



December 4, 2014

Memorandum

To: Members of the Board

From: Melissa Loughan, Assistant Director

Through: *Wendy M. Payne*
Wendy M. Payne, Executive Director

Subj: DoD Implementation Guidance Request Project Plan – **Tab D**¹

OBJECTIVE

The objective of this session is to provide the Board with the project plan for the Department of Defense (DoD) Implementation Guidance Request project and an update, including a briefing from FASAB's contractor from AOC Solutions Mr. Norwood Jackson.

BRIEFING MATERIAL

The proposed Project Plan is attached to this transmittal memorandum. You may electronically access all of the briefing material at <http://www.fasab.gov/board-activities/meeting/briefing-materials/>.

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

Attachments:

Attachment A- Project Plan

Attachment B- Contractor Prepared- December Project Status Briefing Paper

Attachment C- DCFO Letter to FASAB (dated February 21, 2014)

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.

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Attachment A
DoD Implementation Guidance Request
PROJECT PLAN



December 2014



Why

Why is the DoD Implementation Guidance Request Project needed?

- DoD PP&E, inventories and operating materials & supplies continue to be cited as an underlying material weakness contributing to the government-wide disclaimer.
- The Board's mission is accomplished in a large degree through the availability of implementation guidance.
- The Board should identify any voids that may exist in standards.



What

What issues does the project plan to address?

- use of reasonable baseline estimates of the cost of inventory and operating materials & supplies
- treatment of deployed assets
- timing of capitalization of research and development



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DOD- IMPLEMENTATION GUIDANCE REQUEST PROJECT PLAN

Purpose:	This project is being undertaken by FASAB because the Department of Defense (DoD) identified six areas of concern for the board's consideration. The purpose of this project is to address three areas the board believes may warrant FASAB action separate from ongoing projects or that cannot be addressed through other appropriate channels. These areas are (1) use of reasonable baseline estimates of the cost of inventory and operating materials, (2) accounting treatment of deployed assets, and (3) timing of capitalization of research and development efforts given spiral development efforts. The DoD also requested guidance on the treatment of (1) in-kind lease payments, (2) contract financing payments, and (3) revolving fund activities. Based on staff <i>preliminary</i> research, it appears these areas will not need FASAB action. In-kind lease payments will be addressed through the ongoing project on lease accounting. Contract financing payments was resolved by internal DoD action. DoD questions regarding revolving fund activities relate to budgetary reporting and can be resolved through consultation with the Office of Management and Budget.
Applicability:	This project applies to the government-wide reporting entity and to component reporting entities that prepare and present general purpose financial reports in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, <i>The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board</i> .
Objectives:	FASAB will assist DoD by providing practical guidance to resolve long-standing issues identified by DoD. Specifically, the primary objectives will be to resolve the issues within the framework of existing accounting standards and where necessary provide the appropriate guidance to address remaining issues.
Assigned staff:	Melissa Loughan
Other resources:	Contractor support for certain aspects as well as a task force if deemed necessary. The board recognizes that active DoD participation is needed to address these long-standing concerns.

Timeline: September 2014 – October 2014

- Contract issued
- Research & Background
- Project Planning
- Kick off Meeting with DoD

October 2014 – January 2015

- Meetings with DoD components, including 2nd follow-up meetings as necessary
- Status Report to the Board at the December 2014 meeting

February 2015 – June 2015

- Status Report to the Board at the February 2015 meeting
- Deliberate issues and options at the April and June meetings

July 2015- December 2015

- Develop due process documents

January 2016– May 2016

- Issue ED

June 2016 –August 2016

- Consideration of comment letters and Public Hearing as needed
- Staff drafts final SFFAS based on responses to ED and board member deliberation of comments.

August 2016 Meeting

- Board approval of final SFFAS before it is transmitted to sponsors and for a 45-day Congressional review.

February 2017

- Final SFFAS issued

PROPOSED APPROACH

I. Background

In response to the Department of Defense (DoD) request of February 21, 2014, the Federal Accounting Standards Advisory Board initiated a project to address three areas identified by the DoD as areas of concern.

The purpose of this project is to address (1) use of reasonable baseline estimates of the cost of inventory and operating materials & supplies (SFFAS 3), (2) treatment of deployed assets, and (3) timing of capitalization of research and development efforts. The primary objectives will be to resolve the issues within the framework of existing accounting standards and where necessary provide the appropriate guidance to address remaining issues. FASAB staff determined the following approach and is subject to change as research is complete.

Requested Guidance Area:	Approach :
Inventory and Operating Materials & Supplies (SFFAS 3) – extend the use of reasonable baseline estimates (application of SFFAS 35, <i>Estimating the Historical Cost of General PP&E</i>)	Potential for FASAB action or AAPC technical release. FASAB (with contractor support) will consider whether guidance can reduce the cost of implementation and, if so, provide guidance. If not, provide staff guidance clarifying that SFFAS 35 may be applied. [See Contractor Briefing Paper]
Treatment of deployed assets ² – is it appropriate to expense at time of deployment?	Potential for FASAB action or AAPC technical release. This area will also be addressed with contractor support. [See Contractor Briefing Paper]
Research and Development – determine the proper timing of capitalization in a changing R&D world.	Potential for FASAB action or AAPC technical release. FASAB has not developed comprehensive R&D standards. Issues relating to the timing of capitalization may be addressed through the AAPC. Other issues may require FASAB consideration. Based on FASAB’s review of the 2015 Budget, DoD has approximately \$64.4B for R&D. ³

The Board has contracted with AOC Solutions (specifically, the program executive is Mr. Norwood Jackson) to identify and analyze options for guidance on operating materials and supplies (OM&S) and the proper treatment of deployed assets. The successful achievement of the objectives of this project is dependent on the involvement of senior officials from DoD.

² Treatment of deployed assets or classes of deployed assets-- it should be understood that deployed assets must first be accounted for as PP&E. This deals with whether expensing historical cost at time of deployment - when the only thing that changes is the location – is appropriate.

³ Meetings with the appropriate individuals and offices in this area are anticipated in the near future.

II. Consider Existing Concepts, Standards and Other Guidance and Reports:

Based on staff's review of existing SFFASs, key standards pertinent to this project are:

- SFFAS 3, *Accounting for Inventory and Related Property*
- SFFAS 6, *Accounting for Property, Plant, and Equipment*
- SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*
- SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*
- Interpretation 7, *Items Held for Remanufacture*
- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*

Because of the importance of SFFAS 3, 6, 23, 35, Interpretation 7, TR13, and TR 15, staff believed it important to provide a brief summary.

Statement of Federal Financial Accounting Standards 3, *Accounting for Inventory and Related Property* provides accounting standards that apply to several types of tangible property, other than long term fixed assets, held by federal government agencies. The areas of importance for this project relate to inventory and operating materials and supplies.

Inventory Held For Sale

The standards require reporting of inventory by categories as follows: (1) inventory held for sale, (2) inventory held in reserve for future use, (3) excess, obsolete, and unserviceable inventory, and (4) inventory held for repair.

The standards require historical cost or latest acquisition cost valuation of inventory held for sale and inventory held in reserve for future sale. The standards permit use of any other valuation method (e.g., standard cost) which reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. The standards do not provide for use of the last-in, first-out cost flow assumption or lower of cost or market valuation. When latest acquisition cost valuation is used the inventory is revalued periodically and an allowance account is established for unrealized holding gains and losses.

Excess, obsolete and unserviceable inventory is to be valued at net realizable value. Inventory held for repair is to be valued at either historical cost or latest acquisition cost less an allowance for the estimated repair cost.

Operating Materials and Supplies

Operating materials and supplies are to be accounted for under the consumption method and valued at historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. In addition, categories for (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies must be reported.

An exception to the consumption method is provided when (1) the operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method. In any of these events, the purchases method may be used.

Board members are encouraged to review SFFAS 3, *Accounting for Inventory and Related Property* at http://fasab.gov/pdf/files/handbook_sffas_3.pdf

Statement of Federal Financial Accounting Standards 6, *Accounting for Property, Plant, and Equipment* accounts for Federally owned property, plant, and equipment (PP&E). Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and
- they have been acquired or constructed with the intention of being used, or being available for use by the entity.

Property, plant, and equipment also includes:

- assets acquired through capital leases, including leasehold improvements;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.

Property, plant, and equipment excludes items (1) held in anticipation of physical consumption such as operating materials and supplies⁵ and (2) the Federal entity has a reversionary interest in.

All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use.

SFFAS 6 also addresses expense recognition and removal of general PP&E for disposal, retirement, or removal from service. It also provides disclosure requirements.

Board members are encouraged to review SFFAS 6, *Accounting for Property, Plant, and Equipment* at http://fasab.gov/pdf/files/handbook_sffas_6.pdf

Statement of Federal Financial Accounting Standards 23: *Eliminating the Category National Defense Property, Plant, and Equipment* rescinded the term “ND PP&E” and those items are classified as general PP&E. Accordingly, the cost of these items are capitalized and, with the exception of the cost of land and land improvements that produce permanent benefits, depreciated. This Statement also notes that all entities are permitted to use the composite or group depreciation methodology to calculate depreciation. The capitalization amount for G-PP&E assets previously considered ND PP&E should be based on historical cost in accordance with the provisions of SFFAS 6, as amended, and should be the initial historical cost for the base unit, including any major improvements or modifications. When establishing the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended, reasonable estimates may be used.

Board members are encouraged to review SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment* at http://fasab.gov/pdf/files/handbook_sffas_23.pdf

Statement of Federal Financial Accounting Standards 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* clarifies that reasonable estimates of original transaction data historical cost may be used to value general property, plant, and equipment (G-PP&E). The use of reasonable estimates is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and do not yet have adequate controls or systems to capture these costs. In addition, these amendments also apply in those cases where entities have decided to use estimates to determine the historical cost values of G-PP&E.

Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of existing G-PP&E, in accordance with the asset recognition and measurement provisions provided. Estimates may be based on

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

Board members are encouraged to review SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* at http://fasab.gov/pdf/files/handbook_sffas_35.pdf

Interpretation 7: *Items Held for Remanufacture*

The interpretation was provided in response to a request from the DoD and provides guidance relating to items subject to overhaul or repair. The overall objective remained

recognition of historical cost information while allowing flexibility in classification based on DoD practices. The interpretation defines items "held for remanufacture" as those in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. "Items held for remanufacture" share characteristics with "items held for repair" and items in the process of production and may be aggregated with either class. The interpretation explicitly notes that management should use judgment to determine a reasonable, consistent and cost-effective manner to classify processes as "repair" or "remanufacture." Guidance on valuation is also provided.

Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment* addresses the historical cost estimating of G-PP&E. The guide provides direction on types of estimating methodologies and the documentation to support the valuation estimates of G-PP&E. This guidance provides a foundation for preparers to exercise judgment in formulating those estimates.

The examples outlined in TR13 illustrate the use of various estimating methodologies to derive the historical cost of G-PP&E in accordance with SFFAS 35. SFFAS 35 clarifies that federal entities should report their G-PP&E based on historical cost information in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended. The specific examples in this guidance are how agencies derived estimated historical costs using the following methods:

- a. Deflation of current replacement costs,
- b. Appraisals (with deflation to the year of purchase),
- c. Expenditures,
- d. Budgets and appropriations, and
- e. G-PP&E in possession of Contractors.

Board members are encouraged to review TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment* at http://fasab.gov/pdf/files/handbook_tr_13.pdf

Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* promotes an understanding of organizational considerations that affect the application of the standards for general property, plant, and equipment (G-PP&E) except for internal use software. The implementation guidance relates to recognition requirements for programmatic, managerial, administrative, and other elements of program costs incurred during the G-PP&E lifecycle, decisions regarding the granularity of cost information, and acceptable methods for recognizing those costs. It also relates to the concept of a cost accumulation and allocation decision framework (i.e., acceptable methods of accumulating, assigning, and reporting cost data), and management's role in applying the cost accumulation, assignment, and allocation decision framework.

Illustrations provide examples to depict the Asset Acquisition Lifecycle Phases listing the phase, cost activity, recognition and recognition per entity internal accounting basis.

Board members are encouraged to review Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* at http://fasab.gov/pdf/files/handbook_tr_15.pdf

Other relevant concepts and SFFACs and SFFASs would be the following:

Concept Statements:

SFFAC 1: Objectives of Federal Financial Reporting

SFFAC 5: Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements

SFFAC 6: Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information

SFFAC 7: Statement of Federal Financial Accounting Concepts 7: Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording

Standard Statements:

SFFAS 40: Deferred Maintenance and Repairs: Definitional Changes

SFFAS 42: Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32

SFFAS 44: Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use

Other Reports

KPMG Study (under contract to DoD): *Report on the Evaluation of National Defense PP&E Reporting Approaches*, to assist the FASAB in its deliberations, the Department of Defense (DoD) engaged KPMG LLP (KPMG) to: (1) develop a tutorial for the FASAB to assist it in understanding the complexity of the DoD ND PP&E acquisition process, (2) evaluate various ND PP&E accounting and reporting approaches and, (3) recommend an approach that will provide users of DoD financial statements with meaningful and analytically useful ND PP&E information that can be implemented reasonably by the DoD.

KPMG evaluated four ND PP&E accounting and reporting approaches: (1) capitalizing and reporting ND PP&E on the balance sheet, (2) capitalizing and reporting ND PP&E as Required Supplementary Stewardship Information (RSSI), (3) reporting units of ND PP&E as RSSI, and (4) reporting ND PP&E investments as RSSI. KPMG concluded that none of the foregoing approaches alone satisfies all of the financial reporting objectives or the operational needs of the DoD. Consequently, they developed an

alternative approach that includes several informational components for consideration by the FASAB. KPMG recommended that the standard on accounting for, and reporting of, ND PP&E provide for the capitalization on the balance sheet of ND PP&E acquisition programs. The Board developed an exposure draft proposing a similar approach. The proposal was not acted on because the DoD subsequently requested that the category of ND PP&E be eliminated.

GAO-10-695, Department of Defense: *Additional Actions Needed to Improve Financial Management of Military Equipment*, Published: Jul 26, 2010- GAO found that weaknesses that impaired the department's ability to identify, aggregate, and account for the full cost of military equipment it acquires comprised seven major categories. Specifically, DOD had not (1) maintained support for the existence, completeness, and cost of recorded assets; (2) structured its contracts at the level of detail needed to allocate costs to contract deliverables; (3) provided guidance to help ensure consistency for asset accounting; (4) implemented monitoring controls to help ensure compliance with department policies; (5) defined departmentwide cost accounting requirements; (6) developed departmentwide cost accounting capabilities; and (7) integrated its systems. GAO made 11 recommendations intended to strengthen actions DOD has taken to begin improving its ability to identify, aggregate, and account for the cost of military equipment acquired through major defense acquisition programs. Specifically, the recommendations focused on the need to define departmentwide cost accounting requirements and develop the process and system capabilities needed to support cost accounting and management. DOD concurred with the recommendations.

The full report can be found at <http://www.gao.gov/products/GAO-10-695>.

III. Resources

The Board has contracted with AOC Solutions (specifically, the program executive is Mr. Norwood Jackson) to identify and analyze options for guidance on operating materials and supplies (OM&S) and the proper treatment of deployed assets. Mr. Jackson, CPA, is a recognized leader in Federal accounting, auditing, and business operations with over 38 years of experience serving various governmental organizations in accounting, auditing, and business process assessment and improvement. Mr. Jackson has 40 Years of experience in accounting, auditing, and business process analysis and improvement with a focus on the federal government during the past 23 years. He is a former member of the Federal Accounting Standards Advisory Board, Comptroller General's Advisory Council on Government Auditing Standards, Auditing Standards Board of the American Institute of Certified Public Accountants and former deputy Controller of the Office of Federal Financial Management at the Office of Management and Budget.

The use of a Task Force will be determined as we get further into the research phase of the project. However, it is important to note that while it may not be considered an official task force, a working group and points for contact for the project have been established. This was compiled with the assistance of the Office of the Under Secretary of Defense, Comptroller in preparation of the kick off meeting for the project.

IV. Research Steps

Staff has begun initial research of relevant accounting standards, reports and GAO reports. See above.

Staff has also begun review of DoD policies and procedures—specifically the Department of Defense Financial Management Regulation (DoD FMR) which can be found at http://comptroller.defense.gov/FMR/vol1_chapters.aspx.

Staff has also considered recent financial statements and other reports and will provide excerpts of pertinent information in briefing papers as appropriate.

POTENTIAL PROJECT MANAGEMENT CONCERNS

The successful achievement of the objectives of this project is dependent on the involvement of senior officials from DoD—including from the Office of the Undersecretary of Defense – Comptroller (OUSD-C) and each of the Military Departments. In addition, representatives from the OUSD-C and Military Departments must be in a position to help define the information needed for analysis and provide that information timely as well as available to discuss the feasibility of accounting alternatives.

Objectives of the project and success factors were conveyed in a kick-off meeting held on September 30, 2014.

The objective of this session is to provide the Board with the project plan for the DoD Implementation Guidance Request project and to keep the board informed of efforts on this project.

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.

AOC Solutions, Inc.

Chantilly, Virginia

Federal Accounting Standards Advisory Board Project

Valuation of Inventory and Related Property and Deployed Property, Plant, and Equipment

**December 17, 2014 Project Status
Briefing**

Norwood (Woody) Jackson, CPA
AOC Solutions Project Manager

Introduction

Project Tasks

Provide professional support to assist the FASAB with identifying and analyzing options for: (1) guidance on the valuation of legacy inventory and operating materials & supplies (OM&S) covered by SFFAS 3, *Accounting for Inventory and Related Property*, which will attain the objectives of SFFAS 3 while reducing the implementation cost and (2) the proper treatment¹ of deployed assets or classes of deployed assets such as those unlikely to return to a U. S. base.

Results to Date in Brief

Inventory and Related Property (See Attachment 1)

Department of Defense (DoD) Military Departments and the Defense Logistics Agency (DLA) have adopted Moving Average Cost (MAC) for inventory valuation with exceptions for certain inventory types (e.g., munitions, which are managed by the Army and valued at LAC). With respect to baseline valuation at transition to MAC, the DLA completed a comprehensive review of historical data to arrive at the MAC value; the Navy used latest acquisition cost (LAC) values at transition; the Army used LAC or valuation data from the Army Master Data File (AMDF); and the Air Force used (and continues to use) a combination of historical and current procurement values to arrive at MAC for all material inventories. We have not met with the Marine Corps yet.

With respect to the Army, we are waiting for additional information on valuation methods used at transition and currently in use, including the legacy systems used by the Army to account for inventory and related property. We also have questions about information already provided, specifically the valuation of inventory and related property in the AMDF, which the Army indicated was the basis for the valuation of inventory in its ERP, the Logistic Modernization Program (LMP). The AMDF is not a valuation method, it is a system. Accounting for munitions is another area

¹ Treatment of deployed assets or classes of deployed assets -- it should be understood that deployed assets must first be accounted for as PP&E. This task deals with whether expensing historical cost at time of deployment - when the only thing that changes is the location - is appropriate.

that requires followup inquiry given the Army's role in munitions management.

With respect to the Air Force, we have followup questions intended to obtain a better understanding of the data and method used to arrive at MAC.

Principal Items are centrally managed and the questionnaire did not explicitly address these items. We have now submitted questions to the Military Departments pertaining to accounting for Principal Items. Principal Items are almost half of the value of Inventory and Related Property.

In the weeks ahead, we anticipate submitting questions to the Military Departments pertaining to valuation of reparables and to obtain information needed to clarify responses to questions asked earlier.

Deployed Property, Plant, and Equipment (PP&E)

In our initial meeting to begin the project the attendees from all Military Departments stated their belief that deployed PP&E should not be expensed. They stressed that this would create significant accounting problems, for example, each Military Department would have to obtain a record of deployed PP&E at the time of deployment, expense the PP&E, and record it upon return from deployment. Some representatives also pointed out that there are current policies for reporting and accounting for destroyed PP&E. The representatives indicated that the DoD has policies and procedures to account for PP&E destroyed or transferred to other governments. This appeared to be a consistent theme in subsequent meetings with Military Departments and the Acquisitions, Technology, and Logistics (AT&L) Property and Equipment (P&E) Program Office. Attendees at meetings indicated DoD is required to account (and ensure proper accountability) for PP&E notwithstanding its location. The attendees also believed that expensing deployed PP&E may be conceptually unsound.

We expect to hold additional discussions on this subject in January.

Inventory and Related Property

Project Approach

- Identify applicable accounting standards
- Identify DoD policies, processes, and systems used in the valuation of inventory and operating materials and supplies
- Identify systems valuation information, including valuation approaches to establish baseline estimates at transition to historical cost
- Identify current inventory valuation methods
- Identify systems analytical capabilities where necessary

Applicable Accounting Standards

Statement of Federal Financial Accounting Standards (SFFAS) No. 3, *Accounting for Inventory and Related Property*.

SFFAS No. 3 provides for accounting for inventory and related property at historical cost. It allows the use of latest acquisition cost (LAC), which prices inventory at the last invoice price, but requires a revaluation to historical cost at least annually. The revaluation results in an unrealized holding gain or loss.

SFFAS No. 3 defines inventory as “Tangible personal property that is (1) held for sale, (2) in process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee.”

SFFAS No. 3 defines operating materials and supplies (OM&S) as “tangible personal property to be consumed in normal operations.”

SFFAS No. 3 also addresses inventory held for repair, which is significant to DoD. In the DoD vernacular, inventory held for repair is identified as “reparables.” SFFAS No. 3 provides for the valuation of inventory held for repair in one of two ways: (1) the allowance method or (2) the direct method.

- “Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established. The allowance is a contra-asset account. The annual (or other period) credits required to bring the repair allowance to the current estimated cost of repairs shall be recognized

as a current period operating expense. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.”

- “Under the direct method, inventory held for repair shall be valued at the same value as serviceable item less the estimated repair costs. When the repair is made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.”

Exception to Valuation: SFFAS No. 3 provides an exception to the historical cost valuation requirement. “Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine approximate costs, and (2) immediate marketability at quoted prices, and unit interchangeability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.”

The exception to valuation provision of SFFAS No. 3 is relevant to DoD. As the project has developed to date, we understand that Military Department legacy inventory systems did not retain a historical cost record. Rather its systems revalued the inventory value to the last unit purchase price (i.e., LAC). The verifiability of revaluations from LAC to historical cost has been questioned. Consequently, in 2003 DoD adopted Moving Average Cost (MAC) as its formal inventory valuation policy. The issue then became valuation at transition to MAC.

Applicable DoD Policies

DoD 7000.14-R Department of Defense Financial Management Regulations (FMRS), Volume 4, Accounting Policy

Section 0105, paragraph B requires the use of historical cost using MAC

DoD Principal Inventory Systems

- **Defense Logistics Agency (DLA)**
 - Legacy system:
 - Standard Automated Materiel Management System (SAMMS)
 - Current system:
 - Enterprise Business System (EBS), an enterprise resource planning (ERP) solution
- **Department of the Navy**
 - Legacy system:
 - Material Financial Control System (MFCS)
 - Current system:
 - ERP
- **Department of the Army**
 - Legacy systems: To be determined.
 - Current system: Logistics Modernization Program (LMP)
- **Department of the Air Force:**
 - Legacy systems:
 - Stock Control System (SCS), which has multiple modules that share data tables, is used at the Depot level (DLA sites) to track spare parts and consumables
 - Standard Base Supply System (SBSS) is used to track spare parts and consumables at the base level
 - Defense Medical Supply System (DMLSS)
 - Cadet Administration Management Information System (CAMIS)
 - Current system:
 - Legacy systems. The Air Force ERP is under development
- **Marine Corps:** Not yet scheduled
 - Legacy system:
 - Current system:

Inventory Valuation Methodology Currently and at Transition to MAC

- **Defense Logistics Agency**
 - DLA's EBS system values inventory at moving average cost (MAC).
 - DLA transitioned to MAC in the 2002-2004 timeframe.
 - DLA engaged in an extensive review of its historical records maintained in its data warehouse and other sources to develop a baseline historical cost record for each inventory item (identified by National Stock Number (NSN)).
 - DLA recorded the developed MAC value in EBS.
 - DLA now uses its ERP for inventory accounting.
- **Department of the Navy**
 - The Navy's ERP values inventory at MAC.
 - The Navy fully transitioned to MAC in 2014.
 - The Navy used latest acquisition cost (LAC) as the baseline inventory values at the time of transition to its ERP. The Navy's legacy systems did not have a record of historical cost.
 - The Navy indicated that inventory outside of the working capital fund is not accounted for in the ERP.
- **Department of the Army**
 - For LMP Deployment 1
 - Corpus Christi Army Depot (CCAD) and Tobyhanna Army Depot (TYAD) used:
 - Latest Acquisition Cost (LAC) for the Supply Management Activity (SMA) inventory valuation
 - Army Master Data File (AMDF) for Depot Maintenance Army (DMA) inventory valuation
 - For LMP Deployment 2
 - Aviation Missile Command (AMCOM) and Letterkenny Army Depot (LEAD) used:
 - Army Master Data File (AMDF) for Supply Management Activity (SMA) inventory valuation

- Corpus Christi and Letterkenny Army Depots used:
 - Army Master Data File (AMDF) for both Supply Management Activity (SMA) and Depot Maintenance Army (DMA) Inventory
 - For LMP Deployment 3
 - Tank-automotive & Armaments Command (TACOM), Joint Munitions Command (JMC) and corresponding Depots, Arsenal and AMMO Plants used:
 - Moving Average Cost (MAC) file provided by TACOM to load Inventory into LMP at MAC.
 - Group LMP Deployment For TACOM and Non-Army Managed Items (NAMI):
 - Used AMDF
 - All "SMA" inventories are non-Army managed materials (predominantly DLA with some GSA).
 - Data Source for D2 and the TACOM NAMI Group was:
 - 1st source – Logistics Support Activity (LOGSA) Logistics Integrated Data Base (LIDB)
 - 2nd source – Federal Logistics Information System (FLIS); Defense Logistics Information Service (DLIS)
 - 3rd source – Commodity Command Standard System (CCSS) (estimated or standard price per unit); Standard Depot System (SDS).
 - Army personnel cannot confirm the data source(s) for D1.
- **Department of the Air Force:**
 - The Air Force values inventory and related items at MAC except for munitions, medical inventory, Air Force Academy inventory, and the Consolidated Sustainment Activity Group (CSAG) Maintenance OM&S inventory.
 - The Air Force calculates its MAC value using data from multiple systems. For example, quantity data may come from one or more systems while cost data may come from other systems.
 - Inventory quantities are obtained from the Standard Base Supply System (SBSS) and the Financial Inventory Accounting and Billing System (FIABS, a module within the Stock Control System)

- The Stock Control System (SCS) maintains both LAC and MAC information; however, the reported MAC values are calculated periodically using cost and item count data from the Standard Base Supply System (SBSS) and Financial Inventory Accounting and Billing System (FIABS) along with new procurement values. The values obtained from systems (older values) are weighted with new procurement units and values to arrive at MAC for each inventory item (identified by National Stock Number (NSN) or National Identification Number (NIN)).
 - Munitions are valued at LAC. The Air Force's valuation is subject to the Army's valuation method for munitions. The Army is the custodian for approximately 50% of the Air Force's munitions.
 - Medical inventory is valued at LAC. Medical inventory has a very high turnover rate (approximately 200 times annually) with the exception of items held in war reserves. Consequently, LAC approximates MAC.
 - Air Force Academy inventory is valued at LAC. Academy inventory turns over approximately 100 times annually. Consequently, LAC approximates MAC.
 - Consolidated Sustainment Activity Group (CSAG) Maintenance Division inventory is valued using a weighted average costing methodology and expensed as used in the repair and refurbishment of end items (e.g. planes)
- **Marine Corps:** To be scheduled

Deployed Property, Plant, and Equipment

Project Approach

- Identify accounting standards applicable to PP&E
- Identify DoD PP&E accounting policies
- Obtain a definition of deployed PP&E
- Obtain an understanding of conditions under which PP&E is deployed
- Develop criteria for use in defining PP&E subject to a deployment standard
- Determine the PP&E subject to a deployment standard
- Develop guidance on accounting for PP&E at the time of deployment and the return from deployment

Applicable Accounting Standards

- SFFAS 6, *Accounting for Property, Plant, and Equipment*
- SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment*

Applicable DoD Policies

- DoD 7000.14-R Department of Defense Financial Management Regulations (FMRS), Volume 4, Accounting Policy, Section 0107, Subsection 010701

Project Status

We provided a questionnaire to each Military Department to obtain an understanding of how they define deployed PP&E and whether they have policies that address accounting for deployed PP&E. We received a completed questionnaire from the Army and general comments from the Navy

representatives during our meeting with representatives from the Navy Financial Management office. We have not received a completed questionnaire from the Air Force and have yet to meet with the Marine Corps.

In our materials for guiding our meetings with the DoD Comptroller and Military Department representatives we provided the following questions to assist with this project task.

1. Is there a common definition of deployed PP&E?
2. Are there policies that address accounting and management of deployed PP&E?
3. If there are policies that address accounting and management of deployed PP&E, could you provide a list of the principal policies?
4. Do PP&E accounting and management systems distinguish or identify deployed PP&E?
5. Are there issues associated with accounting for and the management of deployed PP&E?
6. Who are the contact persons we should work with as this project proceeds?

In individual meetings with Military Department representatives the representative from one Department indicated that his Department returned all capitalized PP&E from deployment. PP&E destroyed during deployment was reported using standard reporting mechanisms and accounted for accordingly. The Army responses to our questionnaire follow. In summary, the Army has a mechanism for accounting for PP&E regardless of whether it is deployed, however defined. In addition, the Army reports that it has a mechanism for reporting destroyed PP&E and PP&E transferred to other sovereign governments. The Air Force responses to our deployment questions are forthcoming. We have not met with the Marine Corps. The Army's responses to the Deployed PP&E Questionnaire follows.

- **Is there a common definition of deployed PP&E?**

The Army does not distinguish between deployed or home station equipment management. Accountability and reporting requirements remain the same.

- **Are there specific policies that address accounting and management of deployed assets?**

No. Accountability and accountability management policies remain the same. The SECARMY can approve War Time specific procedures which simplify procedures in a combat zone, but accountability requirements remain.

- **What are the systems used to account for PP&E and deployed PP&E?**

In both deployed and non-deployed environments Property Book Unit Supply Enhanced (PBUSE) (soon GCSS-Army), Army War Reserves Deployment System (AWRDS) and LMP are used to account for retail and wholesale Tangible Asset property, respectively. These systems are only used to account for and manage Tangible Assets.

- **Do PP&E accounting and management systems distinguish between deployed and non-deployed PP&E?**

Not the equipment, but the equipment location. In PBUSE an Installation code is associated with all units (UICs) and Department of Defense Activity Address Code (DODAACs) along with their associated TAC1, 2, and 3 addresses. The TAC reflects the deployed or home station locations.

- **Are there issues associated with accounting for and the management of deployed PP&E?**

No. Not as long as deployed organizations adhere to published standards and guidance issued by the theater chain of command.

- **What is the mechanism for reporting PP&E destroyed or transferred to other entities?**

Destroyed Tangible Assets are determined to be a loss to the unit through the DD 200 Financial Liability Investigation of Property Loss (FLIPL) process, and when the FLIPL is approved, the equipment is coded (title transferred)- out in PBUSE.

Property transfers:

Intra Army transfers between tactical units through lateral transfer procedures laid out in AR 710-2-1, section III through PBUSE.

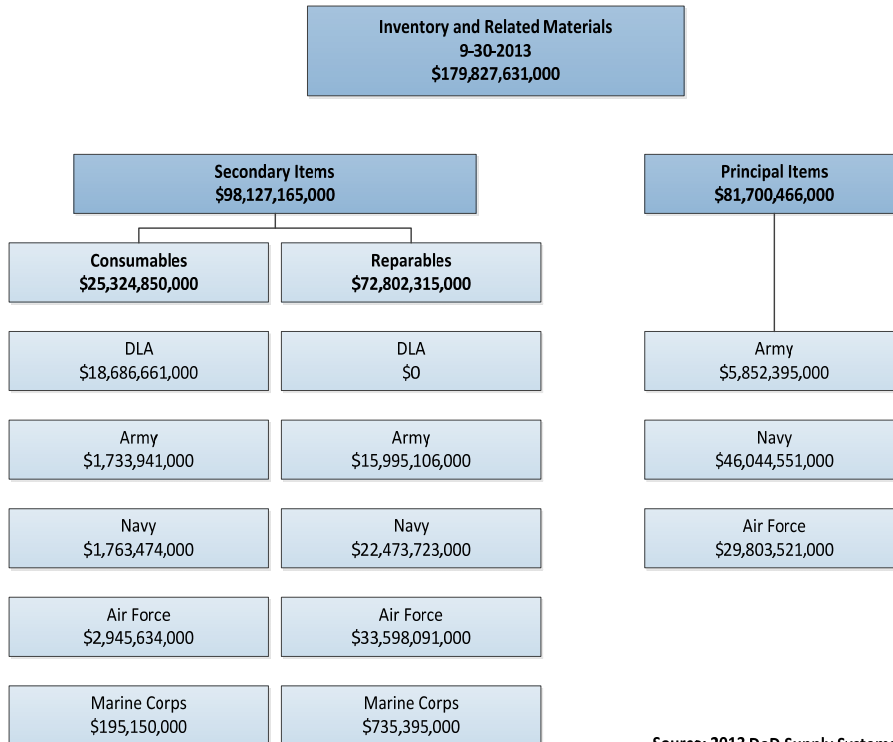
Transfer of Army equipment to other departments/agencies (Air Force, Marines, Navy, DOS) requires SECDEF endorsement. The losing organization will use the SECDEF approval as supporting documentation to drop the equipment from Army Accountability in PBUSE or LMP. These processes are laid out in AR710-2.

Army Equipment identified for transfer to foreign nations is known as Foreign Excess Personal Property (FEPP) – FEPP nominations are approved through DOS to SECDEF and once approved, the losing entity conducts a financial liability investigation for property loss to document the FEPP, recognize its loss to the United States, and removes those items from the property book.

Equipment divested or disposed through DLA-DS. The DLA provides screening, demilitarization, and disposal or sale of equipment transferred from the unit to DLA under DD 1348-1A (issue or turn in document) . Proceeds from property or scrap sales go to offset the DLA DS bill. US Munitions List or Commerce Control List Equipment or property, marked for disposal, will not be transferred to a non-DOD entity.

Attachment 1

**Inventory and Related Property
Amounts Held by Military Departments**



Source: 2013 DoD Supply Systems
Inventory Report

Attachment 1**Inventory and Related Property
Definitions****Secondary Items**

Secondary Items include Consumables and Reparables.

Consumables: An item of supply or an individual item (except explosive ordnance and major end items of equipment) that is normally expended or used up beyond recovery in the use for which it is designed or intended.

Reparables: An item of supply subject to economical repair and for which the repair (at either the depot or field level) is considered in satisfying computed requirements at any inventory level.

Principal Items

An end item or a replacement assembly of such important to operational readiness that management techniques require centralized individual item management throughout the supply system to include items stocked a depot level, base level, and using unit level.

Principal items do not include complete aircraft, ships, tanks, helicopters, other combat and tactical vehicles, ICBMs, intermediate range ballistic missiles, or space vehicles

Principle Items Include:

- Weapons
- Major aircraft subsystems and related equipment
- Major ship subsystems, small craft and related equipment
- Munitions and related equipment
- Tank, combat, and tactical vehicle subsystems
- Support vehicles and railway equipment
- Electronics, communications, control and information systems, and related equipment
- Propulsion systems, aircraft engines, and related equipment
- Uncategorized major equipment



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FEB 21 2014

COMPTROLLER

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548

Dear Ms. Payne:

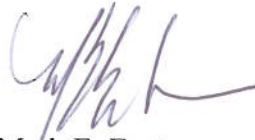
The Department of Defense (DoD) appreciates the opportunity to provide input on the Federal Accounting Standards Advisory Board (FASAB) Three-Year Plan and Annual Report. The DoD proposes six projects for FASAB consideration.

- 1) Statement of Federal Financial Accounting Standards (SFFAS) 35, "Estimating the Historical Cost of General Property, Plant and Equipment," permits the use of reasonable estimates to determine historical cost values of property, plant, and equipment. The DoD requests a similar standard for inventory and operating materials and supply (OM&S). Inventory and OM&S valuations, such as moving average cost, are also based on historical cost. Extending the use of reasonable baseline estimates for inventory and OM&S would assist DoD in properly valuing its inventory and OM&S.
- 2) There are long-standing disagreements about the proper reporting of certain contract finance payments for property, plant, and equipment (PP&E). The accounting disagreement concerns the types of contract financing payments regulated by the Federal Acquisition Regulation used during the construction or acquisition of PP&E assets and as it relates to the use of the "construction work in process" account. SFFAS 6 states, "PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agency of the entity. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E." Under certain fixed price contracts, the DoD makes financing payments which are not based on progress completed. The DoD generally is not liable for the goods being produced until DoD accepts them. Therefore, DoD has reported these contract financing payments as advances. SFFAS 1 states, "Advances are cash outlays made by a Federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or as advance payments for the cost of goods and services the entity acquires." Clarifying the proper recording treatment of these payments, as advances or construction in process, would support DoD audit readiness efforts.

- 3) In fulfilling its mission, the DoD deploys PP&E assets across the world. Many times, these assets are destroyed or are become unusable. At times, it is more cost-effective not to return the assets to the United States. Therefore, the possibility of expensing rather than capitalizing deployed assets may be a more appropriate accounting treatment for these assets. FASAB consideration of this possibility is appreciated.
- 4) Revolving Fund or business-type activities are largely ignored in Federal accounting standards. They receive budget authority through offsetting collections, contract authority, and borrowing authority. These business-type organizations are required to follow appropriation type guidance, while performing service for fee or maintaining supplies for sale. There is little authoritative guidance for them to follow. Developing reporting/accounting guidance for Revolving Fund activity (business-type enterprise) in the Federal Environment would assist these types of organizations.
- 5) FASAB is currently developing revisions to SFFAS 10, "Accounting for Internal Use Software," primarily due to changes in how these assets are developed. They are no longer following a "waterfall" methodology. The same analysis needs to be reviewed for other types of research and development. Determining the proper timing of capitalization in a changing research and development world requires a new review.
- 6) FASAB has begun reviewing accounting for leases in its review of SFFAS 5, "Accounting for Liabilities of the Federal Government," and SFFAS 6, "Accounting for Property Plant and Equipment." In the changing economic environment, Federal agencies have begun using in-kind lease payments, rather than collecting rental fees. In-kind lease payment examples include free or reduced utility expenses, new construction, leasehold improvements, easements, and others. Recommend FASAB develop guidance to account for in-kind lease payments. None currently exist.

Please contact Ms. Maryla E. Engelking if you have any questions. You can reach her by email at maryla.e.engelking.civ@mail.mil or by phone at 703-602-0155.

Sincerely,



Mark E. Easton
Deputy Chief Financial Officer