

## CHAPTER 55

### SUPPLY MANAGEMENT OPERATIONS

A. GENERAL. This chapter prescribes policy and unique accounting requirements applicable to the Supply Management business area.

B. AUTHORIZED CUSTOMERS. A Supply Management business area is authorized to sell items to:

1. A Federal Government-funded activity or an activity empowered to perform a Federal Government-legislated function.

2. A DoD-sponsored nonappropriated fund instrumentality.

3. A State Department-sponsored employee commissary located outside the United States.

4. A foreign government when an authorized contractual relationship has been established.

5. A Federal Government contractor, when the contract specifically provides for the purchase of items by the contractor from the Government.

6. Members of the Armed Forces and other individuals authorized by law when purchasing commissary and clothing items.

7. Other entities, when authorized by duly appointed officials.

C. FINANCING

1. Items for Sale. Resources of the Supply Management business area are available to finance the acquisition and repair of items to be sold to customers.

2. Commissary Support. The costs of providing and managing commissary items, including related operating costs incurred to support the mission of commissaries, shall be identified as commissary operating costs. These costs include, but are not limited to, costs incurred to support commissaries at a headquarters or regional level. Commissary operating costs shall be charged to, and reimbursed by, appropriations made available to the Defense Business Operations Fund for commissaries and the commissary trust revolving fund as prescribed in DoD 1330.17-R, "Armed Services Commissary Regulations."

D. ITEMS TO BE INCLUDED IN THE SUPPLY MANAGEMENT BUSINESS AREA

1. General. Generally, supplies held for the purpose of sale to other DoD Components or activities within a Component and, when authorized by legislation, items procured for sale to members of the Armed Forces and other individuals or organizations may be included in the Supply Management business area. The Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology) may designate an item to be procured by the Supply Management business area and may assign the management responsibility of any item to one DoD Component from another DoD Component.

DoD Components are encouraged to propose such assignments that would result in more efficient management of supplies.

2. Military Exchange Items. Items procured primarily for sale to members of the Armed Forces and other individuals or organizations authorized by legislation may be included in the Supply Management Business Area. These include clothing sold by a military clothing resale activity, and items sold in a ship's store.

3. Military Clothing Items. The Military Exchange systems are authorized to act as agents of the Supply Management Business Area for the purpose of selling military clothing items to members of the Armed Forces. Military clothing requirements in the Department of Defense shall be procured through the Supply Management Business Area and billed at standard prices.

a. The Military Services shall include the costs of new bag items in the military personnel appropriation budget request and new organizational items in the operation and maintenance appropriation budget request. A replacement item shall be deemed a new item for the purposes of this policy if the cost of a replacement item exceeds the cost of the prior item by more than 10 percent in constant dollars.

b. The military personnel appropriation budget and the operation and maintenance appropriation budget should be sufficient to fund the quantity of the initial buy of an item of clothing including the establishment of wholesale inventory levels. New clothing items required prior to receipt of appropriated funds shall be funded in these same accounts by reprogramming action.

c. New clothing items shall be phased in after the stocks of the item being replaced are attrited. The new item shall not be available for issue by the item manager until the stocks of the item being replaced are reduced to less than an amount mutually agreed upon between the item manager and the customer military personnel appropriation account manager. The item manager shall prepare a billing to the applicable military personnel appropriation account in an amount sufficient to cover the cost of the stocks of the item being replaced.

4. Fuel. Fuel requirements in the Department of Defense shall be procured through a Supply Management business area and billed at standard prices to DoD Funded customers. In isolated locations where the Defense Logistics Agency (DLA) has authorized local procurement but the Component Supply Management business area cannot directly procure the fuel, a DoD Supply Management business area shall process billings to the procuring account to stabilize the procurements at DoD standard prices.

5. Forgings and Castings. The availability of forgings, castings, and molds should assist in controlling the contract cost of future procurements of the same items. Therefore, the Supply Management business area may procure forgings and castings or production molds, when appropriate, for Supply Management business area items only after justification to and approval by the item manager. The justification for the procurement of forgings, castings, and molds should include an analysis of the stability of the design and the related technical requirements and anticipated savings from lower production costs on subsequent procurements because of the availability of Government provided

property, reduced leadtimes, and from increased competition. The acquisition cost of forgings, castings, and molds shall be determined for each item at the time of acquisition. Each forging, casting, and mold shall be assigned a stock number and recorded as an asset in an appropriate account. The cost of forgings, castings, and molds that are broken or lost shall be recorded as a current period operating expense. The item manager shall store, protect, and preserve forgings, castings, and molds for use as Government furnished material and Government furnished equipment on subsequent procurements.

6. Drawings and Technical Data. The Supply Management business area shall finance the procurement of drawings and technical data needed in support of design stable stocked items previously or currently procured by the Supply Management business area only after justification to and approval by the item manager. The justification for the procurement of drawings and technical data should include an analysis of the stability of the design and the related technical requirements for the item and anticipated savings from increased competition, improved quality standards, or increased capability to evaluate the usefulness of existing items in the supply system. The costs of the drawings and technical data for Supply Management business area items are normally included in the costs of operations (not materiel costs) for DoD Supply Management business areas and recovered in the standard price.

7. Spares. The Supply Management business areas will acquire initial and replenishment spares consistent with the materiel support date. Initial spares are spare and repair parts supporting newly fielded weapons systems during initial period of operation until the supply system can support the demand generated by the systems. Replenishment spares are those spare and repair parts required to resupply initial stockage.

a. Reparables. As defined in DoD 4140.1-R, "DoD Materiel Management Regulation," a reparable item is an item of supply subject to economical repair and for which the repair (at either depot or field level) is considered in satisfying computed requirements at any inventory level. Supply Management Business Areas are authorized to finance the transportation, acquisition, overhaul, progressive maintenance, renovation, rework, repair, manufacture, reclamation, alteration, and/or software support of reparable items.

#### E. INVENTORY GENERAL LEDGER ACCOUNTS

1. Authorized Inventory General Ledger Accounts. Inventory and related property accounts authorized for use at Defense Business Operations Fund activities are listed in chapter 7 of Volume 1, "General Financial Management Information, Systems, and Requirement," of this Regulation. Certain inventory accounts are authorized for use only in the Supply Management business area and Defense Commissary Agency. The inventory accounts authorized for use only in the Supply Management business area and Defense Commissary Agency are listed below. If one of the below listed accounts is not descriptive of a recurring and significant inventory event that affects the value of inventory at standard price, then an additional holding gain/loss subaccount(s) should be requested to be established for that purpose. Such requests should be forwarded to the Director for Accounting Policy, Office of the Deputy Under Secretary of Defense (Comptroller/Financial Management).

- 1520 Inventory, Met
  - 1521 Inventory Held for Sale
    - 1521.1 Inventory in Transit from Procurement
    - 1521.2 Inventory in Transit from DoD Entities
  - 1522 Inventory Held for Future Sale
  - 1523 Inventory Held for Repair
    - 1523.1 Exchange (DLR) Inventory in Transit
  - 1524 Inventory - Excess, Obsolete, and Beyond Repair
  - 1529 Inventory - Allowance
    - 1529.1 Allowance for Holding Gain/Loss - Inventory Held for Sale
      - 1529.1A Realization of Holding Gains/Losses
      - 1529.1B Purchases at Standard Price
      - 1529.1C Purchases at Cost
      - 1529.1D Materiel Returns at Standard Price
      - 1529.1E Materiel Returns - Credit Given
      - 1529.1F Materiel Returns Without Credit Given
      - 1529.1G Standard Price Changes-Gain
      - 1529.1H Accounting Adjustments-Gain
      - 1529.1J Assembly/Disassembly-Gain
      - 1529.1K Physical Inventory Adjustments-Gain
      - 1529.1L Incoming Shipments-Gain
      - 1529.1M Completed Inventory Repairs
      - 1529.1N Receipts of Materiel Without Charge
      - 1529.1P Other-Gain
      - 1529.1Q Latest Acquisition Cost Adjustment
      - 1529.1R Standard Price Changes-Loss
      - 1529.1S Accounting Adjustments-Loss
      - 1529.1T Assembly/Disassembly-Loss
      - 1529.1U Physical Inventory Adjustments-Loss
      - 1529.1V Incoming Shipments-Loss
      - 1529.1W Shrinkage and Other Adjustments-Loss
      - 1529.1X Actual Repair Costs
      - 1529.1Y Issues Without Reimbursement
      - 1529.1Z Other-Loss
    - 1529.2 Allowance for Holding Gain/Loss - Inventory Held for Future Sale
    - 1529.3 Allowance for Repair Costs
      - 1529.3A Estimated Repair Costs
      - 1529.3B Estimated Exchange Costs
  - 1573 War Reserve/Mobilization Stock
    - 1579.2 Allowance for Holding Gain/Loss - War Reserve/Mobilization Stock

2. Reconciliations. At least quarterly, line item accountability records shall be reconciled to balances recorded in the general ledger inventory accounts. Differences between line item accountability records and general ledger balances shall be investigated to determine the cause(s) of the difference. Reconciliations may be required more frequently to identify the cause(s) of the difference(s). Errors found during the investigation shall be corrected. Addendum 1, "Assessment of Inventory Amounts," included with this chapter provides further reconciliation guidance.

3. Adjustments for Physical Counts. Physical counts of inventories shall be taken in accordance with the procedures prescribed in DoD 4140.1-R, "DoD Materiel Management Regulation." In accordance with the procedures outlined in DoD 4140.1-R, the general ledger shall be adjusted for differences between the general ledger balances and the physical count.

4. Inventory Gains, Losses and Adjustments. Separate accounts shall be maintained to identify transactions that result in inventory gains, losses and adjustments. The accounts to be used in the Supply Operations business area are listed below. The use of subsidiary accounts as needed is optional.

7191 Inventory Gains

7291 Inventory Losses or Adjustments

- 7291.1 Shrinkage Losses
- 7291.2 Excess/Obsolescence/Spoilage Loss
- 7291.3 Other Inventory Losses

F. CAPITALIZED INVENTORY

1. Transfers-In Without Reimbursement. On hand and on order inventories of supplies financed by other appropriations and funds shall be recorded as contributed capital as required by 10 U.S.C. 2208 when the Supply Management business area undertakes management responsibility for the items. Bills for inventories on order at the time of the transfer shall be paid by the appropriation or fund ordering the item. This is appropriate since the appropriation or fund ordering the item was funded through the budget process to procure the item. As provided in 10 U.S.C. 2208, credits may not be made by a Supply Management business area to an appropriation or fund for capitalized inventories. However, stock withdrawal authorizations may be approved as provided in paragraph G.3. below. Capitalized inventory items shall be recorded as follows:

Dr 1521 Inventory Held for Sale	\$10,000	
Cr 1529.1N Receipts of Materiel Without Charge		\$10,000

Entry to record receipt of inventory items totaling \$10,000 provided from another appropriation or fund without reimbursement to that appropriation or fund. Documentation supporting this entry includes journal vouchers and receiving reports.

2. Transfers of Reimbursable Procurements. The Supply Management business area may record a liability for an item transferred from a non-DBOF account only when the item is undelivered at the time of the transfer and the obligation for the item on the books of the organization from which the item was transferred resulted from a reimbursable order from a customer. The liability recorded in the supply management records shall be liquidated by a payment to the transferring appropriation or fund based upon a payment to the Supply Management business area by the customer. The Supply Management business area shall record a liability for inventories transferred as follows:

Dr 1521 Inventory Held for Sale	\$10,000
Cr 2111 Accounts Payable - Government - Current	\$8,000
Cr 1529.1N Receipts of Materiel Without charge	\$2,000

Entry to record receipt of inventory items totaling \$10,000 for which reimbursement of \$8,000 will be provided. The difference in amount between the reimbursement amount and the inventory value is recorded to account 1529.1L. Documentation supporting this entry includes a customer order or requisition.

3. Stock Withdrawal Authorizations. When items are transferred from an appropriated account to a DBOF Supply Management activity, circumstances may exist in which sufficient funds are not available for the donating activity to subsequently purchase those items from the DBOF activity when needed. In such situations, the Under Secretary of Defense (Comptroller) may be requested to approve an authorization for issues without reimbursement. The request for a stock withdrawal authorization shall identify the amount of items capitalized from the customer's appropriation or fund and the estimated amount of the transferred items required by the customer until funds can be provided through the budget process. An approved stock withdrawal authorization permits the DBOF activity to issue items to the specified customer without reimbursement up to the authorized limit for a fiscal year. Once the limit has been reached, or the fiscal year has passed, issues shall be on a reimbursable basis. Stock withdrawal authorizations may not be recorded as a liability. An issue under a stock withdrawal authorization shall be recorded as follows:

Dr 3231 Transfers-Out to Government Agencies Without Reimbursement
Dr 1529.1A Realization of Holding Gains/Losses
Cr 1521 Inventory Held for Sale

Documentation supporting this entry includes material release orders and shipping documents.

4. Logistical Management Transfers. Logistical management transfers result from changes in the funding appropriation for an item. If the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology) designate a logistical management transfer of item(s) from the supply management business area to an appropriation (see paragraph E.) or from an appropriation to the supply management business area, an increase or a decrease to inventory for a nonreimbursable transfer shall be recorded at the value of the item being transferred. A transfer-in of an item, once operations have commenced, will be recorded as in a., below. Items transferred-out shall be recorded as in b., below.

- a. Entry to record a logistical management transfer in.  
Documentation supporting this entry includes material receipts and catalog data.

Dr 1521 Inventory held for Sale
Cr 1529.1L Incoming Shipments-Gain

- b. Entry to record a logistical management transfer out. Documentation supporting this entry includes material release orders, shipping documents, and catalog data.

Dr 3231 Transfers-Out to Government Agencies Without Reimbursement

Dr 1529.1A Realization of Holding Gains/Losses

Cr 1521 Inventory Held for Sale

5. Accounting for Customer Returns. Customer returns may constitute a significant impact on current period revenue and inventory holding gains for the DoD Supply Management business area.

a. Returns Without Credit. The value of customer returns for which credit is not granted shall be recorded as an inventory gain rather than a transfer without reimbursement. For example, see below.

Dr 1521.2 Inventory in Transit from DoD Entities \$1,000  
Cr 1529.1F Materiel Returns Without Credit Given \$1,000

Entry to record customer returns without credit prior to its receipt.

Dr 1521 Inventory Held for Sale \$1,000  
Cr 1521.2 Inventory in Transit from DoD Entities \$1,000

Entry to record receipt of inventory in transit. The documentation supporting this entry includes receiving reports and evidence. of inspection of returned items.

b. Returns With Credit. The value of customer returns for which credit is granted shall be accounted for as a decrease to current period revenues. For example, see below.

Dr 1521.2 Inventory in Transit from DoD Entities \$1,000  
Cr 1529.1D Materiel Returns at Standard Price \$200

Dr 1529.1E Materiel Returns - Credit Given \$ 800  
Cr 1311 Accounts Receivable - Government - Current \$800

Entry to record customer returns with credit prior to its receipt. (The above illustration demonstrates the return of a \$1,000 inventory item for which \$800 credit is granted.)

Dr 1521 Inventory Held for Sale \$1,000  
Cr 1521.2 Inventory in Transit from DoD Entities \$1,000

Entry to record receipt of inventory in transit. The documentation supporting this entry includes receiving reports and evidence of inspection of returned items.

6. Transfers to Reutilization and Marketing (R&M). The loss, if any, on items declared excess, obsolete, or beyond repair is taken by the stockage point holding that item when the determination is made. [NOTE: The words "beyond

repair," in the context of this general ledger account, means damaged inventory that is not economical to repair.] After recordation of the loss, transfers of excess, obsolete or beyond repair items to a Defense Reutilization and Marketing Office (DRMO) shall, be accounted for as follows:

- a. Dr 7291.2 Excess/Obsolescence/Spoilage Loss  
    Cr 1524 Inventory - Excess, Obsolete, and Beyond Repair

Stockage point entry to record transfers to a DRMO. The documentation supporting this entry includes material release orders and shipping documents. The value recorded in account 1524 is the estimated net realizable value of the excess, obsolete, or beyond repair item and not its standard price or latest acquisition cost. (See Addendum 2, Paras B.9/C.3.)

- b. Dr 1765 Property Awaiting Disposal  
    Cr 7193 Other Miscellaneous Gains

DRMO Entry to record transfers from a stockage point. The documentation supporting this entry includes material release orders and shipping documents. The value recorded in account 1765 should be the net realizable value.

#### G. FINANCIAL STATEMENT INVENTORY CATEGORIES

1. General. Inventory is tangible personal property, titled to the government, that is on hand or intransit (e.g., accepted at origin from a vendor, or moving between DoD activities) and is held for sale, future sale, repair, or pending transfer to disposal. The Supply Management business area and Defense Commissary Agency are the only Defense Business Operations Fund business areas that should hold inventory. Except for excess, obsolete, and unserviceable inventory, inventory shall be valued using the latest acquisition cost method. The following are not inventory:

- a. Items purchased by depot maintenance activities to be consumed in the process of repair and by other activities to be consumed in the course of operations shall be recorded and reported as "Operating Materials and Supplies," (Account Series 1510) versus "Inventory," (Account Series 1520) "Operating Materials and Supplies" shall be valued and reported at historical cost.

- b. Inventory excludes some other assets held for sale, such as (1) stockpile materials (including war reserve materiel), (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; the purpose, however, of acquiring them is not to provide a product or a service for a fee.

2. Recognition. Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the acquiring entity, whichever occurs first. Inventory expense shall be recognized upon a sale and the value of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract or other agreement regarding shipping and/or delivery.

3. Inventory Classifications. There are five general classifications of inventory -- Inventory Held for Sale; Inventory Held for Future Sale; Excess, Obsolete, and Beyond Repair Inventory; Inventory Held for Repair; and Inventory in Transit. A description of those five categories follow:

a. Inventory Held for Sale. This category of inventory includes most supply system materiel in issuable condition.

b. Inventory Held for Future Sale. This category will be used to report the value of stocks not expected to be consumed until after the completion of the budget year. That is, economic retention stocks, contingency retention stocks and potential reutilization/disposal stocks. (War reserve materiel is reported as stockpile materials, not inventory.)

c. Excess, Obsolete, and Beyond Repair Inventory. This is a single category composed of three elements. However, it is not necessary or expected that a separate record be kept of each element. The elements of this inventory category are provided solely for information and not for subaccount purposes. The elements of this category are:

(1) Excess inventory consists of items items that are determined to be beyond economic and contingency retention stock levels and, as a result, reported as potential reutilization/disposal materiel. Until such materiel is actually declared excess and dropped from inventory, it shall be reported as "Inventory - Excess, Obsolete, and Beyond Repair."

(2) Obsolete inventory is inventory that is no longer needed due to changes in technology, laws, customs, or operations.

(3) Beyond repair inventory excludes unserviceable items but, instead, consists of items that are not expected to survive repair after technical evaluation at a maintenance activity and damaged inventory that is not economical to repair.

d. Inventory Held for Repair. These are inventory items that are not in issuable condition (but not beyond economic repair) and are awaiting repair before they are eligible for sale. A repairable item is an item of supply subject to economical repair and for which the repair (at either depot or field level) is considered in satisfying computed requirements at any inventory level. A depot level repairable item is one that is designated for repair at the depot level or that is designated for repair below the depot level, but if repair cannot be accomplished at that level, will have its unserviceable carcass either forwarded to the depot for repair or condemnation, or reported to its inventory control point (ICP) for disposition. A field level repairable item is one that is normally repaired below the depot level of maintenance and for which condemnation authority can be exercised below the depot level of maintenance.

e. Inventory In Transit. These are inventory items in transit from commercial and government suppliers. Account 1521.1, "Inventory In Transit from Procurement," and account 1521.2, "Inventory in Transit from DoD Entities," are used to record from whom the inventory is in transit. These accounts shall be used to record the initial acceptance of inventory items when title has passed

but the items have not been received and accepted into inventory. The following illustrate the most common entries to this account:

Dr 1521.1 Inventory In Transit from Procurement	\$10,000	
Cr 1529.1C Purchases at Cost		\$2,000
Cr 2113 Accounts Payable - Public - Current		\$8,000

Entry to record the value of inventory in transit from procurement for which the standard price is \$10,000 and the invoice cost is \$8,000.

Dr 1521.2 Inventory In Transit from DoD Entities	\$10,000	
Cr 1529.1E Materiel Returns - Credit Given		\$2,000
Cr 1311 Accounts Receivable - Government - Current		\$8,000

Entry to record the value of inventory in transit that is being returned by customers for credit.

Dr 1523.1 Exchange (DLR) Inventory in Transit	\$ 5,000	
Dr 1311 Accounts Receivable-Government-Current	\$ 3,000	
Cr 5101 Revenue from Goods Sold - DBOF		\$5,000
Cr 1529.3 Allowance for Repair Costs		\$3,000

Entry to record sale of inventory and the associated cost of the goods sold when a reparable item is exchanged for a ready for issue inventory item.

Dr 1521 Inventory Held For Sale	\$20,000	
Cr 1521.1 Inventory-In Transit from Procurement		\$10,000
Cr 1521.2 Inventory-In Transit from DoD Entities		\$10,000

Dr 1523 Inventory Held for Repair	\$ 5,000	
Cr 1523.1 Exchange (DLR) Inventory in Transit		\$ 5,000

Entries to record receipt of inventory in transit.

4. Relationship of General Ledger Inventory Accounts to Logistic Stratification Level and Supply Condition Codes. Inventory recorded in financial records should be identifiable to inventory recorded in logistic records and vice versa. To provide for such identification, stratification levels and supply condition codes are identified in subparagraph G.4.c. below to the financial inventory classifications. While supply system inventory reports within the logistics area are sometimes prepared more often, they are currently required only semiannually. However, financial inventory is reported monthly. Therefore, in order to report the value of inventory monthly, percentages must be derived from the last available stratification and perpetuated on a monthly basis until a new stratification is received.

a. Stratification Levels. Stratification is the process of applying the quantity of an individual item against the requirements for the same item in a prescribed priority and time sequence. The stratification levels are defined in DoD 4140.1-R, "DoD Materiel Management Regulation." The stratification levels currently in use within the Department of Defense are

- (1) Approved Acquisition Objective,
- (2) Economic Retention Stock,
- (3) Contingency Retention Stock and
- (4) Potential Reutilization/Disposal Materiel.

b. Supply Condition Codes. Supply condition codes classify materiel in terms of readiness for issue and use or identify action underway to change the status of materiel. Supply condition codes currently in use within the Department of Defense are defined in DoD 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures." Those supply condition codes are:

- (1) Code A - Serviceable (Issuable Without Qualification).
- (2) Code B - Serviceable (Issuable With Qualification).
- (3) Code C - Serviceable (Priority Issue).
- (4) Code D - Serviceable (Test/Modification).
- (5) Code E - Unserviceable (Limited Restoration).
- (6) Code F - Unserviceable (Reparable).
- (7) Code G - Unserviceable (Incomplete).
- (8) Code H - Unserviceable (Condemned).
- (9) Code I - NOT ASSIGNED.
- (10) Code J - Suspended (In Stock).
- (11) Code K - Suspended (Returns).
- (12) Code L - Suspended (Litigation).
- (13) Code M - Suspended (In Work).
- (14) Code N - Suspended (Ammunition Suitable for Emergency Combat Use Only).
- (15) Code O - NOT ASSIGNED.
- (16) Code P - Unserviceable (Reclamation).
- (17) Code Q - Suspended (Quality Deficient Exhibit).
- (18) Code R - Suspended (Reclaimed Items, Awaiting Condition Determination).
- (19) Code S - Unserviceable (Scrap).
- (20) Codes T-Z - NOT ASSIGNED.

c. Relationship of Logistic Categories to Accounting Classifications for Inventory. The following table shows the relationship of logistic supply categories to general ledger inventory accounts.

#### H. FINANCIAL STATEMENT VALUATION OF INVENTORY ITEMS

1. General. Within the Department of, Defense, inventory is reported on financial statements at its latest acquisition cost. Additionally, an allowance amount for unrealized gains and losses is also reported so that the net of the inventory at its latest acquisition cost less the allowance amount for unrealized gains and losses will yield an approximation of historical (actual) cost.

2. Latest Acquisition Cost. DoD inventory is normally an asset of the Supply and Commissary resale systems only. Except for excess, obsolete, and beyond economical repair inventory, inventory shall be valued using the latest acquisition cost method. The latest acquisition cost method provides that the last representative invoice price (i.e., the specific item's cost used in setting the current year stabilized standard price) shall be applied to all like

General Ledger Account	Stratification Level	Supply Condition Codes
1521 Inventory Held For Sale	(1) Approved Acquisition Objective (AAO)	A Issuable Without Qualification
		B Issuable With Qualification
		C Priority Issue
		D Test/Modification
1522 Inventory Held For Future Sale	(1) Economic Retention Stock (2) Contingency Retention Stock	A Issuable Without Qualification
		B Issuable With Qualification
		C Priority Issue
		D Test/Modification
		E Limited Restoration
		J Suspended (In Stock)
		K Suspended (Returns)
		L Suspended (Litigation)
N Suspended (Ammunition Suitable for Emergency Combat Work Only)		
1523 Inventory Held for Repair	(1) Approved Acquisition Objective (AAO) (2) Economic Retention Stock (3) Contingency Retention Stock	F Repairable
		G Incomplete
		M Suspended (In Work)
		Q Suspended (Quality Deficient Exhibits)
		R Suspended (Reclaimed Items, Awaiting Condition Determination)
1524 Inventory - Excess, Obsolete, or Beyond Repair	(1) Approved Acquisition Objective (AAO) (2) Economic Retention Stock (3) Contingency Retention Stock	H Condemned
		P Reclamation
		S Scrap
		..... (4) Potential Reutilization Stock
		Condition Codes A - S
1573 War Reserve/Mobilization Stock	(1) Part of Approved Acquisition Objective (AAO)	(Condition Codes do not distinguish War Reserve/Mobilization items from inventory items.)

units held including units acquired through donation, non monetary exchange, return from end use or reutilization. For Commissary resale items and all other

items, including those obtained through local purchase and items not held in revolving funds, price changes based on latest invoice shall be posted during the first posting cycle after receipt of invoice. For price-stabilized items in the supply system price changes based on latest invoice shall be posted annually, unless other posting cycle is approved by the Under Secretary of Defense (Comptroller).

3. Inventory Values for Financial Statement Presentation. Inventory is reported on DoD financial statements at its latest acquisition cost less the allowance for unrealized gains and losses so that the net of the inventory will yield an approximation of historical (actual) cost.

a. Inventory Held for Sale and Inventory Held for Future Sale. Within the Department of Defense, inventory held for sale and inventory held for future sale shall be valued at its latest acquisition cost. For financial statement presentation, DBOF supply management business areas maintaining inventory values at standard [selling] price must adjust the inventory values at standard [selling] price to latest acquisition cost by removing operating cost recovery amounts and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. Addendum 2, paragraph B.10., of this chapter provides an example of the month end adjustment process.

b. Inventory Held for Repair. Inventory held for repair shall be reported on DoD inventory reports and financial statements as described above. General ledger account 1529.3A, "Estimated Repair Costs," has been established to record, on an aggregate basis, the average cost to repair items that require repair. General ledger account 1529.3B, "Estimated Exchange Costs," has been established to record an estimate of operating costs to accept and process exchange items and includes carcass attrition (washouts) and transportation costs. When repairs are completed, the actual cost of repairs shall be charged to general ledger account 1529.1X, "Actual Repair Costs." Paragraph N.4. of this chapter illustrates this accounting process.

c. Excess, Obsolete, and Beyond Repair Inventory. Excess, obsolete, and beyond repair inventory shall be valued at its expected net realizable value. "Net realizable value" is the current salvage rate, expressed as a percentage of latest acquisition cost, as that rate is reported by the Defense Reutilization and Marketing Service (DRMS). The difference between the value of the inventory before identification as excess, obsolete, and beyond repair and its expected net realizable value after such identification shall be recognized as a loss (or gain) in current period operations. Any subsequent adjustments to its net realizable value shall be also recognized as a loss (or gain) in the period in which such adjustment occurs. [NOTE: Materiel transferred to the DRMS, whether from the supply system, other DBOF, or non-DBOF activities, non appropriated fund operations, or other agencies of the federal government, will be reported by the DRMS, not as inventory, but as other personal property (general ledger account 1765, "Property Awaiting Disposal") and valued by the DRMS at the current salvage rate as specified in this paragraph.]

d. Inventory in Transit. Inventory in transit from commercial vendors, general ledger account 1521.1, "Inventory in Transit from Procurement," shall be recorded at the value of material in transit based upon amounts paid or to be paid. Inventory in transit from another DoD stockage point, general

ledger account 1521.2, "Inventory in Transit from DoD Entities," shall be recorded at latest acquisition cost {e.g., standard price). Depot level reparable (i.e., carcasses) provided in exchange for serviceable items shall be recorded in general ledger account 1523.1, "Exchange (DLR) Inventory in Transit," at the same value (i.e., standard price) of a serviceable item. However, an allowance for repairs contra-asset account shall also be established to record the estimated cost of the repair and the surcharge associated with the exchanged item. The net of the DLR in transit amount and its allowance account shall equal the value of the carcass (see paragraph N.4. for an illustration of this process).

e. Valuation Illustration. As noted above, for financial statement presentation, DBOF supply management business areas maintaining inventory values at standard [selling] price must adjust the inventory values at standard [selling] price to latest acquisition cost. Addendum 2, paragraph B.10., of this chapter provides an example of the month end adjustment process. Basically, the procedure to revalue inventory to its latest acquisition cost is to deduct the operating cost recovery amount and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. This procedure should be applied only to the inventory financial classifications of "Inventory Held for Sale," "Inventory Held for Future Sale," and "Inventory Held for Repair." Inventory reported as "Inventory - Excess, Obsolete, and Beyond Repair," should be recorded at its net realizable value and therefore does not have an allowance account associated with it. As an illustration, assume that the operating cost recovery percentage for all financial inventory categories was equal to 15 percent of the standard price. In that case, the following would result (accounting entries are illustrated in Addendum 2, paragraph B.10.):

	Inventory at Standard <u>Price</u>	-	Less <u>Surcharge</u>	=	Inventory at Latest Acquisition <u>Cost</u>
Inventory Held for Sale	\$17,850	-	\$2,675	=	\$15,175
Less: Allowance	<u>\$ 4,177</u>	-	\$2,675	=	<u>\$ 1,502</u>
Equals: Actual Cost	\$13,673				\$13,673
Inventory Held for Future Sale	\$ -0-				
Less: Allowance	<u>\$ -0-</u>				
Equals: Actual Cost	\$ -0-				
Inventory Held for Repair	\$ 5,250	-	\$1,050	=	\$ 4,200
Less: Allowance	<u>\$ 2,700</u>	-	\$1,050	=	<u>\$ 1,650</u>
Equals: Actual Cost	\$ 2,550				\$ 2,550
Inventory-Excess, Obsolete, and Beyond Repair	\$ 70				\$ 70
Less: Allowance	<u>N/A</u>				<u>N/A</u>
Equals: Realizable Value	\$ 2,550				\$ 70
Total Inventory	\$23,170	-	\$3,725	=	\$19,445
Less: Total Allowance	<u>\$ 6,877</u>	-	\$3,725	=	<u>\$ 3,152</u>
Equals: Cost (Value)	\$16,293				\$16,293

4. Holding Gains and Losses. Holding gains and losses, as reported on financial statements, are the difference between the latest acquisition cost of inventory and the historical (actual) cost of that inventory. Holding gains and losses result, in part, from changes in the value of inventory due to increases or decreases in the latest acquisition cost between the beginning of a reporting period and the end of the reporting period. Holding gains and losses are reported without operating cost recovery factors that may be added to items in inventory to determine standard (sales) price.

a. Unrealized Holding Gains and Losses. "Unrealized" refers to any gain or loss associated with inventory still held by the entity. Unrealized holding gains and losses pertain to the holding gains and losses associated with the inventory on hand during the reporting period that has not been sold or otherwise left the stocking point. Unrealized gains and losses are recorded in an allowance for unrealized holding gains/losses account. That account is a contra-asset account and is reported on the Statement of Financial Condition as an offset to the reported inventory valued at latest acquisition cost. The ending balance of the allowance for unrealized holding gains/losses shall be the cumulative difference between the historical cost, based on estimated or actual valuation, and the latest acquisition cost of ending inventory. The net of inventory at its latest acquisition cost less the amount of unrealized holding gains or losses results in an approximation of historical cost.

b. Realized Holding Gains and Losses. Realized holding gains and losses pertain to the holding gains and losses associated with inventory that has been sold, recapitalized, or otherwise disposed of during the reporting period. When a sale or other inventory transaction occurs, the previously recorded gain (or loss) in the allowance for unrealized gain/loss account is reduced thereby becoming realized as part of the cost of goods sold on the Statement of Operations.

5. Illustrative Accounting Entries for Inventory Transactions. Currently, the Military Departments and the Defense Logistics Agency account for inventory in a method different from each other. Even though the method of accounting is different, each method should yield the same inventory values for reporting on the Statement of Financial Condition and the costs of goods sold reported on the Statement of Operations. Addendum 2, "Accounting for Inventories when Using Standard Price Practices," of this chapter provides an illustration of inventory accounting for use by the Military Departments. Addendum 3, "Accounting for Inventories when Using Latest Acquisition Cost Practices," of this chapter provides an illustration of inventory accounting for use by the Defense Logistics Agency.

6. Year-End Closing/Adjusting Entry For Allowance Account. Annually, accounts subsidiary to an allowance account shall be closed to the parent account. The following accounting entries are appropriate.

a. Allowance for Holding Gain/Loss - Inventory Held for Sale. At fiscal yearend, after preparation of financial statements, the following closing entry shall be made. The purpose of the closing entry is to accumulate the net of all holding gains and holding losses so that the subsidiary accounts may start the new fiscal year with a zero (\$-0-) balance.

Dr 1529.1B Purchases at Standard Price  
 Dr 1529.1D Materiel Returns at Standard Price  
 Dr 1529.1F Materiel Returns Without Credit Given  
 Dr 1529.1G Standard Price Changes-Gain  
 Dr 1529.1H Accounting Adjustments-Gain  
 Dr 1529.1J Assembly/Disassembly-Gain  
 Dr 1529.1K Physical Inventory Adjustments-Gain  
 Dr 1529.1L Incoming Shipments-Gain  
 Dr 1529.1M Completed Inventory Repairs  
 Dr 1529.1N Receipts of Materiel Without Charge  
 Dr 1529.1P Other-Gain  
 Dr 1529.1Q Latest Acquisition Cost Adjustment  
 Cr 1529.1 Allowance for Holding Gain/Loss - Inventory Held for Sale  
  
 Dr 1529.1 Allowance for Holding Gain/Loss - Inventory Held for Sale  
 Cr 1529.1A Realization of Holding Gains/Losses  
 Cr 1529.1E Materiel Returns - Credit Given  
 Cr 1529.1C Purchases at Cost  
 Cr 1529.1R Standard Price Changes-Loss  
 Cr 1529.1S Accounting Adjustments-Loss  
 Cr 1529.1T Assembly/Disassembly-Loss  
 Cr 1529.1U Physical Inventory Adjustments-Loss  
 Cr 1529.1V Incoming Shipments-Loss  
 Cr 1529.1W Shrinkage and Other Adjustments-Loss  
 Cr 1529.1X Actual Repair Costs  
 Cr 1529.1Y Issues Without Reimbursement  
 Cr 1529.1Z Other-Loss

b. Allowance for Holding Gain/Loss - Inventory Held for Future Sale.

General ledger account 1529.2, "Allowance for Holding Gain/Loss - Inventory Held for Future Sale," has no subsidiary accounts. Therefore, there are no fiscal yearend closing or adjusting entries necessary.

c. Allowance for Repairs. No fiscal yearend closing or adjusting entry is necessary as the general ledger subsidiary accounts. 1529.3A, "Estimated Repair Costs," and 1529.3A, "Estimated Exchange costs," are relieved (debited) upon completion of repairs as follows:

Dr 1529.3A Estimated Repair Cost  
 Dr 1529.3B Estimated Exchange Cost  
 Cr 1529.1M Completed Inventory Repairs

I. PRICING OF INVENTORY ITEMS

1. Introduction. Policies and procedures to be used in the development of prices for Supply Management Business Area items are contained in volume 2, "Budget Formulation and Execution," of the DoD Financial Management Regulation, DoD 7000.14-R.

2. Standard Price. As a general rule, each cataloged item with a national stock number assigned which is managed by a DoD Inventory Control Point shall have a standard price for sales to all authorized customers, except as may be authorized elsewhere in this chapter. Components shall establish product prices at the lowest practical item level in order to promote cost

visibility/management and to motivate cost effective customer/supplier behavior. At a minimum prices should be established by Federal Supply Class (FSC) or other comparable level at which specific cost allocations can be made. Product pricing levels above the FSC must be approved by the Office of the Under Secretary of Defense (Comptroller). The standard sales price of each item shall be determined in advance of the execution year to allow for publication before the price is effective. The standard sales price becomes effective for billing purposes on the first day of the fiscal year. A standard price will not be changed during the fiscal year without the prior approval of the Office of the Under Secretary of Defense (Comptroller) except as provided for in paragraph I.5. of this chapter. However, the dollar amount of unfilled customer orders accepted at the previous fiscal year's standard price shall be adjusted (upon notification to the customer) to reflect the latest standard price when notice of the price change is received. Normally all recurring local procurements shall be cataloged and assigned a local standard price including any retail level cost recovery element except when the volume of local procurements of an item does not justify the assignment of a local standard price. In those cases, a local purchase of such a nonstandard item shall be priced based upon procurement cost plus any retail level cost recovery element.

a. Acquisition Cost. The most current cost of a representative procurement is the basis for establishing a standard price for an item. Acquisition cost may be calculated by dividing the most current cost amounts by the sum of their quantities. For items without a procurement history, an acquisition cost may be estimated based upon current manufacturer's price listings or market price quotations. The acquisition cost of an item procured by means of a multiyear contract may include up front costs such as setup costs that will not be incurred in future years. In those situations, the setup cost should be prorated over the total planned volume of items to be purchased under the contract.

b. Cost Recovery Elements for Wholesale-Managed Items. A cost recovery element (previously, and inaccurately, termed "surcharge") shall be included in the standard sales price of an item including direct deliveries from contractors, commercial items, nonstandard items, manufacturer's part numbered items, and other items without a standard price. Cost recovery shall consist of elements for operating costs including prior year gains and losses, transportation, inventory expenses, inventory maintenance, price stabilization, repair costs including attrition, and local cost recovery elements. Individual item prices will be established by including the cost recovery elements, by percentage or fixed amount, with the acquisition cost of the item. A percentage allocation of cost recovery elements to individual items should be used for those items for which the cost recovery elements vary closely with the acquisition cost of the item. A fixed amount should be used for those items for which the cost recovery elements do not closely vary with the acquisition cost. Proposed cost recovery elements shall be developed by wholesale division, inventory control point, or major material category as appropriate and submitted to the Office of the Under Secretary of Defense (Comptroller) for approval. The purpose of the cost recovery elements are to balance total revenues with total net operating costs, plus or minus changes in levels of assets, such as inventory or cash. Total net operating costs shall not include requirements funded by appropriations, such as war reserve appropriated amounts. The cost recovery elements shall encompass:

(1) Supply Operations Support Costs. The costs of operating wholesale inventory control points and wholesale supply depots shall be financed by the Supply Management business area. Such costs include civilian labor and benefits, military labor, supplies, purchased services, and other costs exclusive of costs, such as transportation and inventory maintenance, that are recouped by other cost recovery elements. The costs of performing equivalent functions at the retail (installation/area supply support) level shall not be included in the surcharge assessed by the wholesale activities.

(2) Centralized Command and Service Costs. The costs incurred by separate activities and functions that exist primarily to benefit the mission of a wholesale inventory control point and/or a wholesale supply depot. Mission support cost pools shall be established that identify costs incurred by activities and functions that directly provide benefits to wholesale inventory control points, and wholesale supply depots. These cost pools will include all costs (civilian labor and benefits, supplies, purchased services, and other costs) incurred in functions such as line management (command and control), staff management (policy functions), centralized service functions (e.g., procurement, accounting, personnel, ADP, etc). The portion of such overhead cost pools that directly benefit the Supply Management business area mission shall be allocated to, and reimbursed by, the Supply Management business area. The allocation shall be based upon the relationship of the cost of the benefits provided to the Supply Management business area to the cost for all activities or functions.

(3) Depreciation. Cost of depreciation on capital equipment and other applicable assets.

(4) Capital Surcharge. An element added, when needed, to fund the increment, if any, in excess of depreciation expense recovery that is necessary to finance the approved capital investment program.

(5) Shipping and Transportation. The term "shipping and transportation" includes costs for packing, crating, handling, transportation, and, where appropriate, port loading, and unloading. Items may be shipped from a stocking point (issues) or to a stocking point (returns).

(a) Inventory Issues. Costs to be included are transportation costs for items issued by the Supply Management Business Area. To the extent that first destination transportation is not included in the acquisition cost, an estimate of the cost shall be included in this element. Second destination transportation costs should be based on the assumption of lowest cost, generally surface transportation, delivery as adjusted by projected changes in the budget year. Second destination transportation costs financed by a Supply Management Business Area generally include only transportation within the continental United States (CONUS) and between overseas locations. An additional transportation charge shall be assessed for expedited delivery and delivery outside CONUS based on destination, e.g., Europe, Far East, Near East. For commissary items, the cost of transportation of items shipped to commissaries in Alaska and Hawaii shall be included in the price charged to the commissary and recovered by a special transportation cost recovery element included in the price charged to Alaska and Hawaii commissary customers.

(b) Customer Returned Items With and Without Credit. Costs to be included are Shipping and transportation costs only for items approved by an item manager for return from DoD customers to the Supply Management business area. The Supply Management business area shall reimburse transportation and other shipping costs only for items approved by an item manager for return from customers. Shipping and transportation cost for items that have not been approved by an item manager for return from customers shall not be paid by the Supply Management business area.

(c) Depot Level Reparable Exchange Carcasses. Costs to be included are shipping and transportation costs for the return of reparable exchange carcasses from customers. As a result of including a cost recovery factor into finance shipping and transportation costs for returns of carcasses from customers, the customer will not be charged separately for carcass returns.

(d) Lateral Redistribution. Costs to be included are shipping and transportation costs for lateral distributions of stock when directed by an item manager. When a shipment is made at the direction of an Integrated Materiel Manager (IMM), the supplying (issuing) activity shall be reimbursed by the IMM for the costs of packing, crating, handling, and transportation to move that materiel.

(6) Inventory Expenses. Normal inventory expenses to be included in this cost recovery element are the net of losses and gains from incoming and outgoing shipments, physical inventory adjustments, inventory losses as a result of shrinkage, theft, deterioration, damage contamination, defective items if not reimbursed by supplier, obsolescence, and adjustments to reconcile internal records. Obsolescence consists of the current replacement cost of new or modified items required to replace items no longer needed due to changes in technology, laws, customs, or operations (for example, modification or replacement of a weapon system or commodity). Extraordinary losses such as those due to armed hostilities, riot, or significant damage due to fire, flood, earthquake, storms, or other abnormal events are not normal inventory losses and should not be included in the cost recovery element for inventory expenses. Appropriations should be sought from Congress to fund extraordinary losses.

(7) Inventory Maintenance. The inventory maintenance cost recovery element finances the acquisition of inventories which are required over and above demand replacement (excluding mobilization requirements which are financed by appropriations) to maintain the level of material support at the currently approved position. The cost recovery element for inventory maintenance should be the net impact (increases and decreases) of changes to inventory levels anticipated during the period. In a declining force structure environment, the need for an inventory maintenance cost recovery element is not anticipated.

(8) Economic Adjustments. The economic adjustment element is designed to compensate for inflation or deflation, that is expected to occur on procurements during the period of time that the prices are in effect; adjust for prior year gains or losses; maintain the approved level of Funds with Treasury; and provide consistency with the budget for DoD customers. The Under Secretary of Defense (Comptroller) issues annual inflation guidance based on

the Administration's economic assumptions. Adjustments to product prices contained in the annual budget submissions and supporting congressional justification materials shall be based on that inflation guidance.

(9) Carcass Attrition (Washouts and Losses). Activities that manage maintenance and repair missions on an exchange carcass basis incur replacement cost for carcass washouts and losses. Carcass washouts (sometimes termed "condemnations") are carcasses that, during the initial inspection, are determined to be repairable but during the repair process are determined to be unrepairable and are also determined to require replacement. If the carcass is determined to be unrepairable because of customer cannibalization or other malicious damage caused by the customer, the customer shall be charged the difference between the exchange price and the current standard price and this cost shall not be included in the surcharge element. The second unique repairable cost to be included in this special cost recovery element is the replacement cost for carcasses lost, for example, in transit to the customer or to the supply system. Lost carcasses shall be investigated and necessary internal controls strengthened as required by DoD 7200.10-M, "Department of Defense Accounting and Reporting for Government Property Lost, Damaged, or Destroyed."

(10) Retail Losses. A cost recovery element to compensate for losses experienced at the retail supply activity level shall be included as a credit (reduction) in standard prices charged to retail activities. However, prices charged to customers of retail activities and commissaries shall not reflect this discount.

c. Cost Recovery Elements for Retail-Managed Items. A cost recovery element used by a retail level supply activity;

(1) Will include inventory (material) expenses. Inventory expenses applicable to the retail-managed items are the net impact of gains and losses at the retail level, obsolescence, and shelf-life deterioration.

(2) May include a special local cost recovery element, when approved by the Office of the Under Secretary of Defense (Comptroller), added to the cost of locally purchased items.

3. Foreign Military and Private Party Sales. As prescribed in Volume 15, "Security Assistance Policy and Procedures, of this Regulation, the selling price of Defense Business operations Fund items to Foreign Military Sales customers shall be the current Defense Business Operations Fund price for that item.

4. Lateral Redistribution of Stock. An item manager may direct a lower stockage level to issue stock when the total cost of such action is lower or when the item manager does not have stock available to meet a requisition's response time and the lower level does--such action is termed "lateral redistribution." As provided in DoD 4140.1-R, "DoD Materiel Management Regulation," billing procedures associated with lateral redistributions directed by an item manager will ensure an issuing activity is reimbursed for both the standard price of the material and the standard packing, crating, handling, and transportation costs associated with a redistribution. The item

manager will bill the requesting activity for the standard price of the material and reimburse the issuing activity for the standard price of the material and the standard packing, crating, handling, and transportation costs.

5. Authorized Reductions of Standard Prices. DoD Components shall set product prices on an annual basis. Those prices cannot be changed during a fiscal year without justification to, and prior written approval of, the Office of the Under Secretary of Defense (Comptroller). The only exceptions to the requirement for prior approval from the Office of the Under Secretary of Defense (Comptroller) are:

a. subsistence items sold to a commissary may be changed on a procurement lot basis;

b. subsistence items sold for troop issue purposes may be changed on a monthly basis;

c. clothing items required for a mandatory clothing bag may be changed when a related change occurs in the clothing allowance for military personnel.

d. unit of issue changes;

e. first time buys;

f. price challenges or breakouts;

g. discounted product prices (see Paragraph I.6.);

h. customer requested product changes: and

i. seasonal price variations for materiel normally bought for direct vendor delivery.

6. Discount Pricing. As a general rule, all product prices must reflect the full cost of the product and the related management activity. However, discount pricing is permitted under the following conditions:

a. Prior approval of the Director for Revolving Funds, Office of the Under Secretary of Defense (Comptroller) for an item for which a Component desires to charge the customer a discounted price. The request to discount an item price should be accompanied with an analysis of the cost (profit/loss) impact anticipated as a result of charging a lower price.

b. Age, condition, or model: Reductions from standard prices may be made subsequent to approval by the Director for Revolving Funds, Office of the Under Secretary of Defense (Comptroller) upon determination that there is an actual difference in utility or desirability of an item because of age, condition, or model for items being phased out of the system, items no longer being procured, items with limited remaining shelf life, items in a less than "fully serviceable" condition, and items in long supply, i.e., assets stratified as "potential reutilization stock."

7. Pricing for Additional/Premium Service. Components may establish and offer variable levels of service related to a product, at variable prices, to allow customers the opportunity to economize according to their needs. Appropriate fees may be established annually and may vary according to the item/class of items. Refunds (credits) will be made available for those instances where a customer has paid for a level of service which was not provided. This permissible policy is not intended to authorize a reduced charge for some customers. It is intended to authorize an additional charge for customers who ask, and are willing to pay, for enhanced service. Individual orders may be assessed additional cost recovery rates based on the following elements:

- a. Expedited delivery.
- b. Delivery outside the continental United States based on destination, e.g., Europe, Far East, Near East.
- c. Depot handling fees related to order issues only. This fee(s) will include a minimum charge for low priced orders, a standard charge for bin item issues, a standard charge for normal bulk item issues, and special charges for unusual bulk item issues, e.g., special handling and extraordinary quantities.

J. ISSUES WITHOUT REIMBURSEMENT. A Supply Management business area item may not be issued or transferred without reimbursement except as specifically authorized below:

1. Domestic Civil Emergency. A Supply Management business area item may be issued without immediate reimbursement when action is being taken to provide civil emergency relief assistance in accordance with the policies and procedures provided in DoD Directive 3025.1, "Military Support to Civil Authorities." However, an accounts receivable shall be established for such amounts. Subsequently, funding should be made available to cover the costs of the relief effort, and the Supply Management business area shall be reimbursed for any outstanding accounts receivable.

2. Civil Disturbances. A Supply Management business area item may be issued without immediate reimbursement when action is being taken to control a civil disturbance in accordance with the policies and procedures provided in DoD Directive 3025.12, "Employment of Military Resources in the Event of Civil Disturbances." However, an accounts receivable shall be established for such amounts. Subsequently, the Supply Management Business Area should be reimbursed for any outstanding accounts receivable based upon the procedures provided in DoD Instruction 7200.9, "Financing and Reporting Costs of Military Resources Used in Civil Disturbances," and Volume 6, Chapter 11 of this Regulation.

3. Foreign Disaster. The State Department is responsible for initiating and financing foreign disaster relief efforts pursuant to the Foreign Assistance Act of 1961. Procedures for issues of Supply Management business area material to assist in the event of a foreign disaster and reimbursements shall be in accordance with DoD Directive 5100.46, "Foreign Disaster Relief."

4. NATO Country. A Supply Management business area item may be issued to a NATO country without reimbursement under a replacement-in-kind arrangement under DoD Instruction 2010.10 (reference (s)). Nonreimbursable issues under this authority shall be changed to a reimbursable issue within 12 months if not replaced by the NATO country.

5. Military Emergency. A Supply Management business area item may be issued without immediate reimbursement when a Federal official or military officer has certified that an emergency exists under Section 3732, Revised Statutes, as implemented by DoD Directive 7220.8, "Policies and Procedures Governing the Use of the Authority of Section 3732, Revised Statutes," or emergency provisions in the current DoD Appropriations Act. However, an accounts receivable shall be established for such amounts. When funding is made available to cover the costs of the emergency, the Supply Management business area shall be reimbursed for any outstanding accounts receivable.

6. Presidentially Directed Drawdowns. A Supply Management business area item may be issued to a foreign country without reimbursement when the President has directed a drawdown of defense articles from stocks under authority such as Sections 506 and 522, 22 U.S.C. 2318. The standard price of such issues shall be reported to the Director, Defense Security Assistance Agency for inclusion in subsequent foreign assistance budget requests and to the Office of the Under Secretary of Defense (Comptroller), Revolving Funds Directorate, in order to determine the cash impact of such issues. The cash impact shall be added to the economic adjustment cost recovery element.

7. War Reserve Assets. A Supply Management business area item may be issued without reimbursement when an item is designated as a war reserve asset and the issue has been approved to satisfy requirements of a mobilization of U.S. Armed Forces.

8. Deficiencies in War Reserve Requirements. A Supply Management business area item may be issued without reimbursement when an item is issued under the policies of DoD 4140.1-R, "DoD Materiel Management Regulation," to satisfy deficiencies in war reserve requirements or between activities within the Supply Management business area. Items issued at any level, wholesale or retail, to satisfy customer requisitions shall be reimbursable from war reserve reinvestment appropriations.

9. Disposal of Excess Items. After a request to, and receipt from, the item manager of a disposal release order, excess, obsolete, or unserviceable Supply Management business area items may be issued to a Defense Reutilization and Marketing Office (DRMO) without reimbursement from the DRMO.

10. Items Nearing Obsolescence. A Supply Management business area item may be issued without reimbursement when the item is not a war reserve asset, it has six months or less of remaining shelf-life and the item manager has granted approval for the item to be issued on a nonreimbursable basis.

11. Logistical Management Transfers. Logistical management transfers result from changes in the funding appropriation for an item. If the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology) designate a logistical management transfer of item(s) from an appropriation to the supply management business area, an

increase to inventory for a nonreimbursable transfer shall be recorded at the value of the item being transferred. Normally, items transferred as a result of a logistical management transfer are transferred without reimbursement. However, under certain circumstances and with prior approval from the Office of the Under Secretary of Defense (Comptroller), transfers-in of inventory may be with reimbursement to the transferring account. Those conditions, all of which must be met, are:

a. The inventory was on order but undelivered to the transferring account at the time of the transfer.

b. The transferring account is not a business area within the Defense Business Operations Fund.

c. The inventory was ordered by the transferring account as a result of a reimbursable order from a customer of that account.

12. Other. When approval has been granted by the Secretary of Defense.

K. GOVERNMENT-FURNISHED MATERIAL (GFM). Consideration shall be given to the issuance of Supply Management Business Area items to a contractor in the development of contractual specifications. The use of GFM may limit the cost of an item, particularly for contractor overhead and profit, and may result in increased competition by encouraging more potential contractors to bid. Purposes for which GFM may be furnished include:

1. Fabrication. A Supply Management Business Area item issued by the direction of the item manager to a contractor for consumption in the fabrication, assembly, or disassembly of another Supply Management Business Area item for the benefit of the Supply Management business area shall be accounted for in account 1584, "Work in process - GFM." A Supply Management Business Area item issued by the direction of the item manager to a DoD activity for consumption in the fabrication, assembly, or disassembly of another item for the benefit of the Supply Management business area shall be accounted for in account 1583, "Work in process - Other Government Activities." The cost of the item consumed and other costs incurred in the fabrication, assembly, or disassembly of the new item shall be recorded as a portion of the procurement cost of the new item(s).

2. Repair Alteration, or Modification

a. Items Consumed in the Process of Repair of other Items. A supply Management business area item issued by the direction of the item manager to a contractor for consumption in the repair, alteration, or modification process shall be accounted for in account 1584, "Work in process - GFM." A Supply Management business area item issued by the direction of the item manager to a DoD activity for consumption in the repair, alteration, or modification process shall be accounted for in account 1583, "Work in Progress - Other Government Activities."

b. Items Issued for Repair. A reparable carcass or other item of inventory issued by the direction of the item manager to either a DoD activity or a contractor for repair, alteration, or modification shall be accounted for

in account 1523, "Inventory Held for Repair." Upon receipt of the repaired item, it shall be accounted for in account 1521, "Inventory Held for Sale."

3. Forgings and Castings. The cost of forgings and castings used as Government furnished material shall be included as a part of the acquisition cost of the item that includes the forging and casting in its production.

L. GOVERNMENT-FURNISHED EQUIPMENT (GFE). Machine tools, equipment, and test equipment used in the manufacture of Supply Management business area items may be purchased by the Government and provided as GFE under a contract when economically justifiable; for example, an economic buy, repair methodology, or life-of-type buy. Supply Management business areas may not be used to procure GFE for use in the manufacture of items funded with other appropriations or funds. The Supply Management business area shall finance the cost of the GFE by use of direct appropriations if the item being produced is for mobilization purposes. If the item is being produced, in significant quantities, for a combination of operating or mobilization purposes, the costs may be prorated according to the ratio of the needs for each purpose or assigned to the primary purpose. The Supply Management business area shall, maintain accountability for the GFE while in the hands of the contractor. Purposes for which GFE may be furnished include:

1. Testing. The costs of testing and inspection of a Supply Management business area item issued by direction of the item manager to a DoD or contractor facility for inspection or for testing purposes shall be charged to the Supply Management business area or appropriations available for those purposes. The costs of repairing an item damaged during testing or inspection or the standard price, if the item is destroyed beyond repair, shall be charged to the Supply Management business area or appropriations available for those purposes.

2. Forgings and Castings. The cost of molds provided to a contractor as Government furnished equipment for use in the manufacturing of a Supply Management business area item shall be accounted for as equipment in the hands of contractors in a subaccount to the appropriate inventory account. The contractor shall be held accountable for the return of the items in good condition upon completion of the contract.

#### M. LOANS AND LEASES

1. Authorized Recipients. Property items may only be loaned or leased to activities specified below for the stated purpose. The recipient shall be required to sign a receipt for the item. This receipt shall include a statement of the intended purpose of the loan or lease. Each loan or lease of an item shall be approved by the accountable office, the comptroller, or equivalent, of the activity responsible for accountability over the item. The approval shall include a description of the item including the price, condition, anticipated return date; and a certification that the loan or lease of the item will not jeopardize the capability to support national defense requirements. Property may be loaned to:

a. DoD Funded Customers. Items may be loaned to a DoD funded customer for a maximum of 120 days to support an approved training exercise, a military emergency, or a natural disaster.

b. U.S. Secret Service. An item may be loaned to the U.S. Secret service for a maximum of 120 days for purposes prescribed under the policies and procedures in DoD Directive 3025.13, "Employment of Department of Defense Resources in Support of the United States."

c. Civilian Law Enforcement Officials. An item may be loaned to a civilian law enforcement activity for a maximum of 120 days for purposes prescribed under the policies and procedures in DoD Directive 5525.5, "DoD Cooperation with Civilian Law Enforcement Officials."

d. State and Local Governments. An item may be loaned to a state or local government for a maximum of 120 days for a specific purpose, under the policies and procedures prescribed in DoD Directive 3025.1, "Military Support to Civil Authorities."

e. National Veterans' Organizations. Under the authority of 10 U.S.C. 2541, an item (e.g., cots, blankets, pillows, mattresses, bed sacks, and other supplies) may be loaned to a recognized national veterans' organization for a maximum of 120 days to support a national or state convention or a regional youth athletic or recreational tournament sponsored by the veterans organization. A bond equal to the current standard price of the item shall be obtained before the item is loaned. The veteran's organization must pay for all expenses incurred in the delivery, return, rehabilitation, or replacement of the property.

f. American National Red Cross. Under the authority of 10 U.S.C. 2542, an equipment item may be loaned to an organization formed by the American National Red Cross for a maximum of 120 days for the purpose of instruction and practice needed to aid the Army, Navy, or Air Force in time of war. 10 U.S.C. 2542 requires that a bond for the care and safekeeping of the loaned property equal to twice the value of the property shall be obtained before the item is loaned.

g. Inaugural Committee. Under the authority of 10 U.S.C. 2543, items may be loaned to an Inaugural Committee established under 36 U.S.C. 721 to support an inauguration of the President of the United States for a period not to exceed 9 days beyond the inauguration ceremony. A bond equal to the current standard price of the item shall be obtained before the item is loaned. The Inaugural Committee shall pay for all expenses incurred for the delivery, return, rehabilitation, replacement, or operation of the property.

h. Boy Scout Jamborees. Under the authority of 10 U.S.C. 2544, cots, blankets, commissary equipment, flags, refrigerators, and other equipment may be loaned to the Boy Scouts of America for the use of Scouts, Scouters, and officials who attend any national or world Boy Scout Jamboree. In addition, services and expendable medical supplies, as may be necessary or useful to the extent that items are in stock and items or services are available may be furnished without reimbursement. Items may be loaned for a maximum of 120 days. A bond equal to the value of the loaned items shall be obtained before

the items are loaned. No expense shall be incurred by the United States Government for the delivery, return, rehabilitation, or replacement of such equipment.

i. Humanitarian Relief. Under the authority of 10 U.S.C. 2544, nonlethal excess supplies may be made available for transfer to the Department of State for its distribution for humanitarian relief. The term "nonlethal excess supplies" means property, other than real property, of the Department of Defense that is excess property as defined in regulations of the Department of Defense; and that is not a weapon, ammunition, or other equipment or material that is designed to inflict serious bodily harm or death.

j. Foreign Countries or International Organizations. An item may be leased to an eligible foreign country or international organization under the authority of the Arms Export Control Act. Policy and procedures for the lease of material to foreign countries and international organizations is contained in Chapter 12 of DoD 5105.38-M, "Security Assistance Manual," and volume 15 of the DoD Financial Management Regulation, "Security Assistance Policy and Procedures," DOD 7000.14-R, Section 713. Refer to these references for approval channels and expense requirements in addition to paragraph 2 and 3 below.

k. Other Leases. Under the authority of 10 U.S.C. 2667, a non-excess Supply Management Business Area item may be leased to an organization when the Secretary of Defense or the Secretary of the Military Department has determined that the item is not needed for DoD use during the proposed lease period and the lease will promote the national defense or otherwise be in the public interest.

2. Approvals. Each loan or lease of an item shall be approved by the comptroller, or equivalent, of the activity responsible for accountability over the item. The approval shall include a description of the item including the price, condition, anticipated return date; and a certification that the loan of the item will not jeopardize the capability to support national defense requirements.

3. Expenses. The recipient shall pay for any transportation, packing, crating, and handling costs associated with the loan or lease of the item. At the time of return of the item, the recipient shall be required to pay any costs necessary to restore the item to its original condition or to pay for any item the recipient does not return within the approved period of the loan or lease.

#### N. REPARABLES

1. Standard Price. The standard price for reparable items, including the cost recovery elements, shall be developed consistent with the policies prescribed for other Supply Management Business Area items. Sales of reparable items made without a return shall be priced at the standard price. Exchange arrangements are not authorized for customers outside the Federal Government except for a Foreign Military Sales (FMS) customer investing in Cooperative Logistics Supply Support Arrangements (CLSSA). Sales to customers outside the Federal Government shall be priced in accordance with Volume 11A, Chapter 1, "General Reimbursement procedures and Supporting Documentation," [currently in

Chapter 26 of, DoD 7220.9-M, "DoD Accounting Manual,"] and Volume 15, "Security Assistance Policy and Procedures," of this Regulation.

2. Exchange Price. For the issue of a reparable item in which the requisitioner indicates a carcass will be returned, the customer will be charged the exchange price, i.e., the established repair cost plus the appropriate cost recovery elements. The exchange price for reparable items shall be determined by a homogeneous grouping such as National Stock Number (NSN), Federal Supply Classification (FSC), subclassification, repair category, or materiel category. The exchange price may consist of a percentage factor times the standard price. The exchange price shall be established before the beginning of each fiscal year for each homogeneous group and provided to customers and shall remain constant throughout the execution fiscal year.

3. Calculation of Exchange Price. The exchange price shall be calculated on the most representative unit repair cost of the item plus the appropriate cost recovery elements to recover the cost of managing the item. The same cost recovery elements used in the standard price calculation shall be used in the calculation of the exchange price plus cost recovery elements for carcass attrition (washout and loss) and shipping and transportation costs for returns of carcasses from customers. If the standard price is less than the exchange price, a review of the standard price and the exchange should be made to validate their accuracy. If the standard price is less than the exchange price because new items are not currently being acquired, the standard price shall be increased 20 percent over the exchange price to incentivize the customer to return the carcass to the wholesale system.

4. Illustration of Accounting for Inventory Held for Repair. Most items held for repair are obtained as the result of an exchange transaction. The process consists of the sale of a serviceable item in exchange for an item that needs repair plus a promise to pay (accounts receivable) or the actual payment (cash) for the difference in value between the two items. If the item needing repair has not been received at the time of exchange, an in-transit account shall be established to account for the due-in. Upon receipt of the item needing repair, it is sent to a repair facility. While at the repair facility, the item continues to be accounted for by the supply system as inventory held for repair and not as work in progress. Upon return of the repaired item, it becomes available for sale and is placed into the appropriate inventory for sale account. The accounting entries to accomplish this process are illustrated below.

(1) Exchange of Serviceable Item for Reparable Item. Inventory items requiring repair are generally obtained from customers as a partial exchange for a serviceable inventory item. The remaining exchange should be an account receivable equal to the selling price of the serviceable item less the estimated repair and exchange cost of the exchange item. The estimated repair and exchange costs shall be established on an aggregate basis, using an average cost to repair. Inventory held for repair shall be valued at the same value as a serviceable item. However, contra-asset accounts (i.e., account 1529.3A, "Estimated Repair Costs," and account 1529.3B, "Estimated Exchange Costs") shall be established for the estimated repair and exchange cost. An exchange of a serviceable item for reparable item is illustrated by the following accounting example:

Dr 1523.1 Exchange (DLR) Inventory in Transit	\$5,250	
Dr 1311 Accounts Receivable-Government-Current	\$2,700	
Cr 5101 Revenue from Goods Sold - DBOF		\$5,250
Cr 1529.3A Estimated Repair Costs		\$1,650
Cr 1529.3B Estimated Exchange Costs		\$1,050

Entry to record sale of inventory when a reparable item is to be exchanged for a ready for issue inventory item. In this case, the current standard price of the exchanged item is \$5,250 and the estimated repair cost for the item is \$1,650. (Note: The estimated repair cost need not be established for the particular item to be exchanged but, instead, may be an average cost to repair exchange items of the same type.)

(2) Receipt of Reparable Item.

Dr 1523 Inventory Held for Repair	\$5,250	
Cr 1523.1 Exchange (DLR) Inventory in Transit		\$5,250

Entry to record receipt of exchange (DLR) inventory. The exchange item is recorded at its standard price. (A standard allowance for repair was established at the time the exchange transaction occurred -- see above.)

(3) Reparable Items Sent to Repair Facility. Reparable items sent to a repair facility shall continue to be reported by the supply systems as "Inventory Held for Repair," and not as work in progress by the supply system while items are at a repair facility.

(4) Receipt of Repaired Item from Repair Facility. When the repair is actually made, the value of the repaired item included in Account 1523, "Inventory Held for Repair," shall be relieved from that account and reclassified to Account 1521, "Inventory Held for Sale." The amount payable to the repair facility for the repair is recorded in Account 1529.1X, "Actual Repair Cost," and as an Account Payable. Receipt of repaired items is illustrated by the following accounting example:

Dr 1521 Inventory Held for Sale	\$5,250	
Cr 1523 Inventory Held for Repair		\$5,250
Dr 1529.1X Actual Repair Costs	\$1,500	
Cr 2111 Accounts Payable-Government-Current		\$1,500
Dr 1529.3A Estimated Repair Cost	\$1,650	
Dr 1529.3B Estimated Exchange Cost	\$1,050	
Cr 1529.1M Completed Inventory Repairs		\$2,700

Entry to record receipt of repaired items from a repair facility. In this illustration, although the estimated repair cost was \$1,650, the repair facility charged only \$1,500 for the repair work. [Note: In many instances, the amount charged by a DoD repair facility is equal to the estimated repair cost.]

## 0. WAR RESERVE MATERIALS

1. Definition. War reserve/mobilization items are those materials that, in addition to peacetime assets normally available on any given date, are necessary to equip and support the increase in military requirements forecasts contingent on an outbreak of war and sustain operations until resupply can be effected. War reserve materiel includes secondary items procured and/or stored in support of wartime scenarios established in Defense Planning Guidance or contingency operations identified in specific Operational Plans. Within the Defense Business Operations Fund, war reserve/ mobilization stock shall be classified as an element of stockpile materials. War reserve materials, are not held with the intent of selling in the ordinary course of business. Stockpile materials are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. (National Defense Stockpile materials are accounted for within the National Defense Stockpile Transaction Fund, which is not part of the DBOF. Stockpile materials are discussed in Volume 4, Chapter 4, of this Regulation.)

2. Funding for War Reserve Materials. War reserve materials shall be funded from appropriations made direct to the DBOF. Such appropriated amounts shall be reflected as a separate goal within the applicable Supply Management or Commissary Resale business area annual operating budget letter. Items such as ammunition and/or principal and major end items procured for war reserve shall not be DBOF-funded, but shall be funded through amounts available to Component/Defense Agency procurement appropriations.

3. Accounting for War Reserve Materials. Purchases of DBOF-funded war reserve items shall be accounted for at the same level of detail as items procured for peacetime requirements. The value of war reserve items shall be recorded in a separate general ledger accounts, or appropriate subaccounts, to retain separate visibility of such assets. The general ledger accounts established for those purposes are account 1573, "War Reserve/Mobilization Stock," and account 1579.2 "Allowance for Holding Gain/Loss - War Reserve/Mobilization Stock." War reserve items are not available for sale in the ordinary course of business; therefore, cost of war reserve items shall be separately maintained and reported from inventory costs to ensure that the unit cost targets for the Supply Management business are not affected.

### 4. Valuation of War Reserve Materials

a. Latest Acquisition Cost. War Reserve materials shall be valued on the basis of latest acquisition cost.

b. Allowance for Holding Gains and Losses. General ledger account 1579.2, "Allowance for Holding Gain/Loss - War Reserve/Mobilization Stock," shall be established to account for valuation changes.

c. Exception to Valuation of War Reserve Materials. The carrying amount of war reserve materials that have suffered (a) a permanent decline in value to an amount less than their cost or (b) damage or decay shall be reduced to the expected net realizable value of the materials. The decline in value shall be recognized as a loss in the period in which it occurs.

5. Disposition of War Reserve Materials. War Reserve materials are held in reserve to be available for transfer without reimbursement when the issue of a war reserve asset has been approved to satisfy requirements of a mobilization of U.S. Armed Forces. However, if authorized, war reserve and other stockpile materials may be sold. The accounting for each of those possibilities is as follows:

a. Transfer Without Reimbursement. An issue of war reserve without reimbursement shall be recorded as follows:

Dr 3231 Transfers-Out to Government Agencies Without  
Reimbursement  
Cr 1573 War Reserve/Mobilization Stock

Documentation supporting this entry includes material release orders and shipping documents.

b. War Reserve Materials Authorized For Sale. War reserve materials are not held with the intent of selling in the ordinary course of business. However, they may be sold when authorized. When war reserve materials are authorized to be sold, those materials shall be disclosed, as applicable, as inventory held for sale (Account 1521, "Inventory Held For Sale"). The materials authorized for sale shall be valued using the same basis as used for other same commodities normally held for sale. The accounting entry to reclassify war reserve material as inventory held for sale is:

Dr 1521 Inventory Held For Sale  
Cr 1573 War Reserve/Mobilization Stock

5. Financial Statement Disclosure Requirements. Notes accompanying financial statements shall include:

- a. General composition of war reserve materials.
- b. Basis for valuing war reserve materials; including valuation method and any cost flow assumption.
- c. Changes from prior year accounting methods, if any.
- d. Restrictions on the use of war reserve materials.

P. RETURN OF ITEMS TO THE SUPPLY MANAGEMENT BUSINESS AREA

1. Customers Who May Return Items. A customer within the Federal Government may return an item to a Supply Management Business Area. Section 2208 of 10 U.S.C. states, "The appraised value of supplies returned to working capital funds by a department, activity, or agency may be charged to that fund. The proceeds thereof shall be credited to current applicable appropriations and are available for expenditure for the same purposes that those appropriations are so available. Credits may not be made to appropriations under this subsection as a result of capitalization of inventories . . ."

2. Customers Who May Not Return Items. A customer outside of the Federal Government may not return an item to a DoD Supply Management Business Area. If such a customer has an item to return, the DoD Supply Management Business Area

may buy the item back from the customer as described in Volume 15, "Security Assistance Policy and Procedures," of this Regulation.

3. Credit Options. Credits for returned items shall be granted by the item manager based upon receipt, inspection, and classification of the item.

a. Return of a Fully Serviceable Consumable or Repairable Item. When approved by the item manager, a credit shall be granted to a Federal Government customer in the amount of the current standard price less the current fiscal year's approved cost recovery elements for the return of a fully serviceable consumable or repairable item that is within the approved acquisition objective. Credit shall be granted by the item manager based upon receipt, inspection, and classification of the item. A return that stratifies to a war reserve requirement does not qualify for credit.

b. Return of Repairable Carcass When Part of an Exchange Transaction. When approved by the item manager, a credit shall be granted to (1) a Federal Government customer or (2) a Foreign Military Sales (FMS) customer investing in Cooperative Logistics Supply Support Arrangements (CLSSA) for the return of a less than fully serviceable, economically repairable item when the item is within the approved acquisition objective. Such credit shall be in the amount of the current standard price, less the exchange price. (The exchange price is the total of the established repair cost and the appropriate cost recovery elements.) A returned item that stratifies to a war reserve requirement does not qualify for credit.

c. Return of a Repairable Carcass When not Part of an Exchange Transaction. When approved by the item manager, a credit shall be granted for the return of a repairable carcass from a Federal Government funded customer without an exchange if the Supply Management Business Area forecasts a need for the carcass within the approved acquisition objective. The credit shall be in the amount of the value of the carcass to the Supply Management Business Area but not more than the current standard price, less the exchange price. (The exchange price is the total of the established repair cost and the appropriate cost recovery elements.)

d. Return of Defective Items. A credit shall be granted to a customer at standard price for defective items issued by a Supply Management Business Area, including specification defects, when a customer's quality deficiency report has been validated.

4. Credits Applied Toward Future Requirements. Credits granted may be applied against future customer demands in the current fiscal year for items or directly credited to the current year available funds of the customer.

5. Shipping Costs. Shipping costs include packing, crating, handling, transportation, port loading, and unloading. The Supply Management business area shall reimburse transportation and other shipping costs only for items approved by an item manager for return from customers. Shipping and transportation cost for items that have not been approved by an item manager for return from customers shall not be paid by the Supply Management business area.

## Q. EXCESS ITEMS DISPOSITION

1. Items of Excess Items to Reutilization and Marketing. Excess, obsolete, or beyond repair Supply Management business area items may be transferred without reimbursement, when authorized by the responsible National Inventory Control Point Manager, to a Defense Reutilization and Marketing Office (DRMO). Any DoD-funded customer may obtain any item from a DRMO, without reimbursement to the supply Management business area even if the item was previously a Supply Management business area item. A DRMO shall issue an item without reimbursement to a Supply Management business area when the item is required to satisfy a Supply Management business area requirement.

2. Issues of Excess Items to Other DoD Activities. An issue of a Supply Management business area item excess to the needs of the National Inventory Control Point Manager may be made directly to a DoD-funded customer without reimbursement to satisfy deficiencies in mobilization reserve requirements. In accordance with paragraph I.4. of this chapter, a lateral redistribution of an item excess to the immediate needs of a retail activity from that activity, to another, when directed and controlled by a wholesale manager, shall be without reimbursement from the receiving activity. Rather, the wholesale manager shall bill the receiving activity for the standard price of the material and reimburse the issuing activity for the standard price of the material and its standard packing, crating, handling, and transportation costs.

## R. CONTRACT AUTHORITY FOR SUPPLY MANAGEMENT OPERATIONS

1. General. Based upon the authority in 10 U.S.C. 2210, the OMB apportions anticipated contract authority at the beginning of a fiscal year for the amount of the approved Supply Management business area program. This anticipated contract authority becomes realized contract authority when obligations are incurred by the Supply Management business area. Unfunded contract authority is the amount that obligations incurred are in excess of customer orders accepted. Contract authority provided to Supply Management business area is subject to apportionment as required by the Antideficiency Act in accordance with the procedures prescribed in OMB Circular A-34, "Instructions on Budget Execution."

2. Budgetary Resources. Supply Management business area budgetary resources available for use during a fiscal year consist of any appropriated and reappropriated amounts made available; the net of any nonexpenditure transfers into and out of the Supply Management business area and other Federal Government accounts; balances made available from the previous fiscal year; and apportioned anticipated contract authority. Normally, obligation authority for Supply Management business area activities is derived from two primary sources. These sources are (a) contract authority and, (b) appropriated funds for war reserve/mobilization purposes. Supply Management, business area liabilities are payable from the fund balance with Treasury. The two primary sources for the fund balance with Treasury for DoD Supply Management business areas are (a) collections from customers and (b) appropriations.

a. Appropriated Balances Brought Forward. At the end of each fiscal year, unused balances of funds appropriated to the Supply Management business area shall be used to offset the need for anticipated contract authority. Such amounts are not available for use until they are reapportioned and

reflected on the supporting financing schedule as an increase to the limit imposed for obligation authority on an approved apportionment in the new fiscal year.

b. Anticipated Contract Authority. The OMB may approve and apportion anticipated contract authority in the amount of the approved Supply Management Business Area operating program.

(1) A request for apportionment of anticipated contract authority forwarded to the OMB shall be recorded as follows:

Dr 4211 Anticipated Reimbursements - Specific Apportionment  
Cr 4440 Revolving Funds Available for Apportionment

Entry to record a request for apportionment of anticipated reimbursements forwarded to the OMB. The documentation supporting this entry is a DD 1105, "Apportionment and Reapportionment Schedule."

(2) The receipt of the approved apportionment request shall be recorded as follows:

Dr 4440 Revolving Funds Available for Apportionment  
Cr 4514 Unallocated Apportionment - Reimbursable  
Program - Current Period

Entry to record the receipt of the approved apportionment request. The documentation supporting this entry is an approved DD 1105, "Apportionment and Reapportionment Schedule."

(3) Allocations issued shall be recorded as follows:

Dr 4514 Unallocated Apportionment - Reimbursable  
Program - Current Period  
Cr 4543 Allocations Issued - Reimbursable Program -  
Current Period

Entry to record allocations issued. The documentation supporting this entry is an approved allocation document.

(4) Allocations received shall be recorded as follows:

Dr 4550 Internal Fund Distributions Received  
Cr 4563 Unallotted Allocations - Reimbursable  
Program - Current Period

Entry to record allocations received. The documentation supporting this entry is an approved" allocation document.

(5) Allotments issued shall be recorded as follows:

Dr 4563 Unallotted Allocations - Reimbursable Program -  
Current Period  
Cr 4573 Allotments Issued - Reimbursable Program -  
Current Period

Entry to record allotments issued. The documentation supporting this entry is an approved allotment document.

(6) Allotments received shall be recorded as follows:

Dr 4582 Allotted Reimbursable Program - Current Period  
Cr 4614 Uncommitted/Unobligated Allotments -  
Reimbursable Program - Current Period

Entry to record allotments received. The documentation supporting this entry is an approved allotment document.

c. OMB Footnote. The OMB apportionment of anticipated reimbursements as anticipated contract authority currently includes a footnote, consistent with the following:

Pursuant to 10 U.S.C. 2210(b) obligations/commitments may be incurred in excess of the amount of the apportioned resources actually realized in the amount of contract authority approved, but not in excess of the total apportioned. The estimated unfunded balance of this contract authority pursuant to 10 U.S.C. 2210(b) of \$\_\_\_\_\_ on September 30, 19xx is increased by \$\_\_\_\_\_ provided that this amount is automatically reduced to the extent that orders are realized.

d. Realized Contract Authority. Anticipated contract authority becomes realized contract authority when obligations are incurred. Therefore:

(1) At the end of each month, the balance of apportioned, anticipated reimbursements recorded in account 4211, "Anticipated Reimbursements - Specific Apportionment" shall be adjusted by the net change in operating obligations incurred during the month as recorded in account 4820, "Undelivered Orders - Reimbursable Program," account 4920, "Accrued Expenditures - Unpaid - Reimbursable Program," and account 4940, "Accrued Expenditures - Paid - Reimbursable Program." For example:

Dr 4131 Contract Authority - Without Liquidating Appropriation  
Cr 4211 Anticipated Reimbursements - Specific Apportionment

Entry to record realized contract authority. Documentation supporting this entry includes reports of obligations incurred.

(2) At the end of each fiscal year, the cumulative balance in account 4131, "Contract Authority - Without Liquidating Appropriation," shall be supported and adjusted as necessary to equal the results of the following Computation:

(a) Add the year-end balances in accounts 4800, "Undelivered Orders," 4910, "Accrued Expenditures - Unpaid - Direct Program," and 4920, "Accrued Expenditures - Unpaid - Reimbursable Program."

(b) From this sum subtract the sum of the year-end balances in accounts 4230, "Unfilled Customer Orders," 4251, "Reimbursements Earned-Uncollected-Automatic Apportionment," 4252, "Reimbursements Earned - Uncollected - Specific Apportionment," and 1010, "Fund Balance With Treasury."

(c) The cumulative from inception balance in account 4131, "Contract Authority - Without Liquidating Appropriation," should equal the results of this computation. If not equal, the 4131 account shall be adjusted to equal the result. For example, if the contract authority should be adjusted down as a result of this computation:

Dr 4211 Anticipated Reimbursements - Specific Apportionment  
Cr 4131 Contract Authority - Without Liquidating  
Appropriation

Documentation supporting this entry includes a journal voucher documenting the above required process.

e. Liquidation of Realized Contract Authority. The receipt of customer orders liquidate realized contract authority. Customer orders received are requisitions and other orders accepted for items to be furnished on a reimbursable basis. Budgetary resources provided from a customer order are available to fund obligations, provided that, in the case of orders from the public, an advance has been collected. Throughout the fiscal year, the cumulative amount of resources available from customer orders is adjusted to the extent that orders are canceled, or revised upward or downward because of standard price changes, quantity adjustments, etc. The amount of budgetary resources available for obligation from customer orders is the sum of orders received from Federal Government accounts that represent valid obligations of the ordering account, plus advances received on orders accepted from the public. Orders from the public include orders received from state and local governments. These budgetary resources shall replace the budgetary resources apportioned as anticipated reimbursements and should be accounted for at the departmental level based upon the net change in customer orders received during the month as recorded in account 4222, "Customer Orders Accepted - Specific Apportionment," as follows.

(1) Activity Level Processing. The receipt of a customer order at the activity level shall be recorded as an increase to customer orders accepted and an increase to unfilled customer orders. This is necessary because supply operation business areas receive obligation authority based upon anticipated reimbursements without regard to the timing of the receipt of the customer order. If the normal accounting for the receipt of a customer order

is used, duplicate obligation authority from the receipt of the order would occur at the allotment level. The required entries are:

Dr 4232 Unfilled Customer Orders - Specific Apportionment  
Cr 4222 Customer Orders Accepted - Specific  
Apportionment

Entry to record acceptance of a customer order at the activity level for supply operations business areas. The documentation supporting this entry includes customer requisitions and reimbursable orders accepted.

(2) Departmental Level Processing. For apportioned business areas, these budgetary resources shall replace the budgetary resources apportioned as anticipated reimbursements at the departmental level based upon the net change in customer orders received during the month as recorded in account 4222, "Customer Orders Accepted - Specific Apportionment," as follows.

Dr 4222 Customer Orders Accepted - Specific Apportionment  
Cr 4131 Contract Authority - Without Liquidating  
Appropriation

Entry to record replacement of obligational authority provided through contract authority with obligational authority provided through customer orders. Documentation supporting this entry includes reports of customer orders accepted.

f. Unobligated Budgetary Resources. At the end of each fiscal year, any unobligated balances of appropriated funds applicable to apportioned business operation fund business areas shall be used to offset the need for unfunded contract authority. Such funds are not available for use until they are reapportioned and reflected on the supporting financing schedule as an increase to the limit imposed for obligation authority on an approved apportionment in the new fiscal year. Any unobligated balance at the end of the fiscal year is adjusted to zero. For example:

Dr 4543 Allocations Issued - Reimbursable Program -  
Current Period  
Cr 4211 Anticipated Reimbursements - Specific Apportionment

Entry to eliminate anticipated contract authority at the Departmental level.

Dr 4614 Uncommitted/Unobligated Allotments - Reimbursable  
Program - Current Period  
Cr 4582 Allotted Reimbursable Program - Current Period

Entry to eliminate anticipated contract authority at the allotment level. Documentation supporting this entry includes a withdrawal of an allotment of funds.

## S. MULTIPLE YEAR CONTRACTS

1. General. Multiyear contracts permit the purchase on one contract of more than one annual program increment of items in order to obtain a maximum economic advantage. For example, an economic order quantity in a multiyear contract may exceed a normal annual buy and yet be advantageous to the Government. Supply Management business areas are authorized to use multiple year contracts to procure items from a single contractor. Sole source items with a stable demand projection that are procured from a single contractor shall be evaluated to determine if the items should be acquired by means of a multiple year contract. As with multiyear contracts funded by procurement appropriations, the Supply Management Business Area may purchase items in an amount corresponding to the economic order quantities deemed appropriate for procurement in each year. Components, parts, and raw material for use in manufacture of items being acquired under a multiyear contract may be procured in quantities exceeding the current annual requirement when it is more economical and cost effective to do so. This is referred to as advance economic order quantity (EOQ) procurement. Advance EOQ procurements integral to multiyear contracts shall be funded in the most economical manner. They may be funded fully in single year increments on a termination liability basis, or included in a multiyear contract along with the nonrecurring contract costs. Under 10 U.S.C. 2306, the Department of Defense is authorized to enter into multiyear contracts containing cancellation clauses that may include both nonrecurring and recurring costs. This law specifies congressional reporting requirements based on cancellation ceilings. Further, annual DoD Appropriations Acts may contain specific language requiring limitations on the use of multiyear contracts. For example, total procurements under a single multiple year contract may not exceed \$500 million or a termination liability under a single contract may not exceed \$20 million without the approval of the Congress under the provisions of the current DoD Appropriations Act. In addition, a single proposed multiple year contract in excess of \$100 million or \$10 million in estimated termination liability shall be submitted to the Office of the Under Secretary of Defense (Comptroller) for approval prior to awarding the contract. Each separate option to extend a multiple year contract shall be considered as a single multiple year contract for the purposes of this approval requirement. The DoD Components shall refer to annual guidance contained in Under Secretary of Defense (Comptroller) Multiyear Procurement Appropriation Language Guidance Memoranda for specific requirements and restrictions imposed by the Congress.

2. Obligations. The Supply Management Business Area shall obligate the minimum amount required for the period of the contract.

a. If the contract provides for annual terms with options to extend the terms in subsequent years, the obligation shall be for the amount required to be procured by the Government in the first year. The obligation for each option year shall be recorded when the option is exercised.

b. If the contract provides for minimum quantities over a period of more than one year, the obligation shall be recorded for the sum of all of the minimum quantities times the agreed price. If the contract provides for minimum dollar amounts for a period of more than one year, the obligation shall be recorded for the sum of the minimum dollar amounts.

3. Cost of Items. The cost of items procured by multiple year contracts shall be the amount paid for each item. If termination costs are incurred or if minimum guaranteed amounts are not met for items procured, the additional costs paid under the terms of the contract shall be recorded as Supply Management Business Area materiel obligations.

#### T. BUDGETARY ACCOUNTS

1. General. Budgetary accounts are used to control and account for obligation authority received from appropriations and contract authority, both apportioned by OMB. Supply Management Business Areas are subject to apportionment as required by the Anti-Deficiency Act in accordance with the procedures prescribed in OMB Circular A-34, "Instructions on Budget Execution."

2. Allocations. The general provisions of the annual Appropriations Act provide that "Except in amounts equal to the amounts appropriated to working capital funds in this Act, no obligations may be made against a working capital fund to procure war reserve material inventory unless the Secretary of Defense has notified the Congress prior to any such obligation." Obligation authority for mobilization purposes shall be allocated and allotted separately as direct program. Obligations for mobilization purposes are defined in Volume 2, "Budget formulation and Execution," of this Regulation. Operating obligations consist of all obligations that do not meet the criteria defined for mobilization and shall be allocated and allotted separately as reimbursable program. Obligations shall be accounted for and reported separately as mobilization and operating. Subaccounts to the budgetary accounts prescribed by this Regulation shall be established by the Defense Finance and Accounting Service to satisfy these requirements.

## ASSESSMENT OF INVENTORY AMOUNTS

Determinations as to the reasonableness of amounts shown in the general ledger accounts and reported in financial statements shall be based on a top-down approach. This approach is necessary because the size of DoD inventories normally precludes a 100 percent physical inventory.

a. As a first step, the balance in the inventory general ledger account shall be compared to logistic records. This comparison shall reconcile differences resulting from inventory receipts and issues that were not posted to the general ledger accounts but that were recorded in logistic records or vice versa. The purpose of this reconciliation is to support a management determination that the balances in the accounting system and the logistics system are in substantial agreement.

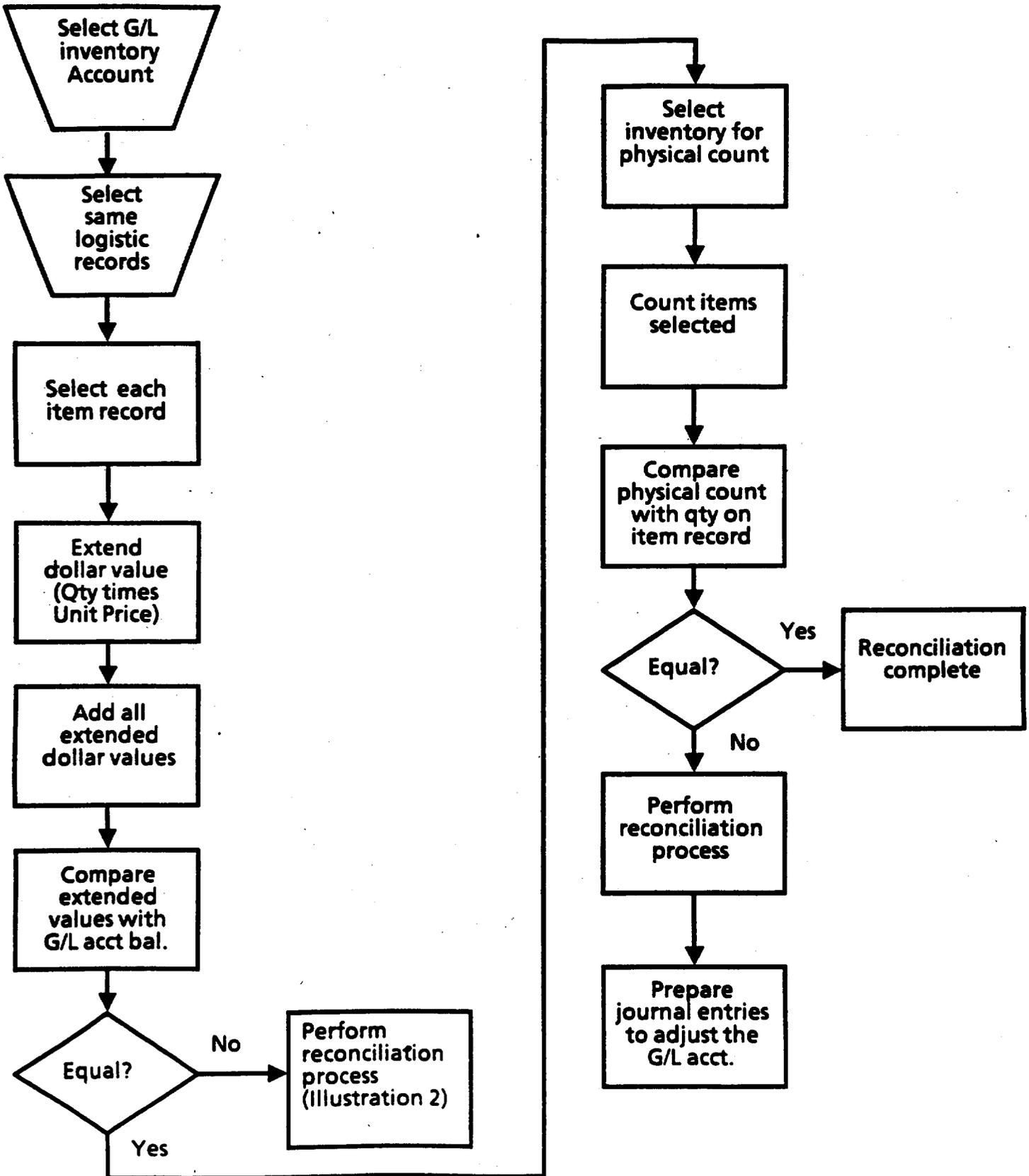
b. When the reconciliation of the logistic records to the general ledger account balances is completed, physical inventories shall be taken to ensure that the number of items reflected in logistic records are reasonably accurate. The reconciliation process is displayed in illustrations 1 through 4 of this addendum. Illustration 4 is a work sheet intended to demonstrate the overall reconciliation of the general ledger accounts with the logistic records. As such it is usable for both stages of the reconciliation process.

c. Physical counts of DoD inventories shall be taken periodically and must be designed to provide a reasonable assurance that logistic records accurately reflect on hand quantities. The sizes of these inventories preclude a 100 percent count except in unusual circumstances such as a major breakdown in internal controls. Therefore, it is frequently necessary to use statistical sampling techniques. Acceptable statistical sampling techniques are widely prescribed and any acceptable technique may be used so long as every item included in inventory has a probability of selection. When a DoD Component elects to use statistical sampling techniques the results must be such as to provide reasonable assurance that the general ledger accounts are accurate with a 90 percent level of confidence and a precision level of + or - 2.5 percent.

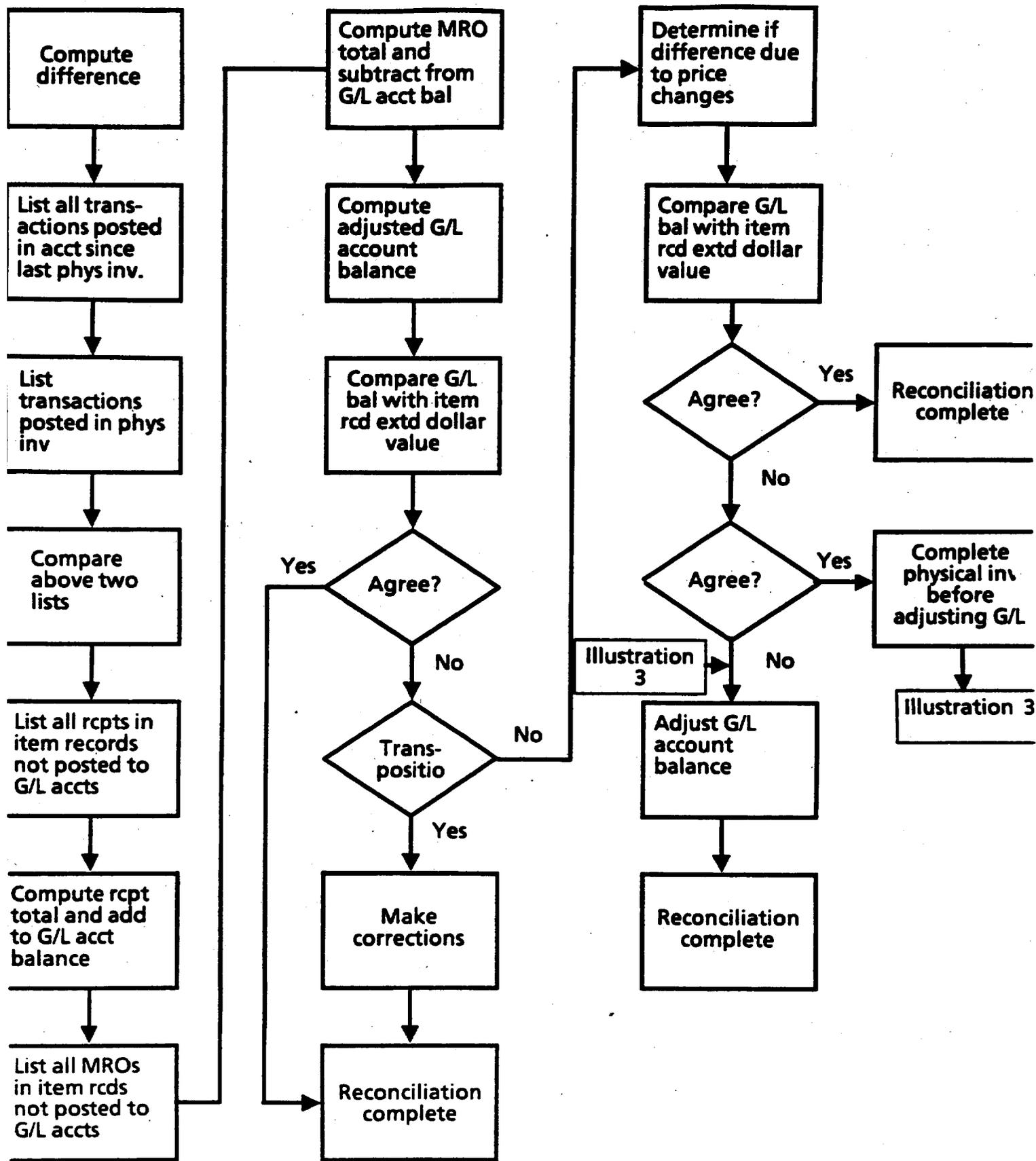
d. Care must be taken to consider infloat documentation, i.e., receipts and issues before reaching any conclusions that property records are not accurate.

e. Adjustments to logistic records and financial records shall be made only for those specific items where the physical counts or supporting documentation (e.g., receiving reports, inventory records, issue documents) disclose overages or underages. However, there should be a statistical projection of the dollar impact on the financial records. If the dollar value is material, the sample size should be increased and another estimate of the impact made. If this estimate also discloses a material impact then a complete inventory shall be taken or the financial statements qualified to disclose the fact that the reported inventory values are inaccurate. Failure to conduct required physical inventories shall be disclosed as a material weakness in Section 4 of the Federal Managers' Financial Integrity Act statement if the inventory dollar value is significant.

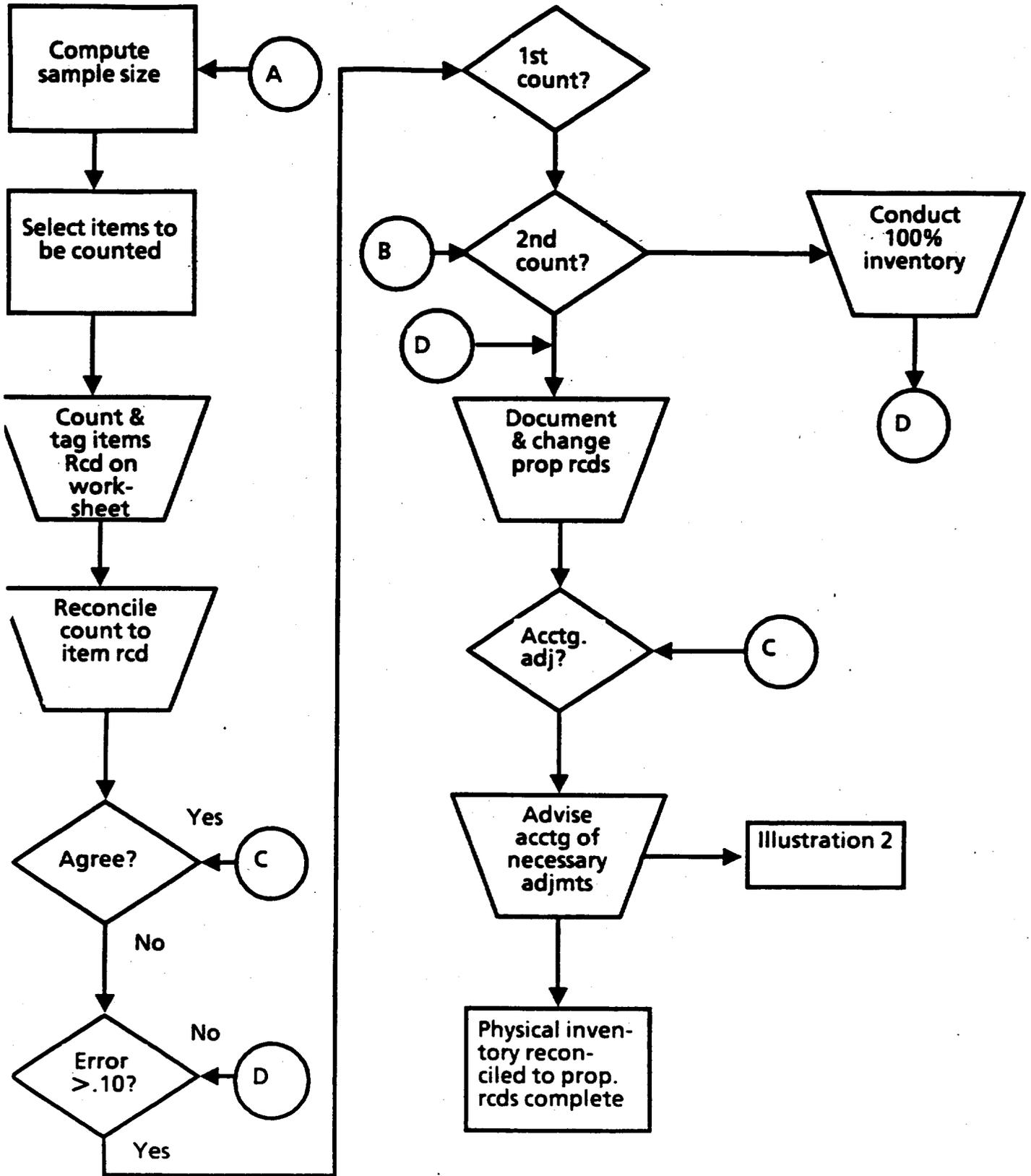
f. Adjustments to the general ledger accounts and the item logistic records shall be supported by a DD Form 200 "Report of Survey," prepared in accordance with DoD Manual 7200.10-M, "Department of Defense Accounting and Reporting for Government Property Lost, Damaged, or Destroyed." DD Form 200 is used for preparing the government property lost, gained, damaged or destroyed report on inventory.



INVENTORY RECONCILIATION PROCESS -  
GENERAL LEDGER/ITEM PROPERTY ACCOUNTABILITY RECORDS



INVENTORY RECONCILIATION PROCESS -  
PHYSICAL COUNT PROCEDURE



INVENTORY RECONCILIATION PROCESS -  
GENERAL LEDGER/ITEM ACCOUNTABILITY RECORDS WORK SHEET

Balance in G/L acct	\$ _____	Total of item accountability records	\$ _____
ADD:		ADD:	
Inventory receipts not recorded in G/L acct	\$ _____	Increases to G/L acct not made to item accountability records (List on separate sheet)	\$ _____
Price increases not recorded in G/L acct	\$ _____		
Other increases to inventory not recorded in G/L acct (List on separate sheet)	\$ _____		
Total additions	\$ _____		
SUBTRACT:		SUBTRACT:	
Inventory issues not recorded in G/L acct	\$ _____	Decreases to G/L acct not made to item accountability records (list on separate sheet)	\$ _____
Price decreases not recorded in G/L acct	\$ _____		
Other decreases to inventory not recorded in G/L acct (List on separate sheet)	\$ _____		
Total subtractions	\$ _____	Adjusted item accountability records balance	\$ _____
Adjusted G/L acct balance	\$ _____		

## ACCOUNTING ILLUSTRATION

### ACCOUNTING FOR INVENTORIES WHEN USING STANDARD PRICE PRACTICES

#### A. GENERAL

1. The military departments record inventory at its standard [sales] price. As a rule, that value changes only once a year and is effective as of the first day of a fiscal year. The standard price includes cost recovery factors (commonly termed "surcharges") to recover operating costs and anticipate price inflation changes. The difference between the standard price of an inventory item and its acquisition cost is an unrealized gain which will not become realized until that item is classified as potential excess, sold or otherwise leaves the supply management stocking point. Holding gain and loss accounts have been established to accumulate the value of holding gains and losses during the fiscal year. When inventory is sold or otherwise disposed, the previously unrealized holding gain or loss is realized and recorded in account 1529.1A, "Realization of Holding Gains/Losses." The holding gain and loss accounts are:

- 1529.1A Realization of Holding Gains/Losses
- 1529.1B Purchases at Standard Price
- 1529.1C Purchases at Cost
- 1529.1D Materiel Returns at Standard Price
- 1529.1E Materiel Returns - Credit Given
- 1529.1F Materiel Returns Without Credit Given
- 1529.1G Standard Price Changes-Gain
- 1529.1H Accounting Adjustments-Gain
- 1529.1J Assembly/Disassembly-Gain
- 1529.1K Physical Inventory Adjustments-Gain
- 1529.1L Incoming Shipments-Gain
- 1529.1M Completed Inventory Repairs
- 1529.1N Receipts of Materiel Without Charge
- 1529.1P Other-Gain
- 1529.1Q Latest Acquisition Cost Adjustment
- 1529.1R Standard Price Changes-Loss
- 1529.1S Accounting Adjustments-Loss
- 1529.1T Assembly/Disassembly-Loss
- 1529.1U Physical Inventory Adjustments-Loss
- 1529.1V Incoming Shipments-Loss
- 1529.1W Shrinkage and Other Adjustments-Loss
- 1529.1X Actual Repair Costs
- 1529.1Y Issues Without Reimbursement
- 1529.1Z Other-Loss

NOTE: Every event that results in a change in the standard price value of existing inventory should be reflected in one of the holding gain or loss accounts specified above. If one of the above accounts is not descriptive of a recurring and significant inventory event that affects the value of inventory at standard price, then an additional holding gain/loss subaccount(s) should be requested to be established for that purpose. Such requests should be forwarded to the Director for Accounting Policy, Office of the Under Secretary of Defense (Comptroller/Financial Management).

2. Through use of the above allowance accounts, inventories should be reported on the Statement of Financial Condition and cost of Goods Sold at latest acquisition cost and operating results should not be adversely affected by unrealized gains and losses in inventory values and differences between monthly and annual reporting processes.

3. For financial statement presentation, inventory is shown at its latest acquisition cost. The cost of inventory items sold is shown, in accordance with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property," at an approximation of its historical (actual) cost. The inventory accounts minus the unrealized gains or losses amount in the allowance account will approximate inventory at acquisition cost.

4. The following illustration provides an explanation of the accounting necessary to properly record the DBOF supply management inventory for those supply management business areas which maintain inventory values at standard (selling) price. The illustration demonstrates the affect on unrealized holding gains due to standard price adjustments, purchases, inventory returns, and other transactions. The illustration also demonstrates the computations necessary to properly adjust cost of goods sold to the actual cost of the items sold.

5. The accounting for, and reporting of, inventory requires the cooperation of, and information from, both the entity at which daily transactions occur and the entity that uses the transaction data. For reporting purposes, the transactions described herein may be recorded at the reporting level if the transaction level does not have the capability to do so at this time. As soon as systems permit, the transactions should all be recorded at the transaction level. Many, but not all, of the accounting entries contained within this addendum should be prepared at the transaction level. The transaction level should be able to recognize many of the holding gain and loss accounts as a reclassification of existing accounts. The significant difference is that those accounts are classified differently than they were previously. The reclassification was necessary so that the unrealized holding gain or loss would be recognized only when inventory is sold or otherwise leaves the supply management stocking point.

6. Roughly, the following steps shall be performed in accounting for, and reporting of, inventory at its latest acquisition cost. The following direction must be consistently followed. Any changes to the following steps should be proposed to the Director for Accounting Policy, Office of the Under Secretary of Defense (Comptroller/Financial Management). DoD Component system or other differences may require deviation from the following steps; however, prior to implementation, those deviations must be approved by the Director for Accounting Policy.

Step 1 Establish initial inventory allowance account to identify cost recovery factors, prior year inflation, repair costs, and write-down of potential excess at the amount of the last adjustment contained in the FY 1994 Chief Financial Officer Act financial report submission. (NOTE: This is a one-time step to initially establish the allowance account at the same value as reported on the prior year CFO submission. For following years, the

inventory allowance account will be continued at its then current amount.)

- Step 2 Monthly, Stratify on-hand inventory by authorized levels using most current stratification data available. (Currently, inventory stratification data is updated only quarterly. That data, when received, is the most current stratification data available and shall be used for 3 months until the next quarterly stratification report is available.) Stratification levels include:
- Approved acquisition level
  - Authorized retention
  - Potential excess
- Step 3 Stratify on-hand inventory by:
- Reparables
  - Non-Reparables (Consumables)
- Step 4 Stratify on-hand inventory by:
- Serviceable
  - Unserviceable
- Step 5 Remove cost recovery factors (i.e., surcharges) and, if applicable, prior year inflation factors from all on-hand inventories.
- Step 6 For unserviceable portion of on-hand reparable inventories, remove repair cost percentage.
- Step 7 For potential excess and unserviceable portion of non-reparable on-hand inventories, adjust to net realizable value. (Annually, the adjustment percentage changes. Currently, it is approximately 2 percent of sales price.)
- Step 8 For in-transit inventories, determine:
- Amount from contractors
  - Amount of reparable
    - Serviceable
    - Unserviceable
- Step 9 For in-transit inventories, determine if:
- Amount from contractors is at acquisition cost
  - Amount of reparable is at sales price less cost recovery and inflation factors and repair cost
- Step 10 For in-transit inventories, remove, cost recovery factor (i.e., surcharges) and prior year inflation factors
- Step 11 For unserviceable portion of in-transit reparable inventories, remove repair cost percentage if necessary
- Step 12 For non-reparable portion of in-transit unserviceable inventories, adjust to net realizable value

Step 13 prepare journal vouchers to record in the allowance account all gains and losses to inventory occurring during the month, e.g.

- Purchases at sales price and purchases at cost
- Customer returns without cost
- Sales price gains and losses
- Physical inventory and accounting gains and losses
- Incoming shipments gains and losses
- Shrinkage, damage, and other losses

Step 14 prepare journal vouchers to record decrease in allowance account based upon the percentage of allowance account to inventory times total sales for:

- Sales to customers
- Transfers to disposal

Step 15 Prepare journal vouchers at the end of the month to adjust on-hand and in-transit inventories as described above in order to establish inventory at latest acquisition cost.

B. MONTH ONE

1. ESTABLISH INITIAL INVENTORY ALLOWANCE AMOUNT. As of October 1, 1994, general ledger account 1529.1, "Allowance for Holding Gain/Loss - Inventory Held "for Sale," general ledger account 1529.2, "Allowance for Holding Gain/Loss - Inventory Held in Reserve for Future Sale," and general ledger account 1529.3, "Allowance for Repairs," should be established to identify cost recovery factors (i.e., surcharges), prior year inflation, repair costs, and write-down of potential excess at the same amount of the last adjustment contained in the FY 1994 Chief Financial Officer Act financial report submission. This is a one-time step to initially establish the allowance account at the same value as reported on the prior year CFO submission. For following years, the inventory allowance account will be continued at its then current amount. For illustration purposes, assume the initial allowance amount for "Inventory Held For Sale" is \$7,000. The following tables are included to assist in the understanding of the inventory accounting process. The entries may be made at the transaction level or summarized at the monthly reporting level but not at both levels. The table to illustrate the beginning inventory position for "Inventory Held for Sale," is:

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500



Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000

4. CUSTOMER RETURNS OF MATERIAL WITHOUT CREDIT

Dr 1521 Inventory Held for Sale \$1,050  
 Cr 1529.1F Materiel Returns Without Credit Given \$1,050

Entry to record a return of 3 inventory items from customers for which a credit is not granted. The Standard Price of each item is \$350 (3 x \$350 = \$1,050).

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$-0-

5. CUSTOMER RETURNS OF MATERIAL WITH CREDIT

Dr 1521 Inventory Held for Sale \$1,050. 1/  
 Cr 1529.1D Materiel Returns at Standard \$1,050 1/

Dr 1529.1E Materiel Returns - Credit Given \$ 600 2/  
 Cr 1311 Accounts Receivable-Government-Current \$ 600 2/

Entry to record a return of 3 inventory items from customers for which a credit of \$200 per item is granted.

1/ The Standard Price of each item is \$350 (3 x \$350 = \$1,050).

2/ \$200 credit per item x 3 items = \$600

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$-0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$-0-
B.5.	3	\$ 1,050	\$ 450	\$ 600

6. SALE OF INVENTORY WITHOUT AN EXCHANGE

Dr 1311 Accounts Receivable-Government - Current \$14,000 1/  
 Cr 5101 Revenue from Goods Sold - DBOF \$14,000 1/

Dr 6500 Cost of Goods Sold \$14,000 2/  
 Cr 1521 Inventory Held for Sale \$14,000 2/

Entry to record sale of inventory and the associated cost of the goods sold. (Although the revenue and the cost of goods sold are, under the standard price method, initially recorded at the same value, a month-end adjusting entry adjusts the balance recorded as Cost of Goods Sold to the actual cost.)

1/ 40 items are sold for \$350 per item for a total of \$14,000.

2/ The standard price is \$350 per item for a total inventory reduction of \$14,000 (40 items x \$350 = \$14,000). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N\A

7. SALE OF INVENTORY WITH AN EXCHANGE

Dr 1523.1 Exchange (DLR) Inventory in Transit	\$5,250	<u>1/</u>
Dr 1311 Accounts Receivable-Government-Current	\$2,700	<u>2/</u>
Cr 5101 Revenue from Goods Sold - DBOF	\$5,250	<u>3/</u>
Cr 1529.3A Estimated Repair Costs	\$1,650	<u>4/</u>
Cr 1529.3B Allowance for Surcharge	\$1,050	<u>5/</u>
Dr 6500 Cost of Goods Sold	\$5,250	<u>6/</u>
Cr 1521 Inventory Held for Sale	\$5,250	<u>6/</u>

Entry to record sale of inventory and the associated cost of the goods sold when a reparable item is exchanged for a ready for issue item. Fifteen carcasses are exchanged for ready for issue items.

- 1/ 15 carcasses needing repair are to be sent, but have not yet been sent, in partial exchange for the items sold. The in-transit carcasses are recorded in Account 1523.1, "Exchange (DLR) Inventory in Transit," at their standard Price of \$5,250 [ $\$350$  Standard Price x 15 carcasses = \$5,250. An estimated repair cost is established -- see note 4/ below.]
- 2/ The \$2,700 amount billed is the difference between the \$5,250 standard price of the items less the \$2550 value of the exchanged carcasses.
- 3/ 15 items sold for \$350 per item = \$5,250
- 4/ 15 carcasses x \$110 estimated cost to repair a carcass = \$1,650
- 5/ Approximate surcharge included in ready for issue inventory items. In this case, about 20%. [ $20\% \times \$5250 = \$1050$ ]
- 6/ The standard price is \$350 per item for a Inventory Held for Sale reduction of \$5,250 (15 items x \$350 = \$5,250). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A

Exchange (DLR) Inventory in Transit				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.7.	15	\$ 5,250	\$ 2,700	\$ 2,550

8. RECEIPT OF EXCHANGE (DLR) INVENTORY

Dr 1523 Inventory Held for Repair \$5,250  
 Cr 1523.1 Exchange (DLR) Inventory in Transit \$5,250

Entry to record receipt of exchange (DLR) inventory. The exchange item is recorded at its standard price. (A standard allowance for repair was established at the time the exchange transaction occurred -- see #7 above.)

Inventory Held for Repair				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.8.	15	\$ 5,250	\$ 2,700	\$ 2,550

Exchange (DLR) Inventory in Transit				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (cost)
B.7.	15	\$ 5,250	\$ 2,700	\$ 2,550
B.8.	(15)	(\$ 5,250)	<del>\$ 2,700</del>	<del>\$ 2,550</del>
Total	-0-	-0-	-0-	-0-

9. REVALUATION OF EXCESS OR BEYOND REPAIR INVENTORY

Inventory is revalued to its net realizable value (approximately, 2 percent of standard price) when (1) it is stratified as potential reutilization/disposal [i.e., potential excess], (2) regardless of stratification level, carries a condition code of "H - Condemned," "P - Reclamation," or "S - Scrap," or (3) determined to be beyond repair [i.e., not able to be repaired]. The loss on revaluation writedown shall be recognized in the period in which the writedown occurs. The loss shall not include unrealized gains associated with

that inventory. The illustration below is to recognize the loss associated with items stratified as potential excess.

Dr 1524	Inventory - Excess, Obsolete, and Beyond Repair	\$ 70	<u>1/</u>
Dr 1529.1A	Realization of Holding Gains/Losses	\$ 819	<u>2/</u>
Dr 7291.2	Excess/Obsolescence/Spoilage Loss	\$2,611	<u>3/</u>
Cr 1521	Inventory Held for Sale	\$3,500	<u>1/</u>

Entry to reclassify inventory items when those items are stratified as potential excess. In this illustration, 10 items with a carrying value of \$350 per item = \$3,500 were declared potential excess. [NOTE: In this illustration, these potential excess items are to be subsequently transferred to reutilization. See "Month 2," transaction 3 on pages 85-86.]

- 1/ 10 items with a Standard Price of \$350 per item = \$3,500 were determined potentially excess. Items declared potentially excess should be valued at net realizable value (currently, approximately 2 percent of standard price).
- 2/ When items move between inventory categories, the allowance accounts in the respective inventory categories are decreased/increased respectively. In this case, items are moving from the "Inventory Held for Sale" category to the "Inventory - Excess, Obsolete, and Beyond Repair" category. The amount of the allowance is determined through use of the percentage amount determined in the month-end adjustment of cost of goods (see item 10 below). The percentage amount, in this illustration, is 76.60 percent.  $76.60 \text{ percent} \times \$3,500 = \$2,681 - \$3,500 = \$819$ .
- 3/ The \$3500 carrying value of the inventory less the \$70 salvage value and less the \$819 allowance equals the \$2,611 loss.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$ 1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A
B.9.	(10)	(\$ 3,500)	(\$ 819)	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.9.	10	\$ 70	N/A	N/A

10. MONTH END ADJUSTMENT OF INVENTORY VALUES TO LATEST ACQUISITION COST

a. The preceding processes are designed for those DBOF supply management business areas maintaining inventory values at standard [selling] price. For financial statement presentation, the inventory values at standard [selling] price must be adjusted to latest acquisition cost. DOD Components that value inventory at the standard (selling) price of that inventory shall revalue that inventory to its latest acquisition cost for financial reporting purposes.

b. The procedure to revalue inventory to its latest acquisition cost is to deduct the cost recovery (surcharge) amount and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. For example, assume that the surcharge factor is 15 percent. Then, inventory at standard price would be reduced in valuation by 15 percent with an equal reduction (by dollar amount, not percentage amount) made to the allowance for holding gain loss account. If the potential excess and beyond repair (i.e., not repairable) inventory has been previously recorded in the financial inventory category, "Inventory - Excess, Obsolete, and Beyond Repair," should be recorded at its net realizable value and does not have an allowance account associated with it. If the entry to adjust the value of potential excess inventory has not been previously made, as indicated in transaction B.9. above, then the entry should be made at this time. The end-of-month entries to adjust inventory recorded at, standard [selling] price to its latest acquisition cost are:

INVENTORY HELD FOR SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment	\$2,675	
Cr 1521 Inventory Held for Sale		\$2,675

#### INVENTORY HELD FOR REPAIR

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.3B Estimated Exchange Costs	\$1,050	
Cr 1523 Inventory Held for Repair		\$1,050

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable are as follows:

#### INVENTORY IN TRANSIT FROM PROCUREMENT

Generally, inventory in transit from commercial sources is at acquisition cost and no month-end adjustment is necessary. However, if inventory in transit from commercial sources is valued at standard price, then the following is necessary to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment	
Cr 1521.1 Inventory in Transit from Procurement	

#### INVENTORY IN TRANSIT FROM DoD ENTITIES

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment	
Cr 1521.2 Inventory in Transit from DoD Entities	

#### INVENTORY HELD FOR FUTURE SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale  
 Cr 1522 Inventory Held for Future Sale

c. The result of applying the adjustment shall result in an equal, but opposite, adjustment for financial statement presentation purposes to the ending inventory value and that inventory's unrealized holding gain as shown below:

<u>Inventory Category</u>	<u>Standard Price</u>	<u>Adjustment Amount</u>	<u>Latest Acquisition Cost</u>
Inventory Held For Sale	\$17,850	\$2,675	\$15,175
Inventory Held for Repair	<u>\$ 5,250</u>	<u>\$1,050</u>	<u>\$ 4,200</u>
TOTAL	\$23,100	\$3,725	\$19,375

<u>Allowance Category</u>	<u>Pre-Adjustment Value</u>	<u>Adjustment Amount</u>	<u>Post-Adjustment Value</u>
Latest Acquisition Cost Adjustment	\$4,177	\$2,675	\$1,502
Allowance for Repair	<u>\$2,700</u>	<u>\$1,050</u>	<u>\$1,650</u>
TOTAL	\$6,877	\$3,725	\$3,152

d. The end of month adjustments shown above shall be reversed immediately after financial statement preparation. The reversing entries are:

INVENTORY HELD FOR SALE

Dr 1521 Inventory Held for Sale \$2,675  
 Cr 1529.1Q Latest Acquisition Cost Adjustment \$2,675

INVENTORY HELD FOR REPAIR

Dr 1523 Inventory Held for Repair \$1,050  
 Cr 1529.3B Estimated Exchange Costs \$1,050

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

INVENTORY IN TRANSIT FROM PROCUREMENT

Dr 1521.1 Inventory in Transit from Procurement  
 Cr 1529.1Q Latest Acquisition Cost Adjustment

INVENTORY IN TRANSIT FROM DoD ENTITIES

Dr 1521.2 Inventory in Transit from DoD Entities  
 Cr 1529.1Q Latest Acquisition Cost Adjustment

INVENTORY HELD FOR FUTURE SALE

Dr 1522 Inventory Held for Future Sale  
 Cr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale

11. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A Realization of Holding Gains/Losses \$4,504 1/  
 Cr 6500 Cost of Goods Sold \$4,504 1/

In the preceding entries (transactions B.6. and B.7.), account 6500, "Cost of Goods Sold," was debited for the standard price of inventory sold. The purpose of this entry is to adjust account 6500 to the cost (vice standard price) of inventory sold. The standard price (i.e., sales price) will generally be more than the cost due to the inclusion of cost recovery elements in the selling price.

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized <u>Gain</u>	Standard <u>Price</u>
Beginning Inventory	\$27,500	\$7,000	\$34,500
Price Change		\$ 500	\$ 500
Purchases	<u>\$ 3,600</u>	<u>\$2,000</u>	<u>\$ 5,600</u>
TOTAL	<u>\$31,100</u>	<u>\$9,500</u>	<u>\$40,600</u>
Excess Inventory	(\$ 2,681)	(\$ 819)*	(\$ 3,500)
Cost of Goods Sold	<u>(\$14,746)</u>	<u>(\$4,504)*</u>	<u>(\$19,250)</u>
Ending Inventory (at Standard)	\$13,673	\$4,177	\$17,850
LAC Adjustment (see B.10.)		<u>(\$2,675)</u>	<u>(\$ 2,675)</u>
Ending Inventory (at LAC)		<u>\$1,502</u>	<u>\$15,175</u>

\* Cost of Goods Sold Computation

\$9,500 Unrealized Gain + \$40,600 Standard Price = .234  
 .234 x \$3,500 Excess Inventory at Standard Price = \$819 gain reduction  
 .234 x \$19,250 Goods Sold at Standard Price = \$4,504 realized gain  
 \$19,250 Goods Sold at Standard Price - \$4,504 realized gain = \$14,746

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$34,500	\$7,000	\$27,500
B.2.	-0-	\$ 500	\$ 500	\$ -0-
B.3.	10	\$ 3,500	\$ 500	\$ 3,000
B.4.	3	\$ 1,050	\$1,050	\$ -0-
B.5.	3	\$ 1,050	\$ 450	\$ 600
B.6.	(40)	(\$14,000)		N/A
B.7.	(15)	(\$ 5,250)		N/A
B.9.	(10)	(\$ 3,500)	(\$ 819)	N/A
B.11.	-0-		(\$4,504)	(\$14,746)
Total	51	\$17,850	\$4,177	\$13,673

**FINANCIAL STATEMENT PRESENTATION**  
**(Prior to LAC Adjustment)**  
**MONTH ONE**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$34,500			\$ -0-	\$34,500
(a) Less: Beginning Allowance	\$ 7,000				\$ 7,000
(b) Plus: Purchases at Cost	\$ 3,000				\$ 3,000
(c) Plus: Customer Returns - Credit Given	\$ 600				\$ 600
(d) Plus: DLR Exchange Credits				\$2,550	\$ 2,550
(e) Less: Inventory Losses Realized	\$2,611				\$2,611
Internal Movements between Inventory Classifications	(\$ 70)		\$ 70		\$ -0-
(2) Less: Ending Inventory	\$17,850		\$ 70	\$5,250	\$23,170
(a) Plus: Ending Allowance	\$ 4,177			\$2,700	\$ 6,877
Cost of Goods Sold	\$14,746		\$ -0-	\$ -0-	\$14,746

**FINANCIAL STATEMENT PRESENTATION**  
**(After LAC Adjustment)**  
**MONTH ONE**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$29,500			\$ -0-	\$29,500
(a) Less: Beginning Allowance	\$ 2,000				\$ 2,000
(b) Plus: Purchases at Cost	\$ 3,000				\$ 3,000
(c) Plus: Customer Returns - Credit Given	\$ 600				\$ 600
(d) Plus: DLR Exchange Credits				\$2,550	\$ 2,550
(e) Less: Inventory Losses Realized	\$2,611				\$2,611
Internal Movements between Inventory Classifications	(\$ 70)		\$ 70		\$ -0-
(2) Less: Ending Inventory	\$15,175		\$ 70	\$4,200	\$19,445
(a) Plus: Ending Allowance	<u>\$ 1,502</u>			<u>\$1,650</u>	<u>\$ 3,152</u>
Cost. of Goods Sold	\$14,746		\$ -0-	\$ -0-	\$14,746

C. MONTH TWO

1. PURCHASE OF INVENTORY ITEMS

Dr 1521 Inventory Held for Sale	\$8,750	<u>1/</u>
Cr 1529.10 Purchases at Standard Price	\$8,750	<u>1/</u>
Dr 1529.1C Purchases at Cost	\$7,750	<u>2/</u>
Cr 2110 Applicable Accounts Payable Series	\$7,750	<u>2/</u>

1/ The standard price of each item is \$350 (25x \$350 = \$8,750)

2/ The purchase cost of each item is \$310 (25x \$310 = \$7,750)

The unrealized gain per item is \$8,750 - \$7,750 = \$1,000

Entry to record \$310 per item purchase of 25 inventory items with a standard price of \$350 per item.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750

2. REPAIR OF EXCHANGED INVENTORY

Dr 1521 Inventory Held for Sale	\$4,550	<u>1/</u>
Dr 1524 Inventory - Excess, Obsolete, and Beyond Repair	\$ 14	<u>2/</u>
Dr 7291.2 Excess/Obsolescence/Spoilage Loss	\$ 686	<u>3/</u>
Cr 1523 Inventory Held for Repair	\$5,250	<u>4/</u>
Dr 1529.1X Actual Repair Costs	\$1,500	<u>5/</u>
Cr 2111 Accounts Payable-Government-Current	\$1,500	<u>5/</u>
Dr 1529.3A Estimated Repair Costs	\$1,650	<u>6/</u>
Dr 1529.3B Estimated Exchange Costs	\$1,050	<u>6/</u>
Cr 1529.1M Completed Inventory Repairs	\$2,700	<u>6/</u>

1/ \$4,550 = the \$350 Standard Price x 13 repaired items. [Note that this amount does not equal the \$5,250 amount recorded in account 1523, "Inventory Held for Repair." In this illustration, the reason for this is because although 15 items were sent for repair, the repair facility determined that 2 of the 15 exchanged items could not be repaired. [\$350 Standard Price per item x 2 items = \$700. \$5,250 - \$700 = \$4,550].

2/ Two of the carcasses could not be repaired. The standard price of the items was \$350 x 2 items = \$700. The net realizable value is approximately 2 percent. \$700 x 2% = \$14.

- 3/ The loss is equal to the \$700 standard price of the two items less the \$14 net realizable value = \$686.
- 4/ Upon receipt of repaired items, GLA 1523, "Inventory Held for Repair," is always reduced (credited) in the amount that was established for the repaired items.
- 5/ 13 of the exchanged carcasses could be repaired. \$1,500 was the amount charged by the repair facility for 13 repaired carcasses.
- 6/ Upon receipt of repaired items, GLA 1529.3A and GLA 1529.3B are always reduced (debited) in the amount that was established for the repaired items.

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350

Inventory Held For Repair				
Transaction	Quantity	Standard Price	Allowance for Repair	Amount Paid (Cost)
B.8.	15	\$ 5,250	\$ 2,700	\$ 2,550
C.2.	(15)	(\$ 5,250)	(\$ 2,700)	(\$ 2,550)
Total	-0-	-0-	-0-	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.9.	10	\$ 70	N/A	N/A
C.2.	2	\$ 14	N/A	N/A

3. TRANSFER OR EXCESS, OBSOLETE, OR BEYOND REPAIR INVENTORY

a. Excess, Obsolete, and Beyond Repair Inventory Transferred by Stock Point to Defense Reutilization and Marketing Service (DRMS)

Dr 7291.2 Excess/Obsolescence/Spoilage Loss \$ 84  
 Cr 1524 Inventory - Excess, Obsolete,  
 and Beyond Repair \$ 84

Entry recorded by stock point to transfer excess, obsolete, or beyond repair items to the DRMS.

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	Salvage Value	Allowance Amount	Amount Paid (Cost)
B.9.	10	\$ 70	N/A	N/A
C.2.	2	\$ 14	N/A	N/A
C.3.a.	(12)	(\$ 84)	N/A	N/A
Total	-0-	-0-	N/A	N/A

b. Excess, Obsolete, and Beyond Repair Inventory Received by Defense Reutilization and Marketing Service (DRMS)

Dr 1765 Property Awaiting Disposal \$ 84  
 Cr 7193 Other Miscellaneous Gains \$ 84

Entry recorded by DRMS for the transferred value of items declared excess, obsolete, or beyond repair.

4. PHYSICAL INVENTORY ADJUSTMENTS

Dr 1521 Inventory Held for Sale \$2,100 1/  
 Cr 1529.1K Physical, Inventory Adjustments-Gain \$2,100 1/

Differences between physical inventory counts and inventory records affect the balance of unrealized holding gains or losses. The adjustment to unrealized gains or losses shall be recorded at the current carrying value of the items (an increase to inventory for gains and a decrease to inventory for losses).

1/ Physical inventory shows that 6 more items exist than records show. (6 items x \$350 Standard Price = \$2,100 gain)

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$ 2,100	N/A

5. SALE OF INVENTORY WITHOUT AN EXCHANGE

Dr 1311 Accounts Receivable-Government - Current	\$22,750	<u>1/</u>
Cr 5101 Revenue from Goods Sold - DBOF	\$22,750	<u>1/</u>
Dr 6500 Cost of Goods Sold	\$22,750	<u>2/</u>
Cr 1521 Inventory Held for Sale	\$22,750	<u>2/</u>

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

1/ 65 items are sold for \$350 per item for a total of \$22,750.

2/ The standard price is \$350 per item for a total inventory reduction of \$22,750 (65 items x \$350 = \$22,750). [See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$2,100	N/A
C.5.	(65)	(\$22,750)		

6. MONTH END ADJUSTMENT OF INVENTORY VALUES TO LATEST ACQUISITION COST

a. The procedure to revalue inventory to its latest acquisition cost is to deduct the cost recovery (surcharge) amount and, if applicable, the prior year inflation amount from both the inventory at standard price value and the allowance for holding gain and loss account. For example, assume that the surcharge factor is 15 percent. Then, inventory at standard price would be reduced in valuation by 15 percent with an equal reduction (by dollar amount, not percentage amount) made to the allowance for holding gain loss account. If the potential excess and beyond repair (i.e., not repairable) inventory has been previously recorded in the financial inventory category, "Inventory - Excess, Obsolete, and Beyond Repair," should be recorded at its net realizable value and does not have an allowance account associated with it. If an entry to adjust the value of potential excess inventory has not been previously made, then the entry should be made at this time. The end-of-month entries to adjust inventory recorded at standard [selling] price to its latest acquisition cost are:

INVENTORY HELD FOR SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding, gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr	1529.1Q Latest Acquisition Cost Adjustment	\$1,575	
	Cr 1521 Inventory Held for Sale		\$1,575

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

INVENTORY HELD FOR REPAIR

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr	1529.3B Estimated Exchange Costs	
	Cr 1523 Inventory Held for Repair	

INVENTORY IN TRANSIT FROM PROCUREMENT

Generally, inventory in transit from commercial sources is at acquisition cost and no month-end adjustment is necessary. However, if inventory in transit from commercial sources is valued at standard price, then the following is necessary to remove, for financial reporting purposes, surcharges [and, if applicable, prior

year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment  
 Cr 1521.1 Inventory in Transit from Procurement

INVENTORY IN TRANSIT FROM DoD ENTITIES

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.1Q Latest Acquisition Cost Adjustment  
 Cr 1521.2 Inventory in Transit from DoD Entities

INVENTORY HELD FOR FUTURE SALE

The purpose of the following entry is to remove, for financial reporting purposes, surcharges [and, if applicable, prior year inflation] from both the inventory at its standard price and unrealized holding gains. After this adjustment, the inventory will be at Latest Acquisition Cost. Immediately after financial report preparation, the entry shall be reversed.

Dr 1529.2 Allowance for Holding Gain/Loss -  
 Inventory Held for Future Sale  
 Cr 1522 Inventory Held for Future Sale

b. The result of applying the adjustment factor shall result in an equal, but opposite, adjustment for financial statement presentation purposes to the ending inventory value and that inventory's unrealized holding gain as shown below:

<u>Inventory Category</u>	<u>Standard Price</u>	<u>Adjustment Amount</u>	<u>Latest Acquisition Cost</u>
Inventory Held For Sale	\$10,500	\$1,575	\$8,925
	Pre-Adjustment Value	Adjustment Amount	Post-Adjustment Value
Latest Acquisition Cost Adjustment	\$2,677	\$1,575	\$1,102

c. The end of month adjustments shown above shall be reversed immediately after financial statement preparation. The reversing entries are:

INVENTORY HELD FOR SALE

Dr 1521 Inventory Held for Sale	\$1,575
Cr 1529.1Q Latest Acquisition Cost Adjustment	\$1,575

NOTE: The following inventory accounts are not used in this illustration. However, the month-end adjusting entry for them, when they are applicable, are as follows:

INVENTORY HELD FOR REPAIR

Dr 1523 Inventory Held for Repair	
Cr 1529.3 Allowance for Repairs	

INVENTORY IN TRANSIT FROM PROCUREMENT

Dr 1521.1 Inventory in Transit from Procurement	
Cr 1529.1Q Latest Acquisition Cost Adjustment	

INVENTORY IN TRANSIT FROM DoD ENTITIES

Dr 1521.2 Inventory in Transit from DoD Entities	
Cr 1529.1Q Latest Acquisition Cost Adjustment	

INVENTORY HELD FOR FUTURE SALE

Dr 1522 Inventory Held for Future Sale	
Cr 1529.2 Allowance for Holding Gain/Loss - Inventory Held for Future Sale	

7. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A Realization of Holding Gains/Losses	\$5,800 <u>1/</u>
Cr 6500 Cost of Goods Sold	\$5,800 <u>1/</u>

In the preceding entry (transaction C.5.), account 6500, "Cost of Goods Sold," was debited for the standard price of inventory sold. The purpose of this entry is to adjust account 6500 to the cost (vice standard price) of inventory sold. The standard price (i.e., sales price) will generally be more than the cost due to the inclusion of cost recovery elements in the selling price.

1/ (See Following Page)

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized Gain	Standard Price
Beginning Inventory	\$13,673	\$4,177	\$17,850
Repaired DLR Transfer	\$ 3,350	\$1,200	\$ 4,550
Gains on Inventory		\$2,100	\$ 2,100
Purchases	<u>\$ 7,750</u>	<u>\$1,000</u>	<u>\$8,750</u>
TOTAL	<u>\$24,773</u>	<u>\$8,477</u>	<u>\$33,250</u>

Cost of Goods Sold	<u>(\$16,950)*</u>	<u>(\$5,800)*</u>	<u>(22,750)</u>
Ending Inventory (at Standard)	\$ 7,823	\$2,677	\$10,500
LAC Adjustment (see C.6.)		<u>(\$1,575)</u>	<u>(\$ 1,575)</u>
Ending Inventory (at LAC)		<u>\$1,102</u>	<u>\$8,925</u>

\* Cost of Goods Sold Commutation

\$8,477 Unrealized Gain + \$33,250 Standard Price = .2549  
.2549 x \$22,750 Goods Sold at Standard Price = \$5,800 realized gain  
\$22,750 Goods Sold at Standard Price - \$5,800 realized gain = \$16,950

Inventory Held For Sale				
Transaction	Quantity	Standard Price	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$17,850	\$4,177	\$13,673
C.1.	25	\$ 8,750	\$1,000	\$ 7,750
C.2.	13	\$ 4,550	\$1,200	\$ 3,350
C.4.	6	\$ 2,100	\$2,100	
C.5.	(65)	(\$22,750)		
C.7.		(\$22,750)	(\$5,800)	(\$16,950)
Total		\$10,500	\$2,677	\$7,823

**FINANCIAL STATEMENT PRESENTATION**  
(Prior to LAC Adjustment)  
**MONTH TWO**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$17,850		\$ 70	\$5,250	\$23,170
(a) Less: Beginning Allowance	\$ 4,177			\$2,700	\$ 6,877
(b) Plus: Purchases at Cost	\$ 7,750			\$1,500	\$ 9,250
(c) Plus: Customer Returns - Credit Given					
(d) Plus: DLR Exchange Credits					
(e) Less: Inventory Losses Realized			\$ 70	\$ 700	\$ 770
Internal Movements of Inventory	\$ 3,350			(\$3,350)	\$ -0-
(2) Less: Ending Inventory	\$10,500			\$ -0-	\$10,500
(a) Plus: Ending Allowance	\$ 2,677				\$ 2,677
Cost of Goods Sold	\$16,950		\$ -0-	\$ -0-	\$16,950

**FINANCIAL STATEMENT PRESENTATION**  
**(After LAC Adjustment)**  
**MONTH TWO**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Inventory Held for Repair	Total
(1) Beginning Inventory	\$15,175		\$ 70	\$4,200	\$19,445
(a) Less: Beginning Allowance	\$ 1,502			\$1,650	\$ 3,152
(b) Plus: Purchases at Cost	\$ 7,750			\$1,500	\$ 9,250
(c) Plus: Customer Returns - Credit Given					
(d) Plus: DLR Exchange Credits					
(e) Less: Inventory Losses Realized			\$ 70	\$ 700	\$ 770
Internal Movements of Inventory	\$ 3,350			(\$3,350)	\$ -0-
(2) Less: Ending Inventory	\$ 8,925			\$ -0-	\$ 8,925
(a) Plus: Ending Allowance	\$ 1,102			\$ -0-	\$ 1,102
Cost of Goods Sold	\$16,950		\$-0-	\$ -0-	\$16,950

## ACCOUNTING ILLUSTRATION

### ACCOUNTING FOR INVENTORIES WHEN LATEST ACQUISITION COST PRACTICES

#### A. GENERAL

1. The Defense Logistics Agency records inventory at its latest acquisition cost. That value may change with each acquisition made during a fiscal year. The difference between the actual cost of items held in inventory and the value of those same items if they were acquired at the latest acquisition cost is an unrealized gain which will not become realized until that item is sold or otherwise leaves the supply management stocking point. Holding gain and loss accounts have been established to accumulate the value of holding gains and losses during the fiscal year. When inventory is classified as potential excess, sold or otherwise leaves the stocking point, the previously unrealized holding gain or loss is realized and recorded in account 1529.1A, "Realization of Holding Gains/Losses." The holding gains and accounts are:

- 1529.1A Realization of Holding Gains/Losses
- 1529.1B Purchases at Standard Price
- 1529.1C Purchases at Cost
- 1529.1D Materiel Returns at Standard Price
- 1529.1E Materiel Returns - Credit Given
- 1529.1F Materiel Returns Without Credit Given
- 1529.1G Standard Price Changes-Gain
- 1529.1H Accounting Adjustments-Gain
- 1529.1J Assembly/Disassembly-Gain
- 1529.1K Physical Inventory Adjustments-Gain
- 1529.1L Incoming Shipments-Gain
- 1529.1M Completed Inventory Repairs
- 1529.1N Receipts of Materiel Without Charge
- 1529.1P Other-Gain
- 1529.1Q Latest Acquisition Cost Adjustment
- 1529.1R Standard Price Changes-Loss
- 1529.1S Accounting Adjustments-Loss
- 1529.1T Assembly/Disassembly-Loss
- 1529.1U Physical Inventory Adjustments-Loss
- 1529.1V Incoming Shipments-Loss
- 1529.1W Shrinkage and Other Adjustments-Loss
- 1529.1X Actual Repair Costs
- 1529.1Y Issues Without Reimbursement
- 1529.1Z Other-Loss

NOTE: Every event that results in a change in the quantity of inventory, the value of existing inventory, or both should be reflected in one of the holding gain or loss accounts specified above. If one of the above accounts is not descriptive of a recurring and significant inventory event, then an additional holding gain/loss account(s) may be established for that purpose.

2. For financial statement presentation, inventory is shown at its latest acquisition cost. The cost of inventory items sold is shown, in accordance with Statement of Federal Financial Accounting Standards No. 3,



Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000	\$27,500
B.2.	10	\$ 3,000	\$ -0-	\$ 3,000

3. ADJUSTMENT OF INVENTORY TO LATEST ACQUISITION COST.

Dr 1521 Inventory Held for Sale \$ 500  
 Cr 1529.1Q Latest Acquisition Cost Adjustment \$ 500 1/

Entry to adjust value of other inventory items in stock to the latest acquisition cost when the recorded value of those items is LESS than the latest acquisition cost. [Assume that 100 items are in inventory and the previous latest acquisition cost was \$295 per item. Those items require revaluation to the current latest acquisition cost of \$300. The revaluation will then require recognition of a \$500 unrealized gain -- 100 items @ \$5 adjustment per item = \$500.]

1/ Gains or losses associated with the valuation of inventory, although recognized, are not realized. Realization of the gain or loss occurs only when an item of inventory is sold or otherwise disposed.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000	\$27,500
B.2.	10	\$ 3,000	\$ -0-	\$ 3,000
B.3.	N/A	\$ 500	\$ 500	N/A

4. CUSTOMER RETURNS OF MATERIAL WITHOUT CREDIT

Dr 1521 Inventory Held for Sale \$900  
 Cr 1529.1F Materiel Returns Without Credit Given \$900

Entry to record a return of 3 inventory items from customers for which a credit is not granted. The Latest Acquisition Cost of each item is \$300 (3 x \$300 = \$900).

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000,	\$27,500
B.2.	10	\$ 3,000	\$ -0-	\$ 3,000
B.3.	N/A	\$ 500	\$ 500	N/A
B.4.	3	\$ 900	\$ 900	\$-0-

5. CUSTOMER RETURNS OF MATERIAL WITH CREDIT

Dr 1521 Inventory Held for Sale \$900 1/  
 Cr 1529.1D Materiel Returns at Standard \$900 1/

Dr 1529.1E Materiel Returns - Credit Given \$600 2/  
 Cr 1311 Accounts Receivable-Government-Current \$600 2/

Entry to record a return of 3 inventory items from customers for which a credit of \$200 per item is granted.  
1/ The LAC of each item is \$300 (3 x \$300 = \$900).  
2/ \$200 credit per item x 3 items = \$600

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000	\$27,500
B.2.	10	\$ 3,000	\$ -0-	\$ 3,000
B.3.	N/A	\$ 500	\$ 500	N/A
B.4.	3	\$ 900	\$ 900	\$-0-
B.5.	3	\$ 900	\$ 300	\$600



illustration, the sales price is \$350 per item x 10 items = \$3500 x 2 percent = \$70).

- 2/ When items move between inventory categories, the allowance account in the respective inventory categories are decreased/increased respectively. In this case items are moving from the "Inventory Held for Sale" category to the "Inventory Held for Future Sale" category. The amount of the allowance is determined by adding the net value of the allowance account from which the inventory is to be transferred and then dividing that net total by the number of items in inventory. In this case, the net total of the allowance account is \$3,700 [ \$2,000 beginning balance + \$500 price change gain + \$1,200 gain on customer returns = \$3,700].  $\$3,700 \div 116 \text{ items} = \$31.90$  per item x 10 items = \$319. An alternative computation is to use the percentage amount determined in the month-end adjustment of cost of goods. That percentage amount, in this illustration is 89.37 percent.  $89.37 \text{ percent} \times \$3,000 = \$2,681 - \$3,000 = \$319$ .
- 3/ The \$3000 carrying value of the inventory less the \$70 salvage value and less the \$319 allowance equals the \$2,611 loss.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000	\$27,500
B.2.	10	\$ 3,000	\$ -0-	\$ 3,000
B.3.	N/A	\$ 500	\$ 500	N/A
B.4.	3	\$ 900	\$ 900	\$-0-
B.5.	3	\$ 900	\$ 300	\$600
B.6.	(55)	\$16,500)		
B.7.	(10)	(\$ 3,000)	(\$ 319)	N/A

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	2% of Standard Price	Allowance Amount	Amount Paid (Cost)
B.7.	10	\$ 70	N/A	N/A

7. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A	Realization of Holding Gains/Losses	\$1,754	<u>1/</u>
Cr 6500	Cost of Goods Sold		\$1,754 <u>1/</u>

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

INVENTORY HELD FOR SALE

1/

	Cost	Unrealized Gain (Loss)	LAC
Beginning Inventory	\$27,500	\$2,000	\$29,500
Price Change		\$ 500	\$ 500
Purchases	<u>\$ 3,600</u>	<u>\$1,200</u>	<u>\$ 4,800</u>
TOTAL	<u>\$31,100</u>	<u>\$3,700</u>	<u>\$34,800</u>
Excess Inventory Transfer	(\$ 2,681)	(\$ 319) *	(\$ 3,000)
Cost of Goods Sold	<u>(\$14,746)</u>	<u>(\$ 1,754) *</u>	<u>(\$16,500)</u>
Ending Inventory	<u>\$13,673</u>	<u>\$ 1,627</u>	<u>\$15,300</u>

\* Cost of Goods Sold Computation

\$3,700 Unrealized Gain + \$34,800 LAC = .1063  
 .1063 x \$3,000 Excess Inventory at LAC = \$319 realized gain  
 .1063 x \$16,500 Cost of Goods Sold at LAC = \$1,754 realized gain  
 \$16,500 Cost of Goods Sold at LAC - \$1,754 realized gain = \$14,746

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	100	\$29,500	\$2,000	\$27,500
B.1.	10	\$ 3,000	\$ -0-	\$ 3,000
B.2.	N/A	\$ 500	\$ 500	N/A
B.3.	3	\$ 900	\$ 900	\$ -0-
B.4.	3	\$ 900	\$ 300	\$ 600
B.5.	(10)	(\$ 3,000)	(\$ 319)	N/A
B.6.	(55)	(\$16,500)		
B.7.	N/A		(\$1,754)	(\$17,427)
Total	51	\$15,300	\$1,627	\$13,673

**FINANCIAL STATEMENT PRESENTATION**  
**MONTH ONE**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Total
(1) Beginning Inventory	\$29,500			\$29,500
(a) Less: Beginning Allowance	\$ 2,000			\$ 2,000
(b) Plus: Purchases at Cost	\$ 3,000			\$ 3,000
(c) Plus: Customer Returns - Credit Given	\$ 600			\$ 600
(d) Plus: DLR Exchange Credits	N/A			
(e) Less: Inventory Losses Realized	\$2,611			\$2,611
Internal Movements between Inventory Classifications	(\$ 70)		\$ 70	\$ -0-
(2) Less: Ending Inventory	\$15,300		\$ 70	\$15,370
(a) Plus: Ending Allowance	\$ 1,627			\$ 1,627
Cost of Goods Sold	\$14,746			\$14,746

C. MONTH TWO

1. PURCHASE OF INVENTORY ITEMS

Dr 1521 Inventory Held for Sale \$7,750  
 Cr 2110 Applicable Accounts Payable Series \$7,750

Entry to record purchase of 25 inventory items at \$310 per item.  
 (If the purchase quantity and price is a representative purchase,  
 then that price shall be the "Latest Acquisition Cost.")

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$15,300	\$1,627	\$13,673
C.1.	25	\$7,750	N/A	\$7,750

2. ADJUSTMENT OF INVENTORY TO LATEST ACQUISITION COST.

Dr 1521 Inventory Held for Sale \$ 510  
 Cr 1529.1Q Latest Acquisition Cost Adjustment \$ 510 1/

Entry to adjust value of the 51 inventory items in stock to the latest acquisition cost. [The latest acquisition cost of the 51 items in stock was \$300 per item. Those items require revaluation to the current latest acquisition cost of \$310. The revaluation will then require recognition of a \$510 unrealized gain -- 51 items @ \$10 adjustment per item = \$510.]

1/ Note that under the latest acquisition cost method, gains or losses associated with the valuation of inventory, although recognized, are not realized. Realization of the holding gain or loss occurs only when an item of inventory is sold.

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount paid (Cost)
Beginning Inventory	51	\$15,300	\$1,627	\$13,673
C.1.	25	\$7,750	N/A	\$7,750
C.2.		\$ 510	\$ 510	N/A

3. TRANSFER OF EXCESS, OBSOLETE, OR BEYOND REPAIR INVENTORY

a. Excess, Obsolete, and Beyond Repair Inventory Transferred by Stock Point to Defense Reutilization and Marketing Service (DRMS)

Dr 7291.2 Excess/Obsolescence/Spoilage Loss \$ 70  
 Cr 1524 Inventory - Excess, Obsolete,  
 and Beyond Repair \$ 70

Entry recorded by stock point to transfer excess, obsolete, or beyond repair items to the DRMS.

Inventory - Excess, Obsolete, and Beyond Repair				
Transaction	Quantity	Salvage Value	Allowance Amount	Amount Paid (Cost)
B.6.	10	\$ 70	N/A	N/A
C.3.a.	(10)	(\$ 70)	N/A	N/A
Total	-0-	-0-	N/A	N/A

b. Excess, Obsolete, and Beyond Repair Inventory Received by Defense Reutilization and Marketing Service (DRMS)

Dr 1765 Property Awaiting Disposal \$ 70  
 Cr 7193 Other Miscellaneous Gains \$ 70

Entry recorded by DRMS for the transferred value of items declared excess, obsolete, or beyond repair.

4. PHYSICAL INVENTORY ADJUSTMENTS

Dr 1521 Inventory Held for Sale \$1,860 1/  
 Cr 1529.1K Physical Inventory Adjustments-Gain \$1,860 1/

Entry to record gains or losses due to differences between physical inventory counts and inventory records in inventory quantities. The gain or loss shall be recorded at the current carrying value of the items (an increase to inventory for gains and a decrease to inventory for losses).

1/ Physical inventory shows that 6 more items exist than records show. (6 items x \$310 LAC = \$1,860 gain)

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$15,300	\$1,627	\$13,673
C.1.	25	\$7,750	N/A	\$7,750
C.2.		\$ 510	\$ 510	N/A
C.4.	6	\$1,860	\$1,860	\$-0-

5. SALE OF INVENTORY

Dr 1311 Accounts Receivable-Government - Current	\$22,750	<u>1/</u>
Cr 5101 Revenue from Goods Sold - DBOF	\$22,750	<u>1/</u>
Dr 6500 Cost of Goods Sold	\$20,150	<u>2/</u>
Cr 1521 Inventory Held for Sale	\$20,150	<u>2/</u>

Entry to record sale of inventory and the associated cost of the goods sold. The sales price will generally be more than the latest acquisition cost due to the inclusion of cost recovery elements in the selling price.

1/ 65 items are sold for \$350 per item for a total of \$22,750.

2/ The latest acquisition cost is \$310 per item for a total inventory reduction of \$20,150 (65 items x \$310 = \$20,150).

[See month-end adjusting entry for adjustment of the "Cost of Goods Sold" account.]

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$15,300	\$1,627	\$13,673
C.1.	25	\$7,750	N/A	\$7,750
C.2.		\$ 510	\$ 510	N/A
C.4.	6	\$ 1,860	\$1,860	\$-0-
C.5.	(65)	(\$20,150)		

6. MONTH-END ADJUSTMENT OF COST OF GOODS SOLD

Dr 1529.1A Realization of Holding Gains/Losses      \$ 2,721 1/  
 Cr 6500 Cost of Goods Sold      \$ 2,721 1/

In the preceding entry (transaction C.5.), account 6500, "Cost of Goods Sold," was debited for the latest acquisition cost of inventory sold. The purpose of this entry is to adjust account 6500 to the historical cost (vice latest acquisition cost) of inventory sold.

1/

INVENTORY HELD FOR SALE

	Cost	Unrealized Gain	LAC
Beginning Inventory	\$13,673	\$1,627	\$15,300
Purchases	\$ 7,750		\$ 7,750
Price Change		\$ 510	\$ 510
Physical Inventory Gain		<u>\$ 1,860</u>	<u>\$ 1,860</u>
TOTAL	<u>\$21,423</u>	<u>\$3,997</u>	<u>\$25,420</u>
Cost of Goods Sold	<u>(\$17,429)</u>	<u>(\$2,721)</u>	<u>(\$20,150)</u>
Ending Inventory	\$ 3,994	\$1,276	\$ 5,270

\* Cost of Goods Sold Computation

\$3,977 Unrealized Gain + \$29,450 LAC = .1350  
 .1350 x \$20,150 Goods Sold at LAC = \$2,721 realized gain  
 \$20,150 Goods Sold at LAC - \$2,721 realized gain = \$17,429

Inventory Held For Sale				
Transaction	Quantity	Latest Acquisition Cost	Allowance Amount	Amount Paid (Cost)
Beginning Inventory	51	\$15,300	\$1,627	\$13,673
C.1.	25	\$ 7,750	N/A	\$ 7,750
C.2.		\$ 510	\$ 510	N/A
C.4.	6	\$ 1,860	\$1,860	\$ -0-
C.5.	(65)	(\$20,150)		
C.6.			(\$ 2,721)	(\$ 17,429)
Total	17	\$ 5,270	\$ 1,276	\$ 3,994

**FINANCIAL STATEMENT PRESENTATION  
MONTH TWO**

<u>Cost of Material Sold from Inventory</u>	Inventory Held For Sale	Inventory Held For Future Sale	Excess Inventory	Total
(1) Beginning Inventory	\$15,300		\$ 70	\$15,370
(a) Less: Beginning Allowance	\$ 1,627			\$ 1,627
(b) Plus: Purchases at Cost	\$ 7,750			\$ 7,750
(c) Plus: Customer Returns - Credit Given				
(d) Plus: DLR Exchange Credits	N/A			
(e) Less: Inventory Losses Realized			\$ 70	\$ 70
Internal Movements of Inventory				
(2) Less: Ending Inventory	\$ 5,270			\$ 5,270
(a) Plus: Ending Allowance	\$ 1,276			\$ 1,276
Cost of Goods Sold	\$17,429		\$-0-	\$17,429