the preparer can determine on their own. For example, DoD may direct their components to determine opening balances as of any date, but they must be GAAP compliant for the reporting period that follows the opening balance date. Thus, establishing opening balances mid-year (March 31st) would mean that the first reporting period could not be a fiscal year. Staff does not believe that additional language is needed because the Statement and basis for conclusion addresses interim reporting and correction of errors at an appropriate high level. In response to DoD's suggestion regarding the confusion on whether corrections can be done, staff believes the Statement is clear in paragraph 40a. and basis for conclusion A63 as provided below.

> 12. 40.a. The alternatives for establishing opening balances may only be applied for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion [footnote 5 omitted] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP and for periods during which it is necessary to correct errors in the opening balances that are discovered in later reporting periods.
>
> A63. In addition, alternative valuation methods provided in this Statement may be applied in correcting errors related to the opening balances discovered in later reporting periods if needed.

Staff Recommendation: *Staff does not recommend further action.*

f. Editorial & Basis for Conclusions Suggestions

Respondents submitted several comments on other aspects of the proposed Statement, some of which were editorial suggestions and other wording recommendations that respondents believed may improve the document or provide further clarity.

Staff did not see the need to list all of the suggestions in the memo because they are included in the individual letters and the staff summary of comment letters. Staff carefully considered each of the comments and adjusted wording as needed within the Statement or basis for conclusions. Any changes that were incorporated are included on the Marked Version of the draft statement with a comment box.

Staff Recommendation: *Staff does not recommend further action.*

Question for the Board: Does the Board agree with the staff recommendation that no further action is required in areas a.-f. above?

Questions for the Board

1. Does the Board agree with the staff recommendations regarding land?

2. Does the Board agree with the staff recommendation addressing disclosures?

3. Does the Board agree with the staff recommendations regarding SFFAS 35?

4. Does the Board agree with the staff recommendation to address the IUS concerns?

5. Does the Board agree with the staff recommendation to address the "line item" concerns?

6. Does the Board agree with the staff recommendation regarding the scope issues?

7. Does the Board agree with the staff recommendation regarding "in-service dates"?

8. Does the Board agree with the staff recommendation that no further action is required in areas a.-f. above?

9. Does the Board have any other questions regarding the comment letters, issues, staff recommendations, or changes proposed to the Statement?

10. Is the Board prepared to move to a pre-ballot draft of the Statement for the April 2016 meeting?

Federal Accounting Standards Advisory Board

ESTABLISHING OPENING BALANCES FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT:

AMENDING STATEMENT OF FEDERAL FINANICAL ACCOUNTING STANDARDS (SFFAS) 6, SFFAS 10, SFFAS 23, AND RESCINDING SFFAS 35

Statement of Federal Financial Accounting Standards XX

Comment [MB1]: Changes to convert the ED to a final document have been accepted and are not marked for ease of reading. Changes included dropping terms such as exposure draft and proposed throughout the document, removing items such as the comments requested by date, transmittal letter, executive summary, and questions for respondents

~~December 22, 2015~~May 10, 2016

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the ~~Government Accountability Office (GAO)~~United States~~,~~ established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. ~~The~~ FASAB is responsible for promulgating accounting standards for the United States g~~G~~overnment. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Comment [MB2]: The Statement was reviewed by our Communications Specialist to ensure conformance and consistency. Certain changes such as these and other editorial suggestions have been marked once but incorporated throughout the document for ease of reading.

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 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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Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, D.C. 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov

SUMMARY

This ~~proposed~~ Statement ~~would~~ provides implementation guidance to allow a reporting entity to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E). ~~To do so, it would~~ It amends Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and ~~would~~ rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.* The alternative methods include (1) using deemed cost to establish opening balances of general PP&E~~,~~ and (2) selecting between deemed cost and prospective capitalization of internal use software (IUS).~~, and (3) excluding land from opening balances with disclosure of acreage information.~~

The alternative methods ~~would be~~ are permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (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 ~~would be~~is available to each reporting entity only once per line item addressed in this Statement.

This Statement ~~would~~ provides alternative methods when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 6, 10, 23, and 35. The alternatives are intended to reduce the barriers to and cost of adopting GAAP.

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INTRODUCTION

PURPOSE

1. This Statement amends Statement of Federal Financial Accounting Standards (SFFAS) 6 *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software,* and SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* by providing implementation guidance to allow a reporting entity to apply alternative methods in establishing opening balances for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods or services.[1]

2. The alternative methods permitted by this Statement may be applied when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

3. This Statement provides implementation guidance to allow a reporting entity to apply an alternative valuation method (deemed cost) in establishing opening balances for general PP&E ~~and to allow an exclusion of land from the opening balances~~ in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP and for the periods during which it is necessary to correct errors in the opening balances that are discovered in later reporting periods. It also provides for selecting between deemed cost and prospective capitalization of internal use software in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP.

4. As a result of these amendments and rescission, all implementation guidance for general PP&E, with the exception of certain provisions applicable to internal use software, will be in SFFAS 6. The Board believes providing implementation guidance for general PP&E other than internal use software in SFFAS 6 will provide a comprehensive guide for users in a single Statement.

Comment [MB3]: To provide this in the intro, it is consistent with par. 12.40.a.

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

MATERIALITY

~~4.~~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.

STANDARDS

SCOPE

~~5.~~6. This Statement applies when a reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The application of this Statement based on the second condition is available to each reporting entity only once per line item addressed in this Statement.

~~6.~~7. This Statement may be applied in establishing **opening balances**[2] for the reporting period that the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP and for the periods during which it is necessary to correct errors in the opening balances that are discovered in later reporting periods.

~~7.~~8. Reporting entities that meet either condition in paragraph 6 and elect to apply the alternative valuation method in establishing opening balances permitted by this Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21, *Reporting Corrections of Errors and Changes in Accounting Principles*, *Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

DEFINITIONS

Definitions in paragraphs 9 – 10 are presented within the standards because they are new terms intended to have a specific meaning when applying the standards.

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~~8.~~9. **Opening Balances-** Opening balances are a~~A~~ccount 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]

~~9.~~10. **Unreserved Assertion-** An unreserved assertion is an unconditional statement.

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

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

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11. This paragraph amends SFFAS 6, *Accounting for Property, Plant, and Equipment* paragraph 26 by adding the following second sentence: "Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein."

Comment [MB4]: See 3. SFFAS 35 Recession in Staff Analysis Memo & Recommendations

The new paragraph 26 of SFFAS 6:

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26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include…..:

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~~10.~~12. This section amends the implementation guidance provided in SFFAS 6, *Accounting for Property, Plant, and Equipment* as described in the following paragraphs.

~~11.~~13. Paragraph 40 is replaced with:

40. Alternative~~s~~ Valuation Method Available for Opening Balances.[4] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in establishing opening balances:

Comment [MB5]: With removal of allowance to exclude land, there is one alternative—deemed cost.

a. The alternative~~s~~ valuation method for establishing opening balances may only be applied for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[5] that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP and for periods during which it is necessary to correct errors in the opening balances that are discovered in later reporting periods.

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

[4] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[5] An unreserved assertion is an unconditional statement.

c. Reporting entities that meet either condition in paragraph 40 and elect to apply ~~any of~~ the alternative valuation method ~~s available~~ in establishing opening balances are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

~~d. Land and land rights. The reporting entity may exclude land and land rights from the opening balance of general PP&E. If this alternative is applied, the reporting entity should expense future land and land right acquisitions.[6]~~

Comment [MB6]: See 1. Land Issue from Staff Analysis and Recommendation.

~~e.~~d. ~~Alternative Valuation Method.~~ **Deemed cost**[7] is an acceptable valuation method for opening balances of general PP&E. Because the reporting entity may have multiple component reporting entities[8] using various valuation methods simultaneously, deemed cost should be based on one, or a combination, of the following valuation methods:[9]

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i. **Replacement cost**[10]

ii. Estimated historical cost (initial amount). Reasonable estimates may be based on:

   a) cost of similar assets at the time of acquisition,
   b) current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index), or
   c) other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

iii. **Fair value**[11]

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e. Once established using deemed cost, opening balances are to be considered consistent with GAAP.

Comment [MB7]: Suggestion to be consistent with language in SFFAS 48

~~[6] The Board intends to begin a project on land in the near future that would review existing standards and consider a consistent approach. Based on the results of that project, the decisions made for opening balances and future acquisitions of land in this Statement may be revised.~~

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

[8] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

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

[10] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life~~.~~ (Statement of Federal Financial Accounting Concepts [~~(~~SFFAC]~~)~~ 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, par. 46).

[11] 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).

f. Establishing in-service dates.

i. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified then the mid-point of the range is an acceptable estimate of the in-service date.

ii. It is not necessary to separately identify the in-service date for material improvements[12] included in the opening balances of ~~to~~ a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service.

g. Disclosure requirements.

~~i. A reporting entity electing to exclude land from its general PP&E opening balances must disclose, with a reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. Each year thereafter, a reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude future land acquisition amounts and provide the disclosures.~~

~~ii.~~ i. A reporting entity electing to apply deemed cost in establishing opening balances for general PP&E should disclose this fact and describe the methods used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of general PP&E included in the opening balance is required.

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

14. This paragraph amends SFFAS 10, *Accounting for Internal Use Software* paragraph 16 by adding the following second sentence: "Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein."

The new paragraph 16 of SFFAS 10:

16. Although the measurement basis remains historical cost, reasonable estimates may be used to establish the capitalized cost of internally developed software, in accordance with the asset recognition and measurement provisions herein. For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred

[12] Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity.

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Comment [MB8]: See 7. In-service dates from Staff Analysis and Recommendation

Comment [MB9]: See 1. Land Issue from Staff Analysis and Recommendation

Comment [MB10]: See 3. SFFAS 35 Recession in Staff Analysis Memo & Recommendations

Formatted: Indent: Left: 0.25", No bullets or numbering during the software development stage.[13] Such cost should be limited to costs incurred after….

~~12.~~15. This section amends the implementation guidance provided in SFFAS 10, *Accounting for Internal Use Software,* as described in the following paragraphs.

~~13.~~16. Paragraph 36 is replaced with:

36. Alternatives for Establishing Opening Balances.[14] The following guidance is applicable for the reporting period when the reporting entity is presenting financial statements, or the line item addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by FASAB either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. The following should be considered in applying an alternative:

a. Alternatives for establishing opening balances may only be applied for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[15] that its financial statements, or the line item addressed by this Statement, are presented fairly in accordance with GAAP and for periods during which it is necessary to correct errors in this opening balance that are discovered in later reporting periods.

b. The application of ~~this method~~ these alternatives based on the second condition specified in paragraph 36 is available only once to each reporting entity. ~~Application of the recognition, measurement, and disclosure requirements of this Statement is required during the reporting period when the reporting entity makes an unreserved assertion.~~

c. Reporting entities that meet either condition in paragraph 36 and elect to apply any of the alternatives available in establishing opening balances are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards 21, *Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*.

d. Alternatives. A reporting entity ~~may~~ should choose among the following alternatives for establishing an opening balance for internal use software. Because a reporting entity may have multiple component reporting entities[16] selecting different

Comment [MB11]: More than one option for IUS

Comment [MB12]: Suggestion to delete because sentence is not needed given other requirements

Comment [MB13]: To clarify that it should be one of the alternatives listed

[13] For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995), pars. 90-92. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display*.

[14] Opening balances are account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

[15] An unreserved assertion is an unconditional statement.

[16] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include

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alternatives, a reporting entity ~~may~~ should establish an opening balance based on one, or a combination of these alternatives. However, application of a particular alternative must be consistent within each of the component reporting entities prior to consolidation.

i. Prospective capitalization. The reporting entity may choose prospective application of SFFAS 10. If the reporting entity elects prospective treatment, the reporting entity should choose between the following acceptable alternatives at the opening balance date:

(a) Exclude all internal use software, inclusive of that under development at the opening balance date, from the opening balance.

(b) Exclude internal use software in service from the opening balance, but include amounts related to internal use software under development at the opening balance date. Internal use software under development should be recognized in opening balances based on the provisions of paragraphs 15 through 27 or on the alternative valuation method provided in paragraph 36.d.ii.

ii. Alternative Valuation Method. Deemed cost[17] is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40ed for implementation guidance regarding deemed cost.

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~~ii.~~iii. Once established using alternatives, opening balances are to be considered consistent with GAAP.

e. Disclosure requirements: A reporting entity electing to apply the alternative methods should disclose this fact and describe the alternatives used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternatives are applied by component reporting entities consolidated into a larger reporting entity, the alternative adopted by each significant component should be disclosed. Financial statements or, as applicable, reports on line items of subsequent periods need not repeat this disclosure, unless the statements for which the alternative was applied in ~~for~~ establishing opening balances ~~was applied~~ are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of internal use software included in the opening balance is required.

AMENDMENTS TO SFFAS 23, *ELIMINATING THE CATEGORY NATIONAL DEFENSE PROPERTY, PLANT, AND EQUIPMENT*

organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

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

~~14.~~17. This section amends the implementation guidance provided in SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment,* as described in the following paragraphs.

~~15.~~18. Paragraph 10 is replaced with:

10. See SFFAS 6 for implementation guidance applicable to all general PP&E.

~~16.~~19. Paragraphs 11-18 of SFFAS 23 are rescinded.

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

~~17.~~20. This paragraph rescinds SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* in its entirety. Provisions from SFFAS 35 were incorporated into the implementation guidance of SFFAS 6 as needed.

~~18.~~21. Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35.

EFFECTIVE DATE

~~19.~~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 Federal Accounting Standards Advisory Board (FASAB)'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~~ing~~ the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request from DoD for guidance on establishing opening balances for general property, plant, and equipment (PP&E). Accounting for the federal government's general PP&E is complex and continues to be a challenge for large federal departments. This topic has been addressed in numerous Statements of Federal Financial Accounting Standards (SFFAS) and Interpretations as well as guidance issued by the Accounting and Auditing Policy Committee. SFFAS 6, *Accounting for Property, Plant, and Equipment*, SFFAS 10, *Accounting for Internal Use Software*, SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, and SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* address the accounting and reporting requirements for general PP&E.

A3. During the project, the Board's staff met with officials from DoD, as well as the audit community, to develop an understanding of the issues currently faced by DoD in establishing their baseline for general PP&E. This included discussing valuation methodologies currently employed, difficulties relevant to management assertions and the completion of audits, and the status of implementation of a generally accepted accounting principles (GAAP) compliant system for the DoD component.

A4. Based on the meetings and information provided it was determined that:

a. DoD financial systems and many aspects of DoD accounting policy for general PP&E have not been in accordance with FASAB GAAP.
b. Many organizations that maintain several different accounting and property systems are involved in acquiring general PP&E assets.
c. DoD has not had consistent procedures related to general PP&E acquisitions or documented processes for retaining source documentation.

d. All major systems DoD has utilized for acquisitions of general PP&E have either never been audited~~,~~ or, when audited, had significant deficiencies or material weaknesses~~ related to them~~.
e. Capital improvement projects have not been reliably tracked, ~~in systems ~~so it is difficult to determine the date they were placed in service or to establish a valuation baseline.
f. DoD has approximately 440,000 separate real property assets, and many real property assets were built more than 40 years ago.
g. DoD records related to land values are not in a structured, searchable system. The records are not digitized and accessing them involves searching boxed records. Also, source documents, such as deeds, may not be complete, and court records often have gaps given the length of time involved.
h. DoD does not have a complete inventory of its internal use software (IUS) and costs of IUS have not been captured consistently.
i. General equipment is a broad category that includes military equipment and consists of hundreds of thousands of assets.

A5. After considering the status of DoD's efforts and the fact that DoD has had numerous years to implement the standards and has shown little progress, the Board discussed the merits of the project. Specifically, one member had concern regarding ~~what ~~the Board's role ~~was ~~and ~~that the Board may be ~~potentially undermining the Board's~~its~~ own credibility by acting to offer relief to DoD because ~~it ~~the department has been unable to adopt GAAP requirements. The Board acknowledges that appearance is a concern. However, the Board has been tasked with establishing standards for which the benefits exceed the cost.

A6. The Board noted that while DoD has had numerous years to meet the standards and become GAAP compliant, they have not. Conditions remain that existed when many of these standards were issued, and the cost to implement all the standards concurrently is greater than would have been incurred if standards were implemented in a timely manner. The goal of this Statement is to avoid requiring the expenditure of taxpayer dollars in recreating information that would have been of greater benefit in the past (for example, to evaluate major acquisition/construction programs as they were executed) but for which the current use is limited to accountability and assessing the cost of current services. The Board has proposed less costly alternatives that will support this use.

A7. The Board believes assisting DoD with establishing a baseline ~~would ~~benefits all parties. Providing a starting point may enable DoD to focus on needed improvements to systems and controls to process transactions going forward and thereby establish and maintain reliable financial information regarding future PP&E acquisitions. Establishing a sound financial management system is of primary importance.

A8. The Board also acknowledges that other standard-setters have provided guidance for organizations implementing an entire body of standards for the first time. The challenge of establishing opening balances for large public sector entities warrants the flexibilities proposed in this Statement.

SUMMARY OF OUTREACH EFFORTS AND RESPONSES

A9. The exposure draft (ED), *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, was issued on December 22, 2015, with comments requested by February 4, 2016.

A10. 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, the CPA Letter*, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on EDs in the past (for example, the Greater Washington Society of CPAs, Association of Government Accountants Financial Management Standards Board).

A11. 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

A12. DoD also received the ED.

A13. 21 responses were received from preparers, auditors, and professional associations. The majority of respondents agreed with proposals to: permit opening balances of general PP&E to be valued based on deemed cost and require the related disclosures, allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software and require the related disclosures and rescind SFFAS 35.

A14. However, the majority of respondents disagreed with the proposals to allow exclusion of land from the opening balances of general PP&E even though other component reporting entities will report the cost of certain land in general PP&E and to require a reporting entity electing to exclude land from its general PP&E opening balances to exclude future land acquisition amounts.

A15. The respondents identified certain issues that could be clarified within the Statement or addressed in the basis for conclusions.

A16. 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.

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Land

~~A8.~~A17. When ~~deliberating~~ developing the proposal regarding general PP&E, the Board considered land somewhat differently from general PP&E. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance, both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information. Because land is not depreciated, the benefits of capitalizing land are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and capitalized. In doing so, the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.

~~A9.~~ The Board carefully considered those aspects of the land category along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board decided to propose a ~~determined the most~~ practical and cost-beneficial approach to establishing an opening balance for land that would ~~was to~~ permit the reporting entity to exclude land from the opening balance of general PP&E. ~~However, the Board can support accountability through disclosures. The~~ Instead, the Board proposed that the reporting entity disclose, with a note reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. ~~A reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude amounts for future land acquisitions. Accordingly, the reporting entity will provide the disclosures each year thereafter.~~

~~A10.~~A18. ~~Some members who supported excluding land expressed concern regarding the resulting inconsistency in reporting and suggested t~~The Board also decided to begin a project on land in the near future to review existing standards and consider a consistent approach. In addition, the members suggested exploring options to improve reporting on land. Other members would like to explore valuing existing land holdings based on deemed cost (consistent with general PP&E) or on a set amount per acre of land.

A19. As noted, the majority of respondents disagreed with the exposure draft to allow exclusion of land from the opening balances of general PP&E. The respondents showed an overwhelming support for a land project to reexamine standards for reporting on land. There was a strong preference that the Board defer any changes to the current requirements, such as allowing an exclusion of land from the balance sheet or actions that may affect future accounting acquisitions, until the Board completes the re-examination. The respondents provided reasons such as: inconsistent accounting treatment, potential material misstatement for entities who own significant amounts of land, and confusion and added cost from a temporary change. However, consistent with the support for permitting opening balances of general PP&E to be valued based on deemed cost, respondents preferred that deemed cost and/or existing standards be used to value beginning balances of land. Therefore, the Board sees no objection to the use of deemed cost in establishing

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Comment [MB14]: Pars. A17-A18 were pars. A27-A29 from the ED but have been moved here & updated as necessary to reflect the history and final Statement. Staff accepted the insertion so Board members would see only the new changes to the paragraphs.

Comment [MB15]: See 1. Land issue in Staff Analysis and Recommendations memo opening balances for land consistent with that for general PP&E as provided in paragraph 12.40.d. of the Statement.

A20. Based on the respondents' comments, the Board determined it was best to defer exclusion of land from the balance sheet, until the Board completes the land project. Therefore the Statement was revised to remove the option for allowing an exclusion of land from the opening balances and the related disclosure requirements paragraph. The removal of these paragraphs also removes the reference to future land acquisitions and land right acquisitions.

SFFAS 35 Rescission

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A21. Although the majority of respondents agreed with the proposal to rescind SFFAS 35 and that reasonable estimates are permitted in the preparation of financial statements, this provision of the Statement generated many comments from respondents—including those respondents that were supportive.

Comment [MB16]: See 3. SFFAS 35 Recession in Staff Analysis Memo & Recommendations

A22. A common suggestion provided by many respondents was that reporting entities would benefit from the inclusion of language from paragraph 19[18] of the ED in SFFAS 6 and SFFAS 10 to clarify that the Board intended reasonable estimates to be applicable to any general PP&E versus just opening balances. Although the Board believes the broad statement provided in in the paragraph should be sufficient to address the matter, members agreed that including the provisions of paragraph 19 of the ED in SFFASs 6 and 10 may be clearer. Specifically, SFFAS 6 paragraph 26 and SFFAS 10 paragraph 16 were amended to include language specifying that although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used.

A23. Audit concern and that SFFAS 35 provides valuable guidance were the most prevalent reasons cited by respondents that disagreed with the proposal to rescind SFFAS 35. However, many of the detailed concerns expressed by respondents are addressed through existing guidance. The Board reiterates (as explained in the exposure draft) that Technical Release 13, Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment, would remain in effect after these amendments and that each significant provision of SFFAS 35 was incorporated in the proposed amendments – including the ability to use estimates in the future. In addition, the Board echoes the language provided in the exposure draft that reminded users that SFFAS 4, Managerial Cost Accounting Standards and Concepts established a requirement for cost accounting that acknowledged the use of cost finding techniques and included coverage of the use of allocating costs on a reasonable and consistent basis. The Board also believes it important to point out the Statement provides for the use of deemed cost to correct errors in the opening balances. Reporting entities are reminded that they should consider all available GAAP guidance when implementing new accounting standards.

Internal use software (IUS)

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A24. While the majority of respondents agreed with the proposal to allow a reporting entity to choose among alternatives in establishing an opening balance for internal use software

Comment [MB17]: See 4. IUS Issue in Staff Analysis and Recommendations memo

[18] "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35."

(IUS), there were several concerns expressed to the Board. Four respondents expressed concern with prospective capitalization of IUS, but agreed with deemed cost as an alternative method for IUS. The respondents did not believe component reporting entities should be able to adopt inconsistent alternatives when establishing an opening balance for IUS. In contrast, one respondent believed prospective capitalization of IUS should be the only option because this would enhance consistency while also appropriately balancing the value and cost of the information in the financial statements.

A25. The Board recognizes the concerns raised by respondents and considered them during the development of the Statement. While the Board understands the importance of consistency and comparability in financial reporting, the Board believes users of federal financial statements often have different objectives and may not necessarily compare asset values among various reporting entities in the way that users of financial statements do in a commercial setting.

A26. The Board considered the fact that there may be component reporting entities that currently receive clean audit opinions (such as working capital funds that that charge rates or others such as intelligence agencies) for which the prospective treatment would be undesirable. The Board determined that it would be best to provide optimum flexibility by providing for the option of deemed cost for IUS. Therefore, the Board agreed the Statement should allow for the alternatives in establishing opening balances for internal use software.

A27. The Statement requires that the application of a particular alternative must be consistent within each of the component reporting entities[19] prior to consolidation and the disclosures of alternatives (if different) adopted by each significant component reporting entity. The Board believes the disclosure requirements regarding the different alternative methods for establishing opening balances for IUS, if applicable, will allow sufficient comparability for users of federal financial statements.

A28. The Board believes allowing a reporting entity to choose among alternatives in establishing an opening balance for IUS remains the best option. Concerns regarding inconsistencies will resolve quickly due to the short useful life of IUS.

Other areas

A29. Certain respondents requested that clarifying language be added to the Statement to expand upon the phrase "one or more line items addressed by this Statement," to define line items as being line items on the financial statements or line items within the footnotes to the financial statements. The exposure draft addressed this point in the basis for conclusions. The Board acknowledges the term line item is quite broad, especially in relation to general PP&E. The preparer can use judgment to decide which line items he or she wishes to consistently present on the face of a financial statement and that is not something that should be specified within this Statement. In establishing opening account

[19] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

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Comment [MB18]: See 5. Line Item Issue in Staff Analysis and Recommendations memo

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balances for general PP&E for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, the presentation of line items on the face of the balance sheet may be at a detail selected by the preparer. For example, line items may be based on class of general PP&E, such as those included in the disclosures or a single line item for all of general PP&E.

A30. A respondent asked for clarification whether the standards apply to the government-wide reporting entity. It is the intention of the Board that all standards apply to any entity – component or government-wide unless otherwise stated. SFFAS 24, Selected Standards for the Consolidated Financial Report of the United States Government states that SFFASs "apply to all federal entities, that is, to the Government as a whole and to component entities …, unless provision is made for different accounting treatment in a current or subsequent SFFAS."

Comment [MB19]: See 6. Scope issues in Staff Analysis and Recommendations memo

~~A11.~~A31. Several respondents provided comments regarding "in-service dates." There appeared to be questions if the in-service dates for material improvements are the same as the base unit and if reporting entities should disregard the in-service dates for material improvements. The Board notes that the Statement is permissive. Material improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service but this treatment is not necessary.

Comment [MB20]: See 7. In-service dates in Staff Analysis and Recommendations memo

ALTERNATIVE VALUATION METHOD AND IMPLEMENTATION GUIDANCE

~~A12.~~A32. During deliberation on the project, the Board considered the recently-approved SFFAS 48, *Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials.* SFFAS 48 permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. Deemed cost, or the amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances, was the alternative valuation method for valuation of opening balances in accordance with SFFAS 3, *Accounting for Inventory and Related Property* in SFFAS 48.

~~A13.~~A33. The Board based part of its decision to select deemed cost in SFFAS 48 on International Public Sector Accounting Standards (IPSAS) 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.

~~A14.~~A34. Consistent with the decisions in SFFAS 48, the Board believes a similar approach is appropriate in this project. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for general PP&E. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 6, as amended where historical records and systems do not support such balances.

~~A15.~~A35. The Board determined permitting a reporting entity to apply alternative valuation methods in establishing opening balances for general PP&E would be most appropriate through implementation guidance. The implementation guidance for general PP&E currently resides in several Statements. Accordingly, this Statement amends SFFAS 6, SFFAS 10, and SFFAS 23, and rescinds SFFAS 35 by providing implementation guidance to allow a reporting entity to apply an alternative valuation method in establishing opening balances for general PP&E. Further, based on these amendments and rescission, all implementation guidance for general PP&E, with the exception of certain provisions applicable to internal use software, will be in SFFAS 6. The Board believes providing implementation guidance for all general PP&E in SFFAS 6 will provide a more inclusive approach and comprehensive guide for users versus reviewing multiple Statements that relate to this topic.

AMENDMENTS TO STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS

Amendments to SFFAS 6, Accounting for Property, Plant, and Equipment

~~A16.~~A36. This Statement amends SFFAS 6 implementation guidance to include alternatives for establishing opening balances. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for general PP&E for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The presentation of line items may be more or less detailed. For example, components of general PP&E, such as land, may be a separate line item, or there may be a single line item for all general PP&E.

A37. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 6, where historical records and systems do not support such balances. Accordingly, this Statement provides flexibility by permitting use of several measurement attributes and estimates. Deemed costs should be based on one, or a combination, of the following valuation methods: replacement cost, estimated historical cost, reasonable estimates, or fair value. The Board believes this is the most cost-effective option.

~~A17.~~ Plant replacement value (PRV)

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~~A18.~~A38. Using the DoD example, providing implementation guidance requires consideration of cost-benefit as well as the current resource constraints. For example, DoD has a dual challenge of establishing the baseline and a system capable of capturing the information to record the acquisition or construction of new general PP&E, thereby updating the information.

~~A19.~~A39. DoD currently uses plant replacement value (PRV) which is based on cost factors, such as averages of contractual cost data from the prior three years, commercially available cost data, and models using general price information. While PRV (a replacement cost model) has not been used for financial reporting purposes, DoD officials have stated it is used for decision-making and management purposes. This Statement allows for PRV to be used in establishing the opening balance for real property in current year dollars and not to be deflated to the in-service year. PRV is inclusive of capital improvements. Accumulated depreciation will be recognized based on the remaining useful life compared to the original useful life. This will not systematically understate the historical cost because~~since~~ capital improvements will not be deflated. However, by allowing current year costs, it may overstate the historical cost and subsequent years' depreciation expense.

~~A20.~~A40. Prior to issuing the ED, DoD raised concern regarding the definition of "replacement cost" from Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording.* DoD questioned whether the PRV method would qualify as replacement cost. As explained in paragraph 47 of SFFAC 7, there may be several ways of arriving at an estimate:

> Replacement cost is a remeasured amount, an entry value that is often advocated for assets used in providing services, such as capital assets and inventory not held for sale. Replacing the remaining service potential of an existing asset is not the same as acquiring an identical asset. However, in practice, it may be difficult to measure remaining service potential directly. There may be several ways of arriving at an approximation. For example, one way would be to measure the current cost of a similar asset, reduced by an appropriate amount to allow for the lower service potential of the existing asset due to its age and condition. Thus, the replacement cost of an asset is not the same as the fair value of either an equivalent new asset or the existing asset at the reporting date. For example, to arrive at the replacement cost of a fifty-year-old office building at the mid-point of its expected life, the fair value of an equivalent, newly constructed office building would have to be adjusted for the value of the difference in age or service potential. In addition, the fair value of the existing building may be higher than the replacement cost because the building can be put to alternative uses that produce greater benefits to the owner.

~~A21.~~A41. The Board cautions that although the PRV ~~method may qualify as replacement cost and~~ can be used in establishing the opening balance for real property, the PRV model and information supporting it would be subject to audit. Allowing PRV for opening balances does not provide assurance that the data and supporting information will be acceptable for audit. At the issuance of the ED, DoD was in the process of developing an approach to estimate the remaining useful life of real property assets, which is a key component to establishing the opening balances for real property. The Board stresses the importance of establishing useful lives and its significance to all general PP&E.

Government property in the hands of contactors

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~~A22.~~A42. Government property in the hands of contactors has been a challenging area for reporting entities. This may include government-furnished equipment and contractor-acquired equipment. Previous Boards believed the accounting treatment for such assets should be consistent with that of other assets ~~since~~ because there is no conceptual difference. Further, most would agree there should be accountability over government-owned assets in the hands of others.

~~A23.~~A43. SFFAS 6 paragraph 18 provides that PP&E includes "property owned by the reporting entity in the hands of others (for example~~e.g.~~, state and local governments, colleges and universities, or Federal contractors)" and paragraph 34 (along with note 34) elaborates that PP&E should be recognized when a title passes or is delivered to the acquiring entity or to an agent of the entity. For PP&E acquired by a contractor on behalf of the entity (for example, the entity will ultimately hold title to the PP&E), PP&E should also be recognized upon delivery, or constructive delivery, whether to the contractor for use in performing contract services or to the entity.

~~A24.~~A44. During the due process deliberation of SFFAS 23 in 2003, this issue also came up. A respondent, unaware of existing standards, encouraged the Board to develop standards that address this type of property because the respondent believed that "accounting control over this property is deplorable." As discussed in the Basis for Conclusions to SFFAS 23, the previous Board found that "despite the existence of standards for contractor held assets since late 1995, little progress has been made in resolving the issue. The Board does not believe that deferral of standards related to vast amounts of PP&E will facilitate resolution of the contractual and administrative details needed to reasonably comply with generally accepted accounting principles."

~~A25.~~A45. The Board understands that certain reporting entities may have long-standing contracts lacking the contractual terms and systems needed to accumulate the necessary information. The alternative valuation method—deemed cost—is applicable to general PP&E in the hands of others. The Board considered o~~O~~ther alternatives, including those proposed by DoD, to mitigate the cost of properly reporting on such PP&E ~~were considered~~. DoD's proposal ~~was~~ intended to ~~allow the DoD to~~ take a prospective approach[20] for establishing completeness and accountability for government property in the hands of contactors. Much of DoD's rationale was based on the belief that government property in the hands of contactors is immaterial and that the equipment has a short useful life. However, existing data have known integrity and reliability issues that preclude reliance on them as a basis for prospective treatment. DoD also based the proposal on the fact that they would incur significant costs to bring these assets to record. The Board notes that GAAP is not the only cost driver. DoD has other accountability obligations and a management need for complete records to support decision making.[21]

~~A26.~~A46. The Board concluded that the current DoD process of including improved contract clauses in new or modified contracts should continue. As existing contracts expire

~~[20] DoD's proposed approach was for those contracts which end prior to October 1, 2016. DoD would not perform procedures to identify property in the hands of contractors not accounted for to establish an opening balance. However, they also would not remove property in the hands of contractors currently recorded. DoD proposed recording the property prospectively at the end of the contract. DoD will record all new contracts from October 1, 2016 forward in accordance with GAAP.~~

[21] In a May 13, 2014, statement to the U. S. Senate Committee on Homeland Security and Governmental Affairs, then DoD Comptroller Robert Hale acknowledged the importance of completeness when he explained, "Our audit strategy focuses first on the elements of our business that most often influence our decision making—namely budgetary dollars and the existence and completeness of property records."

Comment [MB21]: Footnote not necessary since it was a proposed approach, this is not an approved or known approach. It was provided for purposes of the ED.

or are modified, this issue should be resolved. Based on preliminary estimated information presented by DoD, 77% of the current contracts expire in 2016 and 12% expire in 2017. Hence, assuming that these estimates are reasonably accurate, processes would be in place to capture government property in the hands of contactors by 2018 through issuance of new contracts with required clauses. Considering much of the information and data indicates the contracts for government property in the hands of contactors will expire soon and the assets may be immaterial or fully depreciated, with time DoD may be in a position to support that this line item is not materially misstated. This supports that accounting treatment for government property in the hands of contactors should continue to be consistent with general PP&E.

A47. The Board conducted outreach on this issue prior to issuing the exposure draft. Feedback from the audit community conveyed that the issues DoD encountered with property in the hands of contactors are the same for all DoD general PP&E. With respect to DoD's proposal, there were noted audit challenges due to gray areas, such as no firm cut-off date, the need for clarity with definitions, and complexities with implementation. In addition, there were noted existence and completeness challenges. There was also a belief that challenges would remain until the necessary contractual improvements were fully implemented.

~~A27.~~

Combination of valuation methods permitted

~~A28.~~A48. The Board recognizes that large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of a GAAP compliant method. Therefore, this Statement allows for deemed cost to include several valuation methods because the reporting entity may have components (1) using different methods simultaneously and/or (2) adopting a method permitted under SFFAS 6 at different times prior to establishing opening balances. Deemed cost ~~may~~ should be based on one, or a combination, of the accepted valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 6.

~~A29.~~A49. The purpose of this Statement is to provide an alternative valuation method for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of records and related assets, this is the most cost-effective approach for determining opening balances while reporting entities, such as DoD, finalize a sound GAAP compliant financial management system. All activity after the opening balances for general PP&E are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 6.

~~Land deliberations~~

~~A30. When deliberating general PP&E, the Board considered land somewhat differently from general PP&E. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance, both to program managers in operating their activities efficiently and effectively and to executive and congressional~~

Comment [MB22]: DoD suggestion since information is preliminary & evolving

Comment [MB23]: DoD suggestion since information is preliminary & evolving

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Comment [MB24]: As noted, Par. A31 – A33 moved up to A17-A18. Remainder removed as not necessary, it was needed for ED.

~~decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information. Because land is not depreciated, the benefits of capitalizing land are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and capitalized. In doing so, the period operating costs are not overstated. In future periods, the ongoing benefit is that accountability for the asset is established.~~

~~A31. The Board carefully considered those aspects of the land category along with measurement challenges, cost-benefit considerations, and the qualitative characteristics of financial information. The Board determined the most practical and cost-beneficial approach to establishing an opening balance for land was to permit the reporting entity to exclude land from the opening balance of general PP&E. However, the Board can support accountability through disclosures. The Board proposed that the reporting entity disclose, with a note reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. A reporting entity electing to exclude land from its general PP&E opening balance should continue to exclude amounts for future land acquisitions. Accordingly, the reporting entity will provide the disclosures each year thereafter.~~

~~A32. Some members who supported excluding land expressed concern regarding the resulting inconsistency in reporting and suggested the Board begin a project on land in the near future to review existing standards and consider a consistent approach. In addition, the members suggested exploring options to improve reporting on land. Other members would like to explore valuing existing land holdings based on deemed cost (consistent with general PP&E) or on a set amount per acre of land.~~

~~A33. For example, one study[22] estimated the land value in the United States at roughly $4.5 trillion in the third quarter of 2009.~~ Because~~Since the number of acres in the United States is almost 2.3 billion, this equates to approximately $2,000 per acre. Challenges in applying this method are many. Land values vary greatly based on location, potential use, and availability and cost of financing. In addition to establishing a relevant initial valuation, members would need to consider whether the valuation should be updated and, if so, how often. Nonetheless, these members are interested in receiving comments on the usefulness of a general valuation approach that could be applied to government-wide land classified as general PP&E.~~

~~A34. Two members do not believe that it is appropriate to revise current standards to allow write-off of all land acquired in connection with other general PP&E by selected federal entities for several reasons, including:~~

~~a. It is conceptually inconsistent to establish differing bases of accounting between two components for like assets -- in this case, land acquired for use in operations. Reporting land at zero cost is also inconsistent with the accounting for other general PP&E.~~

~~[22] Joseph B. Nichols, Stephen D. Oliner, and Michael R. Mulhall. Commercial and Residential Land Prices Across the United States. *Finance and Economics Discussion Series.* Federal Reserve Board. Divisions of Research & Statistics and Monetary Affairs. 2010-16.~~

~~b. Reporting some land classified as general PP&E at zero cost and disclosing acreage for other land does not provide complete, consistent information across government concerning land.~~
~~c. Developing a "temporary" change in the basis for accounting until the Board completes a broader reconsideration of accounting for land, which may be different, does not support consistent application of the qualitative characteristics.~~
~~d. There is insufficient time to adequately research, to consider, and to develop proposals for alternative valuation bases for land based on the Board's desired timeframes for revisions to standards for other property, plant, and equipmentPP&E.~~

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~~These members support either (1) adopting alternative valuation methodologies for land included in general PP&E, such as deemed cost (similar to other general PP&E) or a set amount per acre or (2) deferring any changes to the current historical cost basis for land classified as general PP&E for certain entities until the proposed Board project to re-examine the appropriate basis of accounting for all land is completed.~~

~~A35. The Board agrees that there is a need for a land project to review existing standards and to consider a consistent approach, but it does not resolve the immediate request for assistance with opening balances. DoD has made resolving general PP&E issues a priority area and requested guidance to avoid diverting DoD resources or taxpayer dollars in these areas to meet requirements. As noted, land is not depreciated, so the benefits of capitalizing land are primarily in the period of acquisition. In future periods, the ongoing benefit is that of accountability for the asset.~~

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~~A36. The Board notes that current standards provide that only land acquired in connection with development or construction of an item of general PP&E should be treated as general PP&E. As a result, vast amounts of land owned by the federal government, also known as "Stewardship Land," are not recognized on the balance sheet. Instead, reporting entities are required to reference a note on the balance sheet that discloses physical units by major land use. Because the reporting of land varies based on the intended use when land is acquired, the project will review existing standards and consider a consistent approach. Based on the results of that project the decisions made for opening balances and future acquisitions of land in this Statement may be revised.~~

~~A37. Therefore, the Board believes the proposal to allowing exclusion of land for opening balances with disclosure of acreage information is the least costly approach, while also ensuring accountability, until the Board completes the land project.~~

Amendments to SFFAS 10, Accounting for Internal Use Software

~~A38.~~A50. SFFAS 10 provides accounting standards for internal use software (IUS) used by federal entities. Previously, IUS had been addressed in SFFAS 6. Because certain questions remained, the Board decided to review the issue and to develop a separate Statement.

~~A39.~~A51. IUS addressed by SFFAS 10 includes purchased commercial "off-the-shelf" software, contractor-developed software, and internally-developed software. Under the provisions of SFFAS 10, IUS is classified as general PP&E as defined in SFFAS 6. With the issuance of SFFAS 10, the section on IUS in SFFAS 6 was rescinded. SFFAS 10 provided guidance regarding the definition of IUS, the types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, as well as other guidance.

~~A40.~~A52. When SFFAS 10 was issued, the previous Board in effect provided for prospective implementation of SFFAS 10 in paragraph 36 by stating that "cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred."

~~A41.~~A53. The Board acknowledges that reporting entities have had numerous years to implement SFFAS 10 (as well as other standards). The fact remains that some entities have not had or do not have systems that can provide the information necessary; therefore, the conditions remain that existed when many of these standards were issued. The Board considered certain unique aspects to ~~the~~ this category of general PP&E that justify a similar treatment that was provided when SFFAS 10 was established. Specifically, the Board believes it would be cost-beneficial to allow prospective treatment of IUS because it typically has a shorter useful life than other assets and is a soft asset that is harder to inventory when compared to tangible assets. These facts make the cost of implementation higher than for other general PP&E and the benefit lower due to the shorter time the IUS would be reported as an asset that would be amortized to expenses.

~~A42.~~A54. Therefore, the Board believes the most appropriate path is to amend the implementation guidance provided in SFFAS 10 to provide for prospective application of IUS if the reporting entity elects to do so. Considering the various stages of implementation within reporting entities, the Board determined that this Statement should provide flexibility. Therefore, the guidance also provides for an alternative valuation method consistent with general PP&E. Considering that IUS is classified as general PP&E, the Board believes it appropriate to allow use of deemed cost and to refer users to the deemed cost implementation guidance in SFFAS 6. Together, these amendments allow the preparer to elect ~~from these three options~~:

a. to establish opening balances for existing IUS based on deemed cost,

b. to establish an opening balance of zero and to capitalize costs consistent with SFFAS 10 prospectively, or

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

~~c.~~A55. Based on the flexibility offered for establishing opening balances IUS, a larger reporting entity may establish an opening balance for IUS based on a combination of multiple component reporting entities' alternatives, which may or may not be the same. Therefore, a larger reporting entity may have multiple component reporting entities[23] that selected different alternatives. This is permitted by the Statement; a larger reporting entity may

[23] SFFAS 47, *Reporting Entity*, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of component reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare GPFFRs. One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

Comment [MB25]: See 2. Disclosures Issue in the Staff Analysis and Recommendations Memo

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establish an opening balance based on a combination of these alternatives, but application of a particular alternative must be consistent within each of the component reporting entities prior to consolidation.

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

~~A43.~~A56. The purpose of SFFAS 23 was to amend certain standards with regard to national defense (ND) PP&E. More specifically, SFFAS 23 rescinded the term "ND PP&E."

~~A44.~~A57. SFFAS 23 also provided implementation guidance for assets reclassified as general PP&E. Much of that guidance referred to the requirements in the implementation guidance provided in SFFAS 6. SFFAS 23 was effective for periods beginning after September 30, 2002, with earlier implementation encouraged. The Board believes it appropriate to rescind the implementation guidance in SFFAS 23 and refer users to the implementation guidance in SFFAS 6 that applies to all general PP&E, including general PP&E assets previously considered ND PP&E.

~~A45.~~A58. By rescinding the paragraphs in SFFAS 23, the Board ensured the appropriate relevant guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board chose not to rescind SFFAS 23 in its entirety because the standards provide other amendments, such as rescinding the term ND PP&E as discussed above, that must be maintained.

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

~~A46.~~A59. The purpose of SFFAS 35 was to clarify that reasonable estimates of original transaction data's historical cost may be used to value general PP&E. It was to establish a cost-effective method to comply with SFFAS 6 by allowing reasonable estimates that were in accordance with SFFAS 6, as amended. While rescinding SFFAS 35 in its entirety, the Board ensured any pertinent guidance was included in the amendments to the SFFAS 6 implementation guidance. The Board did not incorporate language from SFFAS 35 that explicitly allowed for reasonable estimates on a go-forward basis to value general PP&E. Such wording has led to questions as to when estimates may or may not be used.

~~A47.~~A60. As explained in SFFAS 35, Basis for Conclusion paragraph A12:

> The Board stresses to federal entities that the measurement basis for G-PP&E remains historical cost; however, reasonable estimates are allowed. The Board believes entities should use judgment regarding the decision to use estimated historical cost in lieu of original transaction based data. The Board also notes that estimates are widely used throughout the financial statements. In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.

~~A48.~~A61. When SFFAS 35 was issued, the Board believed that allowing or encouraging estimates as reporting entities worked towards implementing systems and processes that could capture beneficial historical data. However, it appears that this has not occurred at all departments, and there has been an overreliance that was unintended. The language in

SFFAS 35 has often been misinterpreted to be something other than reasonable estimates that are in accordance with SFFAS 6.

~~A49.~~A62. Therefore, the Board believes it appropriate to rescind SFFAS 35. The Board acknowledges that reasonable estimates are permitted in the preparation of financial statements, with or without the existence of SFFAS 35. As noted in paragraph A17 of SFFAS 35, "estimates that do not lead to material misstatements are acceptable without guidance from the Board." The majority of the Board believes it would be clearer if SFFAS 35 were rescinded.

~~A50.~~A63. However, at least one member expressed concern with rescinding SFFAS 35 before soliciting input from the financial management community about (1) whether the rescission would send a signal that the Board no longer believes reasonable estimates are acceptable and (2) how other departments may be interpreting SFFAS 35 and the potential impact of the rescission of SFFAS 35. Therefore, the Board agreed to ask a detailed question for respondents on this topic.

~~A51.~~A64. Prior to the issuance of the ED, DoD raised concerns with the Board's proposal to rescind SFFAS 35 based on the time it will take for DoD to become full cost compliant. DoD requested the Board consider retaining SFFAS 35 or providinge~~e~~ transitional guidance in this area. The Board believes that current standards provide flexibility and that there are resources other than SFFAS 35 within the GAAP hierarchy to assist in this area. For example, there is guidance (Technical Releases) to assist in accumulating, allocating, and reporting the cost of general PP&E when there is not a detailed cost accounting system.

~~A52.~~A65. Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*, provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the general PP&E lifecycle, decisions regarding the granularity of cost information, and acceptable methods for recognizing those costs. This implementation guidance is not dependent on SFFAS 35 and would remain applicable even if SFFAS 35 is rescinded.

~~A53.~~A66. Additionally, SFFAS 4 established a requirement for cost accounting that acknowledges~~d~~ the use of cost finding techniques. The requirement is:

> Each reporting entity should accumulate and report the cost of its activities on a regular basis for management information purposes. Costs may be accumulated either through the use of cost accounting systems or through the use of cost finding techniques.

~~A54.~~A67. Management has discretion in applying the cost assignment methods identified in SFFAS 4, *Managerial Cost Accounting Standards and Concepts* to accumulate acquisition costs. Of particular importance is the emphasis on economic feasibility with regard to direct tracing of costs to outputs. SFFAS 4, paragraph 124, provides that "[in] principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

a. Directly tracing costs wherever economically feasible;
b. Assigning costs on a cause-and-effect basis; and
c. Allocating costs on a reasonable and consistent basis."

DISCLOSURES

~~A55.~~A68. The disclosures required are also included in the amendments to the implementation guidance in SFFAS 6 and 10. Specifically, the election to apply the provisions of this Statement should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The first reporting period would be the first year-end financial statement that an unreserved assertion is made. The Board does not believe the first reporting period should be an interim reporting period because interim financial statements presently are unaudited and do not include note disclosures.

~~A56.~~A69. The Board notes that the term “unreserved assertion” may be used in other contexts. For example, certain entities’ management (such as DoD) may be required to make management assertions regarding its financial information and that DoD financial statements are validated as ready for audit by no 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.

~~A57.~~A70. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required. This disclosure need not be repeated unless the financial statements or, as applicable, reports on line items are presented for comparative purposes.

~~A58. A reporting entity electing to exclude land should disclose this fact in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP and continue to be so as long as an amount is not reported on the balance sheet. In addition, those reporting entities electing to exclude an amount for land on the balance sheet should disclose, with a note reference on the balance sheet, the number of acres of land held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period. The Board believes requiring these disclosures would meet accountability requirements and ensure appropriate measures continue to be taken for existence and completeness requirements.~~

Comment [MB26]: See 1. Land issue in the Staff Analysis and Recommendations Memo

~~A59.~~A71. The disclosure requirements included in the amendments to SFFAS 10 are broader because the reporting entity may choose among alternatives for establishing an opening balance for internal use software. It provides for an alternative valuation method of deemed cost that is consistent with general PP&E and prospective capitalization of internal use software. A reporting entity electing to apply the alternative methods should disclose this fact and describe the alternatives used in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items, are presented fairly in accordance with GAAP. In the event different alternatives are applied by component reporting entities consolidated into a larger reporting entity, the alternative adopted by each significant component should be disclosed.

APPLICATION OF THIS STATEMENT

~~A60.~~A72. A component reporting entity that is in the process of implementing systems that are GAAP compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

~~A61.~~A73. Using the DoD example, certain DoD components may have transitioned at an earlier date to GAAP compliant systems; this allows them to assert independently of the larger DoD. DoD will~~ould~~ 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 the 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.

~~A62.~~A74. 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, because~~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 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. It is critical that a reporting entity be prepared to make the unreserved assertion because the election may only be made once. For example, if a reporting entity makes an unreserved assertion regarding the fiscal year 2018 beginning balances, the reporting entity must be able to support the valuation, in all material respects. If the audit for fiscal year 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 fiscal year 2018, or
b. accept a modified audit report until the reporting entity demonstrates compliance with SFFAS 6 (as amended), in all material respects.

~~A63.~~A75. Reporting entities that meet the conditions specified in paragraph 6 and elect to apply the alternative valuation method in establishing opening balances permitted by this

Statement are subject to the reporting requirements under paragraph 13 of Statement of Federal Financial Accounting Standards (SFFAS) 21, Reporting Corrections of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources. Specifically, paragraph 12 of SFFAS 21 states "…for the purposes of this standard, changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards."

~~A64.~~A76. Therefore, reporting entities meeting the conditions and electing to apply this Statement should follow the guidance in SFFAS 21 paragraph 13.a. – 13.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.

~~A65.~~A77. 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, then briefly describe deemed cost and indicate the effect of adoption on beginning net position.

~~A66.~~A78. In addition, alternative valuation methods provided in this Statement may be applied in correcting errors related to the opening balances discovered in later reporting periods if needed.

BOARD APPROVAL

A79. This Statement was approved TBD XXX unanimously. Written ballots are available for public inspection at FASAB's offices.

~~A67.~~

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APPENDIX B: ABBREVIATIONS

DoD	Department of Defense
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
IUS	Internal Use Software
ND	National Defense
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
PRV	Plant Replacement Value
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

APPENDIX C: GLOSSARY

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

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Fair Value- 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.

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Opening Balances- Opening balances are a~~A~~ccount 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.[24]

Replacement Cost- 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.

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Unreserved Assertion- An unreserved assertion is an unconditional statement.

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

FASAB Board Members

D. Scott Showalter~~Tom L. Allen~~, Chair

Gila J. Bronner

Robert F. Dacey

Michael H. Granof

Christina Ho

Sam M. McCall

Mark Reger

George A. Scott ~~D. Scott Showalter~~

Graylin E. Smith

~~Harold I. Steinberg~~

FASAB Staff

Wendy M. Payne, Executive Director

Melissa L. Batchelor

Federal Accounting Standards Advisory Board

441 G Street, NW, Suite 6814

Mailstop 6H19

Washington, D.C. 20548

Telephone (202) 512-7350

Fax (202) 512-7366

www.fasab.gov