

Initial Set of Issues for AAPC GPP&E Task Force Meeting
March 18, 2008

General Property, Plant, and Equipment Defined

SFFAS 6 Par. 23 General property, plant, and equipment is any property, plant, and equipment used in providing goods or services. General PP&E typically has one or more of the following characteristics:

- it could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or services, or to support the mission of the entity, or
- it is used in business-type activities,¹ or
- it is used by entities in activities whose costs can be compared² to those of other entities performing similar activities (e.g., Federal hospital services in comparison to other hospitals).

SFFAS 6 Par. 24 For entities operating as business-type activities, all PP&E shall be categorized as general PP&E whether or not it meets the definition of any other PP&E categories.

SFFAS 6 Par. 25 Land and land rights acquired for or in connection with other general PP&E³ shall be included in general PP&E. In some instance, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.

¹ Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in the Board's exposure draft on *Revenue and Other Financing Sources*.

² The Board is not making a recommendation that cost comparisons actually be made. Nor is it suggesting that costs can be easily compared for a Federal and non-Federal entity. If the activities are somewhat comparable then one should presume that a cost comparison **could** be made.

³ "Acquired for or in connection with other general PP&E" is defined as land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.

INITIAL ISSUES

Group or Composite Depreciation Method: Generally, depreciation is described as applicable to a unit of property. So that each unit has a book cost, an estimated useful life and salvage value, and accumulated depreciation. Group or composite depreciation is used to reduce the clerical burden associated with estimating and tracking depreciation of units.

Group depreciation is based on groups of similar items with approximately the same useful lives. Depreciation is based on the common useful life.

Composite depreciation is based on groupings of dissimilar items with different useful lives. Depreciation is based on a composite life of the grouping. Groupings may be based on (1) a common function or (2) geographic assignment. (Other logical groupings may be considered.)

Existing Guidance:

SFFAS 6 Par. 35: Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E⁴, except land and land rights of unlimited duration.⁵

- Estimates of useful life of general PP&E must consider factors such as physical wear and tear and technological change (e.g., obsolescence).
- Various methods can be used to compute periodic depreciation expense so long as the method is systematic, rational, and best reflects the use of the PP&E.
- Any changes in estimated useful life or salvage/residual value shall be treated prospectively. The change shall be accounted for in the period of the change and future periods. No adjustments shall be made to previously recorded depreciation or amortization.

SFFAS 23 Par. 9f: SFFAS No. 6 is amended by adding the following sentence to paragraph 35 as a separate bulleted line item:
A composite or group depreciation methodology⁶, whereby the costs of PP&E are allocated using the same allocation rate, is permissible.

SFFAS 6 Par. 39: General PP&E shall be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess. It shall be recorded in an appropriate asset account at its expected net realizable value. Any difference in the

⁴ Software and land rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. "Amortization" is applied to intangible assets in the same manner that depreciation is applied to general PP&E--tangible assets.

⁵ Land rights that are for a specified period of time shall be depreciated or amortized over that time period.

⁶ The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

book value of the PP&E and its expected net realizable value shall be recognized as a gain or a loss in the period of adjustment. The expected net realizable value shall be adjusted at the end of each accounting period and any further adjustments in value recognized as a gain or a loss. However, no additional depreciation/amortization shall be taken once such assets are removed from general PP&E in anticipation of disposal, retirement, or removal from service.

Guidance may be needed in the following areas:

- 1 – Is guidance needed to clarify what constitute “similar” items for groups?
- 2 -- Is group depreciation of dissimilar items with a common useful life acceptable?
- 3 – If composite depreciation is used, what bases are acceptable for groupings?
- 4 – Retirement of units included in groups or pools is accomplished by estimating the book value of the units and crediting the plant account and debiting the accumulated depreciation account. Is any deviation from this convention warranted?
- 5 – What type of audit issues might come up and is guidance needed?

Accounting for Assets Deployed:

Is SFFAS 6, applicable to military equipment deployed to hostile or unstable environments? Is explicit guidance needed to address this issue? Is this simply an impairment of an asset issue?

Existing Guidance: SFFAS 10 Accounting for Internal Use Software

Impairment: Post-implementation/Operational Software

28. Impairment should be recognized and measured when one of the following occurs and is related to post-implementation/operational software and/or modules thereof:

- the software is no longer expected to provide substantive service potential and will be removed from service or
- a significant reduction occurs in the capabilities, functions, or uses of the software (or a module thereof).

29. If the impaired software is to remain in use, the loss due to impairment should be measured as the difference between the **book value** and either (1) the cost to acquire software that would perform similar remaining functions (i.e., the unimpaired functions) or, if that is not feasible, (2) the portion of book value attributable to the remaining functional elements of the software. The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. If neither (1) nor (2) above can be determined, the book value should continue to be amortized over the remaining useful life of the software.

30. If the impaired software is to be removed from use, the loss due to impairment should be measured as the difference between the book value and the **net realizable value** (NRV), if any. The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. The NRV, if any, should be transferred to an appropriate asset account until such time as the software is disposed of and the amount is realized.

Cost Accounting (assignment of R&D, support and overhead to general PP&E):

What costs should be capitalized in general PP&E? What direct labor should be capitalized? Should contract administration be added? What about other costs, such as program acquisition management? Direct vs. indirect? Was it the Board's intention to have full costing of GPP&E?

SFFAS 6, Accounting for Property, Plant & Equipment, par 26 states: "All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use." Then the paragraph goes on to give a list of example costs that may be included.

SFFAS 6 Par. 26: All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include:

- amounts paid to vendors;
- transportation charges to the point of initial use;
- handling and storage costs;
- labor and other direct or indirect production costs (for assets produced or constructed);
- engineering, architectural, and other outside services for designs, plans, specifications, and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the cost of the equipment and facilities used in construction work;
- fixed equipment and related installation costs required for activities in a building or facility;
- direct costs of inspection, supervision, and administration of construction contracts and construction work;
- legal and recording fees and damage claims;
- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.⁷

Capitalization Thresholds:

Guidance is needed to establish capitalization thresholds.

Existing Guidance:

SFFAS 6 Par. 13: The Board believes that capitalization thresholds should be established by Federal entities rather than centrally by the Board. Because Federal entities are diverse in size and in uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds. Once established, this threshold(s) should be consistently followed and disclosed in the financial reports.

SFFAS 6 Par. 149 (BFC): Instead of setting a specific threshold, the Board has adopted a materiality approach--just as is done in private sector accounting. Each entity would establish its own threshold as well as guidance on applying the threshold to bulk purchases. The Board believes that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

⁷ "Interest costs" refers to any interest paid by the reporting entity directly to providers of goods or services related to the acquisition or construction of PP&E.

Cleanup Cost

Guidance needed on the implementation of SFFAS 6 requirement to recognize environmental liabilities when PPE is placed in service.

Existing Guidance:

SFFAS 6 Par. 94: Cleanup costs, as defined above, shall be estimated when the associated PP&E is placed in service. The estimate shall be referred to as the "estimated total cleanup cost." There are two approaches to recognizing this total-- one applies to general PP&E and another to stewardship PP&E.

SFFAS 6 Par. 97 – 98:

A portion of estimated total cleanup costs shall be recognized as expense during each period that general PP&E is in operation. This shall be accomplished in a systematic and rational manner based on use of the physical capacity of the associated PP&E (e.g., expected usable landfill area) whenever possible. If physical capacity is not applicable or estimable, the estimated useful life of the associated PP&E may serve as the basis for systematic and rational recognition of expense and accumulation of the liability.

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

Reporting Entity for Real Property Assets

Our defense agencies use and occupy assets; however the ultimate accountability and jurisdiction remain with the Military Services. The disconnect between who reports on the financial statements and who has physical accountability has caused a reconciliation nightmare. The standard does not clearly define the reporting entity for assets and what "Control" could mean for financial reporting purposes.

Staff Guidance on FFRDC – direct management and oversight responsibilities

GPP&E Ownership

An agency has sole use of property owned by another agency but does make any [lease] payments to the owner for the use of the property. The question is who reports the property on their books?

Guidance needed on ownership of PP&E when there are joint investments between contractor and federal government (i.e., often occurs with software).

Related Guidance: SFFAC 3: Entity and Display

Donated GPP&E

SFFAS 6 Par 30: The cost of general PP&E acquired through **donation, devise,⁸ or judicial process** excluding forfeiture (See paragraph 0) shall be estimated fair value at the time acquired by the government.

⁸ A will or clause of a will disposing of property.

Operating Materials and Supplies/Spare Parts

There is a belief that components and sub-assemblies that meet the three FASAB capitalization criteria should be capitalized as equipment.

Need clearer guidance on how to account for reusable equipment vs. consumable inventory.

Should reusable materials be capitalized as PP&E as opposed to materials? Many of the Shuttle parts are interchangeable (engine etc.) and are not consumable. SFFAS#3 addresses Operating materials and Supplies as those items that are consumable.

Existing Guidance:

SFFAS 3: *Accounting for Inventory and Related Property*
Interpretation 7: *Items Held for Remanufacture*

Fully Depreciated GPP&E at Implementation

Fully depreciation assets at Implementation: Should they be included in the Agencies balances?

Existing Guidance:

SFFAS 6 Par 42: For general PP&E that would be substantially depreciated/amortized had it been recorded upon acquisition based on these standards, materiality and cost-benefit should be weighed heavily in determining estimates. Consideration should be given to:

- recording only improvements made during the period beyond the initial expected useful life of general PP&E, and
- making an aggregate entry for whole classes of PP&E (e.g., entire facilities rather than a building by building estimate).

GPP&E Improvements

Accounting for entity owned building improvement: How do you account for cost of building improvement for fully depreciated buildings or partially depreciated buildings. For example, if you spend 10 million to renovate a fully depreciated building and appearing to have extended useful life, would you expense or capitalize? What impact will such have on useful life?

Existing Guidance:

SFFAS 6 Par 37: Costs which either extend the useful life of existing general PP&E, or enlarge or improve its capacity shall be capitalized and depreciated/amortized over the remaining useful life of the associated general PP&E.

GPP&E Removed from Service

Accounting for inactive (both temporarily and permanently) assets: How to account for property returned into service that was previously removed from service when it was fully depreciated or partially depreciated?

Existing Guidance:

SFFAS 6 Par 38 - 39:

In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized⁹ shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

General PP&E shall be removed from general PP&E accounts along with associated accumulated depreciation/amortization, if prior to disposal, retirement or removal from service, it no longer provides service in the operations of the entity. This could be either because it has suffered damage, becomes obsolete in advance of expectations, or is identified as excess. It shall be recorded in an appropriate asset account at its expected net realizable value. Any difference in the book value of the PP&E and its expected net realizable value shall be recognized as a gain or a loss in the period of adjustment. The expected net realizable value shall be adjusted at the end of each accounting period and any further adjustments in value recognized as a gain or a loss. However, no additional depreciation/amortization shall be taken once such assets are removed from general PP&E in anticipation of disposal, retirement, or removal from service.

GPP&E Used as an Operating Lease

Accounting for entity owned assets leased to others under operating leases. The FASAB guidance is not very clear on how to account for assets leased under operating lease.

Existing Guidance:

SFAS 13 Par 19: Operating leases shall be accounted for by the lessor as follows:

- a. The leased property shall be included with or near property, plant, and equipment in the balance sheet. The property shall be depreciated following the lessor's normal depreciation policy, and in the balance sheet the accumulated depreciation shall be deducted from the investment in the leased property.
- b. Rent shall be reported as income over the lease term as it becomes receivable according to the provisions of the lease. However, if the rentals vary from a straight-line basis, the income shall be recognized on a straight-line basis unless another systematic and rational basis is more representative of the time pattern in which use benefit from the leased property is diminished, in which case that basis shall be used.
- c. Initial direct costs shall be deferred and allocated over the lease term in proportion to the recognition of rental income. However, initial direct costs may be charged to expense as incurred if the effect is not materially different from that which would have resulted from the use of the method prescribed in the preceding sentence.

⁹ For example, amounts realized may include cash received for scrap materials or fair value of items received in exchange for PP&E removed from service.

d. If, at the inception of the lease, the fair value of the property in an operating lease involving real estate that would have been classified as a sales-type lease except that it did not meet the criterion in paragraph 7(a) is less than its cost or carrying amount, if different, then a loss equal to that difference shall be recognized at the inception of the lease.

GPP&E Acquired through Exchange

Accounting for exchanged property -- this includes like and unlike exchanges of property.

Existing Guidance:

SFFAS 6 Par 32: The cost of general PP&E acquired through **exchange**¹⁰ shall be the fair value of the PP&E surrendered at the time of exchange.¹¹ If the fair value of the PP&E acquired is more readily determinable than that of the PP&E surrendered, the cost shall be the fair value of PP&E acquired. If neither fair value is determinable the cost of the PP&E acquired shall be the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. Any difference between the net recorded amount of the PP&E surrendered and the cost of the PP&E acquired shall be recognized as a gain or loss. In the event that cash consideration is included in the exchange, the cost of general PP&E acquired shall be increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received.

Determination of Future Alternative Use for GPP&E

Determination of future alternative use for property -- determining whether to capitalize of expense costs associated with property with alternative future use.

Related Guidance: *SFFAS 29 Heritage Assets & Stewardship Land* – Multi-use Heritage Assets

Consideration of a Category of Non-capitalized GPP&E

Amended Guidance:

SFFAS 6 Par 46 – 56: FEDERAL MISSION PROPERTY, PLANT, AND EQUIPMENT

46 Federal mission PP&E includes certain items used to meet a Federal Government mission in which the specific PP&E used is an integral part of the output of the mission.¹² PP&E should be considered Federal mission PP&E if it possesses at least one of each of the two types of characteristics presented below. One type of characteristic relates to the use of Federal mission PP&E and the other relates to its useful life.

¹⁰ This paragraph applies only to exchanges between a Federal entity and a non-Federal entity. Exchanges between Federal entities shall be accounted for as transfers.

¹¹ If the entity enters into an exchange in which the fair value of the PP&E acquired is less than that of the PP&E surrendered, the PP&E acquired shall be recognized at its cost as described in paragraph X and subsequently reduced to its fair value. A loss shall be recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value.

¹² The name "Federal Mission PP&E" may cause readers to erroneously assume that this category should include any PP&E supporting a Federal mission. Federal mission PP&E is limited to those items specifically identified herein as well as any other items exhibiting at least one characteristic from each of the two groups listed.

47 Characteristics related to the use of the Federal mission PP&E are that it:

- has no expected nongovernmental alternative uses; or
- is held for use in the event of emergency, war or natural disaster; or
- is specifically designed for use in a program for which there is no other program or entity (Federal or non-Federal) using similar PP&E with which to compare costs.

48 Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life¹³ due to the unusual manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or premature obsolescence.

49 Federal mission PP&E specifically includes (1) weapons systems PP&E (e.g., fighter/attack aircraft, submarines, and tracked combat vehicles) and (2) space exploration equipment (e.g., space hardware and launch, tracking, and recovery facilities) which will be defined in paragraphs 0 and 0. Federal mission PP&E excludes land.

50 **"Weapons systems"** are a combination of one or more weapons¹⁴ with all related equipment, materials, services, personnel and means of delivery and deployment required for self-sufficiency.¹⁵ This standard addresses only the PP&E component of weapons systems. PP&E included in weapons systems are distinguished from general property, plant, and equipment held by defense agencies and defense support agencies in that they are intended to be used directly by the armed forces to carry out combat missions, when necessary, and to train in peacetime.

51 Weapons systems include only those assets owned by defense agencies and defense-support agencies that would otherwise meet the PP&E definition. Items meeting other than the PP&E asset category definitions (such as items of inventory or operating materials and supplies) are excluded from Federal mission PP&E.

52 **"Space exploration equipment"** includes items that are:

- intended to operate above the atmosphere for space exploration purposes, and
- any specially designed equipment to aid, service, or operate other equipment engaged in the exploration of space.

Recognition and Measurement

53 The periodic cost of acquiring, constructing, improving, reconstructing, or renovating Federal mission PP&E shall be recognized as a cost on the statement of net cost when incurred. The cost shall be disclosed¹⁶ as "cost of Federal mission PP&E." The cost shall include all costs incurred to bring the PP&E to its current condition and location (See paragraph 0 for examples of the costs to be considered).

54 Additional reporting requirements for stewardship reporting will be developed in a

¹³ This may be evidenced by the ability (1) to retire the PP&E and later return it to service or (2) to continually upgrade the PP&E to maintain its usefulness.

¹⁴ Weapons are instruments of combat used to destroy, injure, defeat or threaten an enemy. (adapted from *Dictionary of Weapons and Military Terms*)

¹⁵ Joint Chiefs of Staff, *Department of Defense Dictionary of Military and Associated Terms*, Joint Publication 1-02, March 23, 1994.

¹⁶ Disclosure shall be either on the face of the statement of net cost or in footnotes depending on the materiality of the amounts and the need to distinguish such amounts from other costs relating to measures of outputs or outcomes of the reporting entity.

separate standard.

Implementation Guidance

55 Federal mission PP&E previously recognized as assets and contra-assets for balance sheet reporting shall be removed. The amounts removed shall be charged to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. The amounts removed from the balance sheet shall be disclosed in a footnote.

56 For published financial statements presenting prior year information, no prior year amounts shall be restated.