Federal Accounting Standards Advisory Board

Eliminating the Category National Defense Property, Plant, and Equipment

Rescinding SFFAS No. 11, *Amendments to Property, Plant, and Equipment -- Definitional Changes*
Amending SFFAS No. 8, *Supplementary Stewardship Reporting*
Amending SFFAS No. 6, *Accounting for Property, Plant, and Equipment*

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by May 20, 2002

March 25, 2002

FASAB Board Members

David Mosso, Chairman

Philip T. Calder

John A. Farrell

Joseph L. Kull

James M. Patton

Robert N. Reid

Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:

Rick Wascak

Federal Accounting Standards Advisory Board

441 G Street NW

Suite 6814

Mailstop 6K17V

Washington, DC 20548

Telephone (202) 512-7350

FAX (202) 512-7366

www.fasab.gov

Federal Accounting Standards Advisory Board

March 25, 2002

To: Heads of Agencies, Users, Preparers, and Auditors of Federal Financial Information

The Federal Accounting Standards Advisory Board is requesting comments on the exposure draft (ED), *Eliminating the Category National Defense Property, Plant, and Equipment.*

Currently, the acquisition costs for items classified as national defense (ND) property, plant, and equipment (PP&E) are expensed in the period incurred. In addition, valuation (using either an historical or latest acquisition cost valuation method), condition, and deferred maintenance information for these items is to be presented off-balance sheet.

The amendments proposed in this ED would make the following changes. The term "ND PP&E" would be rescinded. All items previously considered ND PP&E would be classified as general PP&E. Accordingly, these items would be capitalized and, with the exception of land and land improvements that produce permanent benefits, depreciated. This ED also notes that all entities are permitted to use the composite or group depreciation methodology to calculate depreciation. The amendments proposed in this ED would take effect for accounting periods beginning after September 30, 2002.

You are encouraged to comment on any section of this document. To ensure full consideration of your responses by the Board, please provide your rationale for agreement or disagreement with a particular area, including explanations of alternative proposals in areas of disagreement. Respondents are encouraged to consider the issues in light of Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting.*

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form are due by May 20, 2002 and should be sent by e-mail to comesw@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814,
Mailstop 6K17V
Washington, DC 20548

David Mosso
David Mosso
Chairman

This page intentionally blank

EXECUTIVE SUMMARY

What is the Board Proposing?

I. This Exposure Draft (ED) proposes amendments to the standards for national defense (ND) property, plant, and equipment (PP&E).[1] In the existing standards, ND PP&E consists of: (a) PP&E components of weapons systems and support PP&E owned by the Department of Defense (DoD) or its component entities for use in the performance of military missions and (b) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. The costs to acquire, replace, or improve ND PP&E are recognized as an expense in the period incurred. In addition, ND PP&E valuation (using either a historical or latest acquisition cost (LAC) valuation method), condition, and deferred maintenance information are presented as Required Supplementary Stewardship Information (RSSI) or Required Supplementary Information (RSI).

II. The proposed standards would rescind the category "ND PP&E." Consequently, all items previously considered "ND PP&E" would be classified and presented as general PP&E. These assets would be accounted for in accordance with the general PP&E provisions contained in SFFAS No. 6, as amended. In addition, the proposed standards would explicitly recognize the composite or group depreciation methodology as acceptable approaches to depreciate general PP&E.

III. The application of general PP&E provisions of SFFAS No. 6, as amended, to assets formerly considered ND PP&E would be effective for accounting periods beginning after September 30, 2002.

[1] The existing standards are contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 11, *Amendments to Accounting for Property, Plant, and Equipment -- Definitional Changes*; SFFAS No. 8, *Supplementary Stewardship Reporting*; and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

Why is the Board making this proposal?

IV. Since its inception, the Board has recognized that developing accounting standards that meet federal financial reporting objectives would require an incremental approach. SFFAS No. 6 requires that general PP&E be recognized as assets in the basic financial statements and, except for land and land improvements that produce permanent benefits, be charged to expense through depreciation over their useful life. SFFAS No. 6, paragraph 122, states that "allocation of the cost of general PP&E, excluding land, among accounting periods was essential to assessing operating performance." The Board, however, found that for some PP&E, the depreciation effect of the asset on operating performance was not the predominant reporting objective. Instead, stewardship was important (SFFAS No.6, paragraphs 122-123). In 1996, the Board issued standards in SFFAS No. 8 that focused on stewardship responsibilities over ND PP&E – that is, accountability for the physical custody and condition of ND PP&E (SFFAS No. 8, paragraph 11, 118-119). Specifically, for ND PP&E the Board did not believe applying depreciation accounting for these assets would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believed that these assets are developed, used, and retired in a manner that does not lend itself to a "systematic and rational" assignment of costs to accounting periods (i.e., depreciation accounting) and, ultimately, to outputs. (SFFAS No. 6, paragraph l). These standards were not implemented by DoD and, in late 1997, DoD suggested that the Board reconsider the provisions of SFFAS No. 8.

V. In February 1998, FASAB issued an ED proposing that quantity, deferred maintenance, and condition information be presented for ND PP&E. In addition, the proposal would have resulted in presentation of the current and four preceding years' investment in ND PP&E in aggregate. The accumulation of cost would not have been required for ND PP&E under the accounting standards then proposed. The Board received more responses than usual from the non-federal respondents on the 1998 proposal. Virtually all non-federal respondents objected to the proposal. These respondents objected to the 1998 ED on the grounds that the cumulative cost of ND PP&E acquisitions would not be available under the proposal. Non-federal respondents viewed the proposal as reducing the government's ability to be accountable to its citizens. While most respondents supported disclosures of quantity and deferred maintenance information, there was strong resistance to the proposed reduction of financial data on ND PP&E. As time passed, interest in accountability for operating performance increased on the Board, throughout government, and among the public observers of the Board's work. The Board's emphasis on stewardship for ND PP&E became more difficult to sustain to the exclusion of reporting the cost of operations.

VI. Following consideration of reactions to the 1998 ED, FASAB agreed to consider the results of a proposed Department of Defense (DoD) sponsored study on the issue. The study results were presented to DoD and FASAB in late 2000. In September 2001, FASAB issued an ED that proposed movement from the stewardship-focused presentations of SFFAS No. 8 towards information focused on operating performance. The proposal would have resulted in two types of ND PP&E (Major End Items and Mission Support Items) with distinct methods for recognizing periodic cost – one type would be depreciated and one type would not. In addition, quantity, condition, deferred maintenance and investment presentations were proposed. FASAB received fourteen responses – seven from federal government respondents and seven from non-federal respondents. There was significant support for the proposal. However, specific issues were raised by respondents:

a. the two types of ND PP&E proposed – Major End Items and Mission Support Items – are not well defined;
b. the proposal to not depreciate one type - Major End Items - was questioned by several respondents;
c. the need to integrate deferred maintenance, condition information, and assessment of useful lives; and,
d. the assumption that Major End Items are maintained in steady state condition and thus do not depreciate.

VII. Overall respondents supported the proposal as a step forward but with some reservations. One notable exception was the DoD response to the September 2001 ED. In its response, DoD requested that FASAB eliminate the ND PP&E category and require that accounting for all military equipment be consistent with accounting for general PP&E. The existing accounting provisions in SFFAS No. 6 for general PP&E focus heavily on operating performance and require recognition of depreciation expense (with the exception of land and land improvements that produce permanent benefits).

VIII. DoD also argued that (1) determining which military equipment qualifies as ND PP&E would not justify the cost of doing so and the effort still might result in inconsistent classification, and (2) management requires access to consistent, reliable and timely cost information about all of its assets in order to manage DoD in a more business-like manner. DoD's proposal that accounting for all military equipment be consistent with accounting for general PP&E would mean that DoD would report (1) the full cost of DoD assets, (2) the cost of annual operations, and (3) the expected cost of removing certain assets from service through recognition of cleanup costs. The proposal would result in all PP&E used in government operations being treated consistently.

IX. DoD's proposal is being endorsed in this ED because it is consistent with the views of the majority of the Board. In addition, it represents an opportunity to address some reservations expressed by members supporting the September 2001 ED. In paragraphs 73 through 76 of that ED, it was noted that several members viewed the ED as an interim step because they hoped to find a means to depreciate Major End Items or subject them to impairment tests. These members viewed the proposal as "a practical, incremental step toward more meaningful accounting for ND PP&E."

How does this proposal improve federal financial reporting?

X. Military equipment represents economic resources with future service potential just as do items of general PP&E. Recognizing all military equipment as general PP&E would enhance:

a. accountability for and stewardship over economic resources used by the federal government;
b. assessment of the periodic net cost of operations by including measurements of costs incurred for capital used in DoD operations through depreciation charges;
c. consistency and understandability by accounting for operating PP&E in the same way within the DoD and other government agencies; and,
d. relevance, reliability, and comparability of information by reducing the number of alternative means of accounting for PP&E.

How does this proposal contribute to meeting the federal financial reporting objectives?

XI. Allocation of the cost of PP&E - excluding land - used in government operations among accounting periods is essential to assessing operating performance and to relating the full cost of operations to goods and services (or accomplishments). Under the existing standards, the annual cost of all ND PP&E is considered an expense in the single accounting period when incurred. Under the standards as proposed in the September 2001 ED, the cost of certain ND PP&E was proposed to be included in a single accounting period in which the asset was retired. In issuing SFFAS No. 8, the Board asserted that information relative to operating performance would not be useful for National Defense PP&E (paragraph 119) and that it was acceptable to focus instead on the Stewardship objective. A changing government-wide focus on the cost of operations in the Federal government combined with the Board's extensive study and greater understanding about the issue of accounting for National Defense PP&E provides a clear indication that the Operating Performance objective is relevant. These proposed standards would address the Operating Performance objective.

This page intentionally blank

TABLE OF CONTENTS

This page intentionally blank

INTRODUCTION

1. The purpose of this document is to solicit comments on proposed amendments to certain standards for national defense (ND) property, plant, and equipment (PP&E). These standards are contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 11, Amendments to Accounting for Property, Plant, and Equipment -- Definitional Changes, (December 1998); SFFAS No. 8, Supplementary Stewardship Reporting (June 1996); and, SFFAS No. 6, Accounting for Property, Plant, and Equipment (November 1995).

Background

2. Pursuant to SFFAS No. 6, costs to acquire, replace or improve ND PP&E[2] are recognized[3] as an expense in the period incurred. Consistent with the treatment of the acquisition cost of ND PP&E, SFFAS No. 6 also requires that the total estimated cleanup cost be recognized as an expense and a liability established in the period the ND PP&E item is placed in service. A further requirement of SFFAS No. 6, as amended by SFFAS No. 14, is that deferred maintenance amounts be presented as Required Supplementary Information (RSI).[4]

3. The Supplementary Stewardship Reporting standards in SFFAS No. 8 currently require presenting a valuation of ND PP&E. The following values must be presented:

   a. a beginning value balance for ND PP&E;

[2] Originally, ND PP&E was defined in SFFAS No. 6 as Federal mission PP&E. Subsequent to the issuance of SFFAS No. 6, many agencies suggested that the Federal mission PP&E category would be appropriate for agency PP&E not considered by the Board in developing the category. To prevent confusion, inconsistency, and unintended application, the Board replaced the definition of Federal mission PP&E with the definition of ND PP&E currently contained in SFFAS No. 11 to clarify that only DoD and the Maritime Administration's National Defense Reserve Fleet PP&E would be categorized as ND PP&E.
[3] "Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.
[4] This ED does not propose any changes to the requirements for deferred maintenance.

b. the dollar values for ND PP&E acquired during the reporting period;

c. the dollar values for ND PP&E withdrawn during the reporting period;

d. the increase or decrease in values resulting from revaluation of assets using the latest acquisition cost (LAC); and,

e. the end-of-year values by major type or category of ND PP&E.

The values may be determined using either an historical or LAC valuation method.

4. In addition to the values, condition information is required. The valuation and condition information is presented as Required Supplementary Stewardship Information (RSSI) – that is, outside of the principal financial statements.

Summary of Proposed Standards

5. This ED proposes that:

a. The term "ND PP&E" and its definition currently contained in SFFAS No. 11, SFFAS No. 6, as amended, and SFFAS No. 8, as amended, be rescinded;

b. All assets previously considered to be ND PP&E would now be classified as general PP&E and, the provisions for general PP&E and associated cleanup costs for general PP&E contained in SFFAS No. 6, as amended, would be applied; and,

c. Composite or group depreciation methodology continues to be permitted for general PP&E.

Effective Date

6. This Statement is effective for accounting periods beginning after September 30, 2002, with earlier implementation encouraged.

PROPOSED ACCOUNTING STANDARDS

Amendments to Existing Standards

7. The proposed amendments to accounting standards for assets previously identified as national defense (ND) property, plant, and equipment (PP&E) are presented in paragraphs 8 through 16 that follow.

8. The proposed amendments would affect existing standards, for periods beginning after September 30, 2002 or upon early implementation of this standard, in the following manner:

   a. SFFAS No. 11 would be rescinded in its entirety;

   b. The prefatory box preceding paragraph 52 of SFFAS No. 8 would be rescinded;

   c. Paragraphs 52 through 70 of SFFAS No. 8 would be rescinded;

   d. Paragraph 21 of SFFAS No. 6 would be amended by rescinding the category name "Federal mission property, plant, and equipment;"

   e. The heading "Federal mission property, plant, and equipment" on page 14 of SFFAS No. 6 would be rescinded;

   f. Paragraphs 46 through 56 of SFFAS No. 6 would be rescinded, and,

   g. SFFAS No. 6 would be amended by adding the following sentence to paragraph 35 as a separate bulleted line item:

      - A composite or group depreciation methodology[5], whereby the costs of PP&E are allocated using the same allocation rate, is permissible.

[5] The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

Capitalization Upon Implementation

9. The initial capitalization amount for assets previously considered ND PP&E should be based on historical cost in accordance with the asset recognition provisions of SFFAS No. 6, as amended.

10. Historical cost for the assets should be determined as follows:

    a. The initial capitalization amount for these assets should be the initial historical cost for the items including any major improvements or modifications.

    b. If obtaining initial historical cost is not practical, estimated historical cost may be used. Other information may provide support for establishing an estimate of the initial capitalization amount. Such information includes budget, appropriation, or engineering documents and other reports reflecting amounts expended.

    c. Alternatively, estimates of historical cost may be derived by estimating the current replacement costs of similar items and deflating those costs, through the use of price-level indexes, to the acquisition year or estimated acquisition year if the actual year is unknown. Other reasonable approaches for estimating historical cost may be utilized. For example, latest acquisition cost may be substituted for current replacement cost in some situations.

11. A contra asset account--accumulated depreciation--for the assets should be calculated under the provisions provided in paragraphs 41, 42, and 43 of SFFAS No. 6, as amended.

12. For military equipment that is in service upon implementation of this standard, cleanup cost liabilities should be adjusted, as needed.[6]

[6] Under the provisions of SFFAS No. 6, paragraph 97, a portion of the estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation and a liability accumulated over time as expense is recognized. This adjustment may be needed because the DoD may have already recognized the total estimated cleanup costs as a liability and expense for some military equipment per paragraph 101 of SFFAS No. 6, as amended.

13. This standard recognizes some imprecision may result from determining or estimating initial capitalization costs for items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate; and, that such imprecision is acceptable in the transition financial statements.

Implementation Guidance

14. The cumulative effect of adopting this accounting standard should be reported as a "change in accounting principle." The adjustment should be made to the beginning balance of cumulative results of operations in the statement of changes in net position, for the period the change is made.

15. Prior year financial statements presented for comparative purposes should be presented as previously reported.

16. The nature of the changes in accounting principle and its effect on relevant balances should be disclosed in the current period. Financial statements of subsequent periods need not repeat the disclosures.[7]

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

[7] SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles,* paragraphs 12 and 13.

This page intentionally blank

APPENDIX A: BASIS FOR CONCLUSIONS

17. This appendix summarizes some of the considerations deemed significant by the Board 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. One Board member provides an Alternative View pertaining to the composite and group depreciation methods. The Alternative View is presented in APPENDIX B: ALTERNATIVE VIEW.

Background

18. The Federal Accounting Standards Advisory Board (FASAB) has studied accounting and reporting approaches for Property, Plant, and Equipment (PP&E) for a number of years. FASAB's initial standards for PP&E began with the development of Statement of Federal Financial Accounting Standards (SFFAS) Number 6 (No. 6), Accounting for Property, Plant, and Equipment, and followed with SFFAS No. 8, Supplementary Stewardship Reporting.

19. SFFAS No. 6 requires that general PP&E be recognized as assets in the basic financial statements and, except for land and land improvements that produce permanent benefits, be charged to expense through depreciation over their useful life. SFFAS No. 6, paragraph 122, states that "allocation of the cost of general PP&E, excluding land, among accounting periods was essential to assessing operating performance." The Board's federal financial reporting objectives concept statement, SFFAC No.1, focuses on relating costs to accomplishments in reporting an entity's operating performance. To meet the operating performance objective for general PP&E, the Board sought to provide accounting standards that would result in:

    a. relevant and reliable cost information for decision-making by internal users;

b. comprehensive, comparable cost information for decision-making and program evaluation by the public; and,

c. information to help assess the efficiency and effectiveness of asset management.

20. The Board, however, found that for some PP&E, the depreciation effect of the asset on operating performance was not the predominant reporting objective. Instead, stewardship was important. Therefore, three categories of assets (i.e., national defense PP&E (ND PP&E),[8] heritage assets, and land) are referred to collectively as stewardship PP&E.

21. The purpose of SFFAS No. 8 was to establish standards for reporting on the Federal Government's stewardship over certain resources entrusted to it, and certain responsibilities assumed by it. Among these standards are standards for reporting on stewardship PP&E. "Stewardship PP&E" consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differ from general PP&E in that their values may be indeterminable or may have little meaning (e.g., museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (e.g., ND PP&E) to accounting periods that benefit from the ownership of such assets is not meaningful. Specifically, for ND PP&E the Board did not believe applying depreciation accounting for these assets would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believed that these assets are developed, used, and retired in a manner that does not lend itself to a "systematic and rational" assignment of costs to accounting periods (i.e., depreciation accounting) and, ultimately, to outputs.

[8] Prior to the issuance of SFFAS No. 11, *Amendments to Accounting for Property, Plant, and Equipment – Definitional Changes*, (amending SFFAS Nos. 6 and 8) the Board referred to ND PP&E as Federal Mission PP&E. The reasons leading to that change are not relevant to this ED but may be understood by reading SFFAS No. 11. This document uses the amended title and definition in referring to the existing provisions.

22. Accordingly, one result of SFFAS Nos. 6 and 8 was to remove the PP&E components of ND PP&E from the balance sheet. To accomplish this, SFFAS No. 6 (as amended) requires that the cost to acquire ND PP&E components be expensed when incurred. SFFAS No. 8 (as amended), requires presenting ND PP&E as stewardship information and to include the following:

    a. a beginning value balance for ND PP&E, using either a historical or latest acquisition cost (LAC) valuation method;

    b. the dollar values for ND PP&E acquired during the reporting period;

    c. the dollar values for ND PP&E withdrawn during the reporting period;

    d. the increase or decrease in values resulting from revaluation of assets using the LAC; and,

    e. the end-of-year values by major type or category of ND PP&E.

23. In addition to presenting values, SFFAS No. 8 requires that condition information be presented. The presentation of value and condition information is done off-balance sheet as Required Supplementary Stewardship Information (RSSI). In addition to value and condition, SFFAS No. 6, as amended, requires deferred maintenance information to be presented as Required Supplemental Information (RSI) for ND PP&E.

24. In early 1998, the FASAB issued an exposure draft to amend SFFAS Nos. 6 and 8. The exposure draft was initiated (1) to refine the definition of ND PP&E, and (2) in recognition of the need to provide a transition plan due to the DoD's inability to comply with the provisions of SFFAS No. 8. During the process, the Board reconsidered whether SFFAS No. 8 was an appropriate end goal. Ultimately, the 1998 exposure draft included, among other proposals, proposals to replace the requirement to present cumulative cost information in the supplementary stewardship report with a requirement to present ND PP&E annual acquisition costs for each of five years (i.e., annual trend information rather than cumulative costs), quantities, and condition information.

25. Besides considering the written comments in response to this 1998 ED, the Board held a public hearing on these proposals to explore further the concerns expressed by some respondents. Because of the divergent views of both respondents and Board members, the Board did not reach a final conclusion on revisions to the reporting requirements for ND PP&E in SFFAS No. 8. The Board's continued deliberations on the proposed standards highlighted the differences of opinion on this subject among the Board members. Since neither the standards in SFFAS No.8 nor the proposed amendments were acceptable to a majority of the current Board members, it was decided that the accounting for and reporting on ND PP&E requirements be revisited in their entirety. DoD voluntarily undertook a study to address (1) users information needs relative to ND PP&E, (2) the current systems capabilities within DoD, and (3) an assessment of alternative means to meet the reporting objectives set by the Board.

26. The Board acknowledges that the SFFAS No. 8 stewardship approach was adopted, not as a convenience or temporizing expedient, but as a technically desirable approach. However, an increasing government-wide focus on the cost of operations and operating performance in relation to the implications of the Government Performance and Results (GPRA) Act, combined with the Board's and DoD's extensive study and greater understanding about National Defense PP&E, provides a clear indication that the operating performance objective is relevant for ND PP&E.

27. Therefore, in September 2001, the FASAB issued an ED that proposed incremental movement from the stewardship reporting of SFFAS No.8 towards information focused on operating performance. The amendments proposed in that ED would have made the following changes. The definition of ND PP&E would be amended. ND PP&E would consist of 2 separate categories of items within the amended definition: (a) Major End Items and (b) Mission Support Items. Major End Items would be subject to a presentation of the number of

units and condition assessment information by asset type or category. In addition, Major End Items would be capitalized but not depreciated, while Mission Support Items would be capitalized and depreciated. Also, data for the ten largest current acquisition programs would be disclosed.

28. The Board issued the 2001 ED because it believed that the proposals in that ED were the best that could be achieved given the acknowledged shortcomings of DoD accounting and other management information systems, as well as DoD's firm belief that proposed property accounting information would not be useful for management purposes. The 2001 Exposure Draft would have achieved one of the current Board's objectives, which was to establish monetary accountability over military assets. However, because the 2001 Exposure Draft did not require depreciation of some major assets, the September 2001 FASAB Exposure Draft on NDPP&E fell short of comprehensive PP&E accounting under generally accepted accounting principles and in meeting the operating performance objective for general PP&E, as embodied in SFFAS No. 6 (September 2001 ED, paragraphs 73-76). In addition, it would not have fully achieved the objective of SFFAS No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, to account for the full cost of programs with a focus on relating costs to accomplishments in reporting an entity's operating performance.

Proposed Standards

29. While there were divergent views on the proposals in the 2001 ED, many respondents believed ND PP&E should be capitalized and depreciated as is general PP&E. Many Board members had wanted to make this change for some time. This caused the Board to reconsider the proposals in the 2001 ED. The outcome from the deliberations was a consensus of the Board to make the proposal in this ED to classify, capitalize, and depreciate ND PP&E as general PP&E. The Board believes its proposal would put discipline into the asset management process. Many members of the Board believe depreciation,

impairment, deferred maintenance, and condition are interrelated judgments that should result jointly from periodic estimation of the remaining useful service potential of assets. From that perspective, depreciation can be seen to represent expected loss through use, impairment and deferred maintenance to represent unexpected loss, and condition to represent the composite result of all three. The Board believes periodic analysis of the sources of asset diminution is as important, perhaps more so, for national defense assets as for other assets.

30. A second purpose of depreciation accounting is to provide information for measuring the full cost of producing outputs (e.g., deterrence, readiness, training). Full cost, including the depreciation of ND PP&E, would be available for use in assessing the operating performance of responsibility segments for producing outputs and to meet the goals of SFFAC No. 1 and SFFAS No. 4. In addition, the Board believes that classifying all DoD PP&E as general PP&E would improve the public's understanding of federal accounting, add consistency to the application of standards throughout the Federal government, reduce the DoD's cost of development and operation of accounting systems, and preclude the standard setting costs that would be necessary to resolve on-off balance sheet questions. Accordingly, the Board is proposing to rescind SFFAS No.11 and to amend SFFAS No. 6 and SFFAS No. 8.

Exclusion of Special Disclosures

31. The September 2001 Exposure Draft on ND PP&E proposed three special disclosures for ND PP&E. They were:

    a. unit information by type or category of Major End Item[9];

[9] The Accounting for National Defense PP&E and Associated Cleanup Costs ED, dated September 2001, defined Major End Items to be: 1) items that launch, release, carry, or fire a particular piece of ordnance, and 2) items that carry weapons systems-related property, equipment, materials, or personnel. Major End Items (a) have an indeterminate or unpredictable useful life due to the manner in which they are used, improved, modified, or maintained and (b) are subject to premature destruction or obsolescence (e.g., aircraft, ships, combat vehicles, etc.) Also, included in this category are vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet.

b. condition assessment information for Major End Items; and,

c. actual and planned acquisition program costs and unit information for the ten largest current national defense PP&E[10] acquisition programs.

32. These proposed disclosures were developed and proposed after years of deliberation and with varying recognition and measurement requirements for the principal financial statements. After reviewing responses to the September 2001 ED, the Board decided not to propose these three special disclosures as part of this proposal. The Board concluded that these special disclosures may deserve further study or development for the following reasons:

a. Unit information as originally proposed was tied to the Major End Item definition. The definition's effectiveness was questioned by respondents.

b. Unit and condition information has been determined to be "sensitive" information[11] and DoD will cease publication of such information.

c. Many respondents suggested that further research in the area of condition and deferred maintenance presentation is needed to develop consistent and comparable measurement and reporting criteria. However, respondents found condition information to be a useful supplement to deferred maintenance.

d. One respondent suggested that the proposed reporting on the ten largest acquisition programs – based on budgetary measurement – would confuse users since the cost of assets recognized on the balance sheet would be different from budget cost measurements.

[10] SFFAS No. 11 defined ND PP&E as being "PP&E [that] are (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (2) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet."

[11] Any information, the loss, misuse, or unauthorized access to which would or could adversely affect the organizational and/or national interest but which does not meet classification criteria specified in DoD 5200.1-R (reference (c)). Source: DoD 5200.1-M; Acquisition Systems Protection Program; 16 March 1994.

33. Given the resources that have been devoted to resolving the fundamental recognition and measurement guidance for ND PP&E and the substantial efforts underway at DoD to modernize its systems, the Board does not believe it would be useful to withhold this proposal while it deliberates on the merits of any further PP&E disclosures. However, the Board expects to continue its work on PP&E or fixed asset accounting in the near future.

34. In the meantime, the Board does not believe the absence of the previously proposed special disclosures would outweigh the benefits to be gained through this proposal. With regard to the stewardship objective and the need for unit information, the Board notes that the stewardship objective is being met for general PP&E without this special disclosure. Through the course of the audit existence of PP&E and the completeness of PP&E records are verified. This satisfies the basic stewardship function that the double entry system offers.

35. With regard to condition information, the Board notes that deferred maintenance information is currently required. Further, the assessment of useful life needed to assure depreciation is reasonable would result in greater discipline in information associated with the condition of PP&E.

36. The Board expects to revisit these disclosures as it considers a project on integrating depreciation, impairment and deferred maintenance reporting at a future date. The effort would be a government-wide undertaking.

Composite or Group Depreciation

37. The proposal endorses composite or group depreciation as an acceptable approach for depreciating PP&E. The Board acknowledges that features of certain kinds of depreciable assets may cause practical adaptations of depreciation methods. Two of the more common adaptations are the group and composite depreciation methods.

38. In actual practice, certain operational assets are grouped for depreciation purposes. Where an average rate of depreciation is applied to a number of

homogeneous assets, as characterized by similar characteristics and service lives, the procedure is referred to as group depreciation. Where an average or composite rate of depreciation is applied to a number of heterogeneous assets having dissimilar characteristics and service lives, the procedure is referred to as composite depreciation. The two methods are similar in mechanical application of an average rate and in the resulting journal entries. The main difference between them is the group of assets to which they are applied.

39. Under the two methods, all of the assets in the group are recorded in one asset control account, and one accumulated depreciation account is established for the entire group. Consequently, the book value as reflected in these two accounts applies to the entire group and not to individual assets. Subsequent acquisitions of items belonging to the group are added to the group asset account at cost. Depreciation is computed by multiplying an average depreciation rate by the balance in the group asset account regardless of the age of each individual asset represented therein.

40. Upon disposition of an asset from the group, the group asset account is reduced by the original cost of the item and the accumulated depreciation account is charged for the same amount less any residual recovery. These methods generally do not recognize "losses or gains" on retirement of single assets in the group because some assets will be retired before the average service life and others after the average service life. However, when there are abnormal dispositions, the cost and related depreciation amounts may be removed from the accounts and any gain or loss may be recognized.

41. The Board considers the composite and group depreciation methods to be appropriate if applied properly, and in the situation that each one accommodates. As practical cost-benefit applications, they generally attain an acceptable level of reliability, as a systematic and rational method of allocating asset costs to operations over a period of years.[12]

[12] Intermediate Accounting, Sixth Edition; Welsch, Zlatkovich, Harrison; 1982

This page intentionally blank

APPENDIX B: ALTERNATIVE VIEW

42. A Board member requests respondents to comment on whether additional guidance is required on the use of composite and group depreciation techniques. While these techniques are used by various entities to reduce the burden of calculating depreciation for individual items of property, plant and equipment, the extreme diversity of federal government (and especially DoD) assets in terms of useful life and unit cost would seem to present situations where mechanical application of these techniques to non-homogeneous groups could result in allocations of costs to periods that would not be "systematic and rational".

43. The member suggests that the "systematic and rational" qualities would be satisfied if the technique employed for computing depreciation produced cost allocations that approximate those obtained using traditional methods (e.g. straight-line, declining balance, units of production) applied on an individual asset basis. The member does not object to use of computational shortcuts such as composite depreciation, but believes that the standard should include criteria to assure that the application of such techniques does not lead to a result that is less than systematic and rational allocation.

This page intentionally blank

FASAB Board Members

David Mosso, Chairman

Philip T. Calder

John A. Farrell

Joseph L. Kull

James M. Patton

Robert N. Reid

Kenneth J. Winter

FASAB Staff

Wendy M. Comes, Executive Director

Project Staff:

Rick Wascak

Federal Accounting Standards Advisory Board

441 G Street NW

Suite 6814

Mailstop 6K17V

Washington, DC 20548

Telephone (202) 512-7350

FAX (202) 512-7366

www.fasab.gov

FASAB

Presorted First Class
Postage & Fees Paid
GAO
Permit No. G100

Federal Accounting Standards Advisory Board

U.S. General Accounting Office
441 G Street, NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548

Official Business
Penalty for Private Use $300