OFFICE OF THE UNDER SECRETARY OF DEFENSE
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MAR 14 2016

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: Strategy and Implementation Guidance for General Equipment Valuation

The attachment to this memorandum provides the Department's strategy and implementation guidance for General Equipment valuation. The strategy and guidance were collaboratively developed by the Office of the Under Secretary of Defense for Acquisition Technology, and Logistics, the Office of the Under Secretary of Defense (Comptroller), and the General Equipment Working Group.

The Federal Accounting Standards Advisory Board (FASAB) has issued an exposure draft defining an alternative valuation approach known as "deemed cost" which can be used by a Reporting Entity to establish Property, Plant, and Equipment (PP&E) opening balances. The FASAB exposure draft also provides additional guidance on valuing equipment following the establishment of opening balances. Accordingly, the Department has developed the attached policy based on the proposed FASAB guidance. This policy only applies to the General Equipment portion of PP&E. Relevant provisions of this policy will be incorporated into the DoD Financial Management Regulation in a future update.

My point of contact for this subject is Mr. Brian Sykes. Reach him at 703-695-5902 or brian.a.sykes4.civ@mail.mil.

Mark E. Easton
Deputy Chief Financial Officer

Attachment:
As stated

cc:
Principal Deputy Under Secretary of Defense for Acquisition, Technology and Logistics
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Assistant Deputy Chief Management Officer
Deputy Inspector General for Auditing, DoD Office of Inspector General

Department of Defense
Strategy and Implementation Guidance for General Equipment Valuation
March 2016

I. INTRODUCTION

The purpose of this document is to set forth the Department of Defense (DoD or "the Department") strategy for establishing the value of opening balances for General Equipment and to provide guidance to the DoD Components[1] for implementing that strategy. This strategy provides alternative valuation methods for establishing opening General Equipment balances (as described below) only when historical records and systems do not provide a basis for valuation of opening balances in accordance with The Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) 6, "Accounting for Property, Plant, and Equipment."

This guidance addresses the financial statement assertion of valuation which relates to whether assets, liabilities, and net position are included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments are properly recorded. Audit readiness requirements for the other financial statement assertions (existence, completeness, rights and obligations, and presentation and disclosure) should have already been completed by DoD Components.

This document was collaboratively developed by the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (OUSD(AT&L)), the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)), and the General Equipment Working Group. The objective of this document is to provide a strategy and implementation guidance that meets the following three criteria in descending order of importance:

- Compliance with Generally Accepted Accounting Principles (GAAP);
- Cost- and time-effectiveness; and
- Can be implemented consistently across the DoD

This memorandum applies to all DoD owned General Equipment which has been defined by FASAB and the DoD as follows:

SSFAS 6 defines General Equipment as: "Tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity."

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[1] As used in this memorandum, the term DoD Component(s) includes: The Office of the Secretary of Defense; the Military Departments (including their Reserve components); the Office of the Chairman of the Joint Chiefs of Staff and the Joint Staff; the Combatant Commands; the DoD Office of Inspector General; the Defense Agencies; the DoD Field Activities; and all other organizational entities in the DoD.

To provide additional clarity in applying the definition of General Equipment (which is a subset of Personal Property), DoDI 5000.64 includes the following definition: "Personal Property that is functionally complete for its intended purpose, durable, and nonexpendable. Equipment generally has an expected service life of 2 years or more; is not intended for sale; does not ordinarily lose its identity or become a component part of another article when put into use; has been acquired or constructed with the intention of being used."

For purposes of this memorandum, DoD General Equipment has been separated into the following three categories:

- General purpose equipment (including weapon systems);

- Government owned equipment in the possession of contractors, whether Government Furnished Equipment (GFE) or Contractor Acquired Property (CAP); and

- Construction in Progress for equipment (CIP)

II. GENERAL EQUIPMENT VALUATION STRATEGY AND IMPLEMENTATION GUIDANCE OVERVIEW

Unless otherwise noted, the strategy and implementation guidance included in this Overview section applies to all three categories of DoD General Equipment listed above.

A. STRATEGY

On February 17, 2016, FASAB issued an updated exposure draft incorporating respondent comments to its earlier draft titled "Establishing Opening Balances for General Property, Plant and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35" (FASAB Exposure Draft). In order to become an authoritative pronouncement, this FASAB Exposure Draft will need to continue to follow the standard FASAB procedures, including collecting public comments on the exposure draft, and considering them prior to finalizing the Federal Financial Accounting Standard. The DoD's strategy and implementation guidance set out in this memorandum is based on the premise that accounting principles, in the exposure draft will ultimately be issued as an authoritative pronouncement.

The FASAB Exposure Draft provides for alternative valuation methods (i.e., Deemed Cost – defined in section B below) to be used in establishing opening balances if the entity did not have existing systems which could provide the information necessary to produce GAAP-based financial statements without the use of these alternative valuation methods. Deemed Cost is an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances. A reporting entity[2] can only use the alternative valuation method once to establish opening balances. After use of the alternative valuation method, all subsequent transactions must be recorded in accordance with GAAP under SFFAS 6 and related pronouncements/standards, (i.e., at historical cost). Therefore, it is critical that DoD Components have their processes, systems and controls in place and operating effectively prior to establishing their opening balances under the alternative valuation methods.

For each of the three categories of General Equipment noted above, DoD Components will complete the following in preparation for the FY2018 DoD audit:

- Establish and validate opening balances based on Deemed Cost.

- Make an unreserved assertion that its General Equipment[3] is presented fairly and in accordance with GAAP. An unreserved assertion is an unconditional statement. See Section VI Making an Unreserved Assertion below.

- Go-forward Processes– interim approach. Have processes, systems and controls in place to record transactions at historical cost in compliance with GAAP prior to the establishment of opening balances. Some of these processes may involve manual "work arounds" until the end state target environment (as described in Section II B.2 Implementation below) is achieved.

In addition, DoD Components are expected to work towards and achieve the end state target environment, which will include process improvements through automation/integration and monitoring.

B. IMPLEMENTATION

1. Establish and Validate Opening Balances

Opening balances are account balances that exist at the beginning of the reporting period. They are based upon the closing balances of the prior reporting period and reflect the effects of transactions, events and policies of prior periods. DoD Components must have their opening

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[2] The FASAB Exposure Draft in footnote 8 states: "SFFAS 47. Reporting Entity, provides that "component reporting entity" is used broadly to refer to a reporting entity within a larger reporting entity. Examples of reporting entities include organizations such as executive departments and agencies. Component reporting entities would also include sub-components that may themselves prepare General Purpose Federal Financial Reports (GPFFRs). One example is a bureau that is within a larger department that prepares its own standalone GPFFR". In addition, any DoD Component that has a responsibility for maintaining a trial balance for reporting purposes is considered to be a Reporting Entity.

[3] A DoD Component may make an unreserved assertion on its General Equipment line item as set out in its financial statement footnotes or they may make an unreserved assertion on the individual categories of General Equipment (general purpose equipment; government furnished equipment; contractor acquired property; and construction in progress) so long as the DoD Component includes the detail of each General Equipment category in its financial statement footnotes if it is asserting to individual categories of General Equipment.

balances and go-forward processes ready and auditable for the Fiscal Year 2018 annual financial statement audit.

DoD will use Deemed Cost to value the opening balances for General Equipment. Deemed Cost is defined by FASAB as "an amount used as a surrogate for initial amounts that otherwise would be required to establish opening balances." The FASAB Exposure Draft allows for the use of Deemed Cost for establishing opening balances based on alternative valuation methodologies. See Section III below for DoD Approved Deemed Cost Methodologies for General Equipment.

When establishing opening balances using Deemed Cost, DoD Components will calculate a gross value and an accumulated depreciation value for General Equipment assets. Both the gross value Deemed Cost and accumulated depreciation Deemed Cost will be recorded in the accounting records. Recording both the gross value and accumulated depreciation will facilitate consistent reporting for financial statement footnote disclosure with General Equipment recorded after establishment of the opening balances.

When evaluating General Equipment for the purpose of establishing opening balances, DoD Components must consider the capitalization thresholds in effect at the time the General Equipment was acquired. Prior to October 1, 2013 the capitalization threshold for General Equipment was $100,000. The threshold changed to $250,000 for all reporting entities with the exception of the Navy and Air Force General Funds for which the equipment threshold was increased to $1 Million. DoD Components must review their Accountable Property System of Record (APSR) records in accordance with those thresholds (including capital improvements) to ensure that assets are capitalized or expensed appropriately based on their Deemed Cost. As part of this review, DoD Components will not simply value assets already recorded above the capitalization threshold. DoD Components will perform additional analytical procedures to identify any assets that have been improperly capitalized or expensed. Examples of this type of review can include searching for equipment with values of $0 or $1 which are indications of erroneous values. An additional example can include equipment for which an additional zero was added in error, incorrectly placing the asset above the capitalization threshold.

DoD Components will prioritize their efforts in establishing and validating their opening balances based on the assets' impact on the financial statements. The highest priority should be given to those assets with the highest Deemed Cost-derived net book value. However, assets with little or no net book value must not be ignored. Equipment for which the historical cost has already been validated audit ready (including adequate supporting documentation sufficient for audit purposes) does not need to be revalued.

An asset's net book value is calculated by subtracting accumulated depreciation from the recorded acquisition cost. Accumulated depreciation is calculated based on the asset's useful life and placed in service date. Accordingly, placed in service dates are critical to calculating accurate net book values for financial reporting. The validation of placed in service dates, along with other data elements relevant to existence, completeness, rights, and presentation should have already been completed by DoD Components as part of their Financial Improvement and Audit Readiness (FIAR) Wave 3 efforts. DoD Components must also ensure that the useful life used for calculating depreciation is compliant with DoD Policy for general equipment useful lives. See the Estimated Useful Lives for General Equipment in Appendix A.

When prioritizing the opening balance valuation effort, DoD Components must also determine if the asset has undergone any modifications, modernizations, upgrades, and/or improvements that have impacted the asset's value or extended its useful life (See Modifications, Modernizations, Upgrades and Improvements in Appendix A for additional guidance).

Deemed Cost provides additional methodologies to value equipment to establish an opening balance, but it does not change the requirement that the values must be supported. Therefore, recorded values must be supported by adequate and acceptable documentation. This documentation must be readily available to provide to auditors. Documentation supporting modifications, modernizations, upgrades, and improvements must also be included. Examples of supporting documentation for equipment can be found in the April 2015 FIAR Guidance Section 5.D.

2. Processes, Systems and Controls to Achieve the End State Target Environment

The end state DoD target environment for recording General Equipment transactions in accordance with GAAP will leverage Enterprise Resource Planning systems and improved processes to capture and report historical costs (including both direct and indirect costs). It may be several years before the DoD has systems in place for the end state target environment that are capable of valuing equipment using cost accounting to produce actual historical costs based on transactions. Prior to reaching the end state target environment, DoD Components can use reasonable estimates for the purpose of cost assignment/allocation. However, the estimates must be bound by actual program and contract expenditures. The estimates provide a means to allocate the expenditures. Using estimates in this capacity provides two key benefits:

- It provides the DoD the continued use of several estimating methodologies while systems capabilities are developed for the long-term end state target environment; and

- It facilitates reasonableness in the estimate by maintaining a relationship to expended funds, and therefore limits the potential deviation from actual historical cost

Use of estimates to assign/allocate actual costs is in compliance with the FASAB Exposure Draft paragraph 11 and 21, SFFAS 4 "Managerial Cost Accounting Standards and Concepts" paragraphs 124 and 125, and Federal Financial Accounting Technical Release 15: "Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation Assignment and Allocation" paragraphs 20 - 22. Specifically, estimates based on contracts, budgets, engineering documents, etc. used to allocate actual costs would meet the criteria of SFFAS 4 paragraph 124(c) and the definition of estimates in FASAB Handbook, Appendix E – Consolidated Glossary below:

> FASAB Exposure Draft, paragraph 11, which will replace the existing paragraph 26 of SFFAS 6: "All general PP&E shall be recorded at cost. Although the measurement basis

for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use…"

FASAB Exposure Draft, paragraph 21: "Reasonable estimates are permitted in the preparation of financial statements subsequent to the rescission of SFFAS 35."

SFFAS 4, Paragraph 124: "This standard is intended to establish a principle, rather than a methodology, for cost assignment. Also cost assignments may be performed in cost findings and studies or may be performed within a system on a regular basis. In principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

(1) Directly tracing costs wherever economically feasible;

(2) Assigning costs on a cause-and-effect basis; and

(3) Allocating costs on a reasonable and consistent basis."

SFFAS 4, Paragraph 125: "These principles apply to all levels of cost assignments including:

(1) Assigning inter-entity costs to segments;

(2) Assigning the costs of support services and intermediate products among segments of an entity (the intra-entity cost assignments); and

(3) Assigning direct and indirect costs to outputs."

FASAB Handbook, Appendix E, Glossary: "Estimated Cost – The process of projecting a future result in terms of cost, based on information available at the time. Estimated costs, rather than actual costs, are sometimes the basis for credits to work-in-process accounts and debits to finished goods inventory."

The valuation of equipment includes all costs incurred to bring the General Equipment to a form and location suitable for its intended use. Many different cost factors enter into the value of a General Equipment asset. See current SFFAS 6 paragraph 12 for an illustrative list of cost factors.

For all acquisition programs (new and existing), business processes and controls must continue to operate effectively in order to produce financial statements which are in accordance with GAAP. To accomplish this, stakeholders from across the DoD Component (e.g., Finance, Acquisitions, Logistics, etc.) must work together to ensure accounting and valuation for equipment are in accordance with GAAP. It is the responsibility of the DoD Components to form an integrated team comprised of these roles within their functional communities. The success of the integrated team rests with the DoD Components and not through additional mandates from OUSD. It is important that this integrated team begin fully implementing the requirements described below on all new General Equipment acquisition programs and new contract.

Implementation of these requirements must also include documenting processes and controls, testing controls, remediating deficiencies, and ensuring Federal Information System Controls Audit Manual (commonly known as FISCAM) reviews are performed on all systems material to the financial statements (e.g., the APSR, general ledger accounting system, key feeder systems, etc.).

III. DoD APPROVED DEEMED COST METHODOLOGIES FOR GENERAL EQUIPMENT

Deemed Cost for General Equipment will be based upon one, or a combination, of the following valuation methods:

- Estimated historical cost (initial amount) – Reasonable estimates may be based on:
    - Cost of similar assets at the time of acquisition;
    - Current cost of similar assets discounted for inflation since the time of acquisition; or
    - Other reasonable methods including latest acquisition cost and estimation techniques based upon information such as but not limited to budget, appropriations, engineering and acquisition documents, contracts or reports reflecting amounts to be expended.
- Replacement cost – defined as the amount required to replace the remaining service potential of an asset in a current transaction at the reporting date, to include the amount the entity would receive from disposing of the asset at the end of its useful life. Replacement cost is an available method for valuing commercial off the shelf equipment(e.g., replacement of a bulldozer).
- Fair value – defined as the amount at which an asset could be exchanged in a current transaction between two willing parties, other than a forced or liquidation sale.

The FASAB Exposure Draft provides several options for valuing assets based on Deemed Cost. However, for General Equipment the most practical methods continue to be estimating historical costs. These methods were already available to DoD under SFFAS 6, 23, and 35 and will continue to be the Department's preferred approaches to establishing opening balances. DoD Components that anticipate substantial use of replacement cost or fair value methodologies for equipment valuation must contact the FIAR Directorate and the OUSD(AT&L) Property and Equipment Policy (P&EP) Office prior to committing significant resources to these methods.

DoD Components must consider each Deemed Cost method and select the approach that will be the most efficient in producing an auditable value. Several of the most practical methods are described below. P&EP may also be consulted to assess whether valuation resources and documentation developed previously will be useful in assigning values.

A. ESTIMATES BASED ON SIMILAR ASSETS (LIKE-KIND ANALYSIS)

This method is frequently used for commercial off-the-shelf (COTS) General Equipment, but may also be used for other General Equipment, such as Weapon Systems when appropriate. When using this method, DoD Components will consider:

- When using General Equipment from another organization as a comparable asset, DoD Components will need to work closely with that organization to gather the information needed to support the valuation;

- Care must be taken to ensure that the source value is supported. If the comparable asset is not properly supported, the subject General Equipment is also not properly supported; and

- DoD Components must apply appropriate price indices to estimate the cost of the General Equipment in the period when it was placed into service if the comparable General Equipment has a different in-service date. See FASAB Technical Release 13, "Implementation Guide for Estimating the Historical Cost of General Property, Plant and Equipment for additional details for using indices to inflate or deflate costs."

B. CONTRACT BASED ESTIMATES

This methodology involves valuing General Equipment using the pricing data included in contracts. A complete understanding of the acquisition program, including the structure of all related contracts is required to implement this methodology. DoD Components must align activities and costs of General Equipment with relevant accounting standards to isolate the costs that are to be capitalized versus those that are to be expensed (e.g., research and development costs, factory training). When using this methodology, DoD Components will consider the complexity of multiple contracts used to develop or acquire General Equipment assets.

Steps for performing Contract Estimates:

- Program Management Offices (PMOs) will identify all relevant contracts for the acquisition or modification of the General Equipment. Relevant contracts include those that have a financial impact on the value of the asset and/or establish its placed in service date;

- Working with Financial Managers, PMOs will review all line items in the contract to identify costs that will be included in the capitalized acquisition costs and the costs that will be excluded;

- Compile documentation supporting the valuation in accordance with the April 2015 FIAR Guidance Section 5.D (e.g., documentation will include copies of the relevant contract documents); and

- Document the process and results.

C. BUDGET BASED ESTIMATES

This methodology utilizes information included in DoD Component budget exhibits to estimate the value of the General Equipment. The key requirement is that the available Procurement Budget detail must allow DoD Components to clearly associate budgeted amounts with the General Equipment end items. When using this methodology DoD Components will consider:

- Acquisition programs can span many years; and

- Not all costs associated with the budgeted amount are to be capitalized

Steps for performing Budget Estimates:

- Review the relevant President's Procurement Budget documentation for the General Equipment acquisition program to determine whether the budget has adequate detail to support the budget valuation methodology. Specifically, determine whether the budget detail provides visibility of the various cost estimates comprising the General Equipment acquisition program (e.g., end items versus spares);

- Costs are identified and a determination is made as to whether they should be included in the capitalized costs of the General Equipment;

- Compile documentation supporting the valuation in accordance with requirements described in the April 2015 FIAR Guidance Section 5.D (e.g., the documentation would include copies of the referenced budget exhibits); and

- Document the process and results.

To assist the DoD Components in applying the estimation methods described above, DoD Components can seek further and more detailed guidance from AT&L P&EP.

D. COMMERCIAL OFF THE SHELF

Some General Equipment is acquired "off the shelf" and not developed as part of a program (see FAR Part 12). This includes commercially available items acquired via Simplified Acquisition

Procedures (see FAR Part 13); Sealed Bidding (see FAR Part 14); or Contracting by Negotiation (see FAR Part 15). Examples of General Equipment in this category include:

- Commercial Vehicles;
- Heavy-duty Construction Equipment;
- Railroad Engines;
- Dockside Cranes;
- Depot Machinery (e.g., Computer-driven Lathes);
- Computer Hardware; and
- Medical Equipment

The procurement of General Equipment following these existing acquisition processes, which require obtaining an approved purchase request, following the acquisition procedures at either FAR Part 13, FAR Part 14, or FAR Part 15, receiving and accepting the General Equipment, receiving a vendor invoice, and submitting payment for the invoice. The acquisition cost for these assets is determined from the invoice amount and may also be shown on the receiving report. If this supporting documentation is readily available, valuing these assets based on actual historical cost is encouraged but not required. The Component must determine the most efficient and cost effective approach to assign and support auditable values.

E. PRIOR PERIOD ADJUSTMENTS

Prior period adjustments will be required when revaluing General Equipment using Deemed Cost, as well as for changes to the placed in service dates, useful lives, and accumulated depreciation. SFFAS No. 21, "Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS No. 7, Accounting for Revenue and Other Financing Sources," establishes the guidance for adjusting amounts reported in previously issued financial statements.

DoD Components must document the need for any prior period adjustment, support their calculations and adjusted balances, and record the prior period adjustment in accordance with SFFAS No. 21. From a timing perspective, DoD Components shall complete their revaluation efforts and establish opening balances in advance of the FY2018 DoD financial statement audit.

Following the establishment of an opening balance through prior period adjustments and the issuance of financial statements including those prior period adjustments, there may be rare instances in which a significant error in the opening balances is discovered in a later reporting period. In this instance the correction of that error will be based on the correct application of using one of the alternative valuation methods for establishing opening balances as set out in the FASAB Exposure Draft.

F. APSR TO FINANICAL STATEMENT RECONCILIATION

Deemed Cost does not change the requirement that opening balances for equipment must be reconciled to the DoD Component's general ledger equipment and CIP accounts, as well as the DoD Component's APSR.

IV. GOVERNMENT FURNISHED EQUIPMENT (GFE) AND CONTRACTOR ACQUIRED PROPERTY (CAP)

Government furnished property means property in the possession of, or directly acquired by, the Government and subsequently furnished to the contractor for performance of a contract. In terms of accounting treatment, Government furnished equipment (a subset of GFP) is treated the same as other forms of General Equipment.

Contractor acquired property means property acquired, fabricated, or otherwise provided by the contractor for performing a contract and to which the Government has title.

All special tooling, special test equipment or equipment items meeting or exceeding the appropriate capitalization threshold must be capitalized at the time of delivery[4]. Costs should be accumulated in the construction in progress USSGL account until the item is delivered, at which time the costs should be transferred from construction in progress account to the appropriate equipment USSGL account. An accountable property record for CAP shall be established upon its acceptance and delivery. Valuation of the delivered item shall be at the contractor provided fully burdened cost, (i.e., normal or provisional burdens to the direct costs in accordance with the applicable disclosed accounting practices; including an appropriate amount for fee or profit (as reflected in the contract under which the estimated is prepared) in addition to the direct and indirect costs. Placed-in-service dates for equipment (e.g., special tooling or special test equipment) will be the date of acquisition or date of completed manufacture, if a contractor fabricated the asset.

There is a current known issue regarding the completeness of recorded GFE and delivered CAP (which should be treated as General Equipment upon delivery) by DoD Components. In order to address the issue of completeness (i.e., understatement of recorded GFE and CAP) for audit purposes, DoD Components should prepare a quantitative analysis to assess the potential impact on their financial statements of unrecorded GFE and CAP. Based on the assessment on materiality, and any additional assessment of resources required for risk mitigation, the DoD Components will make a cost vs. benefit decision as to whether they will carry out any remediation effort to capture and validate existence and completeness of unrecorded GFE assets.

[4] Per SFFAS 6, par. 34 [footnote 26]: "PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity [Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery. For PP&E acquired by a contractor on behalf of the entity (e.g., the entity will ultimately hold title to the PP&E), PP&E shall also be recognized upon delivery or constructive delivery whether to the contractor for use in performing contract services or to the entity]. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E." The term "constructive delivery" in this standard does not apply to General Equipment assets.

If the DoD Component makes a cost vs. benefit decision not to carry out any remediation efforts for existence, completeness and valuation, then DoD Components will record any unrecorded GFE and delivered CAP at the end of the contract[5]. Any unrecorded equipment assets identified (either through active remediation or at the end of a contract) prior to opening balances being established may be recorded using Deemed Cost. However, assets identified following the establishment of opening balances must be valued in accordance with SFFAS 6.

V. CONSTRUCTION IN PROGRESS FOR EQUIPMENT (CIP)

In addition to the implementation guidance provided in Section II above, DoD Components will conform to the following guidance relating to CIP. Constructed General Equipment must be recorded in the Construction in Progress USSGL account until it is placed in service at which time the balance must be transferred to the General Equipment USSGL account.

A. CONSTRUCTION IN PROGRESS (CIP) OPENING BALANCE

Capital expenditures or progress payments paid to contractors, coinciding with the portion of the work completed for General Equipment being manufactured or constructed, is to be recorded in a Construction in Progress (CIP) account. The CIP balance is included in the footnotes to the financial statements (generally Note 10) and is included in the General Property, Plant, and Equipment line of the Balance Sheet, and must therefore be included in the General Equipment Opening Balance. As a result, each Component's Financial Management Community, working with their Acquisition Community, must establish a CIP balance for each existing/ongoing acquisition program with outstanding General Equipment deliverables. To create the CIP balances, DoD Components must determine capital versus non-capital costs (if the expected value of the completed General Equipment asset will be equal to or greater than the applicable capitalization threshold and it will have a useful life of 2 years or more the than it is a capital cost and should be accumulated in CIP). Where possible, transaction detail should be evaluated to identify costs that need to be capitalized. The opening balance for CIP will represent the amount disbursed to contractors (capital costs only) from program inception less the acquisition cost of General Equipment delivered and capitalized. The difference between the two amounts will be the CIP opening balance. The CIP opening balance formula is:

$$\textbf{CIP Opening Balance} = \textbf{Total Capital Costs Paid to Contractor} - \textbf{Total Amount of GE Capitalized based on Deemed Cost}$$

For some contract types that include contract finance payments,[6] the Component must reconcile the payments to actual progress completed by the Contractor. If the CIP balance based on the

[5] Based on the cost benefit analyses, the Component may elect to forgo recording some CAP as part of equipment opening balances, which if material, would not be in accordance with GAAP.

[6] This applies to Fixed Price contracts with commercial interim payments, commercial installment payments, and progress payments based on cost, as well as Cost Reimbursable Contracts with interim payments.

above formula surpasses progress on the contract and is material, the Component must move the appropriate amount from CIP into the Advances account (USSGL 141000.200).[7]

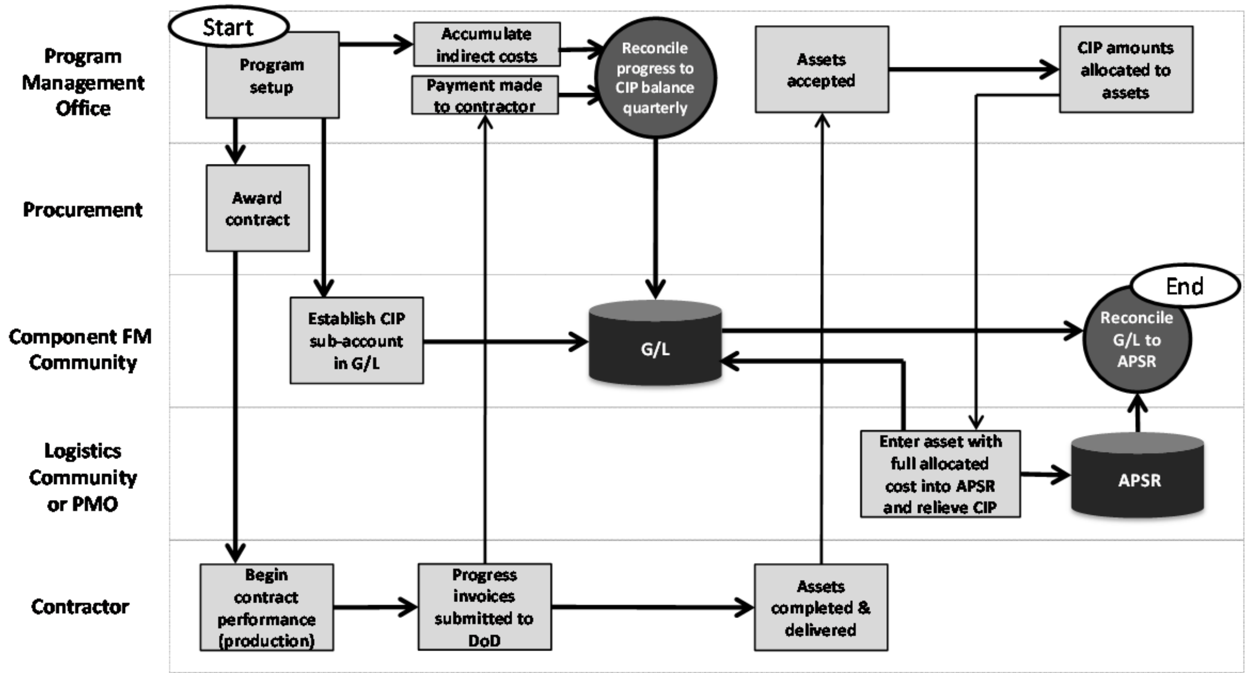
B. CIP GO-FORWARD PROCESS – END STATE TARGET ENVIRONMENT

DoD Components must be able to capture capital costs paid to contractors and accumulate them (where they meet the criteria for capitalization) in CIP. DoD Components must maintain reasonable estimates of per unit costs which will be used to relieve CIP and capitalize the resulting General Equipment asset. An internal DoD study found that other direct and indirect costs such as program management costs are significant to the General Equipment reported balances. Therefore, these costs need to be captured as incurred, recorded in CIP, and allocated to the end item value. DoD Components need to determine how they will capture actual program management costs as well as other costs and the method for how they will allocate these costs.

The CIP balance must reflect actual progress made on the contract. Certain contract finance payments, which includes advance amounts, are to be recorded in the Advance account until the end items are delivered or the contract progress catches up to payments. Conversely, if contract payments lag behind actual construction progress, an accrual may be necessary to increase the CIP balance to an appropriate value. To ensure that CIP amounts reflect actual progress on the contract, DoD Components will perform a periodic reconciliation (at least quarterly) between amounts recorded in CIP and the actual progress on the contract. This may require working with the contractor to perform the reconciliation. Figure 1 illustrates the CIP go-forward process.

[7] Amounts paid in excess of actual progress may not always meet the definition of an advance as defined by FAR 32. However, because GAAP requires that CIP reflect actual progress, amounts in excess of contract progress should be recorded in the Advances account for accounting purposes.

Figure 1: CIP Go Forward Process

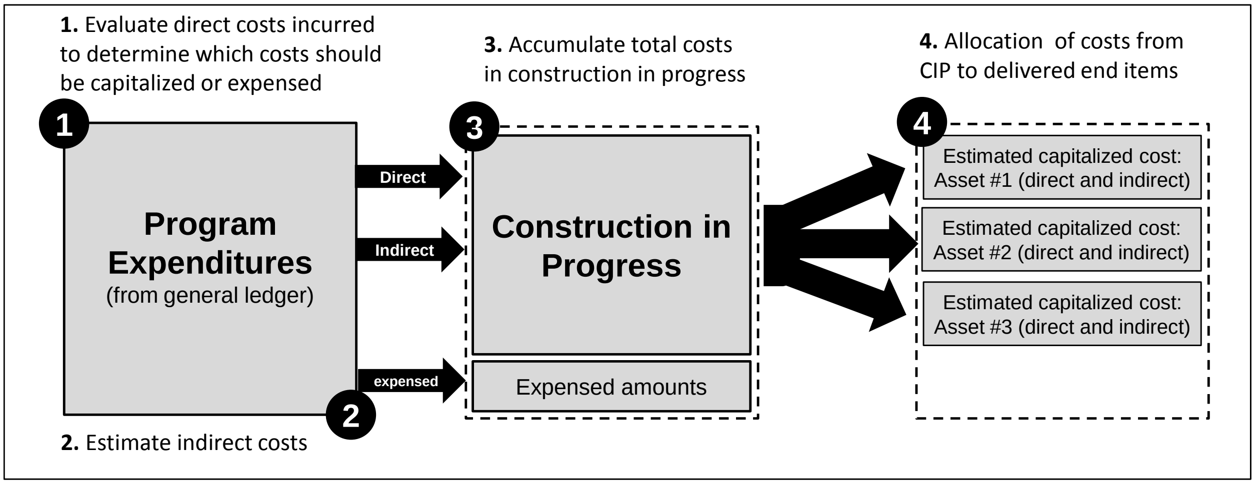


Note: Asset acquisition cost based on financial transactions and cost allocation (SFFAS 6)

C. <u>PROGRAMS AND CONTRACTS IN EFFECT AS OF THE OPENING BALANCE</u>

The figure below illustrates the process for capturing actual capital costs paid to a contractor and accumulating them in a CIP account for existing programs with remaining deliverable equipment end items. Capital costs will be relieved from CIP as the assets are delivered. The value of an asset constructed after the opening balance can be based upon a reasonable estimate of the per unit cost in accordance with SFFAS 6, Accounting for Property Plant and Equipment, and SFFAS 4 Managerial Cost Accounting Concepts and Standards for the Federal Government as described in Section II. Reasonable estimates may be based on established methods that will approximate historical cost such as contracts, budget documents, engineering and acquisition documents, or reports reflecting amounts to be expended. Figure 2 illustrates the allocation of estimates based on expenditures.

Figure 2: Allocation of Estimates Based on Expenditures



Some assets will be under construction at the time the opening balance is established. The value assigned to these assets will consist of two parts. One part will be the portion of the asset under construction as of the opening balance. The value of this portion will be based on how it was estimated when initially calculated and recorded as a Deemed Cost. The second part of the value will be the portion of the asset constructed after the opening balance. The value of this portion of the asset will be recorded in accordance with SFFAS 4 and SFFAS 6 as described in the above paragraph. The resulting value of the asset that will be debited to the general equipment account and credited to the CIP account will be the sum of both parts.

VI. MAKING AN UNRESERVED ASSERTION

A Component will make an unreserved assertion (i.e., unconditional statement) that its financial statements as a whole, or specifically its General Equipment[8], are presented fairly in accordance with GAAP. To make this assertion, two conditions must be met:

- The Component must be able to adequately support its opening balances for General Equipment whether the balances are based on actual historical cost or Deemed Cost; and
- DoD Components must be capable of sustaining the opening equipment balance as well as properly accounting for new acquisitions, retirements and disposals using processes and controls that are in accordance with GAAP.

[8] A DoD Component may make an unreserved assertion on its General Equipment line item as set out in its financial statement footnotes or they may make an unreserved assertion on the individual categories of General Equipment (general equipment; government furnished equipment; contractor acquired property; and construction in progress) so long as the DoD Component includes the detail of each General Equipment category in its financial statement footnotes if it is asserting to individual categories of General Equipment.

DoD Components may only assert to an opening balance using Deemed Cost once. Therefore, prior to making the unreserved assertion, the Component must validate that both conditions are met.

To meet the second condition, DoD Components must demonstrate that effective controls are in place to achieve the Outcomes Demonstrating Audit Readiness relative to the risk associated with its equipment. These outcomes are found in the April 2015 FIAR Guidance pages 146–154.

The unreserved assertion would accompany the Component's financial statements and/or auditor's report on the Component's financial statements.

- Example of <u>Adequate</u> Assertion:
  "The Department of the [__] asserts that its General Fund General Equipment is presented fairly in accordance with GAAP."

- Example of <u>Inadequate</u> Assertion:
  "The Department of the [__] asserts that its General Fund General Equipment is presented fairly in accordance with GAAP with the exception of government property in the possession of contractors."

VII. NEW ACQUISITION PROGRAMS AND CONTRACTS

Significant business process improvements and additional guidance have been developed recently regarding new acquisition programs and contracts. Implementing these and other requirements will greatly assist DoD Components in assigning auditable values to General Equipment and are critical to the sustainment of equipment balances and achievement of the end state target environment. Several of these key requirements are described further below.

A. <u>CONTRACT LINE ITEM NUMBER (CLIN) STRUCTURES FOR NEW CONTRACTS</u>

New acquisition contracts must be written to reflect the end items being manufactured and constructed. In order to trace commitments, obligations, and expenditures to the General Equipment recorded in the DoD Component's accounting records, it is essential that the level of detail in the obligating document be aligned to the level at which items will be delivered, recorded in the accounting records, and managed.

The Defense Financial Acquisition Regulation Supplement (DFARS) provides specific instructions for the composition of the CLINs and Accounting Classification Reference Numbers (ACRNs), which ensures funding citations are appropriately designated for items and services being acquired. Where applicable, the CLINs will be determined to be either capital or non-capital. The table below provides examples of the types of costs to capitalize and expense.

Table 1: Example Cost Types and Accounting Treatment

Acquisition Deliverable	Accounting Treatment
Air Vehicle	• Capitalize the cost, if the full cost is greater than the capitalization threshold • Expense the cost, if the full cost is less than the capitalization threshold
Research, Development, Test and Evaluation*	Expense costs
Acquired Data	Expense costs
Support Equipment	• Capitalize the cost, if the full cost is greater than the capitalization threshold • Expense the cost, if the full cost is less than the capitalization threshold
Initial Spares and Repair Parts	Report as Inventory for Working Capital Fund activities or OM&S for General Fund activities

* RDT&E costs will be capitalized if they are associated with the production of functional end items that will be placed in service or have alternative future uses.

B. IUID

The unique identification (IUID) is essential to effective accountability and weapon system life cycle management and sustainment, and therefore supports financial accounting for equipment. Capitalized General Equipment must be recorded in an APSR using the IUID and associated sub-component IUID information.

C. INVOICES RECEIPT ACCEPTANCE AND PROPERTY TRANSFER (iRAPT)

iRAPT allows the contract acceptance information (e.g., DD Form 250 - Material Inspection and Receiving Report) to be passed electronically to the Department's systems upon acceptance of an end item, thus providing electronic documentation and transactional history to support the acquisition cost of capitalized General Equipment. 10 U.S.C. § 2227 mandated the use of iRAPT as the invoice system to be utilized by Defense contractors, as documented in DFARS Subpart 252.232-7003, "Electronic Submission of Payment Requests and Receiving Reports."

D. ACQUISITION STRATEGY

DoD Components are required to submit an Acquisition Strategy to the Milestone Decision Authority prior to acquiring new weapon systems (General Equipment). The Acquisition Strategy must be updated throughout the acquisition process, specifically before the completion of a milestone. Successful programs will have an Acquisition Strategy that contains sufficient information to determine the financial accounting treatment of costs, a breakdown of the deliverable end items, and a proposed contract structure that will allow appropriate accounting information to be associated with each deliverable item or task.

APPENDIX A: ESTIMATED USEFUL LIVES FOR GENERAL EQUIPMENT

The following table sets out the useful lives to be applied to general purpose equipment (including weapon systems). If a General Equipment asset's useful life held by a DoD Component is not identified in the table, DoD Components may contact Stephen Tkac, Deputy Director, AT&L P&EP at (703) 697-0586 or via e-mail at stephen.h.tkac.civ@mail.mil for specific guidance. In instances where the DoD Component reports a useful life other than what is stated in Table 3 below for General Equipment and Weapon Systems, they will need to document the justification for not using the standard useful life; and, for weapon systems by providing the engineering estimate as specified in the weapon systems requirements documentation.

Table 2: General Equipment Useful Lives

Categories	Sub-Categories	Recommended Useful Life
GENERAL EQUIPMENT ASSETS (EXCLUDING WEAPON SYSTEMS)		
General Purpose Vehicles		
	Heavy Duty Trucks and Buses	5
ADP Systems and Hardware		
	Computers and Peripherals	5
Communication and Medical Equipment		
	High Tech Medical Equipment	5
	Equipment used in Research, Development, Test, and Evaluation (RDT&E)	5
	Radio and Television Broadcasting Equipment	5
All Other Equipment and Machinery		
	All Other Equipment and Machinery	10
Vessels		
	Tugs	20
	Barges	20
	Similar Water Transportation Equipment	20
Generation Equipment		
	Steam Generation Equipment (12.5K pounds per hour or more)	20
	Electric Generation Equipment (500 Kilowatt or more)	20
Capital Improvements		
*See Modernizations, Modifications, Upgrades, and Improvements paragraph below		

WEAPON SYSTEMS		
Ground Systems		
	Armored/Assault Vehicle	15
	Cargo Vehicle	15
	Tracked Vehicle	20
Fixed Wing Aircraft		
	Combat Fixed Wing	20
	Cargo Fixed Wing	25
	Utility Fixed Wing	20
Rotary Wing		
	Combat Rotary Wing	25
	Cargo Rotary Wing	25
	Utility Rotary Wing	30
Ships		
	Combat Ship	35
	Cargo Ship	40
	Aircraft Carrier	50
Submarines		
	Submarine	33
Unmanned Aerial Vehicle Systems		
	UAVS	15
Combat Support Systems		
	Combat Support System	15
	Missile Defense System	20

<u>*Modifications, Modernizations, Upgrades, and Improvements</u>

Costs that either extend the useful life of existing General Equipment, or enlarge or improve its capacity must be capitalized and depreciated/amortized over the lessor of the remaining useful life of the improvement or associated asset. For equipment, these improvements are often referred to as modifications, modernizations, and upgrades. Modifications, modernizations, upgrades, and improvements exceeding the capitalization threshold must be factored into the individual General Equipment end item value. Current DoD guidance requires that:

- The full cost of modifications that extend the useful life of an end item will be added to its net book value and depreciated over the end item’s new remaining useful life; and

- The cost of modifications that enlarge or improve the capacity of an item, but do not extend its useful life, will be capitalized by:

  - Adding the modification cost to the end item’s net book value and depreciating the resulting cost over the remaining useful life of the end item. This option will not be used if the modification’s remaining useful life is less than the useful life of the base asset; or

  - Capitalizing the modification as a separate item and depreciating the modification over the lesser of the life of the modification or the remaining useful life of the end item.