
Statement of Federal Financial Accounting Standards 3: Accounting for Inventory and Related Property

Status

Issued	October 27, 1993
Effective Date	For fiscal years ending September 30, 1994 and thereafter
Interpretations and Technical Releases	TR 4, <i>Reporting on Nonvalued Seized and Forfeited Property</i> , provides recommended disclosure guidance for all material non-valued seized property.
Affects	None.
Affected by	<ul style="list-style-type: none">• SFFAS 7, paragraphs 264-269, affects SFFAS 3, paragraphs 69, 70, 72 and 74-77, plus Table 2, Summary of Accounting Standards, and Table 1, Summary of Accounting Standards-- Forfeited Property, by providing additional accounting standards regarding revenue recognition for forfeited property.• SFFAS 32 amends paragraphs 28, 30, 35, 50, 55, 56, 66, 71, 78, 91, and 109

Summary

This statement provides accounting standards that apply to several types of tangible property, other than long term fixed assets, held by federal government agencies. These accounting standards cover the following assets:

- inventory (i.e., items held for sale);
- operating materials and supplies;
- stockpile materials;
- seized and forfeited property;
- foreclosed property; and
- goods held under price support and stabilization programs (including nonrecourse loans and purchase agreements).

Inventory Held For Sale

The standards require reporting of inventory by categories as follows: (1) inventory held for sale, (2) inventory held in reserve for future use, (3) excess, obsolete, and unserviceable inventory, and (4) inventory held for repair.

The standards require historical cost or latest acquisition cost valuation of inventory held for sale and inventory held in reserve for future sale. The standards permit use of any other valuation method (e.g., standard cost) which reasonably approximates historical cost. When historical cost

valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. The standards do not provide for use of the last-in, first-out cost flow assumption or lower of cost or market valuation. When latest acquisition cost valuation is used the inventory is revalued periodically and an allowance account is established for unrealized holding gains and losses.

Excess, obsolete and unserviceable inventory is to be valued at net realizable value. Inventory held for repair is to be valued at either historical cost or latest acquisition cost less an allowance for the estimated repair cost.

Operating Materials and Supplies

Operating materials and supplies are to be accounted for under the consumption method and valued at historical cost or any method approximating historical cost (e.g., standard cost or latest acquisition cost). When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. In addition, categories for (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies must be reported.

An exception to the consumption method is provided when (1) the operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method. In any of these events, the purchases method may be used.

Stockpile Materials

Stockpile materials are to be accounted for through the consumption method using the historical cost valuation or any method that reasonably approximates historical cost. When historical cost valuation is used, acceptable cost flow assumptions include the first-in, first-out, weighted average or moving average cost flow assumptions. The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) damage or decay shall be reduced to the expected net realizable value of the material.

Seized and Forfeited Property

The market value of seized property other than monetary instruments is to be disclosed in the notes to the financial statements. Seized monetary instruments are recognized as assets with an

offsetting liability. This treatment was provided to foster a higher level of control over seized monetary instruments.

Forfeited property is recognized as an asset upon forfeiture and valued at market value less any liens. Revenue recognition is deferred until sale except for monetary instruments. Special provisions are made for items seized in satisfaction of tax liabilities and for transfer of the property to government entities for their use.

Foreclosed Property

Foreclosed property must be classified as Post-1991 property or Pre-1992 property to remain consistent with the provisions of the Credit Reform Act of 1990. Post-1991 property is associated with loans or loan guarantees issued after September 30, 1991 and is valued at its net present value. Pre-1992 property is associated with loans or loan guarantees issued before September 30, 1991 and is valued at the lower of cost or net realizable value.

Goods Held Under Price Support and Stabilization Programs

Goods held under price support and stabilization programs (e.g., commodities) are valued at the lower of cost or net realizable value. For nonrecourse loan amounts the standards provide that allowances be established for expected losses and losses recognized if it is more likely than not that they will occur and the losses are measurable. For purchase agreements, the standards provide that contingent liabilities be established and losses recognized if it is more likely than not that a loss will occur and that the loss is measurable.

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Executive Summary

1. This is the third statement of recommended accounting standards issued by the Federal Accounting Standards Advisory Board (referred to as FASAB or the Board). The standards presented in this document apply to several types of tangible property, other than long term fixed assets, held by federal government agencies.
2. These accounting standards cover the following assets:
 - inventory (i.e., items held for sale);
 - operating materials and supplies;
 - stockpile materials;
 - seized and forfeited property;
 - foreclosed property; and
 - goods held under price support and stabilization programs (including nonrecourse loans and purchase agreements).¹
3. The following tables summarize the provisions in the recommended accounting standards. The tables highlight the **major** provisions; they should not be substituted for close review of the standards themselves.

¹As well as addressing the commodities acquired through price support and stabilization programs, this standard addresses nonrecourse loans and purchase agreements.

Table 1: Summary of Accounting Standards

Standard	Description	Valuation methods	Recognition requirements and comments
Inventory	Tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be used in the provision of services for a fee.	(1) Historical cost or any other valuation methods which approximate historical cost (2) Latest acquisition cost	An asset upon receipt of title or goods. As cost of goods sold upon delivery to buyer. For latest acquisition cost, an allowance account will be established equal to the cumulative unrealized holding gains/losses associated with ending inventory. Categories will be established for inventory held for sale; inventory held in reserve for future sale; excess, obsolete and unserviceable inventory; and inventory held for repair.
Operating materials and supplies	Tangible personal property to be consumed in normal operations	Historical cost or any other valuation methods which approximate historical cost.	The consumption method shall be applied. However, if operating materials and supplies are (1) not significant amounts, (2) in the hands of the end-user, or (3) if it is not cost beneficial to apply the consumption method, the purchases method may be applied. Categories will be established for operating materials and supplies; operating materials and supplies held in reserve for future use; excess, obsolete and unserviceable operating materials and supplies; and operating materials and supplies held for repair.
Stockpile materials	Strategic and critical materials held due to statutory requirements for use in national defense, conservation, or national emergencies	Historical cost or any other valuation methods which approximate historical cost	As an asset upon receipt of title or goods. As an expense upon disposal, use, or sale.

Table 2: Summary of Accounting Standards

Standard	Description	Valuation methods	Recognition requirements and comments
Seized and forfeited property	Monetary instruments and property acquired as a result of forfeiture proceedings	Market value	As an asset upon forfeiture with a deferred revenue established. ^a As revenue upon sale or disposition of nonmonetary forfeited property. As revenue upon forfeiture for monetary instruments.
Foreclosed property	Assets received in satisfaction of a loan receivable or as a result of a claim under a guaranteed or insured loan	Post-1991; ^b net present value Pre-1992; ^c lower of cost or net realizable value	As an asset upon foreclosure
Commodities	Items acquired, held, sold or otherwise disposed of to stabilize or support market prices	Lower of cost or net realizable value	As an asset upon receipt. As a loss on farm price support if the net realizable value is less than the cost at acquisition. As an expense upon disposal or use.
Commodity nonrecourse loans	Short-term loans with commodities pledged as collateral	The principal amount of the loan less any allowance for expected losses	As an asset upon issuance. As a loss on farm price support at reporting date if they are more likely than not and measurable.
Commodity purchase agreements	Agreements to purchase commodities at a given price at the option of the seller	Estimated amount of the contingent loss	As a contingent liability if the loss is more likely than not and measurable.

^a Seized property other than monetary instruments would not be recognized as the entity's asset since it is not owned by the government. However, the market value of seized property should be disclosed in notes to the financial statements. This recognizes that the entity has a fiduciary responsibility for the property.

Seized monetary instruments are recognized as assets with an offsetting liability to recognize the potential for remission to the owners. This treatment was provided in order to maintain a higher level of financial control over seized monetary instruments.

^b "Post-1991" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees committed after September 30, 1991.

^c "Pre-1992" refers to foreclosed property that is received in satisfaction of loans obligated or loan guarantees committed before October 1, 1991. In addition, any programs or agencies that are specifically exempt from the provisions of the Federal Credit Reform Act should follow accounting provisions for "pre-1992" property.

Introduction

Objective

4. In this Statement, the Board recommends accounting standards for six assets of the federal government and its entities. The first group of assets addressed, those formerly referred to as “inventory,” includes inventory held for sale, operating materials and supplies, stockpile materials, and commodities. The decision to include other assets held for sale resulted in adding two items: (1) seized and forfeited property and (2) foreclosed property.

Approach

5. Following publication of the Board’s Exposure Draft Accounting for Inventory and Related Property on January 8, 1993, the Board received comments from 44 organizations and individuals. A public hearing, at which eight people presented oral comments on the Exposure Draft, was held on April 21 and 22, 1993.
6. In preparing this Statement of recommended standards, the Board considered all the comments received and incorporated changes, as appropriate. The issues raised and the specific changes made are discussed in Appendix A, “Basis of the Board’s Conclusions.”

Materiality

7. The Board intends that the standards’ application be limited to items that are material. “Materiality” has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The Board relies on the Financial Accounting Standards Board’s (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board’s position on the issue of materiality at this time.
8. The accounting and reporting provisions of the Board’s accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.
9. FASB’s Statement of Accounting Concepts No. 2, “Qualitative Characteristics of Accounting Information,” discusses the concept of materiality. According to this statement, the

determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user.

10. The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.
11. In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.
12. This is expressed well in the Government Auditing Standards (the "Yellow Book"):

"In government audits the materiality level and/or threshold of acceptable risk may be lower than in similar-type audits in the private-sector because of the public accountability of the entity, the various legal and regulatory requirements, and the visibility and sensitivity of government programs, activities, and functions." (Ch. 3, par. 33.)
13. While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.
14. Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgment of the entity's efficiency and effectiveness and its compliance with laws and regulations in a material manner.
15. In order to emphasize that materiality should be considered in applying all accounting standards, the Board has decided to place a notice at the end of each recommended accounting standard. The notice will read as follows:

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

Effective Date

16. The Board recommends that the accounting standards presented in this Statement become effective for fiscal year ending September 30, 1994, and thereafter. Earlier implementation is encouraged.

Inventory

17. **Definition.** “Inventory” is tangible personal property that is (1) held for sale, (2) in the process of production for sale, or (3) to be consumed in the production of goods for sale or in the provision of services for a fee. The term “held for sale” shall be interpreted to include items for sale or transfer to (1) entities outside the federal government, or (2) other federal entities. The principal objective of the sale or transfer of inventory is to provide a product or service for a fee that generally recovers full cost or an identified portion of the cost. “Other federal entities” may include entities within the same organization/agency. Sales transactions may be executed through transfer of funds between federal entities; it is not essential that the transaction be an exchange of goods for cash or cash equivalents. In addition, inventory may be acquired through donation or barter. Inventory excludes some other assets held for sale, such as (1) stockpile materials, (2) seized and forfeited property, (3) foreclosed property, and (4) goods held under price support and stabilization programs. These items may be sold; however, the purpose of acquiring them is not to provide a product or a service for a fee.
18. Inventory shall be categorized as (1) inventory held for sale, (2) inventory held in reserve for future sale, (3) excess, obsolete and unserviceable inventory, or (4) inventory held for repair. These categories are defined in paragraphs 17, 27, 29, and 32 respectively.
19. **Recognition.** Inventory shall be recognized when title passes to the purchasing entity or when the goods are delivered to the purchasing entity. Upon sale (when the title passes or the goods are delivered) or upon use in the provision of a service, the related expense shall be recognized and the cost of those goods shall be removed from inventory. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.
20. **Valuation.** Inventory shall be valued at either (1) historical cost or (2) latest acquisition cost.
21. (1) Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated inventory shall be valued at its fair value at the time of donation. Inventory acquired

through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.

22. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions may be applied in arriving at the historical cost of ending inventory and cost of goods sold. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost system).
23. (2) The latest acquisition cost method provides that the last invoice price² (i.e., the specific item's actual cost used in setting the current year stabilized standard [sales] price) be applied to all like units held including those units acquired through donation or nonmonetary exchange. The inventory shall be revalued periodically but at least at the end of each fiscal year. Revaluation results in recognition of unrealized holding gains/losses³ in the ending inventory value. Upon adjustment for unrealized holding gains/losses, the latest acquisition cost method then results in an approximation of historical cost.
24. An allowance for unrealized holding gains/losses in inventory shall be established to capture these gains/losses. The ending balance of this allowance shall be the cumulative difference between the historical cost, based on estimated or actual valuation, and the latest acquisition cost of ending inventory. The balance shall be adjusted each time the inventory balance is adjusted. The adjustment necessary to bring the allowance to the appropriate balance shall be a component of cost of goods sold for the period as described below.
25. The cost of goods sold for the period shall be computed as follows:

Beginning inventory at beginning-of-the-period latest acquisition cost
 less: beginning allowance for unrealized holding gains/losses
plus: actual purchases
 Cost of Goods Available for Sale
 less: ending inventory at end-of-the-period latest acquisition cost
plus: ending allowance for unrealized holding gains/losses
Cost of Goods Sold

²This unit value is referred to as the latest acquisition cost for the remainder of this standard.

³“Holding gains (or losses)” result from holding assets in periods of changing prices. Under historical cost methods, holding gains (or losses) are not separately recognized even though they exist. Under the latest acquisition cost method, holding gains (or losses) will be recognized in the valuation of inventory since that value is adjusted periodically to present the more current latest acquisition costs. These gains or losses are unrealized holding gains or losses.

“Unrealized” refers to any gain or loss associated with inventory still held by the entity. “Realization” of the holding gain or loss occurs only when an item of inventory is sold.

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26. **Exception to Valuation.** Valuing inventories at expected net realizable value is acceptable if there is (1) an inability to determine approximate costs, (2) immediate marketability at quoted prices, and (3) unit interchangeability (e.g., petroleum reserves). Application of this exception may result in inventories being valued at greater than historical cost.

Other Categories of Inventory

27. **Inventory Held in Reserve for Future Sale.** Inventory stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed (although not necessarily in the normal course of operations). These stocks shall be classified as inventory held in reserve for future sale. Inventory held in reserve for future sale shall be valued using the same basis as inventory held for sale in normal operations. The value of inventory held in reserve for future sale shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.
28. The criteria considered by management in identifying inventory held in reserve for future sale shall be disclosed. **Examples** of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items (including the storage and handling costs), (2) the expected replacement cost when needed, (3) the time required to replenish inventory, (4) the potential for deterioration or pilferage, and (5) the likelihood that a supply of the items will be available in the future. The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements.
29. **Excess, Obsolete, and Unserviceable Inventory.** “Excess inventory” is inventory stock that exceeds the demand expected in the normal course of operations because the amount on hand is more than can be sold in the foreseeable future and that does not meet management’s criteria to be held in reserve for future sale. “Obsolete inventory” is inventory that is no longer needed due to changes in technology, laws, customs, or operations. “Unserviceable inventory” is damaged inventory that is more economical to dispose of than to repair. The category “excess, obsolete and unserviceable inventory” shall be either (1) included in the inventory line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.
30. Such inventory shall be valued at its expected net realizable value. The difference between the carrying amount of the inventory before identification as excess, obsolete or unserviceable and its expected net realizable value shall be recognized as a loss (or gain) and either separately reported or disclosed. Any subsequent adjustments to its net realizable

value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain). The U.S. government-wide financial statements need not separately report or disclose the difference between the carrying amount of the inventory and its expected not realizable value.

31. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete and unserviceable inventory.
32. **Inventory Held for Repair.** Inventory held for repair may be treated in one of two ways: (1) the allowance method or (2) the direct method.
 - (1) Under the allowance method, inventory held for repair shall be valued at the same value as a serviceable item. However, an allowance for repairs contra-asset account (i.e., repair allowance) shall be established. The annual (or other period) credit(s) required to bring the repair allowance to the current estimated cost of repairs shall be recognized as current period operating expenses. As the repairs are made the cost of repairs shall be charged (debited) to the allowance for repairs account.
 33. (2) Under the direct method, inventory held for repair shall be valued at the same value as a serviceable item less the estimated repair costs. When the repair is actually made, the cost of the repair shall be capitalized in the inventory account up to the value of a serviceable item. Any difference between the initial estimated repair cost and the actual repair cost shall be either debited or credited to the repair expense account.
34. Transition to either of these two methods may result in recognizing an accumulated amount of needed repairs that were not previously accounted for. To avoid overstating repair expense for the first period that repair expense is accrued, prior period amounts are to be separately identified or estimated. The estimated amount to repair inventory that is attributable to prior periods shall be credited to the repair allowance under the repair allowance method or to the inventory account under the direct method and reported as an adjustment to equity.

Disclosure Requirements

35.
 - General composition of inventory.
 - Basis for determining inventory values; including the valuation method and any cost flow assumptions.
 - Changes from prior year's accounting methods; if any.
 - Balances for each of the following categories of inventory; inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements.
 - Restrictions on the sale of material.

- The decision criteria for identifying the category to which inventory is assigned.
- Changes in the criteria for identifying the category to which inventory is assigned
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Operating Materials And Supplies

36. **Definition.** “Operating materials and supplies” consist of tangible personal property to be consumed in normal operations. Excluded are (1) goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity, (2) stockpile materials, (3) goods held under price stabilization programs, (4) foreclosed property, (5) seized and forfeited property, and (6) inventory.
37. Operating materials and supplies shall be categorized as (1) operating materials and supplies held for use, (2) operating materials and supplies held in reserve for future use, or (3) excess, obsolete and unserviceable operating materials and supplies. These categories are defined in paragraphs 36, 45, and 47 respectively.
38. **Recognition.** The consumption method of accounting for the recognition of expenses shall be applied for operating materials and supplies. Operating materials and supplies shall be recognized and reported as assets when produced or purchased. “Purchased” is defined as when title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery.
39. The cost of goods shall be removed from operating materials and supplies (i.e., the asset account) and reported as an operating expense in the period they are issued to an end user for consumption in normal operations.
40. If (1) operating materials and supplies are not significant amounts, (2) they are in the hands of the end user for use in normal operations, or (3) it is not cost-beneficial to apply the consumption method of accounting, then the purchases method may be applied to operating materials and supplies. The purchases method provides that operating materials and supplies be expensed when purchased.

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41. An end user is any component of a reporting entity that obtains goods for direct use in the component's normal operations. Any component of a reporting entity, including contractors, that maintains or stocks operating materials and supplies for future issuance shall **not** be considered an end user.
 42. **Valuation Under the Consumption Method.** Operating materials and supplies shall be valued on the basis of historical cost.
 43. Historical cost shall include all appropriate purchase and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. Donated operating materials and supplies shall be valued at their fair value at the time of donation. Operating materials and supplies acquired through exchange of nonmonetary assets (e.g., barter) shall be valued at the fair value of the asset received at the time of the exchange. Any difference between the recorded amount of the asset surrendered and the fair value of the asset received shall be recognized as a gain or a loss.
 44. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of ending operating materials and supplies and cost of goods consumed. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).

Other Categories of Operating Materials and Supplies

45. **Operating Materials and Supplies Held in Reserve for Future Use.** Operating materials and supplies stocks may be maintained because they are not readily available in the market or because there is more than a remote chance that they will eventually be needed, although not necessarily in the normal course of operations. These stocks shall be classified as operating materials and supplies held in reserve for future use. Operating materials and supplies held in reserve for future use shall be valued using the same basis as operating materials and supplies held for use in normal operations. The value of operating materials and supplies held in reserve for future use shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements. Such materials and supplies shall be valued the same as operating materials and supplies held for use in normal operations.
46. The criteria considered by management in identifying operating materials and supplies held in reserve for future use shall be disclosed. Examples of factors to be considered in developing the criteria are (1) all relevant costs associated with holding these items

(including the storage and handling costs); (2) the expected replacement cost when needed; (3) the time required to replenish operating materials and supplies; (4) the potential for deterioration or pilferage; and (5) the likelihood that a supply of the item will be available in the future.

47. **Excess, Obsolete, and Unserviceable Operating Materials and Supplies.** “Excess operating materials and supplies” are operating materials and supplies stocks that exceed the amount expected to be used in normal operations because the amount on hand is more than can be used in the foreseeable future and that do not meet management’s criteria to be held in reserve for future use. “Obsolete operating materials and supplies” are operating materials and supplies that are no longer needed due to changes in technology, laws, customs, or operations. “Unserviceable operating materials and supplies” are operating materials and supplies that are physically damaged and cannot be consumed in operations. The category “excess, obsolete and unserviceable operating materials and supplies” shall be either (1) included in the operating materials and supplies line item on the face of the financial statements with separate disclosure in footnotes or (2) shown as a separate line item on the face of the financial statements.
48. Such operating materials and supplies shall be valued at their estimated net realizable value. The difference between the carrying amount of the operating materials and supplies before identification as excess, obsolete or unserviceable and their estimated net realizable value shall be recognized as a loss (or gain) and either reported separately or disclosed. Any subsequent adjustments to their estimated net realizable value or any loss (or gain) upon disposal shall also be recognized as a loss (or gain).
49. Management shall develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies.

Disclosure Requirements

50. • General composition of operating materials and supplies.
- Basis for determining operating materials and supplies values; including valuation method and any cost flow assumptions.
 - Changes from prior year’s accounting methods, if any.
 - Balances for each of the categories of operating materials and supplies described above.
 - Restrictions on the use of material.
 - Decision criteria for identifying the category to which operating materials and supplies are assigned.
 - Changes in the criteria for identifying the category to which operating materials and supplies are assigned.

- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Stockpile Materials

51. **Definition.** “Stockpile materials” are strategic and critical materials held due to statutory requirements for use in national defense, conservation or national emergencies. They are not held with the intent of selling in the ordinary course of business. The following items are specifically excluded from stockpile materials: (1) items that are held by an agency for sale or use in normal operations (see proposed standards for inventory and operating materials and supplies), (2) items that are held for use in the event of an agency’s operating emergency or contingency (see proposed standard for operating materials and supplies), and (3) materials acquired to support market prices (see proposed standard for goods held under price support and stabilization programs).
52. **Recognition.** The consumption method of accounting for the recognition of expense shall be applied for stockpile materials. These materials shall be recognized as assets and reported when produced or purchased. “Purchase” is defined as the date that title passes to the purchasing entity. If the contract between the buyer and the seller is silent regarding passage of title, title is assumed to pass upon delivery of the goods. The cost of stockpile materials shall be removed from stockpile materials and reported as an operating expense when issued for use or sale.
53. **Valuation.** Stockpile materials shall be valued on the basis of historical cost. Historical cost shall include all appropriate purchase, transportation and production costs incurred to bring the items to their current condition and location. Any abnormal costs, such as excessive handling or rework costs, shall be charged to operations of the period. The first-in, first-out (FIFO); weighted average; or moving average cost flow assumptions shall be applied in arriving at the historical cost of stockpile materials. In addition, any other valuation method may be used if the results reasonably approximate those of one of the above historical cost methods (e.g., a standard cost or latest acquisition cost system).
54. **Exception to Valuation.** The carrying amount of materials that have suffered (1) a permanent decline in value to an amount less than their cost or (2) 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 or an expense⁴ in the period in which it occurs.

⁴The decline in value shall be considered an expense if it is an expected decline in the normal course of operations.

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55. **Held for Sale.** When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. The materials authorized for sale shall be valued using the same basis used before they were authorized for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed. The cost of stockpile materials shall be removed from stockpile materials and reported as cost of goods sold when sold. Any gain (or loss) upon disposal shall be recognized as a gain (or loss) at that time. The U.S. government-wide financial statements need not separately report or disclose any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price.

Disclosure Requirements

56. • General composition of stockpile materials.
- Basis for valuing stockpile materials; including valuation method and any cost flow assumption.
 - Changes from prior year's accounting methods, if any.
 - Restrictions on the use of materials.
 - Balances of stockpile materials in each category described above (i.e., stockpile materials and stockpile materials held for sale).
 - Decision criteria for categorizing stockpile materials as held for sale.
 - Changes in criteria for categorizing stockpile materials as held for sale.
 - The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Seized and Forfeited Property

57. As a consequence of various laws, certain property is seized by authorized law enforcement agencies. In some instances, there may be as many as three government entities involved with seized property. The first is the seizing agency. Second, the seizing agency may turn the property over to a custodial agency. Third, financial records may be maintained by a "central fund" created to support the seizure activities of multiple agencies. Alternatively, the seizing agency may carry out one or both of the custodial agency or central fund roles.
58. The seized assets may be subsequently forfeited to the government through abandonment or administrative or judicial procedures. The forfeited property is then sold, converted for use by the government, or transferred to other governmental entities. Because this property is first seized, then all or a portion of it is forfeited, this standard separately addresses the

accounting and reporting for seized property and the accounting and reporting for forfeited property.

Seized Property

59. **Definition.** “Seized property” includes monetary instruments, real property and tangible personal property of others in the actual or constructive possession of the custodial agency.
60. **Recognition.** Seized property shall be accounted for in the financial records of the entity that is operating as the central fund.⁵
61. Seized monetary instruments shall be recognized as seized assets when seized. In addition, a liability shall be established in an amount equal to the seized asset value. Seized monetary instruments are recognized upon seizure due to (1) the fungible nature of monetary instruments and (2) the high level of control over the assets that is necessary.
62. Seized property other than monetary instruments shall be disclosed in the footnotes. The value of the seized property shall be accounted for in an agency’s property management records until the property is forfeited, returned, or otherwise liquidated.
63. **Valuation.** Seized property shall be valued at its market value⁶ when seized or, if market value cannot be readily determined, as soon thereafter as reasonably possible. Market value shall be based on the value of the property assuming an active market exists for the property. If no active market exists for the property in the general area in which it was seized, a value in the principal market nearest the place of seizure shall be used.
64. **Exceptions to Valuation.** Valuation of property seized under the Internal Revenue Code shall be based on the taxpayer’s equity, that is, market value less any third-party liens.
65. Seized monetary instruments shall be valued at their market value.

⁵If the central fund is other than the seizing or custodial agency, the latter should maintain sufficient internal records to carry out its stewardship responsibility.

⁶“Market value” is the estimated amount that can be realized by disposing of an item through arm’s length transactions in the marketplace or the price (usually representative) at which bona fide sales have been consummated for products of like kind, quality, and quantity in a particular market at any moment of time. For investments in marketable securities, the term refers to the per-unit market price of a security times the number of units of that security held.

Disclosure Requirements

66. • Explanation of what constitutes a seizure and a general description of the composition of seized property.
- Method(s) of valuing seizures.
 - Changes from prior year's accounting methods; if any.
 - Analysis of change in seized property, including the dollar value and number of seized properties that are (1) on hand at the beginning of the year, (2) seized during the year, (3) disposed of during the year, and (4) on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seized property and method of disposition where material.
 - The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

Forfeited Property

67. This subsection defines “forfeited property” and presents the accounting and reporting standards for it. Presented below are examples of forfeited property.
- monetary instruments,
 - intangible property,
 - real property and tangible personal property,
 - property acquired by the government in satisfaction of a tax liability, and
 - unclaimed and abandoned merchandise.
68. **Definition.** “Forfeited property” consists of (1) monetary instruments, intangible property, real property, and tangible personal property acquired through forfeiture proceedings; (2) property acquired by the government to satisfy a tax liability; and (3) unclaimed and abandoned merchandise.

[SFFAS 7, par. 264-269 affect par. 69, 70, 71, and 74 through 77.]

69. **Recognition and Valuation.** Monetary instruments shall be reclassified from seized monetary instruments to forfeited monetary instruments when forfeited. Monetary instruments shall be valued at their market value when a forfeiture judgment is obtained. When the asset is recorded, revenue shall be recognized in an amount equal to the value of the monetary instrument and the associated liability for possible remittance shall be removed.

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70. Intangible property, real property and tangible personal property shall be recorded with an offsetting deferred revenue when forfeiture judgment is obtained. The property shall be valued at its fair value at the time of forfeiture. A valuation allowance shall be established for liens or claims from a third-party. This allowance shall be credited for the amount of any expected payments to third-party claimants.
71. Forfeited property that cannot be sold due to legal restrictions but which may be either donated or destroyed shall be subject to the disclosure requirements described below. However, no financial value shall be recognized for these items. The U.S. government-wide financial statements are not subject to the disclosure requirements for forfeited property that cannot be sold due to legal restrictions.
72. Revenue from the sale of property shall be recognized when the property is sold.
73. Property not held for sale may be
- placed into official use,
 - transferred to another federal government agency,
 - distributed to a state or local law enforcement agency, or
 - distributed to a foreign government.
74. When a determination is made that property will be distributed in one of the ways described above and not held for sale, the property shall be reclassified as forfeited property held for donation or use. Revenue associated with property not disposed of through sale shall be recognized upon approval of distribution and the previously established deferred revenue shall be reversed.
75. Revenue shall be classified as it arises from sale or from disposition, and this distinction shall be maintained in the entity's accounting reports.
76. Property acquired by the government in satisfaction of a taxpayer's liability shall be recorded when title to the property passes to the federal government. At that time, a credit shall be made to the related account receivable. The property shall be valued at its market value less any third-party liens. Upon sale of the property, revenue shall be recognized in the amount of the sale proceeds and the property and the third-party liens are removed from the accounts.
77. Unclaimed and abandoned merchandise shall be recorded with an offsetting deferred revenue when statutory and/or regulatory requirements for forfeiture have been met. The merchandise shall be valued at its market value. Upon sale of the merchandise, revenue shall be recognized in the amount of the sale proceeds and the merchandise and the deferred revenue are removed from the accounts.

Disclosure Requirements

78. • Composition of forfeited property.
- Method(s) of valuing forfeited property.
 - Restrictions on the use or disposition of forfeited property.
 - Changes from prior year's accounting methods, if any.
 - Analysis of change in forfeited property providing the dollar value and number of forfeitures that (1) are on hand at the beginning of the year, (2) are made during the year, (3) are disposed of during the year and the method of disposition, and (4) are on hand at the end of the year. This information would be presented by type of property forfeited where material.
 - If available, an estimate of the value of property or funds to be distributed to federal, state and local agencies in future reporting periods.
 - The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Table 1: Summary Of Accounting Standard—Forfeited Property

Category of property	Method of disposition	Valuation method	Recognized as assets	Recognized as revenue
Monetary instruments	Sale; proceeds credited to entity's fund	Market value	Upon seizure	Upon obtaining forfeiture judgment
Intangible property and real and tangible personal property acquired by forfeiture proceeding	Sale	Market value	Upon obtaining forfeiture judgment	Upon sale
	Transferred, distributed, or held for internal use	Market value	Upon obtaining forfeiture judgment	Upon obtaining approval to transfer, distribute or use internally
Property acquired to satisfy tax liability	Sale; proceeds credited to Treasury General Fund	Market value less amount of liens	Upon obtaining title to property	Upon sale of property
Unclaimed/ abandoned merchandise	Sale; proceeds used to reimburse other funds; excess credited to Treasury General Fund	Market value	Upon meeting statutory and/or regulatory requirements	Upon sale

Foreclosed Property

79. **Definition.** The term “foreclosed property” means any asset received in satisfaction of a loan receivable or as a result of payment of a claim under a guaranteed or insured loan (excluding commodities acquired under price support programs). All properties included in foreclosed property are assumed to be held for sale.
80. In accordance with the Federal Credit Reform Act of 1990, the remainder of this standard will refer to specific provisions for pre-1992 foreclosed property and post-1991 foreclosed property. “Pre-1992 foreclosed property” refers to property associated with **direct loans** obligated or **loan guarantees** committed before October 1, 1991. “Post-1991 foreclosed property” refers to property associated with **direct loans** obligated or **loan guarantees** committed after September 30, 1991. The distinction is necessary because for budget purposes, the cash flows associated with post-1991 direct loans and loan guarantees, including the cash flows associated with post-1991 foreclosed property, must be measured on a present value basis. However, pre-1992 foreclosed property need not be valued on this basis. Additionally, any programs that are specifically exempt from the use of present value techniques for determining the costs of direct loans and loan guarantees shall rely on the accounting principles provided for pre-1992 foreclosed property.⁷
81. **Valuation of Foreclosed Property.** Post-1991 foreclosed property is valued at the net present value of the projected future cash flows associated with the property. Pre-1992 foreclosed property is recorded at cost and adjusted to the lower of cost or its net realizable value; any difference is carried in a valuation allowance. Both of these methods are described further below. For either post-1991 or pre-1992 foreclosed property, other valuation methods may be used as an approximation for the above methods if no material differences in valuation will result.
82. **Net Present Value.** The first step in determining net present value is projecting the future cash flows associated with the property. The projected future cash flows shall include estimates of (1) the sales proceeds, (2) rent, management expense, and repair costs during the holding period, and (3) selling expenses (e.g., advertising and commissions). In estimating the sales proceeds, the entity’s historical experience in selling property and the nature of the sale shall be considered. For instance, market value based on sales between willing buyers and sellers may not be appropriate for properties to be disposed of in a forced or liquidation sale. If the entity has historically been unable to realize the fair value of property, this shall be considered in estimating sales proceeds.

⁷Section 506 of the Federal Credit Reform Act exempts specific agencies, such as the Federal Deposit Insurance Corporation and the Tennessee Valley Authority.

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83. The second step is to discount these cash flows to their present value. In order to place the projected cash flows on a present value basis, a discount (interest) rate must be selected. The discount rates used shall be the same rates that were used to discount the cash flows of the related loans or guarantees.
84. Following foreclosure, the net present value (measured in a manner consistent with the measurement at the time of foreclosure) shall be adjusted periodically to recognize both changes in the expected future cash flows and for accrual of interest due to the passage of time. Any adjustments to the carrying amounts shall be included in the presentation of “interest income” and the reestimate of “subsidy expense.”⁸
85. **Net Realizable Value.** Pre-1992 foreclosed property held for sale should be reported in the entity’s financial statements at expected net realizable value. The expected net realizable value shall be based on an estimate of the market value of the property adjusted for any expected losses and any other costs of the sale. The estimate of market value shall be based on (1) the market value of the property if an active market exists; (2) the market value of similar properties if no active market exists; or (3) a reasonable forecast of expected cash flows adjusted for estimates of all holding costs, including any cost of capital. In addition to considering market value, the expected net realizable value shall consider the entity’s historical experience in disposing of foreclosed properties; i.e., if the entity is typically unable to obtain market value for properties, the expected net realizable value shall be adjusted to be consistent with historically experienced losses. Additionally, if the entity will not be able to sell the property under normal market conditions or is forced to sell the property within a given time, this factor shall be considered in arriving at net realizable value.
86. If the expected net realizable value is less than the cost,⁹ a loss has occurred. This loss shall be charged to operations, and a valuation allowance shall be established. If the asset’s net realizable value subsequently increases or decreases, this amount shall be credited or charged to results of operations and the valuation allowance adjusted. However, the asset value shall not be adjusted above cost.
87. **Assets Subject to Claims of Other Parties.** If the property is taken subject to claims of the lender, debtor, or other party, these claims shall be accounted for in a valuation allowance. These claims can be in the form of a lien or a residual interest of the debtor or lender, etc. For post-1991 foreclosed property, these claims shall be recorded at their net present value at the time of foreclosure. The discount rate applied shall be the same rate that applies to the related foreclosed property. For post-1991 foreclosed property, any periodic

⁸See FASAB exposure draft No. 2, *Accounting for Direct Loans and Loan Guarantees*, September, 1992.

⁹Cost is the carrying amount of the loan at the time of foreclosure or, for a loan guarantee, the amount of the claim paid.

changes in the net present value of the claim shall be offset by a charge or a credit to “interest income” and the reestimate of “subsidy expense,” as appropriate under the standards for direct loans and loan guarantees. For pre-1992 foreclosed property, these claims shall be recorded at the expected amount of the cash required to settle the claims.

88. **Receipts and Disbursements During the Holding Period for Post-1991 Foreclosed Property.** Any receipts or disbursements associated with acquiring and holding post-1991 foreclosed property shall be charged or credited to foreclosed property. This shall include rental receipts, maintenance and repair expense, advertising costs, and any other elements of the projected cash flows considered in arriving at the net present value.
89. **Sale of Foreclosed Property.** Upon sale, any difference between the net carrying amount of foreclosed property and the net proceeds of the sale shall be recognized as a component of operating results. For post-1991 foreclosed property, interest income shall be accrued from the previous periodic adjustment in the carrying amount up to the sale date. The difference between the adjusted carrying amount and the net sales proceeds shall be recognized as a reestimate of “subsidy expense.” For pre-1992 foreclosed property, this difference shall be recognized as a gain or a loss on the sale of foreclosed property.
90. **Assets Converted From Held-for-Sale Assets to Operating Assets.** Assets not sold but placed into operation shall be removed from foreclosed property when such action is taken. If reimbursement for the transfer of assets from one program to another is made, the proceeds from the transfer shall be treated in the same manner as a sale to a third-party.

Disclosure Requirements

91. • Valuation basis used for foreclosed property.
- Changes from prior year’s accounting methods, if any.
 - Restrictions on the use/disposal of the property.
 - Balances in the categories described above.
 - Number of properties held and average holding period by type or category.
 - Number of properties for which foreclosure proceedings are in process at the end of the period.
 - The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Goods Held Under Price Support And Stabilization Programs

92. **Definition.** Goods acquired under price support and stabilization programs are referred to as commodities. “Commodities” are items of commerce or trade having an exchange value. They are acquired, held, sold, or otherwise disposed of to satisfy or help satisfy economic goals.
93. In conducting price support operations, the money is frequently disbursed in the form of “nonrecourse loans.” Recipients of such loans pledge specific farm commodities as collateral for the loans and have the alternatives of redeeming the loans (repaying them with interest) or surrendering the commodities in exchange for the outstanding loan balance.
94. Besides acquiring commodities through surrender of collateral for nonrecourse loans, an entity may acquire commodities by a purchase settlement. A purchase settlement is exercised on the basis of a purchase agreement between a producer and the Commodity Credit Corporation (CCC). On the basis of the agreement, a producer has the option to sell commodities to CCC and receive full payment for the commodity at the price support rate. The amount of the purchase settlement is calculated by multiplying the price support rate by the number of units purchased by the CCC. Support price rates are set by law.
95. Because nonrecourse loans and purchase agreements are closely associated with the acquisition of the actual commodities, the three components of the price support program are addressed in this accounting standard.
96. **Recognition.** Nonrecourse loans shall be recognized as assets when the loan principal is disbursed. These loans shall be recorded at the amount of the loan principal. Interest income shall be recognized as it is earned and an interest receivable established.
97. Purchase agreement settlements are executed at the option of the producer (seller). This creates an uncertainty regarding losses to be incurred by the purchaser. At financial statement dates a loss shall be recognized if information indicates that it is probable that a loss has been incurred on purchase agreements outstanding and the amount of the loss can be reasonably measured. The amount of the loss shall be estimated and may be based on the contract price and the expected net realizable value of the commodities to be acquired.
98. If the contingent loss is not recognized because it is less than probable or it is not reasonably measurable, disclosure of the contingency shall be made if it is at least reasonably possible that a loss may occur.

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99. Commodities shall be recognized as assets and reported on the face of the financial statements upon the producer's surrender of title to satisfy a nonrecourse loan or upon purchase by the agency.
100. Revenue shall be recognized upon the sale of commodities. At the time of sale, the carrying amount of the commodities sold shall be removed from commodities and reported as cost of goods sold.
101. The carrying amount of commodities held for other purposes shall be removed from the commodities asset account and reported as an expense upon transfer of the commodity.
102. **Valuation.** All nonrecourse loans shall be valued at the loan amount. Losses on nonrecourse loans shall be recognized when it is more likely than not that the loans will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence. The loan amount shall be preserved in the asset account as the gross value of the loan. When the loss is recognized, a valuation allowance, "allowance for losses", (a contra-asset) shall be established to reduce the gross value to its expected net realizable value. The allowance shall be reestimated on each financial reporting date.
103. The liability for losses on purchase agreements shall be valued at the net of the contract price and the net realizable value of the commodities described in the purchase agreement.¹⁰
104. At the time of acquisition and for financial statement purposes, all commodities shall be valued at the lower of cost or net realizable value.
105. The cost for commodities acquired via a nonrecourse loan settlement is the amount of the loan principal (excluding interest), processing and packaging costs incurred after acquisition, plus other costs (e.g., transportation) incurred in taking title to the commodity.
106. The cost for commodities acquired via a purchase settlement is the unit price agreed upon in the purchase agreement multiplied by the number of units purchased by CCC plus other costs (e.g., transportation) incurred in taking title to the commodity.
107. For financial statement purposes, any adjustments necessary to reduce the carrying amount of commodities to the lower of cost or net realizable value shall be recognized as a loss on farm price support and reported in the current period. The adjustment to the carrying amount shall be recorded in a commodity valuation allowance. Recoveries of losses may be recognized up to the point of any previously recognized losses on the commodities, and the commodity valuation allowance reduced accordingly in the current period.

¹⁰Contract price is the amount the government would be committed to pay in exchange for the commodities.

108. For cost determination, any of the following cost flow assumptions may be applied in arriving at inventory balances and cost of goods sold or transferred: first-in, first-out (FIFO); weighted average; moving average; and specific identification.

Disclosure Requirements

109. • Basis for valuing commodities; including the valuation method and any cost flow assumptions.
- Changes from prior year's accounting methods, if any.
 - Restrictions on the use, disposal, or sale of commodities
 - An analysis of change in the dollar value and volume of commodities, including those (1) on hand at the beginning of the year, (2) acquired during the year, (3) disposed of during the year by method of disposition, (4) on hand at the end of the year, (5) on hand at year's end and estimated to be donated or transferred during the coming period, and (6) that may be received as a result of surrender of collateral related to nonrecourse loans outstanding. The analysis should also show the dollar value and volume of purchase agreement commitments.
 - The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosures applicable to the U.S. government-wide financial statements for these activities.

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

Appendix A: Basis Of The Board's Conclusions

110. This Appendix discusses the substantive comments that the Board received from respondents to the Exposure Draft, *Accounting for Inventory and Related Property*, issued in January 1993. The Appendix explains the Board's conclusions on issues raised by the respondents. A separate section is identified for each of the six recommended standards.

Inventory

111. Several respondents questioned the need for the various inventory categories proposed; inventory held in reserve for future sale; and excess, obsolete and unserviceable inventory. Respondents and speakers stated that (1) the requirement to segregate inventory and inventory held in reserve for future sale could result in arbitrary and subjective balance sheet allocations, (2) the category for excess, obsolete and unserviceable is unnecessary and (3) it is not cost-effective to modify systems to capture this data. However, other respondents supported the categories and indicated that they would result in more meaningful information.
112. Based on the comment letters received and the presentations at the public hearing, the objections seemed to be based on the belief that the Board intended to develop rigid guidelines for the categorization of inventory. However, it is apparent that these or similar categories are used internally by organizations. The Board is merely attempting to improve disclosure related to these categories. The Board concluded that the four categories should be maintained. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.
113. Several respondents opposed identifying the holding costs associated with inventory held in reserve for future sale. They indicated that the information has no apparent utility value, that it was virtually impossible to compute and maintain incremental holding costs for the reserve, and that disclosure would not provide managers with useful information to make relevant decisions. They also indicated that this requirement would be too subjective and difficult to audit. The Board discussed this issue and concluded that the identification of holding cost was a broad issue and deserving of more detailed treatment than could be afforded in the inventory standard. The Board agreed to drop the disclosure requirement and to defer this issue until a later project on cost issues. The same issue was raised with regard to operating materials and supplies and the same conclusion was reached.
114. In the exposure draft, the Board requested opinions on two presentation formats for cost of goods sold and the change in the allowance for holding gains and losses under latest

acquisition cost (LAC) (Par. 87). The following two cost of goods sold computations under the latest acquisition cost method were presented:

Proposed presentation: (Appendix A)	Alternative presentation: (Appendix B)
Cost of Goods Sold:	Cost of Goods Sold:
Beginning Inventory at LAC	Beginning Inventory at LAC
<u>Purchases</u>	less: Allowance
Cost of Goods Available for Sale	<u>Purchases</u>
<u>less: Ending Inventory at LAC</u>	Cost of Goods Available for Sale
Cost of Goods Sold	less: Ending Inventory at LAC
	<u>less: Allowance</u>
	Cost of Goods Sold
Nonoperating Change (Change in the Allowance for Unrealized Holding Gain/Loss on Inventory)	

115. Most respondents to the question regarding the two alternative cost of goods sold computations indicated a preference for the alternative presentation from Appendix B. These respondents stated that changes in cost were “operating” in nature and should be included in the operating results. It was also noted that comparability would be improved under the alternative treatment since cost of goods sold would approximate historical cost. Two respondents provided examples of the “distortion of cost of goods sold” that may result under the proposed presentation. The examples showed that cost of goods sold as calculated under the first proposed treatment (Appendix A of the ED) might actually be less than it would have been under historical cost.
116. In reviewing the responses, it was noted that the “nonoperating change” seems to have been confused by some respondents with the “unrealized holding gain/loss” for the period. The full title, “Nonoperating Change - Change in the Balance of the Allowance for Unrealized Holding Gains/Losses” is, although cumbersome, more descriptive. The change in the balance is made up of decreases, due to liquidation of inventory or cost decreases, and increases, due to holding more inventory or cost increases. The net change should not be confused with the “unrealized holding gain/loss” for the period.
117. The Board, after much discussion, decided to adopt the alternative presentation (Appendix B of the ED). This would avoid (1) confusion as to the significance of the “nonoperating change” and (2) distortion of the cost of goods sold. In addition, for those who wish to know the change in the allowance account, the Board decided that line items should be included in the calculation of the cost of goods sold to show the beginning and ending balances.

118. Some respondents believed that the Board should adopt the lower of cost or market (LCM) rule (traditional under Accounting Research Bulletin (ARB) 43) for valuing inventory. Respondents supporting the LCM rule stated that:

- it provides a basis for measuring the utility of inventory, and
- the operating performance financial reporting objective seems to require that matching or assigning revenues and expenses to the appropriate period be a primary concern.

119. In evaluating the LCM rule the Board considered some of the unique facets of the Federal environment:

- pricing is often based on full cost recovery regardless of changes in market pricing, and
- managers are often required to stock inventory based on legislative or mission concerns that are not driven by profit maximization (therefore, cost fluctuations are not as relevant to performance measurement).

120. The Board concluded that there was no need to include the LCM rule in the inventory standards.

121. The Board requested comments on the impact of historical cost accounting on performance measurement, and the costs and benefits of market value accounting. The majority of respondents that addressed these questions expressed a preference for historical cost accounting due to its verifiability and understandability. They also believed that market value methods were too costly to implement and subjective. Another said that for most government operations, the goal is cost recovery and market value has little relevance.

122. One Board member believes that market value information is more relevant to decision makers than historical cost information. This opinion is shared by many in the academic community. However, the Board devoted considerable resources to the issue of measuring and reporting on holding gains and losses, an essential component of market value accounting, and was unable to resolve the issues that arose in a manner that would have been cost-effective. The Board has decided to rely primarily on historical cost accounting for inventory.

123. The Board also requested comments on the standard cost using replacement cost method. The method was described in detail in Appendix C to the exposure draft. "Standard costs" are defined as predetermined or budgeted per-unit costs. Standard costs are commonly used in manufacturing concerns and are being adopted in service industries as well.

124. In a standard cost system, variances between the actual per-unit cost and the standard per-unit rate are identified. Variances are typically calculated for the individual cost components, such as materials or labor, included in the overall per-unit rate.

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125. Standard costs also provide managers useful information for managing inventory costs. As an agency purchases inventory during the year and incurs operating costs, the actual costs are compared with the standard costs to identify why the cost variances occurred. Since inventory and operating managers are evaluated against the standard, the managers have an incentive to meet the standard, which, in turn, provides for effective inventory cost control.
126. The distinction between the traditional standard cost system and that outlined in the exposure draft relates to replacement cost information. The method on which comments were requested would require standard costs based on the next period's expected replacement costs and overhead rates. Further, no adjustment to historical cost amounts would have been required for external reporting purposes.
127. The majority of the respondents cited substantially the same problems for this method as they cited for market value accounting in general. The calculations were viewed as complex, costly and subjective.
128. One Board member is concerned that this method would be excluded under the recommended standard. The Board does not believe that this is true. Standard cost systems, including replacement cost, are used internally in private industry to generate valuable management information. Standard cost information is then revised to approximate costs under historical cost bases because it is generally accepted accounting practices for financial reporting purposes. Therefore, a managerial costing system employing standards or replacement cost information that improves management's decision making could be entirely consistent with the standard so long as externally reported information approximates historical cost. Further, the Board expects to take up the issue of costing systems in a future project on cost measurement.
129. With regard to inventory held in reserve for future sale, one respondent indicated that the phrase "either reported or disclosed" (par. 39) implies off-balance sheet reporting. The respondent believes that this category should be reported on the balance sheet rather than disclosed. The Board concluded that the decision as to the level of detail shown on the balance sheet should be left to preparers and/or auditors. While the Board did not revise the standard to require reporting on the face of the financials, the language describing the reporting and disclosure options was clarified.
130. One respondent suggested that the standard be revised so that excess, obsolete and unserviceable inventory would be valued at the lower of cost or net realizable value rather than at net realizable value. The respondent indicated that any gains on excess, obsolete or unserviceable inventory due to valuation at net realizable value should be recognized only upon disposal of such inventory and not when identified as such or upon periodic revaluations. Private sector GAAP, per ARB 43, requires that losses be recognized prior to disposal of inventory but that gains not be recognized until realized. This one-sided treatment

has been criticized over the years but has survived based on the principle of conservatism that has prevailed.

131. Since the Federal government does not operate in a “for-profit” environment and does not seek financing from investors who rely on audited financial statements to make decisions, the conservative position taken in the past is not as relevant. However, the Board concluded that no change to the standard was required.
132. Some respondents commented on the absence of the last-in, first-out cost flow (LIFO) method under acceptable cost flow assumptions; stating that LIFO should be included as an acceptable option under historical cost since it tends to match current costs with current revenues. The Board did not include LIFO as an acceptable cost flow assumption due to the stale inventory values reported on the balance sheet as a result. However, the Board did permit use of any method that reasonably approximates historical cost under one of the acceptable cost flow assumptions. Therefore, LIFO could be acceptable for an entity whose inventory turns over rapidly since there may be little difference between LIFO and any other cost flow assumption.
133. One respondent requested that the standard specifically address goods: a) held on consignment, b) acquired through barter, c) donated, d) that must be maintained by statute but have no market value, or e) that will not be sold or consumed but which must be held (e.g., weights and measures). The Board concluded that goods held on consignment were not within the scope of this standard. Goods maintained by statute but having no market value, and goods that will not be sold or consumed but must be held would presumably be categorized as stockpile materials and therefore no change to the standards was warranted. The Board did decide that valuation of goods acquired through barter or donated should be addressed under the inventory, operating materials and supplies, and stockpile materials standards.

Operating Materials And Supplies

134. Respondents suggested that if a valuation method such as latest acquisition cost (LAC) is acceptable for inventory it should also be acceptable for operating materials and supplies. The Board agreed with this proposal since LAC approximates historical cost. Further, the Board believes that any method that approximates historical cost should be acceptable. The standard was revised accordingly.

Stockpile Materials

135. Respondents indicated that the definition of stockpile materials would encompass routinely held reserves as well as major stockpiles of materials. It was the Board's intention to include only those items specifically identified by law as being "stockpiled." Items routinely used but held in unusually large quantities would not be included in this category but would remain components of inventory or operating materials and supplies; possibly categorized as held in reserve for future sale or use.
136. In addition, one respondent identified helium reserves as being mandated by law for "conservation" purposes. The Board concluded that it would be consistent to include these reserves in stockpile materials. The definition has been clarified to limit stockpile materials to items held in order to comply with legal requirements established for purposes of defense, emergency or conservation.
137. As was the case for operating materials and supplies, respondents indicated that use of LAC would be appropriate for stockpile materials. The Board reached the same conclusion for this standard; that any method that approximates historical cost should be acceptable. The standard was revised accordingly.
138. One respondent suggested that an exception to permit market valuation for items that are interchangeable, have a ready market, and for which the unit cost is not determinable be added to the standard. The inventory standard provides this exception and the respondent suggested that it be available for stockpile material so that items such as strategic petroleum reserves could be valued at market value. The Board concluded that since these items are not routinely sold in large quantities the recognition of holding gains/losses may have an adverse impact on measurement of operating performance. Therefore, the exception was not added to the standard for stockpile materials.

Seized And Forfeited Assets

139. A respondent explained at the public hearing that a good portion of the forfeited assets are seized and valued under conditions which make accurate appraisals extremely difficult. As a result, there have been values reported for assets well in excess of what is eventually realized. The determination of the market value prior to the actual sale of the item is very difficult. The respondent has found that when the best estimate of market value is made on an item by item basis, the total value is still found to be overstated.
140. To avoid overstating deferred revenue, the respondent recommended that a valuation allowance be created to adjust the reported value of assets in the financial statements. The

valuation allowance would be based on historical trends or other relevant information; in a manner similar to that used to establish an allowance for uncollectible receivables. For example, information over the last six months may show sale proceeds were 5% to 10% less than appraised values. Further, the respondent believes that use of the valuation allowance would recognize the inherent difficulties in estimating market values and would present better financial information.

141. Although the proposal is not without merit, it may be an unnecessary exercise. Market value is an estimate of the amount to be realized upon disposal of the property and should take into account the marketplace in which the property is expected to be disposed of (e.g., auction, fire sale, retail or wholesale markets, etc.). The use of valuation allowances against any asset category is not prohibited. However, the Board does not believe it necessary to require the use of a valuation allowance in this circumstance.
142. One respondent requested that the standard require that, in addition to recording deferred revenue, deferred distributions be recorded. A respondent at the public hearing explained that historically as much as 50% of the forfeited property is eventually distributed to federal, state, and local law enforcement entities which participated in the case. It was further explained that once property has been forfeited, a participating state, local, or federal agency may have already applied to receive that asset because of its participation in the case. Therefore, the recording of deferred revenue could be accompanied, where appropriate, by the recording of an estimate of deferred distributions. The intent of this is to avoid reporting misleading information in the financial statements.
143. The deferred distribution would represent another level of estimates related to forfeited property. In discussions with representatives from other agencies that handle seized and forfeited property, the Board has been told that no reasonable estimate of deferred distributions was available.
144. In addition to the difficulty in estimating distributions, the Board notes that there is no legal requirement to make a specific distribution until an application has been approved. This is similar in a sense to dividends declared by for-profit enterprises. There is no legal obligation to make a payment until the actual declaration by the Board of Directors; and the entity does not record dividends payable until that time. Therefore, the Board has not revised the standard as suggested. However, the Board has added a disclosure requirement for any reasonable estimate of future distributions.
145. The comment letters also included proposals for miscellaneous changes to this standard:
- 1) In that the government does not have ownership, seized monetary instruments should be disclosed rather than reported on the face of the financials.

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- 2) Seized property other than monetary instruments should be reported as assets, like monetary instruments, with a liability for possible remittance of equal value recorded.
 - 3) For non-monetary forfeited assets the disclosure requirements are adequate to ensure information is available to users. Therefore, non-monetary forfeited assets should not be reported on the face of the financial statements.
 - 4) At the time that forfeiture judgement is obtained, ownership of the property is effectively transferred to the federal agency and the government should recognize the revenue earned at that time rather than deferring it.
146. The first two suggestions relate to seized property. The Board considered these suggestions during its discussions of seized property. The Board did not revise the standard; this was based on (1) the desire to establish strong controls over monetary instruments and (2) the difficulties in valuing and uncertainties regarding disposition associated with seized non-monetary property.
147. The third and fourth items relate to forfeited property. The suggestion to disclose forfeited non-monetary instruments, item 3, would result in understatement of the entity's assets. Disclosure requirements should emphasize that the value reported is merely an "estimate" of the property's value. The suggestion to recognize revenue upon forfeiture, item 4, while theoretically correct was not adopted by the Board. Due to the difficulties in valuing forfeited property and the risk of overstating the revenue the Board decided to defer revenue recognition until the property was sold.
148. One respondent requested that the standard address valuation of property for which there is no value, which cannot be legally sold, but which can be donated to museums or other non-profit organizations (e.g., stuffed endangered species) or destroyed (e.g., narcotics). The standard was revised to clarify the disclosure requirements and to indicate that no financial value need be reported for these items. Entities are not prohibited from reporting information regarding the dollar value of illegal assets seized if they so chose. The standard only relates to financial recognition and disclosure.
149. One respondent indicated that the analysis of change in seizures disclosure requirement is very detailed and should not be required for agencies with only incidental seizure activity. The Board has indicated that the standard is not intended to be applied to immaterial items.
150. One respondent noted that the definitions of seized and forfeited property seem to be limited to monetary instruments, real property and tangible personal property. The respondent asked that this definition be extended to intangible assets (e.g., savings and loan charters). The Board did broaden the definition to address intangible property.

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151. One respondent explained that the exposure draft can be interpreted to advise agencies to account for the assets through the seizing agency's property records and financial statements. However, in most cases, the seizing agency is different from the custodial agency which may take possession of seized property. In addition, there may be a central fund created to support activities of multiple agencies. It was recommended that the standard be modified to recognize the distinction among "seizing agencies", "custodial agencies", and the "central fund" responsible for accounting and reporting for the seized property; and, to remind seizing agencies of their responsibilities to maintain sufficient internal records to carry out their stewardship responsibilities.
152. The exposure draft had defined "seized property" as being "in the actual or constructive possession of the **seizing agency**." The respondent has correctly pointed out that this is not always the case since custodial agencies frequently take possession and/or responsibility for seized property. Depending on the circumstances, each party may have a need to maintain property records regarding seized property. For example, a seizing agency may wish to track property that may be ultimately distributed to it. In addition, seizing agencies may maintain physical possession of the property during the forfeiture process. The Board has modified the definition to include seized property held by custodial agencies.
153. With regard to the request for a clear statement of which agency is to maintain records on seized property, the Board believes that central fund would be responsible for accounting for and reporting seized property, but that seizing agencies or custodial agencies may have a need for property records related to seized property and does not wish to preclude them from doing so. However, in preparing consolidated financial statements care should be taken to avoid double counting these items. With regard to forfeited property, ownership should be the determinant for an entity's recognition of an asset. However, an agency that maintains physical custody, but not ownership, of forfeited property is not precluded from maintaining property records although no asset should be recognized.

Foreclosed Property

154. Many respondents objected to the requirement to value post-1991 foreclosed property at net present value (NPV). The primary objections to the use of NPV were:
- NPV is not a more accurate valuation basis than net realizable value (NRV)
 - NPV does not improve the information presented
 - Difference between NPV and NRV is immaterial
 - Loss of comparability with commercial enterprises
 - Maintenance of two systems to value foreclosed property (pre-1992 and post-1991) is costly and unnecessary
 - Changes in existing systems would be complicated and expensive

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- Cash flows may not be forecast with sufficient accuracy to measure NPV

155. In proposing present value accounting, the Board's primary considerations were to carry out the intent of the Federal Credit Reform Act of 1990 (the Act) and to make financial reporting compatible with the budget. Since foreclosed property is a result of the original loan transaction or loan guarantee, reporting on this activity should be guided by the provisions of the Act.

156. An extensive discussion of the Board's overall decision to require present value accounting is presented in Recommended Accounting Standard No. 2, *Accounting for Direct Loans and Loan Guarantees* (see Appendix A). One of the objectives of financial reporting is to enable the reader to determine the status of budgetary resources, and whether those resources were acquired and used in accordance with the enacted budget.¹¹ The Board believes that only by using the same basis can financial information be used to compare the actual results of operations with the budget.

157. However, the Board wishes to acknowledge that respondents may be correct in stating that in certain cases there may be only immaterial differences between net realizable value (or other methods) and NPV. The standard has been revised to indicate that if no material difference results, other valuation methods may be used as an approximation of the net present value of foreclosed property.

158. One respondent currently values foreclosed vessels at their acquisition price based on its own bid at the foreclosure sale. Following acquisition, the value is depreciated at one-percent per month. Gains or losses are recognized upon sale. The respondent believes that the current practice is more appropriate because: (1) the price paid at foreclosure sale represents the best valuation, (2) estimating future net cash flows requires assumptions and this would be less prudent than utilizing existing specific valuations, and (3) the entity has had to establish the value of the vessels in legal proceedings and has relied on the acquisition price to do so - utilizing a different value in financial records could jeopardize the entity's position in legal proceedings. The Board has not revised the standard as a result of this request. The Board believes that there are no unique circumstances in this case which would preclude conformance to the standard.

¹¹FASAB Exposure Draft, Objectives of Federal Financial Reporting, Vol. 1, par. 13.

Goods Held Under Price Support And Stabilization Programs

159. The proposed standard required that nonrecourse loans be adjusted at time of disbursement to **recognize a loss if the market rate is lower than the loan rate**. This constituted a departure from current practice that is to adjust the loan values to their expected net realizable value at report date. Respondents expressed concern that the proposed method would result in recognizing losses without consideration of the underlying economic transaction (i.e., will the loans be repaid).

160. Based on two respondents' comments, the Board found that the approach originally proposed ignored the "probability" component in recognizing unrealized losses; these losses have typically been recognized only if they are "probable and measurable. Nonrecourse loans, being short-lived, are similar in nature to notes or accounts receivable. Therefore, the Board referred to its recommended standard for accounts receivable. That standard states that:

Losses on receivables should be recognized when it is more likely than not that the receivables will not be totally collected. The phrase "more likely than not" means more than a 50 percent chance of loss occurrence.

An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value. The allowance for uncollectible amounts should be reestimated on each financial reporting date and when information indicates that the latest estimate is no longer correct. (FASAB, Recommended Accounting Standard 1, Paragraphs 44 and 45)

161. In addition, one respondent indicated that the originally proposed standard would have excluded loss recognition due to factors other than fluctuations in the market rates. Losses can occur due to (1) farmers' misuse or handling of the pledged commodities, or (2) fraud. Clearly the concept of loss recognition should be broadened in order to recognize these events. The Board modified the standard for nonrecourse loans to be more consistent with the accounts receivable standard and to encompass the Board's current thinking on the liability project.

162. One respondent argued that purchase agreements constitute a contingent liability. The proposed standard would require recognizing a liability and a loss **if the contract price exceeded the expected net realizable value of the commodities**. It is clear that at any given time the market price may be lower than the contract price but that due to cycles in the harvest and post-harvest market this may not be an indication that the contract will be executed and a loss realized. The Board revised the standard to provide for loss recognition in connection with purchase agreements if the loss is both probable and measurable.