Federal Accounting Standards Advisory Board

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August 30, 2001

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

The Federal Accounting Standards Advisory Board is requesting comments on the exposure draft (ED), Accounting for National Defense PP&E and Associated Cleanup Costs.

Currently, the acquisition costs for items classified as national defense (ND) property, plant, and equipment (PP&E) are expensed in the period incurred. In addition, valuation (using either a historical or latest acquisition cost valuation method), condition, and deferred maintenance information for ND PP&E are to be reported off-balance sheet. Also, the total estimated cleanup cost for ND PP&E is to be recognized as an expense in the period the asset is placed into service.

The amendments proposed in this ED would make the following changes. The definition of ND PP&E would be amended. ND PP&E would consist of 2 separate categories of items within the amended definition: (a) Major End Items and (b) Mission Support Items. Beginning in fiscal year (FY) 2002, Major End Items would be subject to a reporting of the number of units and condition assessment information by asset type or category. Beginning in FY 2006, Major End Items would be capitalized but not depreciated, while Mission Support Items would be capitalized and depreciated. Also, beginning in FY 2006, data for the ten largest current acquisition programs would be disclosed. In addition, the total estimated cleanup cost per Major End Item would be recognized as a part of the acquisition cost as items are placed into service. For Mission Support Items, a portion of the total estimated cleanup cost would be recognized as an expense during each period that the item is in operation. The amendments proposed in this ED that affect the definition of ND PP&E, and unit and condition reporting would take effect in FY 2002. The remaining amendments would take effect in FY2006 or upon implementation of this standard if implemented earlier.

In Appendix D, the Board has posed specific questions for comment. You are encouraged to address some or all of these questions and to comment on any section of this document. In particular, however, the Board would like to bring to your attention Question 4, which addresses provisions for recognition of a periodic cost of ND PP&E, and Question 5, which addresses a difference in accounting for the cleanup cost for the two categories of ND PP&E. While most FASAB members support the standards proposed in this ED, some members believe that there should be some form of periodic recognition of the expense of using capital items, and greater consistency in accounting for environmental cleanup cost. To ensure full consideration of your responses by the Board, please provide your rationale for agreement or disagreement with a particular area, including explanations of alternative proposals in areas of disagreement. Respondents are encouraged to consider the issues in light of Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*. Responses are due by November 29, 2001 and should be sent to:

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In addition, please provide your comments in electronic form. Responses in electronic form may be sent by (1) E-mail to comesw@fasab.gov, or (2) On a diskette mailed to the above address.

David Mosso
Chairman

EXECUTIVE SUMMARY

I. This Exposure Draft (ED) is issued to solicit comments on proposed amendments to the standards for national defense (ND) property, plant, and equipment (PP&E). The existing standards are contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 11, *Amendments to Accounting for Property, Plant, and Equipment -- Definitional Changes*, which was issued in December 1998; SFFAS No. 8, *Supplementary Stewardship Reporting,* which was issued in June 1996; and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, which was issued in November 1995. The proposed amendments would change the definition of ND PP&E, the method of accounting for it, and the information reported about it.

II. In the existing standards, ND PP&E consists of: (a) PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (b) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. Expenditures made to acquire, replace, or improve those PP&E are recognized as an expense in the period incurred, rather than being recognized as assets on the balance sheet. In addition, ND PP&E valuation (using either a historical or latest acquisition cost (LAC) valuation method), condition, and deferred maintenance information are to be reported as Required Supplementary Stewardship Information (RSSI) or Required Supplementary Information (RSI). Also, the total estimated cleanup cost for ND PP&E is to be recognized as an expense in the period the asset is placed into service.

III. The proposed standards define ND PP&E as PP&E essential to the performance of military missions by the Department of Defense or its component entities and vessels in the Maritime Administration's National Defense Reserve Fleet. ND PP&E would consist of 2 separate categories of items: (a) Major End Items and (b) Mission Support Items. In fiscal year (FY) 2002, and thereafter, Major End Items would be subject to a reporting of the number of units and condition assessment information by asset type or category. The provisions of SFFAS No. 6, as amended, and the remaining provision of SFFAS No. 8, concerning the reporting of valuation, would remain in effect until September 30, 2005 or upon implementation of this standard if implemented earlier. Beginning in FY 2006, or upon early implementation of this standard, Major End Items would be capitalized but not depreciated, while Mission Support Items would be capitalized and depreciated. Also, beginning in FY2006, or upon early implementation of this standard, a) data for the ten largest current acquisition programs would be disclosed; b) the total estimated cleanup cost per Major End Item would be recognized as a part of the acquisition cost as items are placed into service; and c) for Mission Support Items, the total estimated cleanup cost would be recognized as an expense and a liability established ratably over the period that the item is in operation.

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INTRODUCTION

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

BACKGROUND

2 Originally, ND PP&E was defined in SFFAS No. 6 as Federal mission PP&E having at least one characteristic from a group of characteristics related to "use" and at least one characteristic from a group of characteristics related to "useful life." Subsequent to the issuance of SFFAS No. 6, many agencies raised questions about the applicability of the Federal mission PP&E standard. To prevent confusion, inconsistency, and unintended application, the Board replaced the definition of Federal mission PP&E with the definition of ND PP&E currently contained in SFFAS No. 11.[1] This ED proposes that the SFFAS No. 11 definition of ND PP&E be amended. ND PP&E would consist of 2 separate categories of items within the amended definition: (a) Major End Items and (b) Mission Support Items.

3 In SFFAS No. 6, the standards require that expenditures made to acquire, replace or improve ND PP&E be recognized[2] as an expense in the period incurred. Consistent with the treatment of the acquisition cost of ND PP&E, the standards in SFFAS No. 6 also require that the total

[1] The reasons for this change are explained fully in SFFAS No. 11.
[2] "Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.

estimated cleanup cost be recognized as an expense and a liability established in the period the ND PP&E item is placed in service. A further requirement of SFFAS No. 6, as amended by SFFAS No. 14, is that deferred maintenance amounts be reported as Required Supplementary Information (RSI).[3]

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

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

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

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

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

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

The values may be determined using either a historical or LAC valuation method. In addition to the values, condition reporting is required. The valuation and condition information is presented as Required Supplementary Stewardship Information (RSSI) – that is, outside of the principal financial statements.

SUMMARY OF PROPOSED STANDARD

5 This ED proposes that the:

[3] This ED does not propose any changes to the requirements for deferred maintenance amounts.

- definition of ND PP&E be revised and consist of 2 separate categories of items within the amended definition: (a) Major End Items, and (b) Mission Support Items,
- ND PP&E be capitalized,[4]
- actual and planned ND PP&E acquisition program costs and unit information be reported for the ten largest current acquisition programs, and
- units and the condition assessment of ND PP&E major end items be reported.

6 The capitalized cost of ND PP&E acquired by means of an acquisition program[5] consists of costs associated with the initial ND PP&E acquisition program and the ND PP&E acquisition program costs for modifications and upgrades to the initially acquired ND PP&E. If ND PP&E is acquired by means other than an acquisition program, the capitalized cost would be the acquisition cost.

7 Guidance is also provided for expensing the cost of ND PP&E after acquisition. For Major End Items, the expense is recognized when a unit is decommissioned, destroyed, or disposed. For ND PP&E acquisition programs terminated before units are in service, the expense is recognized upon program termination. For Mission Support Items, depreciation expense[6] is recognized over the useful life of the asset(s).

[4] "Capitalize" is to record and carry forward into one or more future periods any expenditure the benefits or proceeds from which will then be realized.
[5] An acquisition program is a directed, funded effort that is designed to provide new or improved ND PP&E in response to an operational need or to provide for the continued capability of existing ND PP&E. ND PP&E is generally acquired using the acquisition program process.
[6] "Depreciation expense" is the systematic and rational allocation to expense of the acquisition cost of an asset, less its estimated salvage or residual value over its estimated useful life.

EFFECTIVE DATE

8 The requirements of this Statement are effective in two phases beginning after September 30, 2001.

9 Phase one: For accounting periods beginning after September 30, 2001, the provisions requiring the reporting of units and condition assessment information for Major End Items apply. Specifically, paragraphs 8 through 13 and 18 of SFFAS No. 11, plus paragraph 68, bullet 4, of SFFAS No. 8, are superseded by paragraphs 12, 13, 27 through 30, and 50 of this Statement.

10 Phase two: For accounting periods beginning after September 30, 2005 or upon early implementation of this standard, the provisions of this Standard apply prospectively to ND PP&E acquisition costs incurred during years ending on and after the effective date. Also, for accounting periods beginning after September 30, 2005 or upon early implementation of this standard, the estimated acquisition program cost of ND PP&E acquisition programs in the development or production phase, as well as Major End Items still in active service, should be capitalized. Capitalization of Mission Support Items is to be applied prospectively. Specifically, paragraphs 60 through 70 (except paragraph 68, bullet 4, which was superseded in phase one) of SFFAS No. 8, plus paragraphs 53 through 56 of SFFAS No. 6 are superseded by paragraphs 14 through 26, 31 through 49, and 51 of this Statement.

PROPOSED ACCOUNTING STANDARDS

Amendments to Existing Standards

11 Proposed accounting standards for national defense (ND) property, plant, and equipment (PP&E) are presented in paragraphs 12 through 54 that follow. The proposed standards would affect existing standards in the following manner:

a. SFFAS No. 11, paragraphs 8 through 13 and 18 are superseded effective for periods beginning after September 30, 2001;

b. SFFAS No. 8, paragraph 68, bullet 4 (condition reporting) is superseded effective for periods beginning after September 30, 2001;

c. SFFAS No. 8, paragraphs 60 through 70 (except as noted above) are superseded effective for periods beginning after September 30, 2005 or upon early implementation of this standard; and

d. SFFAS No. 6, paragraphs 53 through 56 are superseded effective for periods beginning after September 30, 2005 or upon early implementation of this standard.

Definition

12 National Defense Property, Plant, and Equipment (ND PP&E) is PP&E used in the performance of military missions [7] by the Department of Defense or its component entities and vessels in the Maritime Administration's National Defense Reserve Fleet.[8] ND PP&E excludes

[7] "Military missions" are defined as the functions performed by the military departments to prepare for the effective pursuit of war and military operations short of war; to conduct combat, peacekeeping, and humanitarian military operations; and to support civilian authorities during civil emergencies.
[8] The National Defense Reserve Fleet vessels are held in a preservation status and are activated only during a military crisis or national emergency.

PP&E accounted for in business operating activities, non-ballistic missiles, real property, and ND PP&E component parts held as spares.[9]

13 Categories of ND PP&E are: (a) Major End Items and (b) Mission Support Items. The following provides guidance in categorizing ND PP&E:

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

b. Mission Support Items are 1) all of the remaining ND PP&E items that are used in the performance of military missions and not categorized as Major End Items, and 2) defense systems (e.g., National Missile Defense System, command and control systems, intelligence and communications systems, etc.) that are used in the performance of military missions.

Asset Recognition and Measurement

14 The cost of ND PP&E should be capitalized by acquisition program when incurred and accounted for by category (i.e., Major End Items and Mission Support Items).

[9] These items are excluded because they meet the definition of other elements of the financial statements.

15 The capitalized cost for ND PP&E that are acquired through an acquisition program[10] should be:

a. the original investment in the acquisition program, and

b. the cost of acquisition programs that modify, modernize, or otherwise improve[11] the existing ND PP&E.

16 The capitalized costs of ND PP&E acquisition programs also should include investments directly attributable to such programs even if other acquisition programs fund such investments. The same acquisition program costs should not be capitalized and reported by more than one PP&E program, as this would result in an overstatement of the total cost of PP&E assets. For example, the acquisition program costs for a destroyer could include the costs for an integrated radar and missile system. Any capitalized cost for the integrated radar and missile system program should exclude all costs of the program that are capitalized and reported in the destroyer acquisition program.

17 If ND PP&E is acquired by means other than an acquisition program, the capitalized cost should be the acquisition cost. This cost should include:

a. the original investment in the ND PP&E, and

b. the costs to modify, modernize, or otherwise improve the existing ND PP&E.

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[10] An acquisition program is a procurement effort that is designed to provide new or improved ND PP&E or to provide for the continued capability of existing ND PP&E. ND PP&E generally is acquired through an acquisition program.

[11] When minor modifications are made to existing ND PP&E, the cost should be charged to expense in the period incurred. Minor modifications are those that do not make the existing PP&E more useful, more efficient, of greater durability, or of greater capacity.

18 Investments in the modifications or improvements to existing ND PP&E should be capitalized without adjustment for components replaced.

19 ND PP&E costs required to be capitalized should include the following:

a. Costs incurred under contracts from program initiation through the development, production, and deployment of program units,[12] and

b. Costs incurred for property and equipment (including Special Tooling and Special Test Equipment) in the possession of, or acquired directly by, the Government or the contractor, and delivered or otherwise made available to a contractor for exclusive use in accomplishing an acquisition program or acquisition contract.

Expense Recognition and Measurement

Major End Items

Write-off Due to Obsolescence, Destruction, or Disposal

20 Major End Items may be decommissioned due to obsolescence, destroyed during conflicts and training, or otherwise disposed of or taken out of service.[13] The book value[14] associated with a Major End Item's decommissioning, destruction, or disposal should be accounted for and reported as a reduction in the total capitalized costs of ND PP&E acquisition programs and as an expense reported in the statement of net

[12] The costs for Basic Research, Applied Research, and Advanced Technology Development (see **Appendix E: Glossary** for definitions) should be excluded.

[13] Major End Items decommissioned, destroyed, disposed, and otherwise taken out of service should be reflected as a deletion in the unit disclosure of changes in type or category of ND PPP&E as provided for in paragraph 28.

[14] *As used here,* "book value" is the portion of the capitalized cost at the time of decommissioning, destruction, or disposal assigned to the unit(s), net of accumulated depreciation. The assignment of costs expensed is based on the guidance contained in paragraphs 34 and 35.

cost for the period such items are decommissioned, destroyed, or disposed.

Book Value of Obsolete, Destroyed, or Disposed, Major End Items

21 The book value of decommissioned, destroyed, or disposed Major End Items should be based on a pro-rata share of the total capitalized ND PP&E acquisition program costs for the Major End Items, including modification and improvement costs previously capitalized.

22 In certain instances, Major End Items may be destroyed prior to full production and substantial ND PP&E acquisition program costs allocable to the entire estimated production run may have been incurred. When such an event occurs, the book value of the destroyed Major End Item should be the item's pro rata share of estimated ND PP&E acquisition program costs. The item's pro rata share should be based on the total estimated acquisition program costs of the ND PP&E acquisition program as of the accounting period the item was destroyed and the estimated total number of Major End Items to be produced as of the accounting period the item was destroyed.

23 Any changes in estimated book value per unit should be treated prospectively. For example, a subsequent change in the estimated number of units or total estimated acquisition program cost should be accounted for in the period of the change and future periods. No adjustments should be made to previously capitalized amounts or expenses.

Terminated Acquisition Programs

24 ND PP&E acquisition programs may be terminated prior to the delivery of any active service units. The book value of the terminated ND PP&E acquisition program should be accounted for and reported as a reduction in the total capitalized cost of ND PP&E acquisition programs and as an expense reported in the statement of net cost for the period management

makes a formal decision to terminate an acquisition program. The book value associated with the terminated ND PP&E should be the total capitalized ND PP&E cost of the acquisition program.

Mission Support Items

Allocation of the Costs of Mission Support Items

25 The cost of Mission Support Items should be allocated to benefiting periods and programs in a systematic and rational manner. The amount allocated is recognized as depreciation expense. Accumulated depreciation expense is recognized as a contra-asset account. A composite or group allocation methodology, whereby the costs of PP&E are allocated using the same allocation rate,[15] is permissible. The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

26 In the period of disposal, retirement, or removal from service, Mission Support Items should be removed from the asset accounts along with associated accumulated depreciation. Any difference between the book value of the Mission Support Items and amounts realized should be recognized as a gain or loss in the period that the Mission Support Item is disposed of, retired, or removed from service.[16]

[15] The composite rate can be calculated based on a weighted or on an unweighted-average estimate of useful lives of assets in the composite.
[16] If group depreciation is used, no gain or loss is recognized. Rather, the original cost – or an estimate of the original cost – is removed from both the asset account and the accumulated depreciation account.

Information Presented as Disclosures or as Required Supplementary Information

27 Unless otherwise noted, the **Unit, Acquisition Programs, and Mission Support Items** information requirements shown below require disclosure. Disclosure is to report information in notes or narrative regarded as an integral part of the basic financial statement. **Condition Assessment** information requirements should be presented as required Supplementary information (RSI).[17]

Major End Items

Unit Information

28 The reporting entity should disclose unit information by type or category for Major End Items.[18] The information should include:

a. Beginning and ending number of units.

b. Number of units added and deleted during the period.

Condition Assessment Information

29 An assessment of condition, state of readiness, or mission capability[19] of the Major End Items should be reported as RSI on an annual basis. Condition assessment methods, standards, and frequency should be consistently applied, as appropriate by type of ND PP&E and Military Service.

30 For each type or category of Major End Item, report the following condition information:

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[17] See section 558, Required Supplementary Information" in *Codification of Statements of Auditing Standards,* American Institute of Certified Public Accountants (AICPA).

[18] Management should use its best judgment in determining the categories of Major End Items that correctly describes unit information.

[19] Condition goals and assessments are determined by the Department of Defense.

a. The condition assessment criteria.

b. The frequency of condition assessments.

c. Condition assessment for most recent three assessment periods.[20]

Acquisition Programs

31 The reporting entity should disclose current and cumulative activity in ND PP&E acquisition programs. The information disclosed should include:

a. Cumulative capitalized ND PP&E acquisition program costs at the beginning and end of the reporting period for each major ND PP&E acquisition program.[21]

b. Current year capitalized ND PP&E acquisition program costs for each major ND PP&E acquisition program.

c. Planned acquisition program costs for each major ND PP&E acquisition program. Planned acquisition cost information should be derived from appropriate planning documents, including the most recent Department of Defense Selected Acquisition Reports (SAR).

d. Reductions in capitalized ND PP&E acquisition program costs related to terminated active Major ND PP&E acquisition programs.

32 The disclosure also should include for each major ND PP&E acquisition program, the number of units[22] originally projected for

[20] Trend information is not required for the year in which the standard is first effective. Two-year trend data is required for the second year in which the standard is effective and three-year data is required for the third year and all years thereafter.

[21] Major ND PP&E acquisition programs represent the 10 largest (in planned dollar terms) current acquisition programs within the Department of Defense.

production under the acquisition program, the revised number of units projected for production,[23] and the number of units delivered to date.

Mission Support Items

33 The information disclosed for Mission Support Items should include the following:

a. The cost, associated accumulated depreciation, and net cost by major type, class, or composite group.

b. The method(s) of depreciation for each major type, class, or composite group.

c. The estimated useful lives of each major type, class, or composite group.

Program Management Offices

34 An estimate for the combined costs incurred during the reporting period of all Program Management Offices responsible for the acquisition of ND PP&E should be reported as Required Supplementary Information (RSI).

Cleanup Cost

35 Paragraph 36 below amends paragraph 101 of SFFAS No. 6. Paragraphs 37 through 47 present the accounting standards for cleanup cost specifically related to ND PP&E. All other paragraphs dealing with the accounting standards for cleanup cost in SFFAS No. 6 remain in effect.

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[22] Units relate to types or categories of Major End Items, e.g., DDG-51. Unit reporting does not apply under this paragraph if the principal output of a major ND PP&E acquisition program is not measured in units, e.g., modifications to existing ND PP&E.

[23] Projected unit information should be derived from the most recent Department of Defense Selected Acquisition Report (SAR), or, for acquisition programs not subject to SAR reporting, most recent planning documents.

36 SFFAS No. 6, paragraph 101 refers to "stewardship PP&E." ND PP&E is not a component of stewardship PP&E. Thus, the term "stewardship PP&E" refers only to heritage assets and stewardship land.

Major End Items

37 For Major End Items, the total estimated cleanup cost[24] per unit should be recognized as a part of the total acquisition program cost for Major End Items as units are placed in service and a liability recognized. The total estimated cleanup cost per unit should be based on the total estimated cleanup cost for all Major End Items in the acquisition program and the estimated total number of Major End Items to be produced. Cleanup costs should include the costs of PP&E or other assets acquired for use in cleanup activities.

38 The related liability and total acquisition program cost should be adjusted when the total estimated cleanup costs are re-estimated as described in SFFAS No. 6, paragraph 96.

39 As units are decommissioned, destroyed, or disposed, the cleanup cost should be recognized as an expense in the period as the book value of the Major End Item is reduced (See paragraphs 20 through 22).

40 In some cases, the manner in which a unit is destroyed may result in a decline in the estimated cleanup cost. This decline should be recognized as a reduction in the acquisition program cost and the related liability. If practicable, the liability reduction should be recognized prior to expensing the pro rata share of the book value of the Major End Item. If not

[24] "Estimated total cleanup cost" is defined and guidance for making estimates and re-estimates is provided in SFFAS No. 6, paragraph 94 through 96.

practicable, this decline should be incorporated in the next re-estimate of total estimated cleanup cost.

41 As cleanup costs are paid, such costs should be recognized as a reduction in the liability for cleanup costs.

42 Disclosure requirements prescribed in SFFAS No. 6, paragraphs 107, 110 and 111 are applicable to Major End Items.

Mission Support Items

43 A portion of the total estimated cleanup cost, if applicable, should be recognized as expense during each period that Mission Support Items is in operation. Cleanup costs should include the costs of PP&E or other assets acquired for use in cleanup activities. The estimated useful life of homogenous PP&E should serve as the basis for systematic recognition of the expense and accumulation of the liability.

44 Recognition of the expense and accumulation of the liability should begin on the date that the PP&E is placed into service, continue in each period that operation continues, and be completed when the PP&E ceases operation.

45 When a re-estimate of the total estimated cleanup cost is made (as described in SFFAS No. 6, paragraph 96), the cumulative effect of changes in total estimated cleanup costs related to current and past operations should be recognized as an expense and the liability adjusted in the period of the change in estimate.

46 As cleanup costs are paid, such costs should be recognized as a reduction in the liability for cleanup costs

47 Disclosure requirements prescribed in SFFAS No. 6, paragraphs 107-111, are applicable to Mission Support Items.

Transition Guidance

Establishing Capitalization at Transition

48 The initial capitalization amount for ND PP&E acquisition programs in the development or production phase, as well as Major End Items in active service, as of September 30, 2005 should be based on historical cost. Capitalization of amounts for Mission Support Items in active service as of September 30, 2005 is not required. Historical cost should be determined as follows:

a. The initial capitalization amount for Major End Items should be the acquisition program cost attributable to the Major End Items still in service, not the total number of Major End Items received under the program.

b. If the reporting entity determines that obtaining initial historical cost is not practical, estimated historical cost may be used. Other information may provide support for establishing an estimate of initial capitalization and an estimated number of Major End Items. Such information includes budget, appropriation, or engineering documents and other reports reflecting the number of Major End Items acquired and amounts expended.

c. Alternatively, with respect to Major End Items, estimates of historical cost may be derived by estimating the current replacement costs[25] of similar Major End Items and deflating those costs, through the use of price-level indexes, to the acquisition year or estimated acquisition year if the actual year is unknown.[26] Other reasonable approaches for estimating the acquisition costs of acquisition programs and Major End Items at

[25] Replacement cost of an asset is the estimated cost of acquiring new and substantially equivalent property at current prices. (Kohler's Dictionary for Accountants)

transition may be utilized. For example, latest acquisition cost[27] may be substituted for current replacement cost if necessary.

49 This standard recognizes an inherent imprecision may result from determining or estimating initial capitalization costs for ND PP&E Major End Items acquired many years prior to the effective date of this standard in an environment in which the historical records were not required to be retained and may therefore be inadequate.

Disclosure During Transition

50 The reporting entity should disclose during the transition period that ND PP&E costs for the current and prior periods have not been included on the balance sheet, the future reporting requirements for these costs, and whether the change would be material to the balance sheet.

Implementation Guidance

51 In the year following the transition period:

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

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

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[26] There are a number of price-level indexes that may be used, both private and public sector, to remove the effects of price-level changes from current prices.
[27] Latest acquisition cost provides that an item be valued at the cost of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. (Adapted from Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards Number 8, *Supplementary Stewardship Reporting,* as amended)

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

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

APPENDIX A: BASIS FOR CONCLUSIONS

52 This appendix summarizes some of the considerations deemed significant by the Board in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. One Board member provides an Alternative View regarding some proposed reporting requirements. The Alternative View is presented in **APPENDIX C.**

Background

53 The Federal Accounting Standards Advisory Board (FASAB) has studied accounting and reporting approaches for National Defense Property, Plant, and Equipment (ND PP&E)[28] for a number of years. FASAB began with the development of Statement of Federal Financial Accounting Standards (SFFAS) Number 6 (No. 6), *Accounting for Property, Plant, and Equipment*, and followed with SFFAS No. 8, *Supplementary Stewardship Reporting*. With the completion of these two standards, the Board had provided standards tailored to PP&E used in diverse federal programs as well as PP&E held primarily for stewardship purposes.

54 One result of SFFAS Nos. 6 and 8 was to remove the PP&E components of weapons systems from the balance sheet. To accomplish this, SFFAS No. 6 (as amended by SFFAS No. 11) requires that the cost to acquire PP&E components of weapons systems be expensed when incurred. SFFAS No. 8 (as amended by SFFAS No. 11), Supplementary

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

Stewardship Reporting, requires reporting ND PP&E at cost. The report should include:

- a beginning valuation balance for ND PP&E, using either a historical or latest acquisition cost (LAC) valuation method;
- the dollar values for ND PP&E acquired during the reporting period;
- the dollar values for ND PP&E withdrawn during the reporting period;
- the increase or decrease in values resulting from revaluation of assets using the LAC; and
- the end-of-year values by major type or category of ND PP&E.

In addition to reporting values, condition information is required. The reporting of value and condition information is done off-balance sheet as Required Supplementary Stewardship Information (RSSI).[29] SFFAS No. 6, as amended, requires that deferred maintenance estimates be presented as Required Supplementary Information (RSI). The deferred maintenance requirement applies to all PP&E and the requirement would not be altered by this proposal.

55 In early 1998, the FASAB issued an exposure draft to amend SFFAS Nos. 6 and 8. The exposure draft was initiated (1) to respond to definitional questions from several agencies, and (2) in recognition of the need to provide a transition plan in light of DoD's inability to comply with the provisions of SFFAS No. 8. During the process, the Board reconsidered whether SFFAS No. 8 was an appropriate end goal. Ultimately, the 1998 exposure draft included, among other proposals, proposals to replace the

[29] In December 2000, the Board issued a Preliminary Views (PV) document on Eliminating the Category "Required Supplementary Stewardship Information." The Board is continuing to deliberate on the future of the RSSI category. However, this proposal does not require use of the RSSI category. If respondents wish to propose use of the RSSI category, they may wish to review the December 2000 PV.

requirement to report cumulative cost information in the supplementary stewardship report with a requirement to report ND PP&E annual acquisition costs for each of five years (i.e., annual trend information rather than cumulative costs), unit, and condition information. In addition to considering the written comments, FASAB held a public hearing on these proposals to explore further the concerns expressed by some respondents.

56 After the public comment period and hearing, the Board proceeded to issue standards relating to various aspects of the proposal. In December of 1998, the FASAB issued SFFAS No. 11, *Amendments to Accounting for Property, Plant, and Equipment – Definitional Changes*, which amended SFFAS Nos. 6 and 8. SFFAS No. 11 accomplished only the definitional changes sought in the 1998 ED. Because of the divergent views of both respondents and Board members on accounting for ND PP&E, the FASAB did not reach a final conclusion on revisions to the reporting requirements for ND PP&E in SFFAS No. 8. FASAB deliberations on the proposed standards highlighted the differences of opinion on this subject.

DoD Study

57 To assist the FASAB and DoD in deliberations, DoD engaged KPMG LLP (KPMG) to conduct a comprehensive study of ND PP&E. The study was to: (1) develop a report on the DoD ND PP&E acquisition process, (2) evaluate various ND PP&E accounting and reporting approaches, and (3) recommend an approach that would provide users of DoD financial statements with more meaningful and analytically useful ND PP&E information that could be reasonably implemented. KPMG provided the report on the acquisition process to the FASAB in June 2000 and a report on its overall findings in December 2000. The overall report included KPMG's evaluation of various accounting and reporting approaches and its recommendation for further FASAB consideration. The report also included a discussion of related implementation and audit issues.

KPMG Report

Report Coverage

58 The KPMG report provided several analyses to support the study proposals. These are:

- A summary of the ND PP&E acquisition process to facilitate an understanding of the complexity of the process and to assist the FASAB and others in understanding how that process affects ND PP&E accounting and reporting.
- A summary discussion of its understanding of the objectives of financial reporting.
- A summary of the results of KPMG's user surveys.
- A summary discussion of the Military Departments' ND PP&E accountability and accounting systems describing the capabilities of the various systems for implementing the recommended standard.
- A discussion of implementation issues, the estimated costs for implementing the proposed standard and timelines.
- A discussion of audit issues associated with the recommended standard and how these issues might be addressed.

Report Evaluation Results

59 KPMG evaluated four ND PP&E accounting and reporting approaches: (1) capitalizing and reporting ND PP&E on the balance sheet, (2) capitalizing and reporting ND PP&E as Required Supplementary Stewardship Information (RSSI), (3) reporting units of ND PP&E as RSSI, and (4) reporting ND PP&E annual investments as RSSI.

Conclusion

60 KPMG concluded that none of the foregoing approaches alone satisfied all of the financial reporting objectives. Consequently, KPMG developed and recommended an alternative approach that includes several informational components for consideration by the FASAB. In most cases, the Board accepted the rationale contained in the KPMG study for the recommended approach and proposals. By accepting the rationale contained in the study it becomes the Board's rationale for the proposals presented in this ED. The complete KPMG study, **Report on the Evaluation of National Defense PP&E Reporting Approaches**, can be accessed on the Internet at the FASAB website (www.financenet.gov/fasab.htm)

Exposure Draft

61 The sections below address some aspects of the proposal that the Board believes warrant further explanation. Some aspects of the proposal may be considered non-controversial and may not be addressed. The Board has attempted to provide rationale for each issue posed in the **Questions for Respondents** section of this ED. Each question presented there is cross-referenced to the discussion below.

Definition of ND PP&E

62 The Board believes that the definition of, as well as the standard on accounting for and reporting of, ND PP&E should be designed to provide guidance for achieving the objectives of federal financial reporting. The Board, in SFFAS No. 6, recognized that a single accounting standard for all PP&E would not result in meeting the reporting objectives.[30] The proposal to modify the ND PP&E definition preserves and extends this reasoning but, based on more detailed research, narrows slightly the items to be

[30] SFFAS No. 6, para. 118.

included in ND PP&E. Items excluded would be assigned to other categories of PP&E or to another asset account.

63 The new definition of NDPP&E extends the use of categorization by creating two categories of ND PP&E -- Major End Items and Mission Support Items. The two-category approach facilitates application of different standards for expense recognition and disclosures for different types of ND PP&E. The categorization Major End Items and Mission Support Items is based largely on the level of predictability associated with useful life. (See paragraphs 70 through 76 below.)

64 The new definition also reclassifies certain PP&E currently defined as ND PP&E by SFFAS No.11 to non-ND PP&E categories. Further review of the types of items included under the original ND PP&E definition led to the proposal to reclassify some items. Examples of items re-classified include Weapons Systems Support Principal End Items, Weapons Systems Support Real Property, and missiles other than Intercontinental Ballistic Missiles and Submarine Launched Ballistic Missiles. Some of these items may be general PP&E, while others may be operating materials and supplies.

65 Both the existing and proposed definitions specifically include vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet (NDRF). The NDRF's ships are held in a preservation status and are activated only during a military crisis or national emergency. Their predominant use is to provide supplemental shipping capacity that the United States can rely on during a military crisis or national emergency. The Board agreed that, because of the NDRF's preservation status and predominant use, the NDRF ships should continue to be categorized as ND PP&E and would be Major End Items. This is consistent with the fact that they are maintained in a constant level of

condition until called into use. Thus, depreciation expense is not relevant or measurable.

Recognition of ND PP&E as an Asset

66 The Board recommends capitalization on the balance sheet of ND PP&E acquisition programs and ND PP&E acquired through other means. The conceptual basis for this recommendation is that the huge amounts of money invested in ND PP&E represent economic resources with future service potential. Also, recognizing ND PP&E on the balance sheet enhances the accountability and stewardship over economic resources by the Federal government.

67 The Board also believes that the proposal is useful in meeting the stewardship reporting objective. The stewardship reporting objective calls for information that would help the reader determine if the government's financial position improved or deteriorated over the period.[31] With ND PP&E included as an asset on federal balance sheets, users would have information (1) on all PP&E used in agency operations, (2) on government investment in resources intended to provide future service, and (3) that – over time – discloses trends in these resources.

Accounting Based on Units or Programs

68 For Major End Items, this proposal focuses on the cost of ND PP&E acquisition programs rather than on the cost of specific units acquired. This treatment recognizes that the DoD acquires ND PP&E Major End Items through very complex acquisition programs that require years of research, development, test, evaluation, and production. Numerous contractors may be involved during this process. It also recognizes that the DoD does not acquire ND PP&E Major End Items by acquiring individual

[31] Statement of Federal Financial Accounting Concepts (SFFAC) No. 1, paragraph 136.

items or purchasing "off-the-shelf" as may be done for General PP&E. Accumulating the cost of ND PP&E Major End Items by acquisition program –rather than units-- would allow the DoD to capture, capitalize and report information in a manner that supports the way that DoD does business.

Modification and Improvements

69 This proposal provides that modifications and improvements – excluding routine minor modifications – be added to the investment in Major End Items without removing the cost of any components removed from service. For example, a new guidance system might be added to an aircraft and the cost of the old guidance system would not be identified and removed from the cost of Major End Items. This approach is consistent with the notion that the cost of an acquisition program is being accumulated.

No Depreciation of Major End Items

70 One of the objectives of financial statements is to report the cost of an entity's operations for a defined period of time. The Board has prescribed the Statement of Net Cost for this purpose. Ordinarily, if assets can be expected to be used over more than one period, a portion of the cost of the asset is assigned to each period so that the sum of the assigned costs are equal to the cost of the asset when it reaches the end of its useful life. A pervasive issue for ND PP&E has been whether it is useful to depreciate ND PP&E over the estimated useful life of the PP&E. In SFFAS No. 6, the Board indicated that depreciation of general PP&E is "essential to assessing operating performance."[32] For ND PP&E, many have asserted that depreciation is not useful because (1) the useful life of complex ND

[32] SFFAS No. 6, para.122.

PP&E is not estimable, and (2) depreciation expense is not essential to assessing operating performance of the entity. Others have asserted that depreciation is useful. In fact, most other nations preparing financial statements do depreciate their equivalent of ND PP&E.

71 The standards proposed by the Board do not recommend depreciation of Major End Items. This proposal relies on the notion that Major End Items are maintained in a ready state through a continual maintenance and repair regimen, effectively preventing routine deterioration. The cost of the maintenance and repair regimen is currently captured as part of the cost of operations and is one component of the cost of having ND PP&E. Some argue that the maintenance, repair and other operating expenses associated with Major End Items are the appropriate focus for assessing the cost of operations or "operating performance." Further, because Major End Items have an unpredictable useful life or are susceptible to premature obsolescence, depreciation accounting and reporting for these items is not recommended.

72 The proposed treatment of Major End Items would result in Major End Items remaining on the balance sheet as an asset at their capitalized cost despite the fact that physical assets generally suffer some decline in usefulness over time. When a Major End Item is decommissioned, destroyed, or disposed the cost attributable to the unit will be expensed and shown as a cost of that period rather than a cost of each of the periods' during which the unit was used.

73 The Board acknowledges that the above described accounting for the cost of Major End Items is not consistent with accounting for general PP&E as prescribed in FASAB Statement Nos. 4 or 6, with accounting prescribed tangible assets and infrastructure pursuant to standards published by FASB and GASB, nor even with the standards proposed in this ED for

Mission Support Items. Furthermore, several Board members, who support issuance of this ED, also believe that the standards proposed are not consistent with the *Objectives of Federal Financial Reporting.* These members support issuance of the ED as an interim step because they believe there is an urgent need to provide new guidance for accounting for ND PP&E. They note that accounting often is an evolutionary process. They can support this proposal as a step in that evolution, but not as a final objective.

74 These members note that a key objective of federal financial reporting is to report the cost of an entity's operations for each reporting period. Normally, this is accomplished by some means of depreciation. Under the proposed standard for major end items, the largest part of ND PP&E that is measured in dollars, no portion of cost will be recognized as an expense of a period until the item is removed from service. Similarly, the entire cleanup cost will be recognized only when the item is removed from service.

75 These Board members believe that, conceptually, Major End Items should either be (1) subjected to an impairment test to periodically confirm that they have not suffered a decline in value due to use or (2) depreciated. Absent this test or routine recognition of declining value through depreciation, these members believe the resources available to the government will be overstated on the balance sheet and the statement of net cost would not reflect the total cost of activities.

76 However, all members agree that these refinements in accounting for the cost of Major End Items would require extensive analysis and improvements in the relevant data and information systems in the Department of Defense. Such improvements and analysis may require several years. Until then, accounting pursuant to the standards proposed

in the ED will represent a practical, incremental step toward more meaningful accounting for ND PP&E. The Board urges respondents to consider the questions carefully in this light, and to propose an alternative approach that the Board should consider if respondents believe that an alternative would be superior.

Depreciation of Mission Support Items

77 With this proposal, Mission Support Items would be subject to depreciation. In contrast to Major End Items, Mission Support Items generally has a more predictable life and is less susceptible to premature obsolescence than Major End Items. The proposal explicitly recognizes composite or group depreciation as an acceptable approach for Mission Support Items. Composite or group depreciation is a practice that has been used to simplify depreciation accounting in other sectors. The Board believes that, where reasonable methods are employed, the result from composite or group depreciation is largely the same as the result from depreciation of units or items.

Program Management Offices

78 The Board deliberated about what costs should be included in the capitalized cost of acquisition programs. That is, whether the capitalized cost should include both direct and indirect costs. While the KPMG report in its overall findings concluded that the indirect costs it identified to be included were not likely to be material, several Board members had reservations about including only direct costs in the capitalized cost. However, a balancing concern was the need for timely action on the ED in order to provide new guidance for accounting for ND PP&E. The Board acknowledged that, at the present time, it did not have sufficient information to propose what indirect costs, if any, should be included in the capitalized cost. It agreed, therefore, that the capitalized cost should

include costs paid to contractors and the cost of property and equipment used by contractors in accomplishing a contract. It also agreed that an unaudited estimate for the combined costs incurred during the reporting period of all Program Management Offices responsible for the acquisition of ND PP&E should be reported as required supplementary information. The auditor has only limited responsibility regarding RSI. By classifying the estimate as RSI, the Board believes the indirect cost estimate can be monitored for materiality, relevant information will be made available for users, and a basis will be provided for possible future refinements to the standards, without imposing excessive cost to calculate and audit the estimate.

Quantity and Condition Disclosure of Major End Items

79 The proposed standards include a requirement to disclose the quantity and report the condition[33] of Major End Items. The Board believes that this information is a crucial component for users in understanding the changes over time in the ND PP&E assets. Further, this information is expected to be useful in meeting the operating performance[34] and systems and controls[35] reporting objectives.

80 Quantity information helps achieve the systems and controls objective. Because the acquisition program cost for ND PP&E is capitalized in place of capitalizing individual items, the Board believes the requirement to report quantities would enhance the control and accountability aspect of the standards. In addition, the Board believes linking the condition information

[33] While the quantity information would be included in disclosures, the condition information would be required supplementary information as defined in AU 558.
[34] Operating performance objective: Federal financial reporting should assist report users in evaluating the ...management of the entity's assets and liabilities. (SFFAC No. 1, para. 122)
[35] Systems and controls objective: Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that ...assets are properly safeguarded to deter fraud, waste, and abuse. (SFFAC No. 1, para 146)

with reported quantities would provide more depth and perspective to meaningful financial information. An illustration of this disclosure is presented in Appendix B, Illustrative Reporting Formats.

81 The operating performance reporting objective requires information on the efficiency and effectiveness of the government's management of its assets. Condition information relates to the effectiveness of the government's management of Major End Items. On the notion that Major End Items are maintained in a ready state through a continual maintenance and repair regimen, the condition information, and particularly trends in condition over time, will serve as a check and to alert the reader to changes in service potential.

Information on Major ND PP&E Acquisition Programs

82 To address the reporting objective of budgetary integrity,[36] the proposed standards provide for disclosure of current year and cumulative cost information along with planned cost and unit output information for the 10 largest (in planned dollar terms) current major ND PP&E acquisition programs. There is general concern about the reduced availability of budgetary resources and cost overruns on government contracts. This proposed requirement would provide readers with information on a defined number of individual major ND PP&E acquisition programs, which are long-term and have large investment amounts, for comparison with relevant

[36] Federal financial reporting should provide information that helps the reader to determine:
1A. How budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization.
1B. The status of budgetary resources.
1C. How information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities. (SFFAC No. 1, paras. 115-119)

internal planning or budgetary data. An illustration of this disclosure is also presented in Appendix B, Illustrative Reporting Formats.

Cleanup Cost

83 In SFFAS No. 6, the standards provide for the recognition of a liability for the total estimated cleanup cost for stewardship PP&E when a stewardship item is placed in service. At that time, the same amount would be recognized as an expense. Thus, the expense for cleaning up ND PP&E is recognized when the cost of the asset is expensed under SFFAS No. 6.

84 In this ED, the Board proposes that the cost of Major End Items be recognized in expense when an item is disposed, destroyed or decommissioned. To align the cleanup cost with the new accounting for ND PP&E cost, the Board proposes that as each unit is placed in service, a equitable pro rata portion of the total estimated cleanup cost attributed to that unit be recognized as a liability. This is the same recognition point as provided in SFFAS No. 6. It is consistent with the notion that cleanup costs become liabilities when the PP&E is "activated."

85 However, the Board proposes in this ED that the expense be recognized when the asset is removed from service rather than over the useful life of the asset. For the same reasons that Major End Items are proposed not to be depreciated, the Board proposes that the cleanup cost expense recognition occur when the item is removed from service. If, at a future date, the Board modifies the timing of expense recognition for Major End Items, the Board could revisit this issue.

86 Also, during the period between recognition of the liability and expense, the cost should be considered a part of the cost of the asset. In essence, the cost is a result of bringing the PP&E into service. That is, the cost is integral to the asset itself. This proposal is similar to the current

Financial Accounting Standards Board (FASB) proposal on retirement obligations.

87 For Mission Support Items, which is proposed to be depreciated similar to general PP&E, the Board proposes that the cleanup cost accounting match the provisions for general PP&E. That is, a pro-rata share of the total estimated cleanup cost is recognized as a liability and expense during each year the PP&E is in service.

88 The timing of the liability recognition will differ between Mission Support Items and Major End Items. That is, the entire estimated liability will be recognized when a Major End Item is placed in service but only a portion of the estimated liability will be recognized when a Mission Support Item is placed in service. The Board acknowledges this difference. While this difference also exists currently between any general PP&E and Stewardship PP&E, some Board members believe the proposed standards for cleanup cost related to Major End Items should be similar to Mission Support Items and recognized ratably over the useful life of the Major End Item.

Initial Capitalization Amounts

89 For periods beginning after September 30, 2005, the estimated acquisition program cost of ND PP&E acquisition programs in the development or production phase and Major End Items still in active service are proposed to be capitalized. However, capitalization of amounts for Mission Support Items in active service as of September 30, 2005 is not required. The basis for this concept is that, because of the way acquisition contracts currently exist, the costs for MEIs and Mission Support Items are combined and cannot be distinguished. It is the belief of the Board that to attempt to segregate the costs or to arrive at an estimated value for the

many smaller items having a shorter life than Major End Items would not be cost beneficial for transition.

Implementation Period

90 To effectively implement the proposed ND PP&E standard, the DoD will need to accomplish the following tasks:

- Policy and Procedures. The first major task, and the most important, is evaluating and revising existing ND PP&E accounting and reporting policies and procedures.
- Contracting Practices. The second task involves the modification of the DoD's contracting practices. The DoD will need to modify the form of contracts, and possibly the provisions of existing contracts, to provide pricing of components of ND PP&E acquisition programs.
- Systems Changes. The third major task involves identifying and implementing needed acquisition, procurement, accountability/logistics, and accounting systems changes.
- Training. The fourth major task involves the development of a comprehensive training program and/or modifications to existing training programs and courses, which includes both initial and recurring training, for the new standards along with the DoD's revised policies and procedures.

91 Due to the extensive changes and modifications that will need to made by the DoD to policies, regulations, procedures, controls, and systems, the Board recommends a 4 year period for full implementation of the standards.

Conclusion of Board

92 The Board believes that this ED contains important steps forward. The Board may continue to study the issues and produce further recommendations when appropriate.

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APPENDIX B: ILLUSTRATIVE REPORTING FORMATS

The illustrative reports are displayed on the following pages.

Disclosure During Transition

SFFAS No. X requires that financial information for ND PP&E Major End Items and Mission Support Items be recognized and reported on the Balance Sheet beginning in fiscal year (FY) 2006. SFFAS No. X also requires that planned and actual acquisition program cost and the program's units be disclosed for the 10 largest acquisition programs in total planned/estimated dollar terms beginning in FY 2006. For this reporting period and all periods prior to implementation of SFFAS X, the Statement of Net Cost recognizes as expenses the expenditures incurred during the reporting period for all ND PP&E Major End Items and Mission Support Items.

Quantity and Condition Reporting (Starting in FY 2002)

For this reporting period, unit and condition assessment information by Major Type/Category of Major End Item is reported. The table below presents the required unit and condition assessment information for Major End Items by major type or category. A brief explanation for each type of information precedes the table. Also, note that the condition assessment information is unaudited.

Unit Information

The reporting of unit information includes the number of active units at the beginning of the year, the number of units added, the number of units deleted, and the total number of active units at the end of the year for the applicable reporting period. The number of units deleted are units that are decommissioned, destroyed during conflict or training, transferred, sold or otherwise disposed of.

In the future, the value associated with Major End Item deleted, as well as terminated ND PP&E acquisition programs, would be expensed in the period such events occur and reported as cost.

Condition Assessment Information

Condition assessment information is defined as Required Supplementary Information and is labeled as "unaudited" in the following table. The condition assessment percentages represent the percent of only active units that are Full-Mission Capable (FMC). Systems and equipment are considered FMC when they are safe and have all mission-essential subsystems installed and operating as designated by a Military Service.

Type or Category	Beginning Balance 10/1/-2002	Additions	Deletions	Ending Balance 9/30/-2003	Unaudited		
					Condition Assessment Period 1	Condition Assessment Period 2	Condition Assessment Period 3
Aircraft							
Combat	8,660	52	351	8,361	79%	77%	
Airlift	6,059	23	148	5,934	94%	92%	
Other	3,740	67	247	3,560	76%	74%	
Sub-total	18,459	142	746	17,855			
Ships							
Submarines	123	1	7	117	68%	66%	
Aircraft carriers	18	0	0	18	67%	65%	
Surface Combatants	269	26	13	282	70%	68%	
Amphibious Warfare Ships	83	0	7	76	67%	65%	
Mine Warfare Ships	38	1	0	39	69%	77%	
Support Ships	241	6	33	214	72%	70%	
Other Ships	3,921	55	229	3,747	74%	72%	
Sub-total	4,693	89	289	4,493			
Combat Vehicles							
Tracked	44,522	328	684	44,166	85%	83%	
Ballistic Missiles							
Ballistic Missiles	8,486	216	29	8,673	83%	81%	

Investment Schedule Reporting (Starting FY 2006)

The following table illustrates an Investment Schedule of ND PP&E acquisition program information for each of the 10 current largest major acquisition programs (in planned dollar terms) The table also illustrates the number of Major End Items originally projected for production, revised projected production, and delivered to date for each major acquisition program.

(Dollars are in millions and units are stated in number of Major End Items. Amounts are for illustration purposes only and do not reflect actual results.)

	ND PP&E Acquisition Program	*Planned Cost*	*Cumulative Cost 10/1/2005*	*Current Year Capitalization*	*Current Year Program Terminations*	*Cumulative Cost 9/30/2006*	*Original Projection of Major End Items*	*Revised Projection of Major End Items 9/30/2006*	*Delivered Major End Items 9/30/2006*
1	DDG 51 Destroyer	$53,000	$41,000	$4,000	$0	$45,000	60	58	51
2	New Attack Submarine	$62,000	$7,000	$2,000	$0	$9,000	20	20	3
3	C-17 Airlift Aircraft	$38,000	$25,000	$2,900	$0	$27,900	134	134	97
4	F-22 Advanced Tactical Fighter	$36,000	$1,500	$2,500	$0	$4,000	300	333	12
5	V-22 Osprey	$27,000	$3,300	$1,400	$0	$4,700	408	408	46
6	F/A-18E/F	$41,000	$10,000	$3,000	$0	$13,000	548	548	140
7	LPD-17 Transport	$11,000	$3,000	$1,500	$0	$4,500	12	12	6
8	B2 Bomber	$60,000	$44,400	$150	0	$44,550	132	21	21
9	Longbow Apache	$24,000	$9,000	$500	$0	$9,500	100	80	70
10	Abrams Tank Upgrade	$6,800	$3,7000	$500	$0	$4,200	N/A- upgrade	N/A- upgrade	N/A- upgrade

APPENDIX C: ALTERNATIVE VIEW

93 This Alternative View is from one Board member who believes various proposed reporting requirements do not meet criteria to be considered essential for financial statement purposes.

General Comments

94 Significant resources are expended to develop and review every item submitted with financial statements and a requirement for submitting additional information should be imposed only if such information is essential, justified by the usefulness of the additional information and is not readily available from other sources. The proposed reporting requirements associated with information on the 10 largest acquisition programs, as well as the reporting of quantity and condition information for Major End Items, do not meet these criteria. Nor does there appear to be any urgent need for, or benefit from, requiring such information. Further, many federal agencies have significant capitalized asset programs and the imposition of reporting requirements on a single agency does not appear to be justified. If this information is considered essential for financial statements, such a requirement should be imposed on all agencies--not just one agency.

10 Largest ND PP&E Acquisition Programs

95 The proposed standard requires the disclosure of information pertaining to the Department of Defense's 10 largest acquisition programs. These disclosures include budgeted amounts, costs incurred and the original and projected program quantities. This requirement does not add value.

96 More detailed information than that required by the proposed standard already is available to Department of Defense managers, the Congress and the public. Applicable information is included in budget justification materials, in publications produced by the Military Departments, in private sector publications such as Jane's Defense and from various other public sources, including the Internet. Further, information available from such sources is not limited to the 10 largest Defense programs; rather applicable information is available for all Department of Defense major acquisition programs.

97 Most important, due to the federal government's budget cycle, and that of the Department of Defense, amounts reported in the Department of Defense's financial statement for the 10 largest acquisition programs most likely would be outdated. Amounts included in the financial statements would be as of September 30th. The Department's budget review process occurs during the period September through January each year, with the President's budget generally released in January. Accordingly, amounts for these 10 programs, as reported in the financial statements, most likely would vary from amounts reported for the same programs in the budget--which would be released at approximately the same time as the Department's financial statements. The outdated estimates included in the financial statements would appear to render such reporting as less than useful, and perhaps misleading. Further, the apparent contradiction between the financial statements and the budget amounts could be anticipated to create confusion and misunderstanding.

Quantity Reporting

98 The proposed standard requires the disclosure of quantity information for Major End Items. The required reporting of this information adds little value. Information on the quantities of Major End Items already is available to Department of Defense managers, to the Congress and to the public. The proposed reporting requirement would not make available information that is not otherwise available. Nor is it needed for accountability purposes. Accountability would be demonstrated through the audit of the amounts capitalized on the Department's balance sheet--similar to the manner in which accountability is demonstrated for other assets reported on the balance sheet. (As an aside, it is noted that an assessment of the Department's control over military equipment conducted by the Inspector General of the Department of Defense indicated a 99.6 percent accuracy rate of the unit-level property books.)

Condition Reporting

99 The proposed standard requires the disclosure of condition information for Major End Items. Obviously, if the quantity of Major End Items is not reported, the condition of such items should not

be required. Additionally, SFFAS No. 6, "Accounting for Property, Plant and Equipment already requires the reporting of deferred maintenance information. Such information is sufficient to enable one to judge the state in which the Department of Defense maintains its Major End Items. Requiring the agency to provide a separate report on condition would appear to impose an unnecessary requirement.

100 Also, because of the sensitivity of the exact capability of Major End Items only a summarization of data would be releasable in any public form. At such a summary level, the information would appear to have little utility to Department of Defense managers, members of the Congress, and others who might use the information for decision-making purposes. In fact, legitimate decision makers could be expected to have access to far more detailed, more timely and more sensitive information.

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APPENDIX D: QUESTIONS FOR RESPONDENTS

101 The Board asks that respondents address the following questions. Respondents may also provide other information for the Board's consideration. Each question includes paragraph references to facilitate review of the related standards and basis for conclusions.

102 **Question 1.** This proposal focuses on the cost of ND PP&E acquisition programs for Major End Items rather than on the cost of specific units acquired. Do you agree that the cost of ND PP&E acquisition programs for Major End Items rather than the cost of specific items or units acquired should be accumulated? Please provide your rationale with your response. (See paragraphs 14 through 17, and 66 through 68.)

103 **Question 2.** This proposal provides that the cost of modifications or improvements to existing ND PP&E be added to the original investment without adjustment to the original cost and accumulated depreciation of any components that are removed. Do you agree with the Board's proposal regarding modifications and improvements? Please provide your rationale with your response. (See paragraphs 18 and 69.)

104 **Question 3.** For periods beginning after September 30, 2005, the estimated acquisition program costs of ND PP&E acquisition programs in the development or production phase, as well as Major End Items still in active service, would be capitalized. Mission Support Items in active service as of September 30, 2005 would not be capitalized. Do you agree with this aspect of the proposal? Please provide your rationale for agreement or disagreement. (See paragraphs 48, 49, and 89.)

105 **Question 4.** This proposal provides that the Statement of Net Cost would include the cost of those Major End Items destroyed or removed from service, as well as the cost of any programs terminated during the period, without some form of periodic recognition of the cost of using Major End Items. For capitalized Mission Support Items, the Statement of Net Cost would include a provision for recognizing an estimate of the cost of using Mission Support Items during the period (i.e., depreciation expense) as well as the undepreciated cost of any Mission Support Items destroyed. Do you agree with this aspect of the proposal? Please provide your rationale for agreement or disagreement. (See paragraphs 20, 24, and 70 through 76.)

106 **Question 5.** The Board proposes that as each Major End Item is placed in service, a pro rata portion of the program's total estimated cleanup cost attributed to that unit should be recognized as a part of the cost of the Major End Item and as a liability. The cleanup cost would then be recognized as an expense on the Statement of Net Cost along with the rest of the cost of the Major End Item when the Major End Item is removed from service. For Mission Support Items, a pro rata portion of the total estimated cleanup cost would be recognized as a liability and expense during each year the PP&E is in service. Thus, the timing of liability recognition is different for the two categories of ND PP&E. Do you agree with this aspect of the proposal? Please provide your rationale for agreement or disagreement. (See paragraphs 37, 39, 43, and 84 through 88.)

107 **Question 6.** The Board proposes a 4 -year period for full implementation of the standards with earlier implementation of quantity and condition reporting. Do you agree with the 4 -year implementation period? Please provide your rationale for agreement or disagreement. (See paragraphs 8 through 11, 90, and 91.)

108 **Question 7.** The Board proposes disclosures for the 10 largest current ND PP&E Major Acquisition Programs—measured in planned dollar amounts—that are in process during the reporting period. The proposed reporting requirements for each project include planned and actual expenditures, and the planned (both current and prior plans) and actual units to be acquired. The proposed ND PP&E Major Acquisition Program reporting requirements include planned expenditures on and the number of units to be acquired. Would the information be useful to readers of the financial statements? Please explain your rationale for each answer and consider what other sources of information might be available for this information. (See paragraphs 31, 32, 82, and 95 through 97.)

109 **Question 8.** The Board proposes that the quantities of ND PP&E Major End Items be disclosed as basic information. Is the requirement to report the quantities of ND PP&E Major End Items beneficial? Would the reader of the financial statements find this information useful? Please explain the rationale for your answer. (See paragraphs 28, 79, 80, and 98.)

110 **Question 9.** The Board proposes that condition information on ND PP&E Major End Items be reported as Required Supplementary Information (RSI). Would deferred maintenance amounts reported in the annual financial statements as required by SFFAS No. 6 (as amended by

SFFAS No. 14) be an adequate indicator of the condition of ND PP&E? Would reporting the condition of ND PP&E information be beneficial and useful to readers of the financial statements? Please explain your rationale for each answer. (See paragraphs 29, 30, 79, 81, 99, and 100.)

111 **Question 10**. The Board proposes that the capitalized cost of ND PP&E consists of: 1) costs incurred under acquisition program or acquisition contracts; and 2) costs incurred for property and equipment acquired for exclusive use in accomplishing an acquisition program or acquisition contract. (These costs are currently funded in the Department of Defense's investment appropriations—research, development, test, and evaluation and procurement.) Do you agree with the aspects of the proposals? Please provide your rationale for agreement or disagreement. (See paragraphs 19 and 68.)

112 **Question 11.** It also proposes that an estimate for the combined costs incurred during the reporting period of all Program Management Offices responsible for the acquisition of ND PP&E be reported as Required Supplementary Information (RSI). Do you agree with the aspects of the proposal? Please provide your rationale for agreement or disagreement. (See paragraphs 34 and 78.)

APPENDIX E: GLOSSARY

Acquisition Program. An acquisition program is a directed, funded effort that is designed to provide new or improved ND PP&E in response to an operational need or to provide for the continued capability of existing ND PP&E. ND PP&E is generally acquired using the acquisition program process. (Accounting for National Defense PP&E and Associated Cleanup Costs ED, September 2001, page 6, footnote 10)

Advanced Technology Development. The systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and producibility (excludes the development of hardware for use). Employs demonstration activities intended to prove or test a technology or method. (Department of Defense Financial Management Regulation)

Applied Research. The systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs could include scientific studies, investigations, research papers, hardware components, software codes and non-system specific development efforts. (Department of Defense Financial Management Regulation)

Basic Research. The systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of a fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers. (Department of Defense Financial Management Regulation)

Capitalize. To record and carry forward into one or more future periods any expenditure the benefits or proceeds from which will then be realized. (SFFAS No.6)

Composite Allocation Methodology. The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. (Kohler's Dictionary for Accountants)

Depreciation Expense. The systematic and rational allocation to expense of the acquisition cost of an asset, less its estimated salvage or residual value over its estimated useful life. (Adapted from SFFAS No. 6)

Group Allocation Methodology. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives. (Kohler's Dictionary for Accountants)

Latest Acquisition Cost. Provides that an item be valued at the cost of the most recent like item purchased, less any discounts, plus any additional costs incurred to bring the item to a form and location suitable for its intended use. (SFFAS No. 8)

Major End Items. Major End Items are 1) items that launch, release, carry, or fire a particular piece of ordnance, and 2) items that carry weapons systems-related property, equipment, materials, or personnel. Major End Items (a) have an indeterminate or unpredictable useful life due to the manner in which they are used, improved, modified, or maintained and (b) are subject to premature destruction or obsolescence (e.g., aircraft, ships, combat vehicles, etc.) Also, included in this category are vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. (Accounting for National Defense PP&E and Associated Cleanup Costs ED, September 2001, page 6, paragraph 13 a.)

Major ND PP&E Acquisition Programs. Represent the 10 largest (in planned dollar terms) current acquisition programs within the Department of Defense. (Accounting for National Defense PP&E and Associated Cleanup Costs ED, September 2001, page 12, footnote 21)

Military Missions. Defined as the functions performed by the military departments to prepare for the effective pursuit of war and military operations short of war; to conduct combat, peacekeeping, and humanitarian military operations; and to support civilian authorities during civil emergencies. (SFFAS No.11)

Mission Support Items Mission Support Items are 1) all of the remaining ND PP&E items that are used in the performance of military missions and not categorized as Major End Items, and 2) Defense systems (e.g., National Missile Defense System, command and control systems, intelligence and communications systems, etc.), that are used in the performance of military missions. (Accounting for National Defense PP&E and Associated Cleanup Costs ED, September 2001, page 6, paragraph 13b.)

National Defense Property, Plant, and Equipment (ND PP&E). PP&E used in the performance of military missions by the Department of Defense or its component entities and vessels in the Maritime Administration's National Defense Reserve Fleet. ND PP&E excludes PP&E accounted for in business operating activities, non-ballistic missiles, real property, and ND PP&E component parts held as spares. (Accounting for National Defense PP&E and Associated Cleanup Costs ED, September 2001, page 5, paragraph 12)

Recognize. To record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts. (SFFAS No. 6)

Replacement Cost. The estimated cost of acquiring new and substantially equivalent property at current prices. (Kohler's Dictionary for Accountants)

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