



August 10, 2016

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Clarification of IUS under development / SFFAS 50– **Tab C**¹

MEMBER ACTIONS REQUESTED:

- Respond to staff question (p.4) by August 22nd
- Prepare to approve staff recommendation or provide alternatives

OBJECTIVE

The objective of this session is to consider a letter from the Department of Defense (DoD) requesting clarification of the recently issued Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending SFFAS 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*. Specifically, DoD requested clarification of how future costs relating to internal use software under development at the time the opening balance is established should be treated.

BRIEFING MATERIAL

The staff analysis is attached along with questions for the Board on page 4. You may electronically access the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>.

Attachment 1- DoD Letter to FASAB (dated August 10, 2016)

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.

MEMBER FEEDBACK

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 batchelorm@fasab.gov with a cc to paynew@fasab.gov.

BACKGROUND

SFFAS 50 was issued August 4, 2016. As you know, we worked quickly to ensure that it was issued before September 30 so that it would be available for reporting entities to implement. We anticipated certain implementation issues may result and envisioned the release of additional guidance (Interpretation, Technical Release, Technical Bulletin, and/or Staff Implementation Guidance). Staff is requesting the AAPC Committee add a project to provide additional guidance.

STAFF ANALYSIS

SFFAS 50 provides for prospective capitalization of internal use software (IUS):

- Opening balance for existing IUS based on deemed cost
- Opening balance of \$0 and apply SFFAS 10 prospectively
- Opening balance of \$0 for IUS in service and to establish an opening balance for IUS in development based on deemed cost, and to apply SFFAS 10 prospectively.

However, some have questioned how the future costs relating to IUS under development should be treated. Or specifically, the interpretation of SFFAS 50 paragraph 36.d.ii.a. [As requested in DoD's letter, see Attachment A.]

Staff has included SFFAS 50 paragraph 36.d. below:

d. Alternative Methods. A reporting entity should choose among the following alternative methods for establishing an opening balance for internal use software. Because a reporting entity may have multiple component or subcomponent reporting entities^{9C} selecting different alternative methods, a reporting entity should establish an opening balance based on one, or a combination, of these alternative methods. However, application of a particular alternative method must be consistent within each individual subcomponent reporting entity prior to consolidation into the larger component reporting or reporting entity.

^{9C} 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 subcomponents that may themselves prepare general purpose federal financial reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR.

- i. Alternative Valuation Method. Deemed cost^{9D} is an acceptable valuation method for opening balances of internal use software. See SSFAS 6 paragraph 40.d. for implementation guidance regarding deemed cost.
- ii. Prospective capitalization. The reporting entity may choose prospective capitalization of internal use software. If the reporting entity elects prospective treatment, the reporting entity should choose between the following acceptable alternative methods 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 (deemed cost) provided in paragraph 36.d.i.

SFFAS 50 par. 36e. states “Once established using alternative methods, opening balances are considered consistent with GAAP.” While it appears clear that the provisions of SFFAS 10 would apply after opening balances are established, questions have come up. Staff also notes that the intent of SFFAS 50 was to provide a cost effective means forward for reporting entities to implement GAAP. Therefore, the Board may wish to consider the most cost-effective means forward for this area.

The intent of the Board in paragraph 36.d.ii.b appears clear; whereas 36.d.ii.a. is somewhat vague as it relates to IUS with a beginning balance of zero.

Staff notes that when reporting entities opt to exclude land and land rights from opening balances, the language is clear that future acquisitions should be expensed. While this is different and a project was underway and there are clear standards in SFFAS 10, staff simply wanted to note that there is a need for clarification. Therefore, staff believes the Board should clarify this through an interpretation.

Staff Recommendation:

Staff recommends that this issue be clarified through an Interpretation of SFFAS 50 consistent with DoD’s request that future costs related to IUS under development at the opening balance date also not be capitalized.

^{9D} Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

Questions for the Board:

Does the Board agree with the staff recommendation to issue an Interpretation?

Or alternatively, does the Board prefer to issue a lower level guidance?

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NEXT STEPS

If the Board agrees with the staff recommendation, staff will present a draft Interpretation for review and approval at the October 2016 Board meeting. Alternatively, if Board members prefer another option (different approach or lower level guidance) staff would request Board members contact me as soon as possible.

ATTACHMENT - 1



OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

AUG 10 2016

COMPTROLLER

The Members of the Federal Accounting Standards Advisory Board (FASAB)
441 G St. NW
Washington, DC 20548

Dear FASAB Board Members:

The Department of Defense (DoD) is in the process of fully implementing the Statements of Federal Financial Accounting Standards (SFFAS). We are requesting a clarification of the reporting requirements prescribed in paragraph 36.d.ii of SFFAS 10, as amended by SFFAS 50.

Paragraph 36.d.ii. provides acceptable prospective alternative valuation methods for internal use software. Paragraph 36.d.ii. (a) provides the following: “Exclude all internal use software, **inclusive of that under development at the opening balance date**, from the opening balance” (emphasis added).

Paragraph 36.d.ii.(b) provides the following: “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**” (emphasis added).

The DoD intends to implement alternative (a), and believes that for Internal Use Software (IUS) projects with development costs excluded at the opening balance sheet date, development costs after the opening balance sheet date on those same IUS projects should be expensed. Any new IUS projects starting after the opening balance sheet date will be accounted for in accordance with the existing full cost and capitalization requirements described in SFFAS 10.

This approach allows the DoD to efficiently allocate its resources toward the objective of establishing and sustaining an auditable operational environment conducive to achieving the prospective implementation of SFFAS 10. To that end, please advise whether or not FASAB’s intent or interpretation is consistent with the DoD’s implementation methodology described above. If our interpretations are consistent, we recommend that FASAB codifies this in the appropriate form of pronouncement or guidance.

We appreciate your consideration on this matter and look forward to your response.

Sincerely,

Alaleh A. Jenkins
Assistant Deputy Chief Financial Officer

