Federal Accounting Standards Advisory Board

August 14, 2015

Memorandum

To: Members of the Board

From: Melissa L. Batchelor, Assistant Director

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials - **Tab I2**[1]

MEETING OBJECTIVES

To make decisions on issues regarding the exposure draft and review the Draft Statement, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*.

BRIEFING MATERIAL

The staff analysis is attached along with questions for the Board on page 9. You may electronically access all of the briefing material at http://www.fasab.gov/board-activities/meeting/briefing-materials/.

Attachment A - Staff Analysis and recommendations

Attachment B - Draft Statement, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials* (Marked Version)

Attachment C- Draft Statement, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials* (Clean Version)

Attachment D – Amendments to SFFAS 3, *Accounting for Inventory and Related Property* (Marked Version) [pars. 17- 56, Inventory, OM&S and Stockpile Materials]

[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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BACKGROUND

The exposure draft, Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials, was issued June 2, 2015 with comments requested by July 20, 2015. Staff provided the comment letters and summary in the first board distribution.

NEXT STEPS

Staff will consider the Board member comments on the Draft Statement and determine if the document can move to the pre-ballot stage and be ready for balloting at the October 2015 meeting.

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

Attachment A- Staff Analysis

After considering the comments, staff notes that all respondents (with the exception of one respondent that did not specify agreement or disagreement) agreed with the proposal.

Staff believes certain issues identified by respondents could be clarified within the Statement or addressed in the Basis for conclusions. Similar comments from respondents are grouped together.

Scope

Three respondents (KPMG, GWSCPA FISC and DOL OCFO) provided comments that related to scope (see D. Listing Of Additional Comments from Respondents comments numbered # 2, 12, and 16.) However, the comments differed. For example, KPMG suggested that clarifying language be added to the scope paragraph to express it is restricted to DoD entities but GWSCPA FISC suggested that references to DoD in the basis for conclusions be removed as it may limit the applicability considering other organizations may be required to implement through the adoption of SFFAS 47. KPMG also suggested that if the scope is not restricted to DoD entities, that the Board incorporate guidance to further clarify when the Statement is not applicable, such as what is done in the International Public Sector Accounting Standard (IPSAS), No. 33, First-Time Adoption of Accrual Basis International Public Sector Accounting Standards, paragraph 3(a)-(c), as follows:

> It does not apply when, for example, a first-time adopter:
>
> (a) Stops presenting financial statements in accordance with prescribed requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with accrual basis IPSASs;
>
> (b) Presented financial statements in the previous reporting period in accordance with prescribed requirements and those financial statements contained an explicit and unreserved statement of compliance with accrual basis IPSASs; or
>
> (c) Presented financial statements in the previous reporting period that contained an explicit and unreserved statement of compliance with accrual basis IPSASs, even if the auditors modified their audit report on those financial statements.

Staff Recommendation: Staff recommends adding guidance to further clarify when the Statement is not applicable, such as what is done in the International Public Sector Accounting Standard (IPSAS), No. 33. Additionally, small edits will be made to the Basis for Conclusions that appear to limit the applicability.

Question for the Board: Does the Board agree with the staff recommendations to clarify the scope?

Terminology/Definitions

Certain respondents suggested additional terms be included in the definitions and that definitions be slightly modified:

Two respondents (KPMG and DoD OIG) stated the term “unreserved assertion” should be defined.

GWSCPA FISC suggested that FASAB define the “initial amount” measurement approach, perhaps in a footnote, and also include discussion of how it relates to SFFAS 3. KPMG explained they were unclear why “initial amount was included in parenthesis in paragraph 10 and suggested removing or explaining its purpose.

KPMG suggested that the definition of deemed cost should not include the phrase “as used in this Statement” because once a term is defined in FASAB literature it should be considered a universal term that could be used in future Statements.

KPMG explained the definition of opening balances contains a footnote that states that the definition is “adapted” from U.S. Auditing Standards-American Institute of CPAs (Clarified). The definition in paragraph 8 of the ED is identical to the definition provided in AU-C 510, Opening Balances – Initial Audit Engagements, Including Reaudit Engagements. KPMG suggested instead of implying that the definition was changed (“adapted”), that footnote 2 state, “Adopted from AU-C 510, Opening Balances – Initial Audit Engagements, Including Reaudit Engagements (AICPA Professional Standards).”

Staff Recommendation: Based on the suggestions, staff suggests adding a definition for unreserved assertion and a footnote for initial amount measurement approach. (Staff notes that the footnote added to paragraph 2 was in previous versions of the Draft but appears that it might have mistakenly been dropped with an edit to the paragraph.) Staff also recommends editing the definition for deemed cost and opening balances as suggested.

Question for the Board: Does the Board agree with the staff recommendation to add a definition for unreserved assertion and a footnote for initial amount measurement approach?

Alternative Valuation Methods for Opening Balances and Effect on Existing Standards-Amendments to SFFAS 3

Two respondents (KPMG and DOL OIG) noted potential confusion or inconsistency with the wording used in the alternative valuation methods for opening balances. (see D. Listing Of Additional Comments from Respondents comments numbered # 4, 5, 6, 7, and 22) DOL OIG explained that there was inconsistency because deemed cost was considered an acceptable alternative valuation method and that it provided for several valuation methods, some of which were allowed under SFFAS 3. There was question about how the alternative valuation method differs from other valuation methods which approximate historical cost and whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods. Staff believes that all methods should remain, including those allowable under SFFAS 3. As explained in the BFC, there is the possibility that deemed cost may consist of SFFAS 3 methods and other methods, so the Statement should allow for that. Along those lines, two respondents (GWSCPA FISC and KPMG) provided comments on the section related to Effect on Existing Standards. GWSCPA FISC explained that the modifying language to SFFAS 3 refers to the new Standard as "implementation guidance" and they recommend that a different term be used and KPMG believed that the information provided was not drafted as an amendment to SFFAS No. 3.

Based on these comments staff believed that providing an amendment SFFAS 3 to incorporate the alternative valuation method for opening balances would clarify any differences and address the concerns. Specifically, staff is recommending in response to the confusion in the comment letters that pertinent provisions of this proposed Statement be added to SFFAS 3 and that the term latest acquisition cost (LAC) be removed from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance). While, technically a reporting entity may still use other valuation methods which approximate historical cost, the revision avoids the confusion between the LAC in deemed cost and the LAC that is equivalent to historical cost (inclusive of the valuation allowance). See **Attachment D – Amendments to SFFAS 3, *Accounting for Inventory and Related Property* (Marked)** for the proposed Amendments to SFFAS 3.

KPMG also suggested that the term "may" as used in paragraph 10 of the ED as exposed presents an auditability challenge and recommended it be changed to "should." KPMG also suggested certain revisions to exclude methods that are allowable under SFFAS 3 because that would not be alternative methods. Staff does not agree with this suggestion. Staff believes the Statement's intent is to be permissive with allowable methods and would not want to restrict it by using the term "should." Instead, staff believes the wording should be as open as possible in case there are other methods not considered and staff has suggested a small wording edit to expand the possible alternatives. Further, the paragraph leading up to the list of allowable items explains that deemed cost "may be based on one or a combination of valuation methods." As stated above, staff believes that all methods should remain, including those allowable under SFFAS 3. As explained in the BFC, there is the possibility that deemed cost may consist of a consolidation of SFFAS 3 methods and other methods, so the Statement should allow for that.

Staff Recommendation: Therefore, staff recommends incorporating amendments as detailed in the "Effect on Existing Standards-Amendments to SFFAS 3, *Accounting for Inventory and Related Property*" and reflected in **Attachment D – Amendments to SFFAS 3, *Accounting for Inventory and Related Property* (Marked)** to incorporate the alternative valuation method for opening balances in SFFAS 3. Staff also recommends a small edit to the paragraph that precedes the list of alternatives to provide for other methods not considered.

Questions for the Board: Does the Board agree with the staff recommendation to amend SFFAS 3, Accounting for Inventory and Related Property?

Does the Board have any questions regarding the proposed amendments?

Disclosure Requirements

Three respondents (KPMG, GWSCPA FISC and DOD IG) relayed comments about the disclosure requirements (See D. Listing of Additional Comments from Respondents comments numbered #8, 15, 20, and 21.)

> GWSCPA FISC stated that when presenting comparative information (e.g., in the year following adoption), generally accepted accounting principles would require that the organization provide additional disclosures that are necessary to make the financial statements more informative. They suggested the Statement clarify whether this disclosure is required in the subsequent year when an agency is presenting comparative financial statements, or whether a phrase similar to what was included in SFFAS 21,paragraph 13(c) ("Financial statements of subsequent periods need not repeat this disclosure") be included in the final Statement. Staff believes language can be added to make this clear.
>
> KPMG noted that there appeared to be an inconsistency with the disclosure language and the Basis for Conclusions language in paragraph A18 because it appeared it implied subsequent reporting to disclose the use of deemed cost until the valuation is at historical cost based on turnover rate. While staff does not agree with this assessment, staff will make the basis clearer and consistent with the Statement.
>
> The DoD OIG suggested clarification on what is meant by first reporting period and stated this would add clarity to the guidance because the first reporting period in which the reporting entity makes an unreserved assertion could be quarterly statements or interim financial statements versus a year end financial statement. They also stated that the required disclosure and description of the method should be made in the notes for each of the interim financial statements applicable to the first period in which the reporting entity makes an unreserved assertion, in addition to the year-end financial statements. They also suggested that the board consider adding a requirement for the amount of the deemed cost be disclosed.
>
> The first reporting period would be the first reporting period (which is typically year-end) that an unreserved assertion is made and that in which full financial

statement disclosures are required. Staff researched the FASAB pronouncements and reporting period is used consistently without explanation as it is commonly known what is meant that it is the year-end—there was one instance where it was noted “as of the end of the fiscal year (or other reporting period if applicable).” It is difficult to foresee that one would interpret it to mean interim statements considering these are unaudited and often not subject to full note disclosures. Staff believes adding language to describe reporting period in this instance may pose additional questions or leave it open to interpretation if it isn’t addressed in future standards. As for the suggestion for disclosure of an amount related to deemed cost, it does not seem appropriate as the intent was to provide a cost effective approach for DoD in this situation. This was explained in the basis for conclusion.

Staff Recommendation: Staff recommends adding language to the disclosure paragraph to clarify subsequent year reporting and comparative year reporting. Staff recommends adding “Financial statements 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.” Staff also recommends revisions to the basis for conclusions to ensure it is consistent and additional language to address the other comments.

Question for the Board: Does the Board agree with the staff recommendation to add language to the disclosure paragraph to clarify subsequent year reporting and comparative year reporting?

COMMENTS REQUIRING NO CHANGES

Based on staff’s analysis and consideration of the following comments, staff did not believe any further action was required:

Obsolete Inventory

One respondent (AGA FMSB) explained that implementing this standard may have an issue of obsolete inventories of supplies, materials and other stockpiled items. The FMSB believes that the standard should include guidance relative to this matter. Organizations that implement this guidance may be inclined to assign a deemed cost of $0 to obsolete items. To properly account for such items, guidance should prohibit the organization from assigning a deemed cost of zero dollars to obsolete items to avoid a write-down in value.

Other categories-Excess, Obsolete, and Unserviceable are addressed in SFFAS 3 and they should be valued at their estimated net realizable value. In addition, with providing the amendments to SFFAS 3 and attachment, the structure should be clearer that it doesn't apply to the other categories-Excess, Obsolete, and Unserviceable.

Evidential Matter

KPMG suggested that the document clearly explain in the basis that the purpose of this Statement is to provide alternative valuation methods for opening balances, however, it does not eliminate the reporting entity's responsibility to maintain evidential matter to support the valuation method(s) selected.

Staff believes that the basis does explain the purpose of the Statement in several places, with the emphasis on alternative valuation method. For example, see paragraphs A19-A24 and A29 which specifically discusses that DoD should ensure issues such as supporting documentation are addressed and validated through sampling or other means prior to making an unreserved assertion. However, staff will consider other ways to strengthen the language and clarify.

Effective date

The DOL OCFO noted several comments regarding the effective date of FY 2017 with earlier implementation encouraged.

Staff notes the important point is that an entity must elect to apply this Statement and deemed cost; it isn't a requirement that is placed upon them, so they are not required to do something in a short period of time. By making the Statement effective sooner with early implantation, it allows components that may have transitioned at an earlier date to an SFFAS 3 compliant system to assert independently of larger component entity, such as DoD.

Staff included several additional questions on the list of Questions for the Board.

Questions for the Board

1. **Does the Board agree with the staff recommendations to clarify the scope?**

2. **Does the Board agree with the staff recommendation to add a definition for unreserved assertion and a footnote for initial amount measurement approach?**

3. **Does the Board agree with the staff recommendation to amend SFFAS 3, *Accounting for Inventory and Related Property*?**

4. **Does the Board have any questions regarding the proposed amendments?**

5. **Does the Board agree with the staff recommendation to add language to the disclosure paragraph to clarify subsequent year reporting and comparative year reporting?**

6. **Does the Board generally agree with staff's recommended language to the basis for conclusions to address comments?**

7. **Does the Board have any other comments or questions on the Draft Statement?**

8. **Would the Board like to proceed to a pre-ballot Draft?**

Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards 48

Comment [ML1]: Staff made changes to convert the ED to a DRAFT Statement and accepted most of those changes (versus tracking) for ease of reading. Therefore, members won't see the executive summary was replaced with a summary, transmittal, request for comments and questions and other items were deleted, etc.

December 15, 2015

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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SUMMARY

This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. This method is permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

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

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INTRODUCTION

PURPOSE

1. This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials. These assets are addressed in Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*.

2. While SFFAS 3 addresses six types of tangible property, only inventory, operating materials and supplies (OM&S), and stockpile materials are required to be valued using the "initial amount" measurement approach.[1] An opening balance consistent with this requirement may not be available when a reporting entity begins presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB). This Statement is intended to provide a cost-effective approach to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3.

Comment [ML2]: Footnote added. Two respondents suggested that initial amount measurement approach be explained. As explained in the staff memo, this footnote was in a previous draft but appears to have been dropped. See GWSCPA FISC and KPMG letter

MATERIALITY

3. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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

~~PROPOSED~~ STANDARDS

SCOPE

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

5. This Statement may only be applied in establishing **opening balances**[2] for the reporting period that the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. ~~The alternative valuation methods permitted in this Statement may not be applied to transactions or events that increase the balance of inventory, OM&S, and stockpile materials after opening balances are established. Thus, a reporting entity applying this Statement must be prepared to comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.~~ This Statement would not apply when an entity:

   a. Stops presenting financial statements, or one or more line items addressed by this Statement, in accordance with GAAP after having previously presented in accordance with GAAP;

   b. Presented financial statements, or one or more line items addressed by this Statement, in previous period(s) in accordance with GAAP; or

   ~~a.~~c. Presented financial statements or one or more line items addressed by this Statement in previous period(s) in accordance with GAAP, even if the auditors issued a modified opinion.

~~5.~~6. This Statement does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are the subject of:

   a. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and

   b. Specific transitional requirements in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by the FASAB.

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Comment [ML3]: After considering KPMG's comment regarding this sentence and discussion among staff, this sentence and the following sentences weren't deemed necessary or appropriate for a scope paragraph. The flow appears much better with what remains and the addition.

Comment [ML4]: To clarify when Statement would not be applicable. See KPMG comment

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

DEFINITIONS

~~6.~~7. **Deemed Cost**— ~~As used in this Statement, "deemed cost" is an a~~Amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

8. **Opening Balances**—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

Comment [ML5]: Footnote corrected. See KPMG comment.

~~7.~~9. **Unreserved Assertion**—An unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.

Comment [ML6]: Provide clarity by defining as suggested by KPMG & DoD OIG

ALTERNATIVE VALUATION METHOD FOR OPENING BALANCES

~~8.~~10. Deemed cost is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials for the reporting period that the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

~~9.~~11. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of ~~any of the following~~ valuation methods, including:[4]

Comment [ML7]: This wording change expands the possible alternatives. While we do not know of others (at DoD) it should be permissive, not limit or restrict.

a. Standard price (selling price)[5] or fair value[6]
b. Latest Acquisition Cost (LAC) Method[7]
c. Replacement cost[8]
d. Estimated historical cost (initial amount)
e. Actual historical cost (initial amount)

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[3] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).~~Adapted from U.S. Auditing Standards-American Institute of CPAs (Clarified), AU-C Glossary- Glossary of Terms.~~

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

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

[6] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)

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

[8] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

~~10.~~12. Once established using deemed cost, opening balances are to be considered consistent with ~~SFFAS 3 requirements~~GAAP. ~~Opening balances should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had an SFFAS 3 valuation method been used~~. No distinction or breakout of the deemed cost amount in ~~amounts arising from~~ the opening balances is required.

Comment [ML8]: Clarification based on comments and with amendment

DISCLOSURE REQUIREMENTS

~~11.~~13. A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. Financial statements of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

Comment [ML9]: To clarify subsequent year reporting and comparative year reporting See comments from GWSCPA FISC and KPMG

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

14. This section amends Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property* as described in the following paragraphs.

Comment [ML10]: Incorporating amendments to provide clarity based on comments

15. Paragraph 20 is replaced with the following paragraph: "Valuation. Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost."

16. Paragraph 22, the last sentence is amended by removing "(e.g., a standard cost system)".

17. Paragraphs 23-25 are rescinded to remove the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance).

18. Paragraph 26 is replaced by the following paragraph which expands the exception to valuation in SFFAS 3 to incorporate the Alternative Valuation Method for Opening Balances provided in this Statement.

Valuation Method for Opening Balances and Exceptions to Valuation.

a. **Alternative Valuation Method for Opening Balances[9].** The alternative valuation method described in paragraph iv. is acceptable when a reporting entity is

[9] 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.

presenting financial statements, or one or more line items, following GAAP promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[10] that its financial statements, or one or more line items are presented fairly in accordance with GAAP.

ii. The application of this method based on the second condition is available once per reporting entity. The alternative valuation method would not apply when an entity:
   1. Stops presenting financial statements or one or more line items using the methods addressed by this paragraph in accordance with GAAP after having previously presented in accordance with GAAP;
   2. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP; or
   3. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP even if the auditors issued a modified opinion.

iii. The use of the alternative valuation methodology does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are subject to the:
   1. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and
   2. Specific transitional guidance in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by FASAB.

iv. Deemed cost[11] is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of valuation methods, including :
   a) Standard price (selling price) or fair value
   b) Latest Acquisition Cost (LAC) Method
   c) Replacement cost
   d) Estimated historical cost (initial amount)
   e) Actual historical cost (initial amount)

[10] An unreserved assertion is an unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.
[11] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

v. Disclosure requirements – A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first 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 of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. Exceptions to Valuation

i. An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:

1. Units of which are interchangeable,
2. Units of which have immediate marketability,
3. Units for which appropriate costs may be difficult to obtain.

Comment [WP11]: This revision clarifies but does not change the substance of the prior wording. The earlier wording was based on but not identical to ARB 43. The proposed wording aligns with ASC current wording.

19. Paragraph 42 is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Operating Material and Supplies."

20. Paragraph 44 is amended by deleting the last sentence,

21. Paragraph 53, the first sentence is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Stockpile Materials." Paragraph 53 is also amended by deleting the last sentence,

~~12. The following heading and paragraph are inserted after paragraph 56:~~

~~Implementation Guidance~~

~~56a. Refer to SFFAS XX, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials* for implementation guidance in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials when presenting financial statements or line items of financial statements following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB) either (1) for the first time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.~~

EFFECTIVE DATE

~~13.~~22. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for the Board's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, provide the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request for guidance on the use of reasonable baseline estimates on the valuation of legacy inventory, operating materials and supplies (OM&S), and stockpile materials. Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, requires valuation at historical cost (initial amounts).

A3. In the initial phase of the project, Board staff met with senior officials from DoD to develop a comprehensive list of inventory valuation methodologies in place and the status of implementation of an SFFAS 3 compliant system for each DoD component.

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

a. Most DoD component legacy systems have valued inventory, OM&S, and stockpile materials at latest acquisition cost or standard cost (selling price) rather than historical cost. These legacy systems do not maintain a record of the cost of previous purchases. Therefore, DoD does not have the data necessary for revaluing inventory, OM&S, and stockpile materials at transition from a non-GAAP to a GAAP valuation (that is, historical cost).
b. DoD components transitioned from non-GAAP legacy systems to SFFAS 3 compliant systems at different times. While DoD has implemented systems that are SFFAS 3 compliant, it is difficult to determine at what point DoD inventory valuation using a historical cost methodology (for example, moving average cost (MAC)) will be cleansed of non-GAAP values derived from legacy systems.
c. DoD components advised that they do not have the information to provide historical turnover rates for the purpose of identifying items that have turnover rates such that the non-GAAP valuation method used prior to the adoption of SFFAS 3 would approximate historical cost.
d. DoD does not have the information for revaluation and that it is not practical or cost effective to develop models for revaluation.

A5. The Exposure Draft, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, was issued on June 2, 2015 with comments requested by July 20, 2015.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, and the CPA Letter, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs, AGA Financial Management Standards Board.)

A7. This broad announcement was followed by direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations- Sub-Committee on Defense
b. House Committee on Armed Services
c. House Committee on Oversight and Government Reform
d. House Committee on the Budget
e. House Committee on Veterans' Affairs
f. Senate Appropriations- Sub-Committee on Defense
g. Senate Committee on Armed Services
h. Senate Committee on Finance
i. Senate Committee on Homeland Security and Governmental Affairs
j. Senate Committee on the Budget
k. Senate Committee on Veterans' Affairs

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A8. The Department of Defense also received the ED.

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A9. Eleven responses were received from preparers, auditors, and professional associations.

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

A11. Two respondents requested that aspects of the scope be clarified. After considering the comments, the Board revised the Statement to clarify when the Statement is not applicable, consistent with International Public Sector Accounting Standard (IPSAS), No. 33. In addition, changes to the basis were made to so it did not appear that references to DoD in the basis for conclusions were intended to limit the applicability of deemed cost. While the Statement resulted from a request from DoD, it may be applied to any reporting entity that falls within the scope of the Statement.

A12. During due process, two respondents noted potential confusion due to the similarities between the valuation methods identified for use in arriving at deemed cost for opening balances and with methods identified for use in SFFAS 3. Respondents questioned how the alternative valuation method differs from other valuation methods which approximate historical cost such as latest acquisition cost. They asked whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods.

A13. The Board believes all reasonable methods should be allowed for opening balances. Therefore, the list of potential deemed cost methods remains expansive. This list includes historical cost because deemed cost may be a consolidation of amounts based on historical cost methods and other methods that do not approximate historical cost. Further, some respondents were confused by the references to latest acquisition cost. The Board's intends that latest acquisition cost without adjustment for unrealized holding gains and losses needed to approximate historical cost be permitted under the deemed cost method; thus, this method was not a method that approximates historical cost as provided by SFFAS 3.

A14. The Board believes that amending SFFAS 3 to incorporate the alternative valuation method for opening balances would clarify the intended application and address the concerns raised by respondents. Specifically, removing the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance). The Board believes removing this discussion of LAC will prevent confusion regarding the use of LAC as a deemed cost approach (not adjusted to approximate historical cost) and LAC adjusted to approximate historical cost through an allowance for unrealized holding gains or losses.

A15. In addition, it was suggested the term "may" as used in paragraph 10 of the ED as exposed presents an auditability challenge and respondents recommended it be changed to "should." The Board's intent is to be permissive regarding methods and the term "should" may limit the application of other reasonable methods not considered in developing the Statement. Further, the Board believes providing for all methods, including those that are allowable under SFFAS 3, provides flexibility and a cost-effective approach for large and complex organizations to include several approaches to valuation because the reporting entity may have components using different approaches and/or adopting an approach permitted under SFFAS 3 at different times.

A16. In addition, three respondents requested clarification on the disclosure requirements. Based on the comments, language was added to the disclosure paragraph to clarify that financial statements of subsequent periods need not repeat this disclosure unless the statements to which deemed cost was applied in establishing opening balances are presented for comparative purposes. One respondent requested clarification on what is meant by first reporting period in relation to interim reporting. The first reporting period would be the first financial statement year end that an unreserved assertion is made. The Board does not believe this would include interim financial statements that presently are unaudited and do not include note disclosures. One respondent requested that the Board consider adding a requirement for the amount of the deemed cost to be disclosed. The Board considered carefully the disclosures that would provide the most meaningful information when developing the Statement. Considering the intent and purpose of this Statement, the Board does not believe such as disclosure would add sufficient value to warrant the significant effort.

A17. During due process, two respondents requested that the term "unreserved assertion" be added to the definitions. The Board revised the Statement to include the term and made other small changes as suggested by respondents that improved the clarity of the document and terms.

ALTERNATIVE VALUATION METHODS

Consideration of Other Accounting Standards

~~A5.~~A18. During deliberation on the project, the Board considered the recently issued International Public Sector Accounting Standards (IPSAS) No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board (IPSASB) reached several relevant conclusions with IPSAS No. 33:

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

~~A6.~~A19. The Board believes that it should take an approach similar to the IPSASB standard. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for inventory, OM&S, and stockpile materials. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances.

Alternative Valuation Method for Opening Balances

~~A7.~~A20. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for inventory, OM&S, and stockpile materials addressed in SFFAS 3 for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

~~A8.~~A21. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances. Therefore, most often deemed cost will be based on the reporting entity's valuation method or system used for managing inventory, OM&S, and stockpile materials prior to the adoption of SFFAS 3.

~~A9.~~A22. Large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Therefore, this Statement allows for deemed cost to include several approaches to valuation because the reporting entity may have components (1) using different approaches simultaneously and/or (2) adopting an approach permitted under SFFAS 3 at different times prior to establishing opening balances. Deemed cost may be one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 3.

~~A10.~~A23. Opening balances in this Statement are the balances at the beginning of the first reporting period when the entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are fairly presented in accordance with GAAP. Once established using deemed cost, opening balances are to be considered consistent with historical cost requirements of SFFAS 3.

~~A11.~~A24. Opening balances, established by application of this Statement, should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had ~~an SFFAS 3~~ a GAAP valuation method been used. Further, no distinction or segregation of amounts arising from the opening balances is required. For example, cost of goods sold using deemed cost need not be distinguished from cost of goods sold at historical cost under a first-in first-out (FIFO) approach. The purpose of this Statement is to provide a cost effective approach for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of individual types of inventory, OM&S, and stockpile materials, acceptance of non-GAAP values at the transition point to SFFAS 3 compliant systems is the most cost-effective approach.

~~A12.~~A25. However, all activity after the opening balances for inventory, OM&S, and stockpile materials are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.

Implementation by Component Reporting Entities

~~A13.~~A26. As stated above, complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Further, reporting entity components may have transitioned to an SFFAS 3 valuation method at different times; however, some components established balances for existing inventory, OM&S, and stockpile materials at the time of transition using methods that were not in accord with SFFAS 3. Therefore, given the timing of the transition to an SFFAS 3 valuation methodology, opening balances for the reporting entity may be based on transitional values based on one of the other methods listed in paragraph 10 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.

~~A14.~~A27. A component reporting entity that is in the process of implementing systems that are SFFAS 3 compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, ~~that is,~~ DoD components) to make the assertion at different times. The ~~DoD~~ reporting entity may make the assertion after a sufficient number of ~~DoD~~ components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity ~~(that is, DoD)~~ when its assertion is made.

~~A15.~~A28. Using ~~With~~ the DoD example, certain DoD components may have transitioned at an earlier date to SFFAS 3 compliant systems; this allows them to assert independently of the larger DoD. DoD would make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be DoD's opening balance deemed cost at the beginning of the period DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

~~A16.~~A29. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election since it may only be made once. Complex entities ~~such as DoD~~ should work with ~~DoD~~ its components to ensure the most appropriate method allowed by this Statement is selected. Further, reporting entities ~~DoD~~ should ensure issues such as supporting documentation are addressed and validated through sampling or other means prior to making the unreserved assertion.

DISCLOUSRE REQUIREMENTS

~~A17.~~A30. The election to apply the provisions of this Statement (deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials) should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required.

A31. The Board discussed that with time the valuation of inventory, OM&S, and stockpile materials will not be materially different than historical cost because the older inventory will may be consumed. If reporting entities are able to document that turnover rates for inventory, OM&S, and stockpile materials are such that the opening balance valuation is at historical cost, a reference to deemed cost would not be required. This, however, does not impose a requirement that reporting entities engage in an effort to conclude that the use of deemed cost is no longer necessary.

BOARD APPROVAL

~~A18.~~A32. This Statement was approved for issuance by XX

APPENDIX B: ABBREVIATIONS

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

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

Opening Balances—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[12]

Unreserved Assertion—An unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.

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[12] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards). ~~Adapted from U.S. Auditing Standards-American Institute of CPAs (Clarified), AU-C Glossary- Glossary of Terms.~~

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Federal Accounting Standards Advisory Board

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

Statement of Federal Financial Accounting Standards 48

December 15, 2015

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at www.fasab.gov.

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SUMMARY

This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies, and stockpile materials. This method is permitted when presenting financial statements, or one or more line items addressed by this Statement, following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

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

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INTRODUCTION

PURPOSE

1. This Statement permits a reporting entity to apply an alternative valuation method in establishing opening balances for inventory, operating materials and supplies (OM&S), and stockpile materials. These assets are addressed in Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*.

2. While SFFAS 3 addresses six types of tangible property, only inventory, operating materials and supplies (OM&S), and stockpile materials are required to be valued using the "initial amount" measurement approach.[1] An opening balance consistent with this requirement may not be available when a reporting entity begins presenting financial statements or one or more line items addressed by this Statement following generally accepted accounting principles (GAAP) promulgated by the Federal Accounting Standards Advisory Board (FASAB). This Statement is intended to provide a cost-effective approach to adoption of GAAP when historical records and systems do not provide a basis for valuation of opening balances in accordance with SFFAS 3.

MATERIALITY

3. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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

STANDARDS

SCOPE

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

5. This Statement may only be applied in establishing **opening balances**[2] for the reporting period that the reporting entity, taken as a whole, makes an **unreserved assertion** that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement would not apply when an entity:

    a. Stops presenting financial statements, or one or more line items addressed by this Statement, in accordance with GAAP after having previously presented in accordance with GAAP;

    b. Presented financial statements, or one or more line items addressed by this Statement, in previous period(s) in accordance with GAAP; or

    c. Presented financial statements or one or more line items addressed by this Statement in previous period(s) in accordance with GAAP, even if the auditors issued a modified opinion.

6. This Statement does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are the subject of:

    a. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and

    b. Specific transitional requirements in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by the FASAB.

DEFINITIONS

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

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

8. **Opening Balances**—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[3]

9. **Unreserved Assertion**—An unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.

ALTERNATIVE VALUATION METHOD FOR OPENING BALANCES

10. Deemed cost is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials for the reporting period that the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

11. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of valuation methods, including:[4]

    a. Standard price (selling price)[5] or fair value[6]
    b. Latest Acquisition Cost (LAC) Method[7]
    c. Replacement cost[8]
    d. Estimated historical cost (initial amount)
    e. Actual historical cost (initial amount)

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

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[3] Adopted from AU-C 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements* (AICPA Professional Standards).
[4] The methods are not listed in any order of preference.
[5] The latest known representative acquisition cost plus authorized cost recovery rate for each item of inventory and related property. This is established annually and is often referred to as selling price. Selling price and fair value may or may not be identical due to the intragovernmental nature of some sales.
[6] Fair value is the amount at which an asset or liability could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. (SFFAC 7, par. 38)
[7] Latest Acquisition Cost (LAC) Method provides that all like units that are held be valued at the invoice price of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. *FASAB Handbook Glossary as of June 30, 2014*
[8] Replacement cost is the amount required for an entity to replace the remaining service potential of an existing asset in a current transaction at the reporting date, including the amount that the entity would receive from disposing of the asset at the end of its useful life. (SFFAC 7, par. 46)

DISCLOSURE REQUIREMENTS

13. A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. Financial statements of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

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

14. This section amends Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property* as described in the following paragraphs.

15. Paragraph 20 is replaced with the following paragraph: “Valuation. Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost.”

16. Paragraph 22, the last sentence is amended by removing “(e.g., a standard cost system)”.

17. Paragraphs 23-25 are rescinded to remove the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance).

18. Paragraph 26 is replaced by the following paragraph which expands the exception to valuation in SFFAS 3 to incorporate the Alternative Valuation Method for Opening Balances provided in this Statement.

Valuation Method for Opening Balances and Exceptions to Valuation.

a. **Alternative Valuation Method for Opening Balances[9].** The alternative valuation method described in paragraph iv. is acceptable when a reporting entity is presenting financial statements, or one or more line items, following GAAP promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

[9] 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.

i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[10] that its financial statements, or one or more line items are presented fairly in accordance with GAAP.

ii. The application of this method based on the second condition is available once per reporting entity. The alternative valuation method would not apply when an entity:
   1. Stops presenting financial statements or one or more line items using the methods addressed by this paragraph in accordance with GAAP after having previously presented in accordance with GAAP;
   2. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP; or
   3. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP even if the auditors issued a modified opinion.

iii. The use of the alternative valuation methodology does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are subject to the:
   1. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and
   2. Specific transitional guidance in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by FASAB.

iv. Deemed cost[11] is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of valuation methods, including :
   a) Standard price (selling price) or fair value
   b) Latest Acquisition Cost (LAC) Method
   c) Replacement cost
   d) Estimated historical cost (initial amount)
   e) Actual historical cost (initial amount)

v. Disclosure requirements – A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first 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

[10] An unreserved assertion is an unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.
[11] Deemed cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances.

GAAP. Financial statements of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. Exceptions to Valuation

i. An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:
   1. Units of which are interchangeable,
   2. Units of which have immediate marketability,
   3. Units for which appropriate costs may be difficult to obtain.

19. Paragraph 42 is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Operating Material and Supplies."

20. Paragraph 44 is amended by deleting the last sentence,

21. Paragraph 53, the first sentence is amended by adding the following after historical cost "or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Stockpile Materials." Paragraph 53 is also amended by deleting the last sentence,

EFFECTIVE DATE

22. This Statement is effective for periods beginning after September 30, 2016. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

Department of Defense Implementation Guidance Request Project

A1. In February 2014, the Department of Defense (DoD) identified several areas of concern for the Board's consideration. The Board agreed to undertake a project to address these areas by providing practical guidance within the framework of existing accounting standards and, where necessary, provide the appropriate guidance to address issues not addressed within the framework of existing accounting standards.

A2. This Statement is related to the request for guidance on the use of reasonable baseline estimates on the valuation of legacy inventory, operating materials and supplies (OM&S), and stockpile materials. Statement of Federal Financial Accounting Standards (SFFAS) 3, *Accounting for Inventory and Related Property*, requires valuation at historical cost (initial amounts).

A3. In the initial phase of the project, Board staff met with senior officials from DoD to develop a comprehensive list of inventory valuation methodologies in place and the status of implementation of an SFFAS 3 compliant system for each DoD component.

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

a. Most DoD component legacy systems have valued inventory, OM&S, and stockpile materials at latest acquisition cost or standard cost (selling price) rather than historical cost. These legacy systems do not maintain a record of the cost of previous purchases. Therefore, DoD does not have the data necessary for revaluing inventory, OM&S, and stockpile materials at transition from a non-GAAP to a GAAP valuation (that is, historical cost).
b. DoD components transitioned from non-GAAP legacy systems to SFFAS 3 compliant systems at different times. While DoD has implemented systems that are SFFAS 3 compliant, it is difficult to determine at what point DoD inventory valuation using a historical cost methodology (for example, moving average cost (MAC)) will be cleansed of non-GAAP values derived from legacy systems.
c. DoD components advised that they do not have the information to provide historical turnover rates for the purpose of identifying items that have turnover rates such that the non-GAAP valuation method used prior to the adoption of SFFAS 3 would approximate historical cost.
d. DoD does not have the information for revaluation and that it is not practical or cost effective to develop models for revaluation.

SUMMARY OF OUTREACH EFFORTS

A5. The Exposure Draft, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, was issued on June 2, 2015 with comments requested by July 20, 2015.

A6. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, FASAB News, the Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, and the CPA Letter, the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and committees of professional associations generally commenting on exposure drafts in the past (for example, the Greater Washington Society of CPAs, AGA Financial Management Standards Board.)

A7. This broad announcement was followed by direct mailings of the ED to the following relevant congressional committees:

a. House Appropriations- Sub-Committee on Defense
b. House Committee on Armed Services
c. House Committee on Oversight and Government Reform
d. House Committee on the Budget
e. House Committee on Veterans' Affairs
f. Senate Appropriations- Sub-Committee on Defense
g. Senate Committee on Armed Services
h. Senate Committee on Finance
i. Senate Committee on Homeland Security and Governmental Affairs
j. Senate Committee on the Budget
k. Senate Committee on Veterans' Affairs

A8. The Department of Defense also received the ED.

A9. Eleven responses were received from preparers, auditors, and professional associations.

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

A11. Two respondents requested that aspects of the scope be clarified. After considering the comments, the Board revised the Statement to clarify when the Statement is not applicable, consistent with International Public Sector Accounting Standard (IPSAS), No. 33. In addition, changes to the basis were made to so it did not appear that references to DoD in the basis for conclusions were intended to limit the applicability of deemed cost. While the Statement resulted from a request from DoD, it may be applied to any reporting entity that falls within the scope of the Statement.

A12. During due process, two respondents noted potential confusion due to the similarities between the valuation methods identified for use in arriving at deemed cost for opening balances and with methods identified for use in SFFAS 3. Respondents questioned how the alternative valuation method differs from other valuation methods which approximate historical cost such as latest acquisition cost. They asked whether methods that are allowable under SFFAS 3 should be removed because those would not be considered alternative methods.

A13. The Board believes all reasonable methods should be allowed for opening balances. Therefore, the list of potential deemed cost methods remains expansive. This list includes historical cost because deemed cost may be a consolidation of amounts based on historical cost methods and other methods that do not approximate historical cost. Further, some respondents were confused by the references to latest acquisition cost. The Board's intends that latest acquisition cost without adjustment for unrealized holding gains and losses needed to approximate historical cost be permitted under the deemed cost method; thus, this method was not a method that approximates historical cost as provided by SFFAS 3.

A14. The Board believes that amending SFFAS 3 to incorporate the alternative valuation method for opening balances would clarify the intended application and address the concerns raised by respondents. Specifically, removing the term latest acquisition cost (LAC) from SFFAS 3 when used to mean that LAC that is equivalent to historical cost (inclusive of the valuation allowance). The Board believes removing this discussion of LAC will prevent confusion regarding the use of LAC as a deemed cost approach (not adjusted to approximate historical cost) and LAC adjusted to approximate historical cost through an allowance for unrealized holding gains or losses.

A15. In addition, it was suggested the term "may" as used in paragraph 10 of the ED as exposed presents an auditability challenge and respondents recommended it be changed to "should." The Board's intent is to be permissive regarding methods and the term "should" may limit the application of other reasonable methods not considered in developing the Statement. Further, the Board believes providing for all methods, including those that are allowable under SFFAS 3, provides flexibility and a cost-effective approach for large and complex organizations to include several approaches to valuation because the reporting entity may have components using different approaches and/or adopting an approach permitted under SFFAS 3 at different times.

A16. In addition, three respondents requested clarification on the disclosure requirements. Based on the comments, language was added to the disclosure paragraph to clarify that financial statements of subsequent periods need not repeat this disclosure unless the statements to which deemed cost was applied in establishing opening balances are presented for comparative purposes. One respondent requested clarification on what is meant by first reporting period in relation to interim reporting. The first reporting period would be the first financial statement year end that an unreserved assertion is made. The Board does not believe this would include interim financial statements that presently are unaudited and do not include note disclosures. One respondent requested that the Board consider adding a requirement for the amount of the deemed cost to be disclosed. The Board considered carefully the disclosures that would provide the most meaningful information when developing the Statement. Considering the intent and purpose of this Statement, the Board does not believe such as disclosure would add sufficient value to warrant the significant effort.

A17. During due process, two respondents requested that the term "unreserved assertion" be added to the definitions. The Board revised the Statement to include the term and made other small changes as suggested by respondents that improved the clarity of the document and terms.

ALTERNATIVE VALUATION METHODS

Consideration of Other Accounting Standards

A18. During deliberation on the project, the Board considered the recently issued International Public Sector Accounting Standards (IPSAS) No. 33, *First Time Adoption of Accrual Basis International Public Sector Accounting Standards*. The International Public Sector Accounting Standards Board (IPSASB) reached several relevant conclusions with IPSAS No. 33:

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

A19. The Board believes that it should take an approach similar to the IPSASB standard. Deemed cost is a surrogate for initial amounts and an acceptable valuation method for opening balances for inventory, OM&S, and stockpile materials. Use of deemed cost is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances.

Alternative Valuation Method for Opening Balances

A20. A reporting entity may use deemed cost as an alternative valuation method in establishing opening account balances for inventory, OM&S, and stockpile materials addressed in SFFAS 3 for the reporting period that the reporting entity first makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP.

A21. This guidance is intended to provide a cost-effective approach to the adoption of SFFAS 3 where historical records and systems do not support such balances. Therefore, most often deemed cost will be based on the reporting entity’s valuation method or system used for managing inventory, OM&S, and stockpile materials prior to the adoption of SFFAS 3.

A22. Large and complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Therefore, this Statement allows for deemed cost to include several approaches to valuation because the reporting entity may have components (1) using different approaches simultaneously and/or (2) adopting an approach permitted under SFFAS 3 at different times prior to establishing opening balances. Deemed cost may be one of or a combination of valuation methods. However, this Statement requires that the accounting for all activity after the opening balance is established comply with SFFAS 3.

A23. Opening balances in this Statement are the balances at the beginning of the first reporting period when the entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are fairly presented in accordance with GAAP. Once established using deemed cost, opening balances are to be considered consistent with historical cost requirements of SFFAS 3.

A24. Opening balances, established by application of this Statement, should be included in ongoing inventory valuation methods as a surrogate for the initial amounts that would have existed had a GAAP valuation method been used. Further, no distinction or segregation of amounts arising from the opening balances is required. For example, cost of goods sold using deemed cost need not be distinguished from cost of goods sold at historical cost under a first-in first-out (FIFO) approach. The purpose of this Statement is to provide a cost effective approach for this specific situation. Absent a reliable record of transactions related to hundreds of thousands of individual types of inventory, OM&S, and stockpile materials, acceptance of non-GAAP values at the transition point to SFFAS 3 compliant systems is the most cost-effective approach.

A25. However, all activity after the opening balances for inventory, OM&S, and stockpile materials are established must comply with the recognition, measurement, presentation, and disclosure requirements in SFFAS 3.

Implementation by Component Reporting Entities

A26. As stated above, complex reporting entities such as DoD may have used a variety of valuation methods prior to the adoption of SFFAS 3. Further, reporting entity components may have transitioned to an SFFAS 3 valuation method at different times; however, some components established balances for existing inventory, OM&S, and stockpile materials at the time of transition using methods that were not in accord with SFFAS 3. Therefore, given the timing of the transition to an SFFAS 3 valuation methodology, opening balances for the reporting entity may be based on transitional values based on one of the other methods listed in paragraph 10 of this Statement and subsequent transactions consistent with SFFAS 3 methods. The result of combining these values is considered deemed cost.

A27. A component reporting entity that is in the process of implementing systems that are SFFAS 3 compliant is permitted to apply this Statement at the time it makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. This Statement allows component reporting entities (for example, DoD components) to make the assertion at different times. The reporting entity may make the assertion after a sufficient number of components do so. This Statement considers the opening balances and subsequent transactions of these component reporting entities as deemed cost for the consolidated reporting entity when its assertion is made.

A28. Using the DoD example, certain DoD components may have transitioned at an earlier date to SFFAS 3 compliant systems; this allows them to assert independently of the larger DoD. DoD would make a DoD-wide assertion when a sufficient number of DoD components are compliant. While a DoD component's "deemed cost" opening balance might be earlier than the DoD-wide opening balance, the consolidation of the various methods would be DoD's opening balance deemed cost at the beginning of the period

DoD was able to make an unreserved assertion on its financial statements or one or more line items addressed by this Statement.

A29. Considering the flexibility allowed with the Statement, reporting entities should ensure they are ready to make an unreserved assertion that their financial statements, or one or more line items addressed by this Statement, are fairly presented prior to making the election since it may only be made once. Complex entities 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 are addressed and validated through sampling or other means prior to making the unreserved assertion.

DISCLOUSRE REQUIREMENTS

A30. The election to apply the provisions of this Statement (deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials) should be disclosed in the financial statements in the first reporting period in which the reporting entity makes an unreserved assertion that its financial statements, or one or more line items addressed by this Statement, are presented fairly in accordance with GAAP. The reporting entity should also disclose a description of what valuation method(s) deemed cost is based on, but no disclosure of amounts valued at deemed cost is required.

A31. The Board discussed that with time the valuation of inventory, OM&S, and stockpile materials will not be materially different than historical cost because the older inventory will may be consumed. If reporting entities are able to document that turnover rates for inventory, OM&S, and stockpile materials are such that the opening balance valuation is at historical cost, a reference to deemed cost would not be required. This, however, does not impose a requirement that reporting entities engage in an effort to conclude that the use of deemed cost is no longer necessary.

BOARD APPROVAL

A32. This Statement was approved for issuance by XX

APPENDIX B: ABBREVIATIONS

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

APPENDIX C: GLOSSARY

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

Opening Balances—Account balances that exist at the beginning of the reporting period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.[12]

Unreserved Assertion—An unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.

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

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Effective Date

16. The Board recommends that the accounting standards presented in this Statement become effective for fiscal year ending September 30, 1994, and thereafter. Earlier implementation is encouraged.

Inventory

17. **Definition.** "Inventory" is tangible personal property that is (1) held for sale, (2) in the 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. The term "held for sale" shall be interpreted to include items for sale or transfer to (1) entities outside the federal government, or (2) other federal entities. The principal objective of the sale or transfer of inventory is to provide a product or service for a fee that generally recovers full cost or an identified portion of the cost. "Other federal entities" may include entities within the same organization/agency. Sales transactions may be executed through transfer of funds between federal entities; it is not essential that the transaction be an exchange of goods for cash or cash equivalents. In addition, inventory may be acquired through donation or barter. Inventory excludes some other assets held for sale, such as (1) stockpile materials, (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; however, the purpose of acquiring them is not to provide a product or a service for a fee.

18. Inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. These categories are defined in paragraphs 17, 27, 29, and 32 respectively.

19. **Recognition.** Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or the goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

20. **Valuation.** Inventory shall be valued at either (1) historical cost or (2) a method that reasonably approximates historical cost.

~~20. Valuation. Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost.~~

21. (1) Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired

through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

22. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods ~~(e.g., a standard cost system)~~.

~~23. (2) The latest acquisition cost method provides that the last invoice price[2] (i.e., the specific item's actual cost used in setting the current year stabilized standard [sales] price) be applied to all like units held including those units acquired through donation or nonmonetary exchange. The inventory shall be revalued periodically but at least at the end of each fiscal year. Revaluation results in recognition of unrealized holding gains/losses[3] in the ending inventory value. Upon adjustment for unrealized holding gains/losses, the latest acquisition cost method then results in an approximation of historical cost.~~

~~24. An allowance for unrealized holding gains/losses in inventory shall be established to capture these gains/losses. The ending balance of this allowance shall be the cumulative difference between the historical cost, based on estimated or actual valuation, and the latest acquisition cost of ending inventory. The balance shall be adjusted each time the inventory balance is adjusted. The adjustment necessary to bring the allowance to the appropriate balance shall be a component of cost of goods sold for the period as described below.~~

~~25. The cost of goods sold for the period shall be computed as follows:~~

~~Beginning inventory at beginning-of-the-period latest acquisition cost~~
~~less: beginning allowance for unrealized holding gains/losses~~
~~plus: actual purchases~~
~~Cost of Goods Available for Sale~~
~~less: ending inventory at end-of-the-period latest acquisition cost~~
~~plus: ending allowance for unrealized holding gains/losses~~
~~Cost of Goods Sold~~

~~[2] This unit value is referred to as the latest acquisition cost for the remainder of this standard.~~

~~[3] "Holding gains (or losses)" result from holding assets in periods of changing prices. Under historical cost methods, holding gains (or losses) are not separately recognized even though they exist. Under the latest acquisition cost method, holding gains (or losses) will be recognized in the valuation of inventory since that value is adjusted periodically to present the more current latest acquisition costs. These gains or losses are unrealized holding gains or losses. "Unrealized" refers to any gain or loss associated with inventory still held by the entity. "Realization" of the holding gain or loss occurs only when an item of inventory is sold.~~

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23. **Alternative Valuation Method for Opening Balances and Exceptions to Valuation.** ~~Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine approximate costs, (2) immediate marketability at quoted prices, and (3) unit interchangeability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.~~

a. **Alternative Valuation Method for Opening Balances[1].** The alternative valuation method described in paragraph iv. is acceptable when a reporting entity is presenting financial statements or one or more line items following GAAP promulgated by the FASAB either (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method.

   i. The alternative valuation method may only be applied in establishing opening balances for the reporting period that the reporting entity, taken as a whole, makes an unreserved assertion[2] that its financial statements, or one or more line items are presented fairly in accordance with GAAP.

   ii. The application of this method based on the second condition is available once per reporting entity. The alternative valuation method would not apply when an entity:

      1. Stops presenting financial statements or one or more line items using the methods addressed by this paragraph in accordance with GAAP after having previously presented in accordance with GAAP;
      2. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP; or
      3. Presented financial statements or one or more line items addressed by this paragraph in previous period(s) in accordance with GAAP even if the auditors issued a modified opinion.

   iii. The use of the alternative valuation methodology does not apply to changes in accounting principles made by a reporting entity that already applies GAAP promulgated by FASAB. Such changes are subject to the:

      1. Requirements of Statement of Federal Financial Accounting Standards 21: *Reporting Correction of Errors and Changes in Accounting Principles*; and
      2. Specific transitional guidance in other SFFASs. The transitional provisions or implementation guidance in other SFFASs apply only to changes made by a reporting entity that already applies GAAP as established by FASAB.

[1] 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.

[2] An unreserved assertion is an unreserved statement by the reporting entity that the financial statements, or one or more line items, are presented in accordance with GAAP.

iv. Deemed cost[3] is an acceptable valuation method for opening balances of inventory, OM&S, and stockpile materials. Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost may be based on one of or a combination of valuation methods, including :

a) Standard price (selling price) or fair value
b) Latest Acquisition Cost (LAC) Method
c) Replacement cost
d) Estimated historical cost (initial amount)
e) Actual historical cost (initial amount)

v. Disclosure requirements – A reporting entity electing to apply deemed cost in establishing opening balances for inventory, OM&S, or stockpile materials should disclose this fact and describe the method used in the first 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 of subsequent periods need not repeat this disclosure unless the statements for which deemed cost was applied in establishing opening balances are presented for comparative purposes. No disclosure of the distinction or breakout of amount of deemed cost of inventory, OM&S, or stockpile materials included in the opening balance is required.

b. Exceptions to Valuation

i. An exception for reporting inventory, OM&S, and stockpile materials at net realizable value is available for agricultural, mineral, and other products (e.g. petroleum) with all the following criteria:

1. Units of which are interchangeable,
2. Units of which have immediate marketability,
3. Units for which appropriate costs may be difficult to obtain.

Other Categories of Inventory

~~26.~~24. **Inventory Held in Reserve for Future Sale.** Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

~~27.~~25. The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. **Examples** of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage, and (5) the likelihood that a supply of the items will be available in the future. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable

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

to the U.S. government-wide financial statements.

~~28.~~26. **Excess, Obsolete, and Unserviceable Inventory.** "Excess inventory" is inventory stock that exceeds the demand expected in the normal course of operations because the amount on hand is more than can be sold in the foreseeable future and that does not meet management's criteria to be held in reserve for future sale. "Obsolete inventory" is inventory that is no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable inventory" is damaged inventory that is more economical to dispose of than to repair. The category "excess, obsolete and unserviceable inventory" shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

~~29.~~27. Such inventory shall be valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. Any subsequent adjustments to its net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain). The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected not realizable value.

~~30.~~28. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.

~~31.~~29. **Inventory Held for Repair.** Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.

(1) 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 annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.

~~32.~~30. (2) Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually 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.

~~33.~~31. Transition to either of these two methods may result in recognizing an accumulated amount of needed repairs that were not previously accounted for. To avoid overstating repair expense for the first period that repair expense is accrued, prior period amounts are to be separately identified or estimated. The estimated amount to repair inventory that is attributable to prior periods shall be credited to the repair allowance under the repair allowance method or to the inventory account under the direct method and reported as an adjustment to equity.

Disclosure Requirements

~~34.~~32. General composition of inventory.

- Basis for determining inventory values; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods; if any.
- Balances for each of the following categories of inventory; inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial

statements.

- Restrictions on the sale of material.
- The decision criteria for identifying the category to which inventory is assigned.
- Changes in the criteria for identifying the category to which inventory is assigned
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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The provisions of this statement need not be applied to immaterial items.

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Operating Materials And Supplies

~~35.~~33. **Definition.** "Operating materials and supplies" consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.

~~36.~~34. Operating materials and supplies shall be categorized as (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. These categories are defined in paragraphs 36, 45, and 47 respectively.

~~37.~~35. **Recognition.** The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and supplies shall be recognized and reported as assets when produced or purchased. "Purchased" is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.

~~38.~~36. The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.

~~39.~~37. If (1) 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 of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

~~40.~~38. An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user.

~~41.~~39. **Valuation Under the Consumption Method.** Operating materials and supplies shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Operating Material and Supplies.

~~42.~~40. Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

~~43.~~41. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed. ~~In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system)~~.

Other Categories of Operating Materials and Supplies

~~44.~~42. **Operating Materials and Supplies Held in Reserve for Future Use.** Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.

~~45.~~43. The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items

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(including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

~~46.~~44. **Excess, Obsolete, and Unserviceable Operating Materials and Supplies.** "Excess operating materials and supplies" are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management's criteria to be held in reserve for future use. "Obsolete operating materials and supplies" are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. "Unserviceable operating materials and supplies" are operating materials and supplies that are physically damaged and cannot be consumed in operations. The category "excess, obsolete and unserviceable operating materials and supplies" shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.

~~47.~~45. Such operating materials and supplies shall be valued at their estimated net realizable value. The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete or unserviceable and their estimated net realizable value shall be recognized as a loss (or gain) and either reported separately or disclosed. Any subsequent adjustments to their estimated net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).

~~48.~~46. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies.

Disclosure Requirements

~~49.~~47. General composition of operating materials and supplies.

- Basis for determining operating materials and supplies values; including valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods, if any.
- Balances for each of the categories of operating materials and supplies described above.
- Restrictions on the use of material.
- Decision criteria for identifying the category to which operating materials and supplies are assigned.
- Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

SFFAS 3

a. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

The provisions of this statement need not be applied to immaterial items.

Stockpile Materials

~~50.~~48. **Definition.** “Stockpile materials” are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business. The following items are specifically excluded from stockpile materials: (1) items that are held by an agency for sale or use in normal operations (see proposed standards for inventory and operating materials and supplies), (2) items that are held for use in the event of an agency’s operating emergency or contingency (see proposed standard for operating materials and supplies), and (3) materials acquired to support market prices (see proposed standard for goods held under price support and stabilization programs).

~~51.~~49. **Recognition.** The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. “Purchase” is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.

~~52.~~50. **Valuation.** Stockpile materials shall be valued on the basis of historical cost or on a basis that reasonably approximates historical cost. The provisions of paragraph 26, Alternative Valuation Methods for Opening Balances, extend to Stockpile Materials. Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of stockpile materials. ~~In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).~~

~~53.~~51. **Exception to Valuation.** The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss or an expense[4] in the period in which it occurs.

[4] The decline in value shall be considered an expense if it is an expected decline in the normal course of operations.

~~54.~~52. **Held for Sale.** When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price.

Disclosure Requirements

~~55.~~53. General composition of stockpile materials.

- Basis for valuing stockpile materials; including valuation method and any cost flow assumption.
- Changes from prior year's accounting methods, if any.
- Restrictions on the use of materials.
- Balances of stockpile materials in each category described above (i.e., stockpile materials and stockpile materials held for sale).
- Decision criteria for categorizing stockpile materials as held for sale.
- Changes in criteria for categorizing stockpile materials as held for sale.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

The provisions of this statement need not be applied to immaterial items.

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Seized and Forfeited Property

~~56.~~54. As a consequence of various laws, certain property is seized by authorized law enforcement agencies. In some instances, there may be as many as three government entities involved with seized property. The first is the seizing agency. Second, the seizing agency may turn the property over to a custodial agency. Third, financial records may be maintained by a "central fund" created to support the seizure activities of multiple agencies. Alternatively, the seizing agency may carry out one or both of the custodial agency or central fund roles.

~~57.~~55. The seized assets may be subsequently forfeited to the government through abandonment or administrative or judicial procedures. The forfeited property is then sold, converted for use by the government, or transferred to other governmental entities. Because this property is first seized, then all or a portion of it is forfeited, this standard separately addresses the