



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

NOV 13 2015

COMPTROLLER

MEMORANDUM FOR ASSISTANT SECRETARIES OF THE MILITARY DEPARTMENTS
(FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES
COMPTROLLERS/CHIEF FINANCIAL OFFICERS OF THE
COMBATANT COMMANDS

SUBJECT: Inventory and Related Property Accounting Policy Requirements

This memorandum establishes policy guidelines for accounting for Inventory and Related Property (I&RP). The guidelines address several issues identified in the I&RP Working Group as impediments to audit readiness:

- Accounting for manufactured inventory subject to progress billing;
- Accounting for initial spares and inventory augmentation purchased as part of a program; and
- Classification of minor items not meeting the definition of operating materials and supplies.

The approaches, outlined in the attached document, are based on methodologies that are compliant with Statement of Federal Financial Accounting Standards (SFFAS) Number 3, "Accounting for Inventory and Related Property," and SFFAS Number 6, "Accounting for Property, Plant, and Equipment." The relevant portions of this policy will be included in a future DoD Financial Management Regulation update.

If needed, please reach Mr. Brian Sykes, my point of contact for this subject, at 703-695-5902 or brian.a.sykes4.civ@mail.mil.



Mark E. Easton
Deputy Chief Financial Officer

Attachment:
As stated

cc:
Deputy Chief Management Officer
Principal Deputy Under Secretary of Defense for Acquisition, Technology and Logistics
Assistant Secretary of the Army (Acquisition, Logistics and Technology)
Assistant Secretary of the Navy (Research, Development and Acquisition)
Assistant Secretary of the Air Force (Acquisition)
Deputy Comptroller (Program/Budget), Office of the Under Secretary of Defense (Comptroller)
Deputy Inspector General for Auditing, DoD Office of Inspector General

Department of Defense
Inventory and Related Property Policy Requirements
November 2015

I. INTRODUCTION

Objective

The objective of this document is to provide approaches to Department of Defense (DoD) Inventory and Related Property (I&RP) audit readiness challenges that meet the following three criteria in descending order of importance:

1. Are compliant with Generally Accepted Accounting Principles (GAAP);
2. Are cost- and time-effective; and
3. Can be implemented consistently across the DoD.

Background

I&RP is tangible personal property and includes such items as inventory for resale, fuels held for sale, spare and repair parts, and clothing and textiles. Inventory available and purchased for resale includes consumable spare and repair parts and repairable items owned and managed by the Department. Related property includes Operating Materials and Supplies (OM&S) and stockpile material. OM&S includes items such as spare and repair parts, ammunition, and tactical missiles held for consumption.

DoD Components are responsible for ensuring that I&RP assets are accounted for in accordance with GAAP. The April 2015 Financial Improvement and Audit Readiness (FIAR) Guidance establishes I&RP as a Mission Critical Asset category because it is likely to be material to the financial statements of many DoD Components. DoD Components have identified several challenges related to accounting for and reporting I&RP in the financial statements that could impact the Department's audit readiness objectives. Three specific issues that are identified and are addressed in this document are:

1. Accounting for manufactured Inventory subject to progress billing;
2. Accounting for the funding of initial spares and inventory augmentation purchased as part of an acquisition program; and
3. Classification of minor items not meeting the definition of OM&S.

The Office of the Under Secretary of Defense (Comptroller) FIAR Directorate and the Office of the Assistant Secretary of Defense for Logistics and Material Readiness have collaborated with Components throughout the Department to establish best practices, methodologies, and approaches for the challenges identified.

Applicable Accounting and Reporting Requirements/Guidance

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

- SFFAS No. 6, “Accounting for Property, Plant, and Equipment”
- DoD Financial Management Regulation 7000.14-R Volume 4, Chapter 4, “Inventory and Related Property”
- DoD Financial Management Regulation 7000.14-R Volume 11B, Chapter 15, “Supply Management Activities”
- Treasury Financial Manual - United States Government General Ledger 2015-03
- April 2015 Financial Improvement and Audit Readiness (FIAR) Guidance
- DoD United States Standard General Ledger (USSGL) Transaction Library and DoD Standard Chart of Accounts
(<http://dcmo.defense.gov/ProductsandServices/StandardFinancialInformationStructure.aspx>)

II. ACCOUNTING FOR MANUFACTURED INVENTORY SUBJECT TO PROGRESS BILLING

Working Capital Fund (WCF) Supply Activities (e.g., Defense Logistics Agency’s Supply Management activity or the Army Supply Management activity) acquire Inventory from private sector and organic (DoD) manufacturers. Supply Activities are frequently billed incrementally by the manufacturer for Inventory items that are in the process of being manufactured. Currently, when incremental billing occurs, Supply Activities recognize a fractional portion of an item as Inventory. That accounting practice does not comply with GAAP and is complex to implement.

Scope

This policy applies to the acquisition of manufactured inventory by WCF Supply Activities.

Policy

DoD’s policy is that the Supply Activity must record any incremental amount billed for manufactured inventory as Work-in-Process (WIP). The Supply Activity will adjust the Inventory-WIP account as appropriate based on the subsequent progress bills received. Refer to the DoD USSGL Transaction Library for detailed debit and credit transactions related to the recording and transfer out of WIP inventory accounts to the appropriate Inventory Held for Sale account(s). Once the Supply Activity receives the completed manufactured or remanufactured end item(s), they will transfer the corresponding value in the Inventory-WIP account to the appropriate Inventory account. Accounting transactions related to this policy need to comply with the DoD Standard Chart of Accounts and the DoD USSGL Transaction Library.

III. ACCOUNTING FOR THE FUNDING OF INITIAL SPARES AND INVENTORY AUGMENTATION PURCHASED AS PART OF AN ACQUISITION PROGRAM

Initial spares are spare and repair parts that support newly fielded weapons systems (as well as non-weapon systems acquired through acquisition programs) during the initial period of operation until the supply chain can support the demand generated by the systems. Inventory augmentation costs finance the acquisition of spare or repair parts which are required over and above the demand replacement generated by the systems. Although WCF Supply Activities are responsible for ensuring spare and repair parts are available to support the fielding of weapon systems and soldiers, they do not receive direct appropriations to purchase initial spares or for

inventory augmentation. They are not responsible for initial capitalization. To capitalize initial inventory, the Component or Components that ultimately will use the inventory acquire the initial spares or inventory augmentation quantities through the acquisition program of record using direct appropriations and provide the initial Inventory to the WCF Supply Activity. When a spare or repair part subsequently is needed by the Component, the Supply Activity will sell the item to the Component. The sale of this inventory to the Component provides the Supply Activity with the revenue needed to liquidate obligations incurred when the Supply Activity purchases replenishment spares. Supply Activities currently use complex and non-GAAP-compliant accounting (e.g., reversing revenue) to record the acquisition and subsequent sale of the initial spares and augmented inventory; such practices must be replaced. Additionally, the current practice of Component program offices using Military Interdepartmental Purchase Requests (MIPRs) to transfer procurement funds to the WCF Supply Activities to fund initial inventory is not an acceptable accounting practice. This is because WCF Supply Activities are not procuring initial inventory for Component program offices, and thus no reciprocal exchange transaction occurs.

Scope

This policy applies to the funding and acquisition of initial spares and to the funding and acquisition of inventory augmentation by program offices as part of an acquisition program.

Policy

DoD's policy is that the acquiring program office will transfer the initial spares or augmented inventory without reimbursement to the Supply Activity. This transfer must be evidenced with sufficient supporting documentation (e.g., form DD1150 Request for Issue/Transfer/Turn-in).

Using this method, the Component purchases the initial spares or augmented inventory and then transfers the property to the Supply Activity (e.g., Army Supply Management activity). The Component must record the associated general ledger entries (both budgetary and proprietary) for the purchase of the property as OM&S prior to the transfer to the Supply Activity. The Component will initiate a title transfer without reimbursement to legally transfer ownership and will remove the property from its accounting records. The Supply Activity will add the property to its working capital fund inventory accounting records. The transfer must be fully documented and the documentation must be retained. This policy will not impact the normal sale transaction from the Supply Activity to the Component and will enable the Supply Activity to account for both the initial receipt of saleable inventory and the subsequent sales transactions in a GAAP-compliant manner.

Refer to the DoD USSGL Transaction Library for detailed debit and credit transactions related to the property transfers without reimbursement.

IV. CLASSIFICATION OF MINOR ITEMS NOT MEETING THE DEFINITION OF OM&S

Components have expressed difficulty in classifying stocked tangible personal property such as infantry helmets or hand tools that does not meet the definition of OM&S established in SFFAS 3.

Scope

This policy applies to DoD owned equipment.

Policy

SFFAS 6 defines Property, Plant, and Equipment as tangible assets that:

- Have an estimated useful life of two or more years;
- Are not intended for sale in the ordinary course of operations; and
- Are intended to be used or available for use by the reporting entity.

Tangible personal property such as infantry helmets and hand tools meets all of the above criteria, and therefore will be classified as equipment. Equipment will be expensed in the period purchased unless its historical cost exceeds the Component's capitalization threshold, in which case the equipment will be capitalized and depreciated over its useful life.

Components must analyze items in their stores to identify items that meet the above criteria, and are encouraged to leverage system data and functions where appropriate to perform the analysis in a cost and time efficient manner. The analysis must be documented and retained in accordance with Component audit needs and relevant document retention policies.

This policy does not replace or omit existing logistics, supply chain, or asset management requirements regardless of the assets' accounting classification.

APPENDIX A: DEFINITIONS

As used in this document the following definitions apply:

Initial Spares – Initial spares are spare and repair parts that support newly fielded weapons systems during the initial period of operation until the supply system can support the demand generated by the systems.

Inventory – 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.

Inventory Augmentation – Inventory augmentation costs finance the acquisition of inventories that are required over and above demand replacement (excluding mobilization requirements which are financed by appropriations) to maintain the level of materiel support at the currently approved position.

Organic Manufacturing – Organic manufacturing organizations are manufacturers that are internal to the DoD in contrast to private sector entities. Organic manufacturers operate more like service providers by assembling products for the Supply Activities. The costs of the material used in assembling products are passed on to the Supply Activities through incremental billing.

Operating Materials and Supplies (OM&S) – 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.

Replenishment Spares – Replenishment spares are spare and repair parts resupplying initial stocks.

WCF Supply Activity – Supply Activities manage inventory held for sale to other DoD Components or activities within a Component and, when authorized by legislation, items procured for sale to members of the U.S. Armed Forces and other individuals or organizations.