Description of document:	Federal Accounting Standards Advisory Board (FASAB) Accounting and Auditing Policy Committee (AAPC) Meeting Briefing Materials, 2014-2016
Requested date:	22-March-2022
Release date:	06-October-2022
Posted date:	15-December-2025
Source of document:	FOIA Request Federal Accounting Standards Advisory Board 441 G Street, NW Washington, DC 20548 Fax: 202-512-7366 Email: fasab@fasab.gov

From: FASAB <FASAB@FASAB.gov>
Sent: Wed, Oct 5, 2022 9:41 am
Subject: RE: FOIA/FACA request for AAPC meeting records

Please see the attached documents. These materials contain no information that is exempt from disclosure under Exemption 5 as an “inter-agency” communication.

Best,
FASAB

ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 7C13
1:00 to 3:00 p.m.[1]

Note: Observers – Please contact Charles Jackson at 202 512-7352 or jacksoncw1@fasab.gov to be added to the building access list. Provide your full name and organization. You must be added to the list by cob **February 25th** to ensure access.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

February 27, 2014

Introduction of New Members & Recognition of Departing Members

- Departing Members
  - Donjette L. Gilmore, DoD
  - John Brewer, USDA

- New Members
  - Kristine Chadwick, Treasury
  - Keith Donzell, HUD
  - Gordon Alston, Commerce
  - Maryla Engelking, DoD

Project Agenda:

- Report from the Internal Use Software (IUS) Task Force

Agenda Committee

- Survey Results -- Implementation Guidance: SFFAS 42: *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*

New Business

Administrative Matters

- Update AAPC Operating Procedures

Adjournment

[1] **INCLEMENT WEATHER POLICY:** If federal offices are closed by OPM, the meeting is canceled. OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

If a delay is triggered, please call 202 512-7350 to hear a recorded announcement about the meeting status before leaving for the meeting. If conditions warrant further delays or cancellation, we will rely on the recorded announcement to alert you to such changes.

Federal Accounting Standards Advisory Board

February 21, 2014

Memorandum

To: Accounting and Auditing Policy Committee

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Implementation Guidance Survey Results: SFFAS 42: *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32***

As a result of informal input suggesting that implementation guidance may be needed, we conducted a survey between January 13th and February 14th to identify potential implementation issues that might arise as a result of SFFAS 42 which becomes effective in fiscal year 2015. The survey period was extended to February 20th due to inclement weather experienced during the survey period.

The survey was sent directly to the following two groups: DM&R Task Force and the SGL/IRC Group. In addition, OMB and Treasury representatives were requested to circulate the survey to the CFO Council and Treasury's FMS. Please refer to Attachment 1 for a copy of the survey form.

A total of 9 responses were received and the majority or 7 of the responses were "negative" – noting that no implementation issues were identified for FASAB's consideration. We did receive 2 "positive" replies and they are detailed in Attachment 2. A summary of those responding to the survey follows on the next page.

Please note that several DM&R Task Force representatives have expressed an interest in volunteering to assist with the development of any forthcoming implementation guidance. They include: Mr. Ivan Graff, DoE; Mr. Robert Lange; DoD, and Mr. Jim Clayton, Institute for Responsible Infrastructure Stewardship.

Table 1.0
Summary of Survey Respondents

#	Date	Agency/Bureau	Negative Reply	Positive Reply
1.	January 16	DHS / Customs & Border Protection	X	
2.	January 27	Department of Energy / Office of Property Management	X	
3.	February 7	Department of the Treasury / Inspector General	X	
4.	February 10	Department of the Treasury / Office of the Public Debt	X	
5.	February 12	Department of the Treasury / Department of the Mint		X
6.	February 14	Department of Commerce / Office of Financial Management	X	
7.	February 14	Department of Interior / Office of Financial Management		X
8.	February 19	Department of the Treasury / Bureau of Fiscal Service	X	
9.	February 19	Department of Defense / DFAS	X	

ATTACHMENTS

1. **Attachment 1 –** Copy of DM&R Implementation Guidance Survey form.
2. **Attachment 2 –** Positive DM&R Implementation Guidance Replies.

If the AAPC requires additional information please contact me at your convenience by telephone at 202.512.6841 or by e-mail at savinid@fasab.gov.

Thank you.

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Call for Implementation Questions: Template Instructions

GUIDANCE: SFFAS 42: Deferred Maintenance and Repairs EFFECTIVE DATE: FY 2015

New deferred maintenance and repairs standards become effective in fiscal year 2015.
Informal input suggests that implementation guidance may be needed.
Implementation guidance can reduce the burden of implementation and improve reporting quality.

Please assist us in identifying implementation issues by completing and submitting the attached form by February 15th.
Submit the form to Domenic Savini at savinid@fasab.gov Detailed instructions are presented below.

Please follow these instructions in completing this Template:

Column A - Identifies Sections of SFFAS 42

1. Carefully review the requirements of the referenced guidance.
2. Consider provisions of the guidance that the entity may have questions about.
3. No entries are to be made in this column. Please insert rows as needed within each section to add your questions by section.

General Instructions for Completing Columns B thru D

4. The objective is to list issues in Column B by specific paragraph reference directly next to Column A: Topical Description.
4a. Please pose all issues as Questions.
5. List Appendix B issues in Column B next to the Appendix B Topical Description.
5a. Illustrative scenarios for which you seek guidance and auditor comments may be presented as separate TABS so marked.
5b. For Appendix B, note if the issue is related to the Sample Note Disclosure language or to an Illustration.

Instructions for Completing Column B

6. Enter the specific paragraph reference, if any, relating to your question.

Instructions for Completing Column C

7. Enter the person and/or department responsible for implementing this portion of the guidance including contact information.

Instructions for Completing Column D

8. Identify entity-specific implementation issues for the above referenced FASAB guidance in the form of a question.
8a. Enter actual issues that are expected to be material to the entity that require FASAB assistance.
8b. Consider describing a situation that the entity finds difficult to address in the separate TAB ("Entity Scneario SFFAS 42") provided.
8c. Consider sharing your draft with your auditors -- provide their comments in the separate TAB ("Auditor Comments SFFAS 42") provided.

Thank you in advance for assisting us in this regard. Should you have any questions please contact Mr. Domenic Savini at 202-512-6841 or email savinid@fasab.gov

Technical Assistance: Identification of Implementation Issues

GUIDANCE: SFFAS 42: Deferred Maintenance and Repairs EFFECTIVE DATE: FY 2015

TOPICAL DESCRIPTION	REFERENCE PARAGRAPH	POINT OF CONTACT & EMAIL	ENTITY - SPECIFIC ISSUES
Column A	Column B	Column C	Column D
Scope and Applicability: Par. 4 thru 6			
Definition: Par. 7 and 8			
Measurement: Par. 9 thru 13			
Component Entity Required Supplementary Information: Par. 14 and 15			
Consolidated Financial Report of the US Government: Par. 16			
Sample Illustration: Appendix B			

Technical Assistance: Entity Scenario

GUIDANCE: SFFAS 42: Deferred Maintenance and Repairs EFFECTIVE DATE: FY 2015

ENTER ENTITY SCENARIO BELOW:

Technical Assistance: Auditor Comments

GUIDANCE: SFFAS 42: Deferred Maintenance and Repairs EFFECTIVE DATE: FY 2015

ENTER AUDITOR COMMENTS BELOW:

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Federal Accounting Standards Advisory Board

February 20, 2014

Memorandum

To: Members of the Board

From: Internal Use Software Working Group Co-Chairs:
Curt Nusbaum, Transportation Security Administration
Rebecca Shiller, National Security Agency

Through: Wendy M. Payne, Executive Director

Subj: Internal Use Software (IUS) Working Group, Progress to Date - **Tab C**

OBJECTIVE:
The objective of this session is to present to the Federal Accounting Standards Advisory Board (FASAB or, "Board") the progress and findings of the IUS Working Group and to seek Board input on the plan to pursue implementation guidance related to Statement of Federal Financial Accounting Standards 10, *Accounting for Internal Use Software* (SFFAS 10).

BRIEFING MATERIAL:
This transmittal memorandum includes an overview of the Working Group's activities, finding, and recommendations. Questions for the Board are included to solicit feedback from the Board on the planned approach and next steps. In addition to this Transmittal Letter, the Working Group has attached the following items:

Attachment #1: Mapping Sub-Group, Deliverable #1: Discussion of relevant requirements related to federal agencies' developed software and an assessment as to whether the Group believes such requirements are in alignment with current SFFAS 10 requirements.

Attachment #2: Standards Sub-Group, Deliverable #1: Discussion of current software development methods and an assessment on the challenges federal agencies face in complying with SFFAS 10 given the nuances of the various software development methods.

Attachment #3: Standards Sub-Group, Deliverable #2: Discussion on key FASAB Accounting Concepts related to the financial accounting of software under SFFAS 10.

Attachment #4: Summary matrix of issues and proposed solutions by development technique.

BACKGROUND:
On 7 February 2013, the Transportation Security Administration (TSA) submitted comments to the FASAB Three-Year Plan (Plan) suggesting the Board include Accounting for IUS as a key topic in the Plan. The Board adopted TSA's suggestion and on 25 June 2013, the Internal Use Software Working Group held a kick-off meeting. During this meeting, the group split into three sub-groups; the Mapping Team, the Benchmarking team, and the Standards Team.

WORKING GROUP'S PRELIMINARY RECOMMENDATION:

Based on the research performed by the IUS Working Group, the Group believes a Technical Release to SFFAS 10 would be appropriate. The Working Group would like to model the new Technical Release after *Technical Release 15: Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* (TR15). The Technical Release would provide greatly needed implementation guidance related to accounting for IUS and would focus on three main topics:

1. Framework and examples for distinguishing between development of major enhancements and minor enhancements and development to address bug fixes or keep software relevant, especially related to iterative software development models.
2. Clarification over the cutoff for capitalization that would broaden the acceptable criteria for capitalization cutoff by including not only final user acceptance testing, but also other indicators or transitioning events that are unique to a specific agency's policies.
3. Framework and examples of appropriate accounting for IUS when significant uncertainties relate to the development and operational use of a software product.

Additionally, although the application of Full Costing methodologies had not been a focus of the Working Group to date, a Technical Release that follows suit with TR15 would give the Board an opportunity to also provide Full Costing implementation guidance related to IUS in the same manner it provided guidance for general PP&E.

The working group considered additional approaches such as expensing all IUS costs and disclosing them within the notes to the financial statements, limiting the definition of items considered operations and maintenance, or capitalizing all costs until a system reaches full operating capability, but decided against these approaches. Some suggested approaches were not pursued because they cannot be supported with accounting theory. Other suggested approaches were not pursued because they likely result in replacing one existing problem with a new problem.

SUB-GROUP OBJECTIVES AND SUMMARY OF FINDINGS

Objectives and a summary of findings for each group are included below.

> ***Mapping Team Objective:*** Review and map existing Office of Management and Budget (OMB) software and information technology requirements and terms to SFFAS 10 to identify inconsistencies and omissions. Identify terminology and align the work that is required under all of the various standards where possible. The team reviewed four reporting requirements: the Clinger-Cohen Act of 1996, OMB Circular A-130 (*Management of Federal Information Resources*), OMB Exhibits 53 (*Agency IT Investment Portfolio*) and 300 (*Capital Asset Plan*), and Enterprise Architecture Documentation.

Mapping Team Summary of Findings: The Mapping Team's assessment of the ability of SFFAS 10 to meet the four reporting requirements reviewed revealed that SFFAS 10 does not provide the necessary information required by these documents. Specifically, the Mapping Team identified that:

1. Researched requirements focused heavily on reporting on budget execution and required actual dollars spent on IUS related activities in the year the expenditures occurred (i.e. in the budget year). This differs from SFFAS 10 which invokes the proprietary accounting concept of matching periodic amortization expenses to the use and economic benefit of an Agency's capitalized asset.
2. Researched requirements directed Agencies to report the full cost of their IUS activities as the total amount spent in a given budget year on IT investments, often broken out by development or maintenance. Conversely, SFFAS 10 defines full cost of IUS development as the total cost spent on a defined developmental period and could be presented at a value that includes accumulated expenditures over multiple years.
3. Documentation guidelines are more stringent within the reviewed requirements than those required by SFFAS 10.

The Mapping Group recommended that the larger group consider the following in moving forward with the final recommendation to the Board:

1. Reporting the full cost of IUS expenditures (outlays) in the year they were incurred to better align with budgetary principles. This could be achieved through a disclosure of total IUS expenditures in the Property, Plant and Equipment footnote under the Internally Developed Software section. This disclosure recommendation may be more appropriate for certain defined types of software development (refer to Standards Team deliverable 1).
2. Since certain types of software development cycles warrant the recognition of a capital asset, the Mapping team suggests that the group consider re-defining the IUS life-cycle to recognize only two phases (pre deployment and post deployment), where pre deployment (including conceptual formulation, analysis of alternatives, etc.) costs are capitalized and post deployment costs are expensed. This would better align to the existing general PP&E accounting standards and to the current legislative and budgetary reporting requirements. This would also reduce the costs of agencies having to differentiate between preliminary design and actual development.
3. The working group should also encourage FASAB to better define the documentation that agencies should retain in order to support accounting for IUS related to any changes adopted from above.

The Mapping Team believed that implementing these recommendations would better align SFFAS 10 with significant overseer requirements for IUS reporting. Specifically, implementing these recommendations would provide management and decision makers with budget data to aid in making future funding and investment decisions. Finally reporting actual expenditures would hold entities accountable to address significant variances from their budget formulation submissions.

Reference Attachment #1: Mapping Group, Deliverable #1

Benchmarking Team Objective: Research private industry and other CFO act agencies to identify best practices in analyzing and capitalizing IUS costs. Also review how the information is used by management (relevant and useful).

Benchmarking Team Summary of Findings: The Mapping Group concluded that private industry faces the same challenges as the private sector and have similar processes.

Standards Team Objective: Research current development cycles and identify challenges in applying SFFAS 10 as currently written. Also, identify accounting concepts applicable to accounting for software and, if appropriate, devise potential ways to affect change to the current standard that still align with the concepts.

Standards Team Summary of Findings, Software Development Cycles: The Standards Team found the software development model has dramatically changed since the issuance of SFFAS 10 in June 1998. The standard was written to conform to the linear/waterfall approach with three distinct life-cycle phases, which was the prevalent development approach at the time. While the standard acknowledges that various development frameworks exist, there is no incorporation of these differences in SFFAS 10. Thus, accounting for IUS becomes increasingly challenging as federal agencies move toward nonlinear models to develop software. Many of the issues in dealing with new development techniques and software architectures (such as the Cloud) are focused on timing of capitalization, costs of capitalization, and estimating useful life. Additionally, development of IUS as applied in SFFAS 10 is more focused on business/administrative types of applications. Agencies also have targeted use software that has a more focused scope supporting agency-specific mission needs. While the development costs may meet the threshold for capitalization, targeted-use software has many unknowns including deployment intentions and useful life.
Any recommended modifications to the standard would need to clearly address the above issues and provide specific guidelines for applying the standard to the changing software development environment.
Reference Attachment #2: Standards Team, Deliverable #1

Standards Team Summary of Findings, Accounting Concepts: SFFAS 10 was designed around software life-cycle phases which include planning, development, and operations. The standard provides a framework for identifying software development phases and processes to help isolate the capitalization period (development phase) for internal use software (SFFAS 10, par 10.) Additionally SFFAS 10 focuses on the full cost (direct and indirect cost) incurred during the software development stage (SFFAS 10, par 16). However, the standard acknowledges that the life cycle management techniques that agencies can use may vary depending on the complexity and risk inherent in the project.
Currently, SFFAS 10 requires the reporting of all asset costs at the initial amount (i.e. amounts paid for them) and the cost of using them over each period is reflected through amortization. With modern software development models using an iterative approach, the current measurement techniques may not be accurately achieving the financial reporting objectives. For these types of development models in which it becomes increasingly costly to isolate development expenditures or in instances where it is

difficult to clearly define deployment and significant enhancements, it might be beneficial to consider a remeasurement model, such as value in use.

The concepts become the underlying basis for any modification in SFFAS 10. As documented, the concepts allow for several methods in approaching the measurement and recognition of the IUS asset created. Any accounting principle change must also be evaluated for consistency and appropriate disclosure guidance provided.
Reference Attachment #3: Standards Groups, Deliverable #2

The working group accumulated the issues and proposed solutions by accounting process and analyzed the alternatives based on development techniques (i.e. linear, cyclical, targeted-use).

Reference Attachment #4: Summary Matrix

DETERMINATION OF NEXT STEPS:

Q1: Does the Board oppose the Working Group moving forward in drafting a Technical Release to SFFAS 10 to provide implementation guidance related to the issues and challenges identified in the Working Group's Deliverables 1-3?

Q2: Assuming the Board does not oppose the planned way forward, does the Board have specific guidance or suggestions on the items the Working Group should focus on for inclusion in the draft Technical Release?

Q3: If the Board opposes the continuation of efforts to draft a Technical Release, does the Board have recommendations for an alternative path?

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Federal Accounting Standards Advisory Board

Internal Use Software Working Group

Mapping Team Deliverable #1

9/11/2013

Contents

Purpose

The purpose of this paper is to present the Federal Accounting Standards Advisory Board (FASAB) Mapping Team Sub-Group's (hereafter referred to as the Mapping Team) research, conclusions, and recommendations on whether Statement of Federal Financial Accounting Standard (SFFAS) No. 10 – *Accounting for Internal Use Software (IUS),* should be amended to achieve the reporting objectives of select Federal legislation, regulations, or guidance that impact IUS. To guide the Mapping Team's efforts, we developed the following objectives:

1. Identify relevant Federal legislation, regulations, or guidance related to a Federal Agency's developed or purchased software reporting requirements.
2. Identify the purpose/intent of the software reporting requirements within the legislation, regulation, or guidance.
3. Assess whether the financial reporting requirements of SFFAS No. 10 meets the relevant Federal legislation, regulation, or guidance related to a Federal Agency's developed or purchased software reporting requirements.
4. Develop recommendations for the FASAB IUS Working Group to consider amending SFFAS No. 10 to achieve the relevant Federal legislation, regulation, or guidance related to a Federal Agency's developed or purchased software reporting requirements.

The Mapping Team Sub-Group used the following references in performing our analysis:

- **Office of Management and Budget (OMB) Circular A-11:** *Preparation, Submission, and Execution of the Budget*
- **OMB Guidance on Exhibit 300:** *Planning, Budgeting, Acquisition, and Management of Information Technology Capital Assets*
- **OMB Guidance on Exhibits 53:** *Information Technology and E-Government*
- **FASAB – Statement of Federal Financial Accounting Standard No. 4** – *Managerial Cost Accounting Concepts and Standards for the Federal Government* (SFFAS No. 4)
- **FASAB – Statement of Federal Financial Accounting Standard No. 10** – *Accounting for Internal Use Software (SFFAS No. 10)*

Objective No. 1 - Identify relevant Federal legislation, regulation, or guidance related to a Federal Agency's developed or purchased software reporting requirements.

The Mapping Team Group reviewed various Federal legislation, regulations, and Federal guidance to assess whether there were specific reporting requirements related to a Federal Agency's developed or purchased software. Based on the Mapping Team's research, the following four items were selected as having the most relevance to a Federal Agency's requirements to report on developed or purchased software:

- Clinger-Cohen Act (CCA) of 1996
- Office of Management and Budget (OMB) Circular 130
- Office of Management and Budget (OMB) Exhibit 53 and Exhibit 300
- Enterprise Architecture Documentation

In the following section, the Mapping Team discussed each of the four items in detail.

Objective No. 2 - Identify the purpose/intent of the software reporting requirements within the legislation, regulation, or guidance.

The main purpose of this section is to discuss the Mapping Team's assessment of the legislation, regulation, or guidance on developed or purchased software reporting requirements. Each of the four items will be discussed separately.

Clinger-Cohen Act (CCA) of 1996 – The CCA was enacted to improve the way the Federal Government Agencies acquire, use, and dispose of Information Technology (IT). Originally titled the Information Technology Management Reform Act (ITMRA) of 1996, CCA was part of the National Defense Authorization Act for FY1996. This act established a comprehensive approach for Executive Agencies to improve the acquisition and management of their resources by:

- Focusing information resource planning to support their strategic missions;
- Implementing a capital planning and investment control (CPIC) process that links to budget formulation and execution;[1]
- Rethinking and restructuring the way they do their work before investing in Information Systems; and
- The need to establish effective leadership. CCA requires each Agency to have a Chief Information Officer (CIO).

The CCA's main objective is to integrate and streamline the CPIC process with budget, financial, and program management decisions[1]. CCA is program management and results measurement focused.

Office of Management and Budget (OMB), Circular A-130 - With respect to purchased or developed software, the purpose of OMB Circular A-130, *Management of Federal Information Resources*, is to provide OMB policy and guidance on IT management in the Federal government. OMB Circular A-130 (hereafter referred to as A-130) is focused on determining the capital planning needs of Federal Agencies and in establishing appropriate controls over IT investments.

Appendix IV to A-130 states, "The Clinger-Cohen Act … grants to the Director of OMB various authorities for overseeing the acquisition, use, and disposal of IT by the Federal government, so as to improve the productivity, efficiency, and effectiveness of Federal programs." Specific to IT management, A-130 includes specific guidelines that require Agencies to:

[1]Section 5122 requires each Agency to "provide the means for senior management personnel of the executive Agency to obtain timely information regarding the progress of an investment in an information system, including a system of milestones for measuring progress, on an independently verifiable basis, in terms of cost, capability of the system to meet specified requirements, timeliness, and quality."

- Develop Agency-specific policies and procedures that provide for timely acquisition of required IT;
- Maintain an inventory of the Agency's major information systems;
- Use the guidance provided in OMB Circular A-11, Planning, Budgeting, and Acquisition of Fixed Assets, to promote effective and efficient capital planning within the organization;
- Document CPIC processes and provide to OMB consistent with the budget process;
- Document the Agency's Enterprise Architecture and provide to OMB as significant changes are incorporated; and
- Update the Agency IT Capital Plan twice annually and submit annually to OMB with the Agency budget submission.

In order to report actual costs and to use these costs going forward as valid estimates for budget formulation-execution comparisons (for use in the Agency IT Capital Planning), the full costs must be captured for the various IT development phases and recorded appropriately. A-130 defines full cost as all direct, indirect, and general and administrative costs incurred in the operation of an information processing service organization.

Office of Management and Budget (OMB), Exhibit 53 and Exhibit 300 – Every Agency subject to Executive Branch review is required to submit an annual IT investment portfolio. Included in the portfolio are Exhibits 53 and 300. The IT investment portfolio is integrated into each Agency's overall budget submission/performance budget justification to demonstrate adherence to overall programming and investment objectives.

OMB uses information recorded within these exhibits to ensure that IT investments align with and support each Agency's strategic plans and that Agencies are using a disciplined CPIC process to manage their IT initiatives. OMB bases budgetary resource decisions on information reported in the exhibits, makes sure that investments are in accordance with OMB polices, and reports to Congress whether IT investments are or are not properly being executed against outlined goals.

In requiring IT investment information to be reported in each Agency's IT investment portfolio, OMB is attempting increase IT investment visibility throughout the federal government. Increased visibility helps reduce the amount of funding wasted on duplicative IT investments, cost overruns, schedule slippage, etc. By presenting information reported in the Exhibits on the IT Dashboard, the Federal government if more effectively able to share information with the public, thereby increasing accountability. The ultimate goal of the IT investment portfolio and Exhibits 53 and 300 is to make investment information transparent to the U.S. public.

Exhibit 53 is a report of all Agency IT investments, including all major and non-major investments. Agencies report on all Federal budgetary resources used to fund IT investments, including prior year (PY) actual expenditures, estimated current year (CY) resources based on enactment, and estimated future budget year (BY) resources. Important investment elements for each investment are documented, including investment description, investment status, alternatives evaluations, etc.

Exhibit 53 also requires Agencies to report specific IT investment information related to many different types of development models, including investments in the cloud environment, investments for mission delivery, and investments in infrastructure.

Exhibit 300 is a Capital Asset Plan completed by each Agency for all major IT systems and IT budget initiatives. The Exhibit further describes the budget justification of capital asset investments and each investment's alignment with strategic and performance goals, including the investments outlined in Exhibit 53.

Exhibit 300 provides overall investment information and justification, outlines the investments alignment with program priorities, and provides a summary of costs for each investment. The summary of costs are presented as actual PY obligations, estimated CY obligations, and estimated BY obligation. This break out by fiscal year is similar to how the Exhibit 53 requires budgetary resources to be broken out. Exhibit 300, like Exhibit 53, requires cost information to be reported for development/modernization/enhancement expenditures and for operation and maintenance expenditures. Exhibit 300 recommends Agencies use a modular development model in the development of the software. However, the Exhibit is still required for more modern software models.

Enterprise Architecture Documentation – The Enterprise Architecture Documentation (EAD) establishes a standardized approach to implementing and enabling Federal Enterprise Architecture. It provides for comparable architectures across the Federal Government that will be more useful in managing change and enabling mission success. EAD also promotes consistent and coherent understanding of program and service performance. It promotes inter-operability between programs, systems, and services – partnering between missions and Agencies, and optimizes inter-operability between programs against shrinking budgets. Finally, EAD is an authoritative reference for the design and the documentation of systems and services to primarily allow for verifiability of configuration. These purposes exist to encourage and promote a conceptual understanding and high-level declaration of an entity's current and potential future investments in IT.

The Enterprise Architecture then structures the documented response of each Agency into four Primary Outcomes: Service Delivery, Functional Integration, Resource Optimization, and Authoritative Reference. These exist to declare the eventual outcome and purpose of the investment concept. Following the identification of outcomes, an Agency must document eight Levels of Scope: 1. International, 2. National, 3. Federal, 4. Sector, 5. Agency, 6. Segment, 7. System, or 8. Application. These levels of scope help note how broad or narrow, at certain levels, the concept will be responsible for serving. Next, Agencies must disclose eight Basic Elements in the following areas: Governance, Principles, Method, Tools, Standards, Use, Reporting, and Audit and agencies must identify the six areas of Documentation: Strategic planning, business services, data and information, enabling applications, host infrastructure, and security. This forces Agencies to consider how they will structure, govern, develop, and maintain the concepts they have developed and recorded for review. The required six reference models: Performance, Business, Data, Application, Infrastructure, and Security support the analysis and reporting across Agencies. Lastly, the Enterprise Architecture provides four Plans and Views: Enterprise Roadmap, Transition Plan, Current Views, and Future Views that provide for phasing of development and execution as well as current and forward referencing.

The Common Approach to Federal Enterprise Architecture (CAFEA) accelerates Agency business transformation and new technology enablement by providing standardization, design principles,

scalability, an enterprise roadmap, and a repeatable architecture project method that is more agile and useful and will produce more authoritative information for intra- and inter-Agency planning, decision-making, and management.

Objective No. 3 - Assess whether the financial reporting requirements of SFFAS No. 10 meets the relevant Federal legislation, regulation, or guidance related to a Federal Agency's developed or purchased software reporting requirements.

In this section, the Mapping Team documents our assessment of whether SFFAS No. 10 achieves the IUS reporting requirements of the four items described in Objective No. 2. To complete this assessment, the Mapping Team first analyzed the objectives and reporting requirement of SFFAS No. 10 as described below.

SFFAS No. 10, Accounting for Internal Use Software

SFFAS No. 10 requires the capitalization of the cost of internal use software whether it is commercial "off-the-shelf" software (COTS), contractor-developed, or internally developed. Such software serves the same purposes as other general PP&E and functions as a long-lived operating asset. This standard provides guidance regarding the cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

This statement provides accounting standards for internal use software used by federal entities. Federal entities purchase COTS, hire contractors to develop substantially all of the desired software (contractor developed), or develop software internally using their own employees, with or without a contractor's assistance (internally developed).

The scope of this statement is as follows:

- Software used to operate an entity's programs (e.g., financial and administrative software, including that used for project management),
- Software used to produce the entity's goods and to provide services (e.g., air traffic control and loan servicing), and
- Software that is developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement.

Software development phases in SFFAS No. 10 include planning, development, and operations. SFFAS No. 10 provides a framework for identifying software development phases and processes to help isolate the capitalization period for internal use software the federal entity is developing. SFFAS No. 10 maintains that "provisions of th[e] statement need not be applied to immaterial items" and that materiality should be determined by each entity. Furthermore, IUS must meet the following criteria to be considered capital:

- Estimated useful life of 2 or more years,
- not intended for sale in ordinary business, and
- has been acquired/developed for use by the entity.

Comparison of Federal IUS Reporting Requirements to SFFAS No. 10

In this section, the Mapping Team assessed whether SFFAS No. 10 met the developed or purchased software reporting requirements of the four Federal legislation, regulations, or guidance related to a Federal Agency's developed or purchased software reporting requirements described in Objective No. 2. Each of the Mapping Team's conclusions on the four items is discussed individually.

Clinger-Cohen Act - SFFAS No. 10 does not address the CCA's main objective which is to integrate and streamline the CPIC process to support budget, financial, and program management decisions. Specifically, SFFAS No. 10 divides the software development process in three most common software development phases, but does not link these phases to an Agency's capital investment and planning model as described in the CCA.

OMB Circular A-130 - SFFAS No. 10 does not address Circular A-130 requirements to report on all costs incurred to implement an IT and/or software project. According to A-130, the development of a valid estimate for IT capital planning and budget formulation requires the full cost of an Agency's IUS development project to be captured, including direct, indirect, and general and administrative costs incurred. SFFAS No. 10 requires the capture of full cost (e.g., direct and indirect) only during the development phase, requiring that costs incurred in the Preliminary Design and Operational Phases be expensed in the year they were incurred. OMB A-130's primarily objective is to address IUS expenditures and not the matching of expenses with the amortization of an assets useful life as required by SFFAS No. 10.

OMB 53 and 300 - SFFAS No. 10 does not address the IUS reporting requirements of OMB Exhibits 53 and 300; specifically, the reporting of software development and budget execution by fiscal year, to include, actual dollars spent in previous years and budgeted amounts for current and future years. SFFAS No. 10 defers the recognition of expense until the project is completed and placed into service and the capitalized cost is amortized over the useful life of the software.

Relevant to SFFAS No. 10 is the *Development/Modernization/Enhancement Expenditures* investment element reported within Exhibit 53. These costs reflect the amounts spent or planned to be spent on developing a new IT asset or amounts spent to significantly modernize or enhance existing IT assets (i.e. costs deemed capital under SFFAS No. 10). Agencies are required to report steady state costs for each IT investment (i.e. operational costs under SFFAS No. 10). Although OMB Exhibits 53 and 300 report costs in a similar manner to the phases established in SFFAS No. 10, there are still many differences in presentation of information in the Exhibits when compared to information required under the standard. OMB Exhibits 53 and 300 are reported by fiscal year, to include actual dollars spent in previous years and budget amounts for current and future years. Conversely, under SFFAS No. 10, software costs could be reported at values that may span multiple fiscal years.

Additionally, SFFAS No. 10 requires that only development costs incurred to build an asset are recognized and carried on the financial statements at net book value. Future benefit received from the asset is recognized through periodic recognition of amortization expense in future reporting periods. The value reported in an Agency's balance sheet for a software asset in any given year would not coincide with the value of steady state costs reported in that year on the Exhibit 53, as the NBV is the total asset's cost less accumulated amortization, not the total amount spent.

Therefore, the reporting of actual IT costs by asset life-cycle phases under SFFAS No. 10 will not align with budget resources documented by fiscal year in Exhibits 53 and 300.

SFFAS No. 4 also requires assets to be reported at full cost; that is the total of direct and indirect costs incurred to develop or create the asset. OMB guidance on the preparation and submission of Exhibits 53 and 300 do not address or take into consideration indirect costs. Finally, SFFAS No. 10 only creates a distinction between integrated hardware/software systems and Internally Developed Software. OMB guidance on Exhibits 53 and 300 however acknowledges that there are various models and platforms related to IT investments.

Enterprise Architecture Documentation - SFFAS No. 10 does not provide the information required by the Common Approach to Federal Enterprise Architecture described in EAD; specifically, data on the standardization, design principles, scalability, enterprise roadmap, or a repeatable architecture project method that is more agile and useful and for intra- and inter-Agency planning, decision-making, and management.

Summary

The Mapping Team's assessment of SFFAS No. 10's ability to meet the four Federal legislation, regulation, or guidance reporting requirements reviewed by the Mapping Team revealed that, SFFAS No. 10 does not provide the necessary information required by these documents. Specifically, the Mapping Team identified:

1. Legislation/regulation/guidance is heavily focused on reporting on budget execution, requiring the actual spend on IUS related activities in the year the expenditure occurred; this differs from SFFAS No. 10 which invokes proprietary accounting concepts to match the periodic amortization/depreciation expense to the use of an Agency's capitalized asset.
2. Legislation/regulation/guidance requires Agencies to report on the full cost of its IUS activities as the total amount spent in a given budget year on IT investment, often broken out by development or maintenance; whereas SFFAS No. 10 defines full cost of IUS development as the total cost spent on a defined development period accumulates and could be presented at a value that includes expenditures over multiple years.
3. Legislation/regulation/guidance documentation requirements are more stringent than those required by SFFAS No. 10.

Objective No. 4 - Develop recommendations for the FASAB IUS Working Group to consider amending SFFAS No. 10 to achieve the relevant Federal legislation, regulation, or guidance related to a Federal Agency's developed or purchased software reporting requirements.

As the working group moves forward in deciding if and how to amend SFFAS No. 10, the Mapping Team suggests, based on research of CCA, OMB A-130, Exhibits 53 and 300, and the EAD, that the following recommendations are considered during deliberation:

- Reporting the full cost of IUS expenditures (outlays) in the year they were incurred would align better with budgetary principles. This could be achieved through a disclosure of total

IUS expenditures in the Property, Plant and Equipment footnote under the Internally Developed Software section. This disclosure recommendation may be more appropriate for certain defined types of software development (refer to Standards Team deliverable 1).

- If certain types of software development cycles still warrant the recognition of a capital asset, the Mapping team suggests that the definition of an IUS life-cycle be re-defined to recognize only two phases (pre deployment and post deployment), where pre deployment (including conceptual formulation, analysis of alternatives, etc.) costs are capitalized and post deployment costs are disclosed. This would better align the existing general PP&E accounting standards with the current legislative and budgetary reporting requirements. This would also reduce the costs of agencies having to differentiate between preliminary design (i.e. the establishment of requirements) and actual development.
- We also suggest that in addition to amending SFFAS No. 10, that the working group encourage FASAB to better define the documentation that agency's should retain in order to support their accounting for IUS for any changes adopted from above.

The Mapping Team believes that implementing these recommendations will better align SFFAS No. 10 with the more significant legislation/regulation/guidance that impacts IUS reporting. Specifically, implementing these recommendations would provide management and decision makers with budget data to aid in making future funding/investment decisions. Finally reporting actual expenditure would hold entities accountable to address significant variances from their budget formulation submissions.

Appendix A – References to Requirement Terms/Definitions

DEPARTMENT OF DEFENSE CHIEF INFORMATION OFFICER DESK REFERENCE. ***Vol. 1: Foundation Documents.*** Clinger-Cohen Act: Definitions and Acronyms of Commonly Used DoD CIO Terms. Aug. 2006. Sept. 9, 2013. Pg. 180. <http://dodcio.defense.gov/Portals/0/Documents/ciodesrefvolone.pdf>.

OFFICE OF MANAGEMENT AND BUDGET. ***Circular No. A-130: Management of Federal Information Resources.*** Section 6: Definitions. Feb. 8, 1996. Sept. 9, 2013. <http://www.whitehouse.gov/omb/circulars_a130#6>.

OFFICE OF MANAGEMENT AND BUDGET. ***Guidance on Exhibits 53 and 300.*** Section 4. What special terms should I know? 2012. Sept. 9, 2013. <http://www.whitehouse.gov/sites/default/files/omb/assets/egov_docs/fy14_guidance_on_exhibits_53_and_300.pdf>.

FASAB IUS WORKING GROUP

Software Development Cycles

Deliverable 1

Standards Team

10/28/2013

A comparison of the application of current software development cycles and environments (i.e. cloud, shared services) to the Statement of Federal Financial Accounting Standards 10, Accounting for Internal Use Software (SFFAS 10).

Contents

PURPOSE

To document various software development cycles and environments (i.e. cloud, shared services) used today and the complexities of applying the Statement of Federal Financial Accounting Standards 10, *Accounting for Internal Use Software* (SFFAS 10), as currently written.

TECHNICAL LITERATURE

- Statement of Federal Financial Accounting Standards 10, *Accounting for Internal Use Software* (SFFAS 10)
- Statement of Federal Financial Accounting Standards 6, *Accounting for Property, Plant, and Equipment* SFFAS 6)
- Federal Financial Accounting and Auditing Technical Release 5: Implementation Guidance on Statement of Federal Financial Accounting Standards 10: *Accounting for Internal Use Software* (TR 5)
- Statement of Federal Financial Accounting Standards 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Standards of Federal Financial Accounting Standards 6 and 23* (SFFAS 35)

SUMMARY

In applying SFFAS 10 for internally developed software (IDS), to include software developed by contractors, many challenges exist due to rapid development in the software industry. SFFAS 10, which followed Financial Accounting Standards Board (FASB) Accounting Standards Codification 350-40, *Internal Use Software* (ASC 350-40), was issued by the Federal Accounting Standards Advisory Board (FASAB) in June 1998. For IDS, the standard was written to conform to a waterfall approach with three distinct life-cycle phases. This standard will need to be revised to reflect complex software development approaches, such as incremental, and iterative development; as well as new software architectures and environments such as the cloud environment and the shared services environment.

SOFTWARE DEVELOPMENT APPROACHES

In accordance with SFFAS 10, *software life-cycle phases include planning, development, and operations* (SFFAS 10, p. 10) as compatible with the Office of Management and Budget (OMB) and the United States Government Accountability Office (GAO) guidance issued in 1998. While SFFAS 10 acknowledges that various iterations of development exist, it references that only two common phases/transition points exist for all information systems- the beginning of development and the end.

Over time the software industry has evolved and today new development frameworks and various cycles exist that impede the consistent application of SFFAS 10 as it is currently written making it harder to distinguish the two aforementioned common phases/ transition points (the beginning and the end). A summary of common software development techniques are described below with additional illustrations provided in **Appendix 1**. [1]

- **Linear Development**
  - **Waterfall Model** – also referred to as the linear-sequential life cycle model in which each phase must be completed fully before the next phase begins.
  - **V-model** - verification and validation model in which each phase must be completed fully before the next phase begins; however, testing of the product is planned in parallel with the corresponding phase of development
- **Incremental Development** – Additional functionality is implemented in each increment/release
  - **Modular Development Model –** requirements are divided into various builds with multiple development cycles making the life cycle a "multi-waterfall" cycle. The cycles are divided into smaller, more easily managed modules. Working versions are produced during the first module and subsequent releases adds function to the previous release.
  - **Rapid Application Development (RAD) Model –** incremental model in which components are developed in parallel as if they are mini projects. The mini projects are delivered and then assembled into a working prototype.
- **Iterative Development** – repeats the cycle of design, build, and test until the desired functionality is completed.
  - **Iterative Model-** development begins by specifying and implementing just part of the software, which can then be reviewed in order to identify further requirements. This process is then repeated, producing a new version of the software for each cycle of the model. Not all requirements are gathered up front for the entire life cycle.
  - **Agile Model –** small incremental releases with each relase building on previous functionality. Working software is delivered frequently (weeks rather than months) and it assumes the end users needs are ever changing in a dynamic environment.
  - **Spiral Model –** four main phases exist in which the software project repeatedly passes through these phases in iterations:
    - *planning* - requirements are gathered;
    - *risk analysis* - risks are identified and alternative solutions are reviewed;
    - *engineering* - the software is produced; and,
    - *evaluation* - the customer evaluates the outputs.

With incremental and iterative development models the ability to deliver a working software product in a shorter time frame (typically iterations of one to eight weeks) provides for a more efficient and effective way of managing federal IT projects. Iterations are based on user stories and customer requirements and have the flexibility to change development direction based on shifting priorities. Both the OMB[2], and the GAO[3] have issued guidance on implementing information technology (IT) development techniques that use methods such as agile.

The use of these models creates several challenges when applying the principles of SFFAS 10.

- **Issue #1:** Determining when the software should be capitalized using the SFFAS 10 definitions of development phases.
- **Issue #2:** Determining what costs should be capitalized.
- **Issue #3:** Determining what constitutes a major enhancement requiring a new capitalized asset.

ISSUE #1: TIMING OF CAPITALIZATION

SFFAS 10 presents three phases of software development that follow a linear approach to an IT project: the preliminary design phase, the software development phase, and the post-implementation/operational phase. Capitalized cost *should include the full cost (direct and indirect cost) incurred during the software development stage. (SFFAS 10, p. 9).* Costs incurred during the preliminary design phase and the operational phase would be expensed in the period incurred.

This is inconsistent with the incremental and iterative methods of software development in which the three phases are blurred and can occur at the same time. A software product may be delivered and tested in its initial form with minimal processing capability. This allows for the federal agency to begin using the software in a limited manner. For example, initial data conversion may occur in conjunction with development and capabilities will continue to be enhanced with each new release/development sprint. Additionally, preliminary design may be occurring based on user stories and requirements that were a result of interaction with the preliminary software release. Fixes, generally occurring in the post-implementation phase will also be occurring. The flexibility to move between the three phases of software development is in direct contrast with a linear approach to accounting for software development.

Additionally, Technical Release 5 explains that each agency should develop and document the agency's policies and procedures around determining the beginning and ending points of development (i.e. the period in which capitalized costs are incurred) (p. 5).While the decision to pursue development exists, the completion of conceptual formulation, design, and testing of software alternatives does not coincide with the development for incremental and iterative models.

ISSUE #2: COSTS OF CAPITALIZATION

Costs that should be capitalized in accordance with SFFAS 10 include *those for new software (e.g., salaries of programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation manuals.*

For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized (SFFAS 10, p. 9).

Examples of costs that should be expensed include the costs of data conversion, repair of minor design flaws, and minor upgrades. *Costs incurred after final acceptance testing has been successfully completed should be expensed (SFFAS 10, p. 9).*

Because the developers are concurrently working on fixes, data conversion, new development, and design for future enhancements, the costs associated with each are difficult to separate. Many project managements lump all software programmer time into development subjecting it to capitalization under the rules of SFFAS 10. In reality some of this time should be expensed. Additionally, while each increment/iteration requires approval to proceed, there is no final acceptance testing which would signal the move from capitalization to expensing of software costs. Lack of final acceptance testing many times makes it difficult to retain proper audit documentation to support the commencement of depreciation.

ISSUE #3: ENHANCEMENTS

The rules of SFFAS 10 state that *the acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities.(SFFAS 10, p.10)*

In incremental and iterative environments, each new increment/iteration is designed to provide additional capabilities in the software. Agencies have difficulty in establishing when the initial software product should be considered a completed working asset, and when continual development in a series of releases becomes significant enough to be considered a new software asset subject to capitalization.

SFFAS 10 guidance on amortization states that *for each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing. (SFFAS 10, p. 12)*

With rapid release of working prototypes, there is difficulty in determining when amortization should begin. The user may be able to implement the software on a limited basis, but future development and capabilities are being continually added. To wait until

the final product is delivered at full capability is also inconsistent with the concept of an "in service" date.

SOFTWARE ARCHITECTURES

"Software application architecture is the process of defining a structured solution that meets all of the technical and operational requirements, while optimizing common quality attributes such as performance, security, and manageability. It involves a series of decisions based on a wide range of factors, and each of these decisions can have considerable impact on the quality, performance, maintainability, and overall success of the application."[4]

Software architecture focuses on the environment in which the software is developed and used. The system, the user, and the business all are interrelated aspects of the software architecture. Development decisions are based on user needs, the IT infrastructure, and business goals. As agencies find ways to collaborate, share services, and rely on new types of infrastructure, the FASAB standards may need to be updated to reflect the changing environments.

SOFTWARE DEVELOPMENT USING THE CLOUD ENVIRONMENT

In recent years there has been a general movement towards hosted software solutions that are flexible, scalable, internet-based, and typically purchased on a subscription basis, generally referred to as cloud services. These cloud services typically require minimal investment in actual software development and focus on delivering tailored solutions more rapidly than under the traditional waterfall approach. There are varying degrees of cloud services; however, the most common ones are: Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS).

The level of software development costs associated with cloud solutions depends on the specific cloud model that is being implemented. Under the SaaS approach, the consumer does not manage or control the underlying cloud infrastructure (includes network, servers, operating systems, storage) or individual application capabilities, with the possible exception of limited user-specific application configuration settings[5].

The capability provided to the consumer under PaaS is to deploy infrastructure consumer-created or acquired applications created using programming languages, libraries, services, and tools supported by the provider onto the cloud. The consumer does not manage or control the underlying cloud infrastructure, but has control over the deployed applications and possibly configuration settings for the application-hosting environment.[6]

The capability provided to the consumer under IaaS is to provision processing, storage, networks, and other fundamental computing resources where the consumer is able to deploy and run arbitrary software, which can include operating systems and applications. The consumer does not manage or control the underlying cloud infrastructure but has control over operating systems, storage, and deployed applications; and possibly limited control of select networking components (e.g., host firewalls).[7]

Implications as a Cloud Service User

Cloud service users primarily incur costs related to fees for service or fees for application software. However, other development costs are incurred based on different cloud models.

Of the three primary cloud models, the SaaS model generates limited, if any, development costs to be capitalized. SaaS models offer consumers flexibility in the configuration of application features activated, application interfaces, system integration, forms, and reports, but result in minimal development costs. However, if a service provider is charging a customer for the service of "software development", the amount of these costs would need to be determined. Additionally, to provide more flexibility and customizable solutions, SaaS providers typically offer a module that enables the consumer to develop custom code that can be added on to the baseline solutions. Maintenance of custom code is typically the responsibility of the consumer, and could be considered software development costs. Under either the PaaS or IaaS models of cloud computing, the level of software development costs that would be considered for capitalization would be directly related to the specific applications that are created by the consumer and hosted on the provider's infrastructure.

Due to the nature of cloud services, the use of the traditional waterfall method which requires extensive requirements gathering and analysis at the beginning of a project is difficult to apply. Cloud services provide the ability to deliver a working software product in a shorter time frame with limited development costs. Both the OMB, and the GAO have issued guidance on implementing flexible systems in shorter timeframes and more efficient cost savings.

The cloud architecture creates several challenges when applying the principles of SFFAS 10.

- **Issue #1:** Determining when the software should be capitalized using the SFFAS 10 definitions of development phases.
- **Issue #2:** Determining what costs should be capitalized.
- **Issue #3:** Determining how to allocate development costs to multiple projects concurrently
    - **IAAS**
    - **PAAS**
- **Issue #4:** Useful life determination
    - **How long does organization plan to retain hosted applications**
    - What would be useful life when IAAS or PAAS when using for multiple development efforts that may have varying useful lives

ISSUE #1: TIMING OF CAPITALIZATION

Software in a cloud environment is able to follow the traditional waterfall approach to development to a limited extent when the model is SaaS. Under this model, requirements for a system are developed, management authorizes and commits to a

project, and user acceptance testing occurs. However, the challenge arises when determining if the software meets the useful life test. The majority of SaaS models are paid on an annual subscription basis, but provide the opportunity for the consumer to cancel prior to each renewal. In the instances in which software is purchased as a subscription, the project is authorized and completed; however, it is indeterminable as to how long the software will be used to perform the intended function with a service life of 2 or more years.

Under both the PaaS and IaaS cloud solutions, the timing of capitalization becomes more challenging in that the platform and the infrastructure may host multiple applications. The underlying costs of the infrastructure and platform should be included in the capitalized cost of each application. However, allocating these costs and determining the timing may be difficult as applications with different useful lives are hosted on the infrastructure and platform.

Further, cloud subscriptions frequently must commence before the application can be configured to meet the consumer's needs or development can commence under Iaas and PaaS. Those configuration costs should be included in the capitalized costs, but the timing may not coincide with the actual go-live date of the application. In these circumstances, the standard does not provide clear direction as to when capitalization should begin. Organizations must determine whether capitalization should coincide with the commencement of the subscription, the completion of configuration, completion of acceptance testing, or the actual go-live date, all of which could result in a different timing of capitalization.

ISSUE #2: COSTS OF CAPITALIZATION

SFFAS 10 provides guidance for determining which costs should be capitalized and which costs should be expensed. However, this guidance is tied to the three linear phases of software development. Due to the nature of the costs within a cloud environment, determining which costs, if any, should be capitalized is a challenge. The major components of cloud solutions are the licensing fees for the subscription and the data storage fees. In order to meet capitalization criteria, the subscription period and the costs of the licenses should be evaluated in accordance with lease criteria as discussed in TR 5. Cost determination is further complicated by data and storage fees that may be charged on a monthly basis. Although those costs are typically expensed, if they relate to the hosting of the specific application and expect to be incurred throughout the useful life of the application, they may need to be evaluated for capitalizations.

Aside from the licensing fees, the nature of the SaaS model specifically does not provide the opportunity for development as the application is built and maintained by the solution provider versus the consumer. Therefore, upgrade costs are typically not incurred under the SaaS model of cloud solutions. However, costs associated with customized add-ons to the baseline software may result in enhancement costs if significant charges are needed.

Under PaaS and IaaS, the costs associated with development would be determined for each application and a portion of the infrastructure or platform costs should be included. However, the challenge is determining if those costs (whether they are general licensing, data, or storage costs), should be capitalized at all. Therefore, determining how those

costs should be allocated to the specific application being developed becomes a secondary challenge.

Additional considerations regarding the costs to be capitalized include asset disposition costs. The cost of general property, plant and equipment (including internal use software) includes installation and disposition costs. Under the cloud environment, consumers frequently incur costs to configure the IUS asset at startup and also to retrieve and download all of its data at contract expiration. The nature of these costs need be evaluated for capitalization as they relate to the overall asset cost. This approach is not congruent with the traditional waterfall approach.

ISSUE #3: ENHANCEMENTS

The rules of SFFAS 10 state that enhancements should be capitalized when they will result in significant additional capabilities.

In the SaaS cloud environment, each new iteration of software is developed and installed by the service provider as part of the licensing and maintenance agreement of the baseline software. Therefore, no enhancement costs would be expected for the baseline as they would be expensed. However, maintenance for upgrades built by the consumer on the baseline software are usually the responsibility of the consumer. Most service providers provide these services for a fee which should then be considered for capitalization.

In the PaaS and IaaS, development costs for enhancements would be capitalized under SFFAS 10 guidance if they meet the capitalization criteria. However, depending on the development approach used for PaaS and IaaS, the applicability of the waterfall approach to capturing costs would need to be determined.

ISSUE #4: USEFUL LIFE

SFFAS 10 defines useful life as a capitalized software project that has an estimated service life of 2 years or more.

Useful life is defined in SFFAS 6, as adapted from Kohler's Dictionary for Accountants, as *the normal operating life in terms of utility to the owner* (SFFAS 6, p. 17)

In the instances in which fully functioning software is hosted under the SaaS model, the project is authorized and completed; however, it is indeterminable how long the software will be used to perform the intended function since it is subscription based. If the subscription is based upon an annual renewal, the criteria for a service life of 2 or more years is not met under the existing standards, and the software would be expensed.

In the IaaS and PaaS, the challenge with determining useful has multiple components. If the term of subscription for the infrastructure or platform is on renewed annually, it would not meet capitalization criteria based on less than two year life. However, if the licensing agreements for the platform or infrastructure services themselves exceed the two year useful life, then they should be considered for capitalization.[8] Depending on the frequency of development and deployment under IaaS and PaaS, the useful life may be a combination of the baseline licensing agreement for the services, and expected level

of software development and deployment under these models. Individual software applications would have their own useful lives, but must take into consideration the overall licensing terms of the underlying IaaS and PaaS agreements need. If the useful of a particular application is expected to extend beyond the baseline IaaS and PaaS agreements, then a determination of whether to extend the IaaS and PaaS useful lives would be required or an adjustment to the application useful life.

Implications as a Cloud Service Provider

Cloud service providers will typically charge service fees to use the cloud, but will also incur various development costs for items such as web site development, development or acquisition of software to be used by the customer, in addition to infrastructure and maintenance costs. Costs related to the development of the cloud are currently capitalized under SFFAS 10, as it is software used to provide a service.

In many instances similar issues exist, as discussed above, when applying SFFAS 10 in instances where the Agency is a cloud service provider. Additional challenges for cloud service provider include ownership of the software asset(s), specifically when written agreements, if they exist, are silent as to ownership rights. In some instances, funding for various components of the cloud have been appropriated to multiple agencies (i.e. Agency A is appropriated funding for the infrastructure while Agency B is appropriated funding for the platform development and various Agencies receive funding for applications to be available for use among multiple entities).

Additionally, for SaaS models, applications become available-for-use to various entities on the cloud. If the entity has a need for the application, additional development costs might be incurred for configuring the application for specific agency needs. Such a scenario involves the consideration of imputed cost for the use of the software (expensed) with actual costs for enhancements/modifications (capitalized).

SOFTWARE DEVELOPMENT IN A SHARED SERVICES ENVIRONMENT

In a shared services environment, IT services are centralized for an agency or for multiple agencies. It is aimed at improving processes and reducing operating costs by leveraging shared platforms and service delivery. While not explicitly detailed in SFFAS No. 10, clear guidance is given in the CIO Council's Federal Shared Services Implementation Guide (drafted to assist agencies with carrying out the processes outlined in OMB's Federal IT Shared Services Strategy).

SFFAS No. 10 outlines the terms in which agencies are to capitalize software packages, though not specifically for shared services, it does cover bundled packages and bulk purchases:

> *Federal entities may purchase software as part of a package of products and services (e.g.,training, maintenance, data conversion, reengineering, site licenses and rights to future upgrades and enhancements). Federal entities should allocate the capitalizable and non-capitalizable cost of the package among individual elements on the basis of a reasonable estimate of their relative*

> *fair values. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements should be expensed. (SFFAS 10, p. 10)*
>
> *Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system. That guidance should consider whether period cost would be distorted or asset values understated by expensing the purchase of numerous copies of a software application or numerous components of a software system and, if so, provide that the collective cost should be capitalized. (SFFAS 10, p. 10)*

Applying the standard adds a measure of difficulty when implementing shared services because of the lack of clarity giving way to issues/concerns that the guidance does not cover.

Challenges that exist in developing software in a shared services environment are as follows:

- **Issue #1:** Ensuring adequate IT resources and infrastructure for the timely implementation of the shared services program. Lack of resources and/or substandard resources will hamper the launch of the agency's shared services program.
- **Issue #2**: Ensuring early buy-in from key stakeholders is fundamental to effective implementation of the shared services environment. The organizational culture resists the transformation to a new way of doing business.

ISSUE #1: INADEQUATE RESOURCES

When entering into a shared services environment program, it is imperative that the necessary equipment is available to launch. Without this crucial step, the success of the program does not exist. It is in the Preliminary Design phase that management defines and identifies the required software/IT resources. While SFFAS No. 10 may be silent on what software is required, it specifically treats preliminary design phase costs as expenses, with capitalization occurring after the conceptual formulation, design and testing of possible software alternatives. The challenge comes in identifying the IT resources and determining each of the agency's responsibility for ensuring the acquisition of sufficient IT resources for proper implementation.

ISSUE #2: STAKEHOLDER BUY-IN/ORGANIZATIONAL CULTURE

There needs to be a top-down, bottom-up understanding of the decision to move to a shared services environment. When OMB implemented its Federal IT Shared Services Strategy for all federal agencies to move to shared services, it became imperative that management executives and staff-level employees alike adhere to the policy. The CIO Council's Federal Shared Services Implementation Guide that details how to implement it was issued in April 2013. Communication and understanding is the key.

Management is needed to authorize and implement the agency process for participating in a shared services environment. The OMB strategy and guidance are new releases for shared services. There is no specific coverage on this topic in SFFAS No.10 which is of

concern as with any new initiative. However, some direction, the software development life-cycle is covered as follows:

> *Software's life-cycle phases include planning, development, and operations. This standard provides a framework for identifying software development phases and processes to help isolate the capitalization period for internal use software that the federal entity is developing. (SFFAS No. 10, p. 6)*

Staff-level employees are critically needed as they perform the day-to-day work and have the technical skills and knowledge necessary for conveying software specifications. Employees are resistant to change fearing that the legacy system in hand is better than the transitioning system.

SOFTWARE DEVELOPED FOR TARGETED USE

Certain software is developed for a specific targeted use of the entity, as opposed to business-type activities (i.e. an ERP or HR system). Software that is developed internally to meet the targeted use of the reporting unit (i.e. Agency, Department) does not typically follow the development cycle and usage as defined in SFAAS No. 10.

In accordance with SFFAS 10, *entities should capitalize the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E)* (SFFAS 10, p. 15).

> *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, or*
> - *It is used by entities in activities whose costs can be compared to those of other entities performing similar activities (e.g Federal hospital services in comparison to other hospitals).* (SFFAS 6, p. 23)

Internal use software is specifically identifiable, can have determinate lives of 2 years or more is not intended for sale in the ordinary course of operations, and has been acquired or constructed with the intention of being used by the entity (SFFAS 10, p. 38)

Challenges that exist as they relate to targeted use software are as follows:

- **Issue #1**: Determining an appropriate useful life for software that is developed for target-specific needs.
- **Issue #2**: Distinguishing enhancements and an intended useful life for applications that are developed to perform a targeted need, in which numerous

versions need to be supported and deployment of the version is contingent on the specified target.

- **Issue #3**: Defining development activities for instances when targeted use software is deployed directly into operations before product testing is completed and formal user acceptance has occurred.

ISSUE #1: USEFUL LIFE

In accordance with the accounting standards, software should have an estimated service life of 2 years or more in its intended function and utility to the owner.

In the instances in which software is developed for target-specific needs, the project is authorized and completed; however, it is indeterminable as to whether the software will be used to perform the intended function with a service life of 2 or more years. This software may never be deployed; may be deployed for a single target and used until the target-specific mission is completed (hours to years); or, may be deployed for one target and then shelved for use on a different target in the future that is lagging on cyber-technologies (i.e. third world nation).

ISSUE #2: MULTIPLE VERSIONS

When determining whether a capitalizable enhancement exist, the accounting standard states that e*nhancements normally require new software specifications and may require a change of all or part of the existing software specifications as well.* (SFFAS 10, p. 26)

Additionally, in determining the useful life, SFFAS 10 references that such useful life should be consistent with the planning of the software's acquisition:

Software that is capitalized pursuant to this standard should be amortized in a systematic and rational manner over the estimated useful life of the software. The estimated useful life used for amortization should be consistent with that used for planning the software's acquisition (SFFAS 10, p. 32).

Certain software is developed for targeted use purposes in which the development and maintenance of numerous versions/instances is necessary; and as such, the existing application is not subject to a "required upgrade" to the latest version. Targeted use applications need multiple instances due to varying platforms/operating systems (i.e. one software application to perform a target-specific need may need to be developed for Windows, Android, iOS, etc. Within the various platforms, application instances are tweaked for various releases (i.e. Windows 7, Windows Vista, Windows XP, etc). When a version of the operating system is upgraded, an enhancement to the software product will need to be made; however, the old instance is still in use and not impaired/obsolete because the targets do not necessarily upgrade as well. For most business applications that are deployed to a customer base, the newest versions of the software typically replaces or is intended to replace the previous version. In this model, the useful life for the enhancement (i.e. newer version) and the impairment of the older version would be evaluated.

For targeted use applications where multiple versions are maintained, "utility to the owner" (as discussed in Issue #1 above) is unknown as it is dependent on commercial industry trends and targets. Certain instances may never need to be utilized, while

others could last for a substantial period of time. In the instance where multiple versions of a software application need to be developed and maintained, enhancements remain necessary to support the application on various platforms and it does not require a change or impairment to the existing software specifications.

In instances where each version must be held indefinitely based on various target needs, management is unable to determine whether such version will be deployed and the basis for determining a useful life upon deployment. Funding for the application is not based on an instance-level and the old software does not get replaced; therefore it is not expensed at the deployment of the newer instance.

ISSUE #3: DEPLOYMENT

The rapid pace of technological advancements that are being made by our adversaries imbeds too much uncertainty as to whether software projects will have a useful life equal to or exceeding two years. In addition, to meet intelligence and information assurance needs in real-time requires a condensed software development life-cycle that prohibits a reliable, consistent, and cost effective determination of whether software projects are in the software development phase as defined by SFFAS 10, as software could cycle in-and-out of development based on the urgency of the targeted use and can be deployed in conjunction with testing.

SFFAS 10 speaks to commencing amortization as follows:

For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on the completion of another module(s), the amortization of that module should begin with both the module and the other module(s) have successfully completed testing (SFFAS 10, p. 33)

In some instances, software deployed directly into operation does not always meet the capability of the end-user and therefore the project must either be abandoned or returned to developers for further design activities. Without the designation of successful testing and the ability to distinguish between software components for the software projects, it is difficult to determine when amortization should commence. The standard emphasizes *the need for a clear point for ending the developmental phase* (SFFAS 10, p. 41) to determine the commencement of amortization; however, if this point is not defined, the software could be held in a work-in-progress account indefinitely.

Also, many times user acceptance testwork is not completed due to the urgency of the target-specific task.

CONCLUSION

Software development has dramatically changed since the issuance of SFFAS 10 in June 1998. The standard was written to conform to the waterfall approach with three

distinct life-cycle phases, which was the prevalent development approach at the time. While the standard acknowledges that various development frameworks exist, there is no incorporation of these differences in SFFAS 10. Thus accounting for IUS becomes increasingly challenging as federal agencies move toward nonlinear approaches to develop software. Many of the issues in dealing with new development techniques and software architectures (such as the Cloud) are focused on timing of capitalization, costs of capitalization, and estimating useful life.

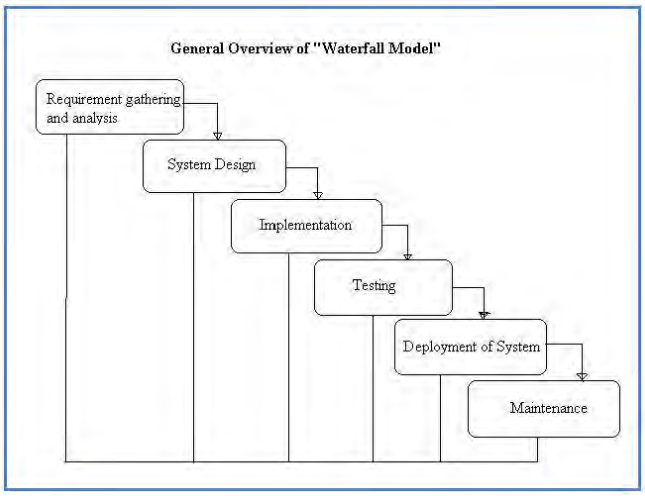
Federal agencies are also moving toward more shared services agreements in an effort to make better use of limited resources. Because, SFFAS 10 has no specific coverage of this topic, there is lack of clarity in applying the concept, especially with regard to asset value and ownership.

Finally, development of internal use software as applied in SFFAS 10 is more focused on administrative type applications. Many agencies have targeted use software that has a more focused scope. While the development costs may meet the threshold for capitalization, mission software has many unknowns including useful life.

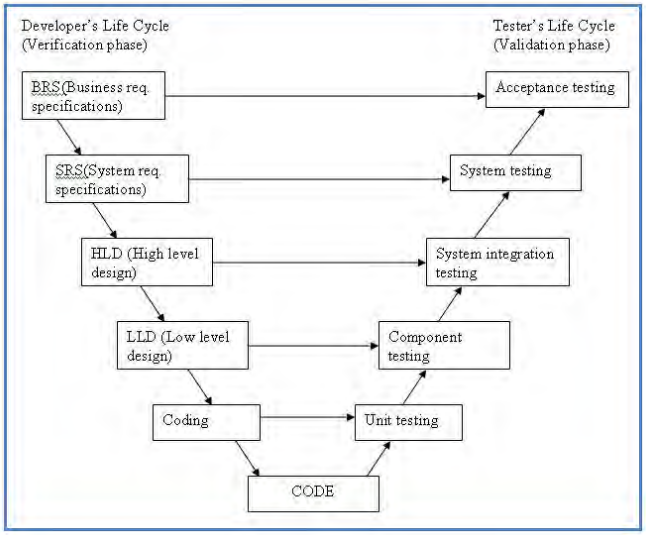
Modifications to the standards will need to clearly address the above issues and provide specific guidelines for applying the standard to the changing software development environment.

APPENDIX 1: SOFTWARE DEVELOPMENT MODEL DIAGRAMS

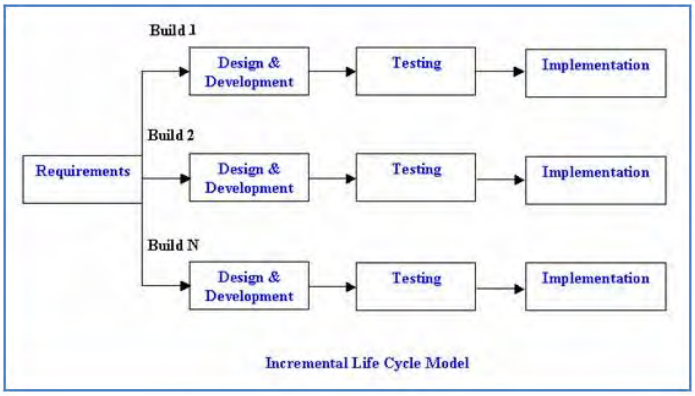
Waterfall Model



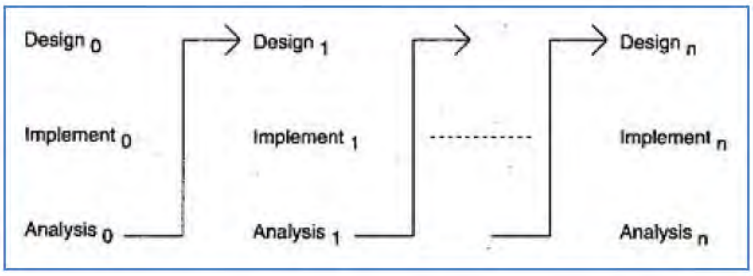
V Model



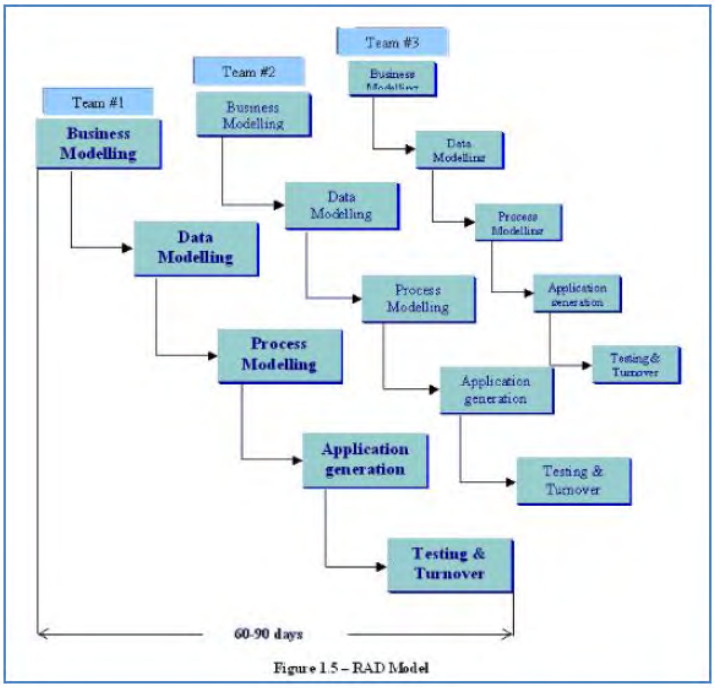
Incremental Model



Iterative Model

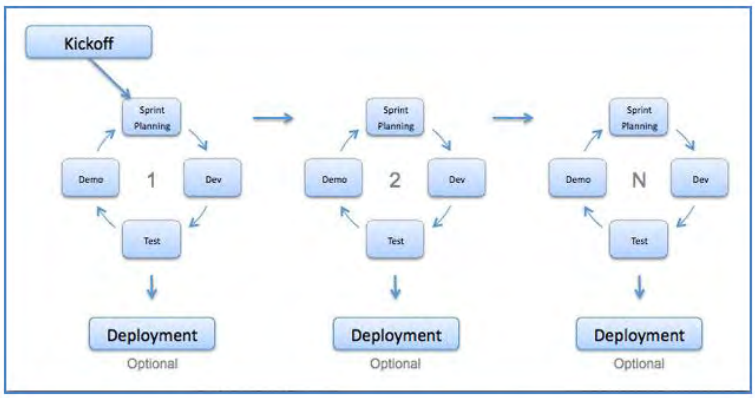


RAD Model

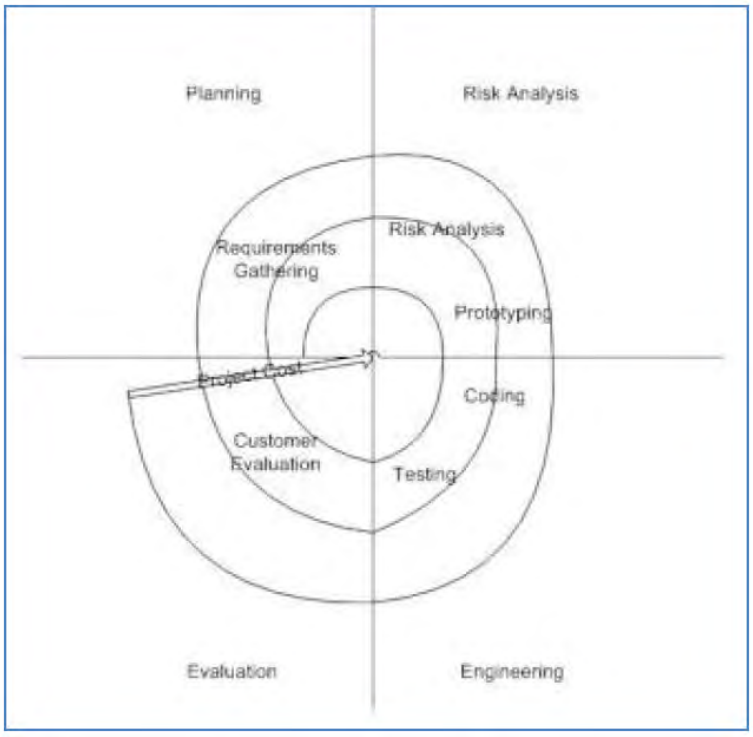


Business modeling: The information flow is identified between various business functions.
Data modeling: Information gathered from business modeling is used to define data objects that are needed for the business.
Process modeling: Data objects defined in data modeling are converted to achieve the business information flow to achieve some specific business objective. Description are identified and created for CRUD of data objects.
Application generation: Automated tools are used to convert process models into code and the actual system.
Testing and turnover: Test new components and all the interfaces.

Agile Development



Spiral Model



ENDNOTES

[1] Information obtained and summarized from ISTQB (International Software Testing Qualification Board) Foundation Level Certification for Software Tester syllabus (Version 2011) and study material (http://istqbexamcertification.com/what-are-the-software-development-models/)
[2] OMB Circulars A-130 and A-11, as well as the Capital Programming Guide, include modular development and contracting approaches for capital assets.
[3] GAO 12-681, *Software Development: Effective Practices and Federal Challenges in Applying Agile Methods*
[4] Microsoft Application Architecture Guide, 2nd Edition – October 2009
[5] National Institute of Standards and Technology, Special Publication 800-145, NIST Definition of Cloud Computing, Recommendations of the National Institute and Standards and Technology, Peter Mell, Timothy Grance, Page 2
[6] IBID, Page 2
[7] IBID, page 3
[8] NOTE: Further discussion on lease accounting, as it relates to software subscriptions, is being reviewed by another FASAB working group.

FASAB IUS WORKING GROUP

Key Concepts

Deliverable 2

Standards Team

9/11/2013

A review of key Statement of Federal Financial Accounting Concepts (SFFAC) as they relate to the criteria and capitalization of Internal Use Software (IUS).

Contents

Introduction

The Federal Accounting Standards Advisory Board (FASAB) created accounting concepts to guide the formulation of federal accounting standards. According to FASAB:

> *Each Statement of Federal Financial Accounting Concepts (SFFAC) is part of a series of concepts statements intended to set forth objectives and fundamentals on which financial accounting and reporting standards will be based. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial accounting-concepts that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties.*
>
> *The Federal Accounting Standards Advisory Board's (FASAB or "the Board") conceptual framework enhances the consistency of standards and serves the public interest by providing structure and direction to federal financial accounting and reporting. (FASAB Handbook, Version 11, p. 6)*

Because these guide accurate financial reporting and interpretation of the standards, they should be referenced and incorporated into any modifications of a standard.

There are three financial accounting concepts that directly impact accounting for and capitalization of Internal Use Software (IUS). These include *SFFAC 1 - Objectives of Financial Reporting*; *SFFAC 5 - Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, and *SFFAC 7 – Measurement of the Elements of Accrual-Basis Financial Statements*.

When updating Statement of Federal Accounting Standard (SFFAS) No. 10 – *Accounting for Internal Use Software*, it is essential to adhere to the fundamental concepts presented which include determining the objectives for financial reporting, recognizing the criteria for an asset, and measuring the cost of the asset accurately.

SFFAC 1, "Objectives of Financial Reporting".

Key excerpts from Concept Statement

SFFAC 1 considers the users of government financial information, when determining the objectives of financial reporting, and classifies the users into four major groups: *citizen, Congress, executives, and program managers* (par. 75).

Financial Reporting Objectives

SFFAC 1 contains four main objectives of financial reporting:

1 Budgetary Integrity – fulfilling the government's duty to be publically accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations (par. 13).
   - The focus is on recording actual data from budget execution against appropriations made by Congress in using existing budgetary standards in accordance with legal authorization (par. 113).
   - The use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities (par. 119).

2 Operating Performance – evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities (par. 14).
   - Federal financial reporting should provide information that helps the reader to determine the efficiency and effectiveness of the government management of its assets and liabilities (par. 130).

3 Stewardship – assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future (par. 15).

4 Systems and Control – understanding whether financial management systems and internal accounting and administrative controls are adequate (par. 17).
   - Transactions are executed in accordance with budgetary and financial laws and other regulations.
   - Assets are properly safeguarded (par. 146).

Consistency Principle for Financial Reporting

> Financial information must have the following basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability (p. 156).

With an emphasis on consistency, the concept states the following:

> Financial reports should be consistent over time; that is, once an accounting principle or reporting method is adopted, it should be used for all similar transactions and events unless there is good cause to change. The concept of consistency in financial reporting extends to many areas, such as valuation methods, basis of accounting, and determination of the financial reporting entity. If accounting principles have changed or if the financial reporting entity has changed, the nature and reason for the change, as well as the effect of the change, should be disclosed (par. 163).

Purpose of the matching principal in Federal Agencies

> Because government services are not usually provided in exchange for voluntary payments or fees, expenses cannot be matched against revenue to measure "earnings" or "net income" as would be done in business accounting. Moreover, directly measuring the value added to society's welfare by government actions is difficult. Nonetheless, expenses can be matched against the provision of services year by year. The resulting cost can then be analyzed in relationship to a variety of measures of the achievement of results (par. 124).
>
> The accrual basis of accounting generally provides a better matching of costs to the production of goods and services, but its use and application for any given purpose must be carefully evaluated (par.197).

Application of Concept to current accounting standards

When evaluating the criteria of determining the financial accounting for IUS, the operating performance objective is the most prevalent. SFFAS 10 distinguishes the costs by effort through defining phases (i.e. preliminary design, development and post-implementation) and amortizes the entity's asset over a useful life which can be determined based on intended funding requirements. Assets are discussed in SFFAC 1 as follows:

> In government, as in the private sector, assets are expected to provide benefits that outweigh costs… Expected benefits often are not cash inflows but rather are the services provided by the asset. Sometimes those services are provided to the government itself (e.g. government office buildings or motor pools). More often, the services are provided to the public (e.g. education and research development) (par. 65).

Additionally, SFFAS 10 emphasizes the need for full costing associated with a project. Full costing is addressed in SFFAC 1 as follows:

> Full assignment of all costs of a period, including general and administrative expenses and all other indirect costs, is an important basis for measuring cost of service. However, full cost is not necessarily the relevant cost for making all decisions (par. 198).

If changes to the current accounting standards are made, it is important to consider the consistency characteristic and matching principal to ensure proper disclosure for the nature and reason for the change.

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SFFAC 5, "Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements"

When proposing changes to the IUS Standard, it is necessary to ensure that the updated guidance in implementing the standard does not conflict with Concept 5's definition of an asset, definition of an expense, basic recognition criteria for assets, and the reporting entity who reports the asset (pg. 1).

Key excerpts from Concept Statement

Definition of an Asset – a resource that embodies the economic benefits or services the federal government controls. Paragraphs 21 – 35 describe essential characteristics of an asset.
Definition of an Expense – outflow of or other decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period. Paragraphs 52 – 56 describe characteristics of expenses and revenues.

The statement establishes two basic recognition criteria that an item must meet to be a candidate for recognition in the body of a financial statement:

1. "the item must meet the definition of an element" (i.e., asset, liability, net position, revenue, expense)
2. "the item must be measurable, meaning a monetary amount can be determined with reasonable certainty or is reasonably estimable."

"Meeting the basic recognition criteria is a necessary but not sufficient condition for recognition. Additional considerations for a recognition decision are measurement of the candidate for recognition and assessments of the materiality and benefit versus cost of the amount measured. Measurement entails selection of an appropriate attribute, such as historical cost, fair value, or expected value, and application of a measurement method. Measurement may require the use of estimates or approximations and, for items that meet the definition of an asset or a liability, an assessment of the probability that future inflows or outflows of economic benefits or services will result from the item" (pg. 2).

Reporting Entity - Questions related to which component entity of the federal government should report an item – review of authorizing legislation, appropriations act and related federal laws could establish the entity which has responsibility, based on the component entity that is responsible and accountable for "receiving, controlling, managing, and utilizing government assets… When no component entity has a

comprehensive relationship, the assets and other elements involved should be reported by the component entity most responsible for managing them" (par 12-13).

The economic benefits or services embodied in resources may be shared by the government and another entity (defined in paragraph 16 as entities external to the federal government or for a component entity this also includes other component entities) through specific arrangements. For example, the government and another entity may enter into a joint venture to share an interest in the resources committed to the joint venture. If so, each party may possess asset comprising its respective share of the benefits for services. Thus, both parties may have assets corresponding to their respective rights (par 28).

Application of Concept to current accounting standards

Modern software development models and government contracting guidance currently trend towards an iterative development model making it harder to distinguish the actual costs incurred (i.e. historical cost) associated with development, as defined in SFFAS 10, in a cost effective manner. While the software assets are currently valued at historical costs, as discussed in further detail below, the concept statements allow for other measurement approaches to be used; however, consideration for consistency of the valuation methodology should be contemplated.

The scope of SFFAS 10 includes "software that is used to produce the entity's goods and to provide services (e.g. air traffic control and loan servicing)" as well as "software that is developed or obtained for internal use and subsequently provided to other federal entities with or without reimbursement." With current government initiatives focused on shared services, in some instances arrangements exist in which software is developed, funded and managed by multiple reporting entities, particularly in the cloud environment. The financial reporting and accounting standards associated with software developed and managed by multiple entities currently do not address this issue.

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SFFAC 7 – "Measurement of the Elements of Accrual-Basis Financial Statements in Periods after Initial Recording"

Updated guidance to SFFAS 10 for IUS, should not conflict with the qualitative characteristics of information in the financial statements, specifically with respect to measurement approaches and attributes.

Key excerpts from Concept Statement

Financial Reporting Objectives and Qualitative Characteristics (pg. 6, par. 6)

"The qualitative characteristics of information in financial reports are:

a. Relevance – The capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations.
b. Understandability – The quality of information that enables users to perceive its significance
c. Reliability – The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent
d. Comparability – The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena
e. Consistency – Conformity from period to period with unchanging policies and procedures
f. Timeliness – Having information available to a decision maker before it loses its capacity to influence decisions"

Measurement – The act or process of assigning dollar amounts to the elements of the financial statements (asset, liabilities, etc) (pg. 1). Measurement of assets and liabilities is grouped into two broad areas: Measurement Approach, and Measurement Attribute and Method.

Measurement Approach – (pg. 7 par. 7a) attributes and methods used for measuring assets and liabilities affect how the information is reported and interpreted

1 "Initial Amount" – amount initially recorded (i.e. the historical cost or historical proceeds (which may be adjusted subsequently for depreciation/amortization/depletion
2 "Remeasured Amount" – an amount measured at each financial statement date, such as the fair value.

Note – the above approaches are further broken down into nominal and constant dollars in paragraph 12.

Measurement Attribute and Method – (pg. 7 par. 7b)

1 "Measurement Attribute" – measurable characteristic of an asset or liability such as fair value, or settlement amount
2 "Measurement Method" – varies depending on the attribute selected, for example if measurement approach selected is "remeasured amount" and measurement attribute is fair value, a measurement method could be researching stock market quotes or obtaining a professional appraisal.

Different measurement attributes and methods may be used for different assets and liabilities, and the selections made can affect the usefulness of reported information for decision making (pg. 7 par. 7b).

Achieving the Financial Reporting Objectives (pg 13 and 14)

Remeasured amounts of assets and liabilities are determined using one of several possible measurement attributes that reflect economic conditions at the financial statement date, including, for example, fair value or settlement amount. Remeasurement updates a previously determined carrying amount to reflect a change in the economic value of an asset or liability that has occurred since the previous financial statement date. A remeasured amount thus differs from an adjustment to an initial amount that does not reflect a change in value. For example, an increase in the accumulated depreciation balance on a building does not change the economic value of the building and does not constitute remeasurement of its carrying amount. Unless the value of the building itself is remeasured at, for example, its fair value, the reported amount will continue to be considered the initial amount. In contrast, an adjustment to an allowance for uncollectible accounts receivable due to an increased risk of noncollection constitutes remeasurement of the carrying amount, even when the gross amount of receivables is not remeasured, because the adjustment reflects a change in the economic value of the receivables—the anticipated net settlement amount (par. 20).

Assessment of which nominal-dollar approach – initial amounts or remeasured amounts – better enables achievement of one or more of the financial reporting objectives vary according to the kinds of information users need and the decision to be made. In practice, federal financial statements traditionally have followed a "mixed-attribute" model. That is, some assets and liabilities, such as general property, plant, and equipment, have been reported at initial amounts (adjusted for depreciation, depletion or amortization, if applicable), and others, such as direct loans and loan guarantees, have been reported at remeasured amounts. (par. 21).

Continuing to report assets and liabilities at their initially recorded amounts in periods following their acquisition or incurrence is a long established approach to financial reporting and users are accustomed to that approach. Initial amounts generally are reliable and objective, based on documented evidence, although subjectivity subsequently may be introduced through the assumptions or methods adopted for calculating depreciation or amortization, such as depreciable lives and salvage values, or as previously indicated, through the allocation of indirect costs (par. 23).

Proponents cite these advantages in support of reporting at their initial amounts the costs of inventory and capital assets and the resultant costs of providing programs and activities (referred to in the operating performance objective). These proponents believe that it is not useful to remeasure and report assets at their potential sales prices or settlement amounts when they are being held to provide services, rather than for sale. In this view, assets held to provide services should be reported at the amounts paid for them (or other initial amounts), and the reported cost of using them each period should be a function of that amount (par. 24).

Reporting remeasured amounts may introduce significant uncertainties and subjectivity into the information provided to users because of the extent of judgment involved in developing these estimates (par. 26).

Supporters of remeasurement believe that users require up-to-date information about the price of assets held for sale or to generate future cash inflows. Further they believe that users also need information about the cost of programs and other ongoing activities based on the current costs of the underlying assets, particularly infrastructure and other capital assets that likely were acquired many years ago (par. 27).

Similarly, supporters of remeasurement believe that remeasured amounts of assets and liabilities, especially for assets acquired many years ago, are more relevant than initial amounts for assessing an entity's current financial position, service potential, and ability to meet obligations when due, as well as the magnitude of the entity's current and probable future resource needs (par. 28).

If an entity reports initial amounts, the statement of net cost reports the expiring benefits from previously expended budgetary resources only when the underlying assets are consumed or sold. The statement of net cost does not provide information about changes that occurs in resource prices or the values of existing assets in the intervening periods. In contrast, if the entity reports remeasured amounts, the information reflects the capacity of the underlying assets to provide goods and services in changing circumstances. The statement of net cost captures the period-to-period changes in asset amounts (holding gains and losses) in the periods in which they occur and reports the resources consumed

at current amounts, information that can help users assess stewardship and operating results each period (par. 30).

Value in Use

The measurement attributes discussed are those most commonly applied or available for use: *fair value, settlement amount, replacement cost, value in use,* and *fulfillment cost*. Additional measurement attributes may be developed in the future. Fair value and settlement amount may be used to determine either the initial amount (historical cost or historical proceeds) or the remeasured amount of an asset or liability. Replacement cost and value in use (for assets) and fulfillment cost (for liabilities) are not applicable for assessing initial amounts because they are attributes of assets and liabilities that an entity already has recorded. These attributes may be used to remeasure recorded amounts at subsequent financial dates (par. 36). *Value in use is the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life (par. 50)*.

Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service. Examples include inventory and equipment with a unique design and purpose, and special purpose buildings, such as prisons. In those cases, the value in use may be greater than the amount the entity could obtain from selling the asset because the selling price would need to accommodate the purchaser's need to adapt the asset to another purpose (par. 51).

The service potential of an asset may be difficult to assess when the asset is used in combination with other assets and the total assessment must be allocated to the individual assets. In those cases, the reliability, consistency, and understandability of the remeasured amounts may be lower than when a direct assessment can be made of the value in use of each asset. The relevance of value in use is high for assessments of an individual entity, both with regard to the entity's management and for users' evaluations of operating performance, especially the entity's efficiency and effectiveness in managing its assets. However, the entity-specific nature of value in use reduces inter-entity comparability (par. 52)

Application of Concept to current accounting standards

Currently, the standard reports all asset costs at the initial amount (i.e. amounts paid for them) and the cost of using them over each period is reflected through amortization. As discussed above, modern software development models are trending towards iterative development in which activities related to development are hard to isolate. As a result, tracking actual costs

using the initial measurement approach as the standard is currently written becomes increasingly costly. For these types of development models in which it becomes increasingly costly to isolate development expenditures or in instances where it is difficult to clearly define deployment and significant enhancements, it might be beneficial to consider a remeasurement model, such as value in use.

Utilizing a value in use model for development models in which the development period is not clearly defined or instances when software is developed for a special, unique purpose (i.e. mission-based software), could provide for the current cost of programs and reflect the capacity of the software to provide goods and services in changing circumstances (i.e. changes in technological advances). It would minimize the entity's judgment in defining a significant enhancement and allow for a methodology in which the total spend on the program (i.e. development and life cycle) is used to support the asset value and support the resources consumed at current amounts. However, it will increase the risk of subjectivity due to the extent of judgment involved to value the asset.

The value in use measurement model is based on the present value of future cash flows expected to be derived from the asset. A discount rate should be applied against the future cash flow projection to support the time value of money. Considerations in implementing the value in use remeasurement technique for software development should include the following:

- The reporting entity should be able to consistently distinguish when the software development costs cannot be clearly delineated and have proper documentation to reach their conclusion.
- Point of initial measurement for asset recognition should be established.
- It is imperative to have a determination of a value in use model reflecting the future value to support the asset value and changes in the statement of net costs. The model needs to include reasonable and supportable assumptions that represent management's best estimate of expected cash flows, including cash flows from use of the asset and eventual disposition over the remaining useful life of the asset. It can be based on the most recent financial budgets and should full costing (i.e. overhead that is directly attributed or allocated to the asset).
- Disclosure requirements should include the valuation process

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Summary

SFFAS 10: Accounting for Internal Use Software was designed around a software's life-cycle phases which include planning, development, and operations. The standard provides a framework for identifying software development phases and processes to help isolate the capitalization period (development phase) for internal use software (SFFAS 10, par 10.) Additionally SFFAS 10 focuses on the full cost (direct and indirect cost) incurred during the software development stage (par 16). However, the standard acknowledges that the life cycle management techniques that agencies can use may vary depending on the complexity and risk inherent in the project (A-130, "Analysis of Key Sections," p. 63)

SFFAC 1: Objectives of Financial Reporting addresses full costing and recognizes that it is not necessarily the relevant cost for making all decisions. Accordingly, accounting systems should permit the calculation of the relevant costs needed for a range of decisions, as determined by the specific situation, and financial reports should reflect costs suitable to the purpose intended (par 198).

SFFAC 1 also focuses on the consistency principle, and the matching principle If accounting principles have changed or if the financial reporting entity has changed, the nature and reason for the change, as well as the effect of the change, should be disclosed (par. 163).

A modification to SFFAS 10 would need to be evaluated in terms of disclosure requirements.

SFFAC 5: Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements is another key concept statement relating to the criteria and capitalization of IUS. In SFFAC 5 there are two basic recognition criteria for an item to be recognized in the financial statements – the item must meet the definition of an element (asset), and the item must be measurable (par 52-56). SFFAC 5 recognizes that additional considerations may be required when making recognition decisions. Measurement is a key element in determining what and how an item is to be presented on the financial statements.

Modern software development models and government contracting guidance currently trend towards an iterative development model making it harder to distinguish the actual costs incurred (i.e. historical cost) associated with development, as defined in SFFAS 10, in a cost effective manner. Alternative measurement methodologies would be evaluated against the measurement principles addressed in the concept statements.

Reporting Entity is also discussed in SFFAC 5. As government initiatives focus on shared services, with development and funding being managed by multiple reporting entities, determining the reporting entity becomes increasingly difficult. The current standard does not address this issue.

SFFAC 7: Measurement of the Elements of Accrual Financial Statements in Periods after Initial Recording focuses on measurement and measurement approach. Different measurement attributes and methods may be used for different assets and liabilities and the selections made can affect the usefulness of reported information (par. 7b). Thus, it is important to strive to achieve the Financial Reporting Objectives as stated in the concepts.

Currently, SFFAS 10 reports all asset costs at the initial amount (i.e. amounts paid for them) and the cost of using them over each period is reflected through amortization. With modern software development models using an iterative approach, the current measurement techniques may not be accurately achieving the financial reporting objectives. For these types of development models in which it becomes increasingly costly to isolate development expenditures or in instances where it is difficult to clearly define deployment and significant enhancements, it might be beneficial to consider a remeasurement model, such as value in use.

In conclusion, the concepts become the underlying basis for any modification in *SFFAS 10: Accounting for Internal Use Software*. As documented, the concepts allow for several methods in approaching the measurement and recognition of the IUS asset created. Any accounting principle change must also be evaluated for consistency and appropriate disclosure guidance provided.

Process	Reference in current standard	Development Technique	Issues	Proposed Solutions	Comments
Step 1: Begin Capitalization	SFFAS 10, Paragraph 16 Capitalized cost should include the full cost (direct and indirect) incurred during the software development stage. Such cost should be limited to cost incurred after: a) management authorizes and commits to a computer software project and believes that it is more likely than not that the project will be completed and the software will be used to perform the intended function with an estimated service life of 2 years or more and b. the completion of conceptual formulation, design, and testing of possible software project alternatives.	Linear/Sequential	None	NA	
		Cyclical	None	NA	
		Target	Targeted-use software does not follow formal acquisition strategies of an Agency as it is volatile based on current events and unknown if it is more likely or not that the project will be completed. Broad requirements are developed (i.e. track target) and then are refined over and over when software is pulled back after being placed into operation in a Beta form.	1. Expense targeted use software and disclose total investment in RSI. 2. Expense target use software. Better define Target-use software in a Technical release to support individual agency decisions to expense such software (i.e. because the definition does not meet the capital criteria set forth in SFFAS 10). No change to existing guidance; can be addressed and supported utilizing existing standards.	For solution 1, at what level? i.e. still need to track at individual level, only if exceeding threshold, all target-use effort, etc.? For solution 2, an implementation guide can be issued with illustrations/examples of applying current standards to existing, common issues.
Step 2: Accumulate WIP - Determine costs to be capitalized	SFFAS 10, Paragraph 17 Such costs include those for new software (e.g. salaries of programmers, systems analysts, program managers, and administrative personnel; associated employee benefits; outside consultants' fees; rent; and supplies) and documentation materials	Linear/Sequential	Modular development could result in development of future modules and maintenance of deployed modules occurring simultaneously	1. Capture all costs incurred after management makes "go" decision through "go-live" decision. These costs may include planning for additional increments or maintaining, enhancing prior increments. Under the provisions of estimation techniques in SFFAS 35, meet periodically with the IT SMEs to determine an appropriate estimate of maintenance costs to exclude from the capitalized portion. No change to existing guidance; can be addressed and supported utilizing existing standards. 2. Define "application maintenance" or "operations & maintenance" in implementation guidance. Perhaps use the first sentence of the definition of "Operations" from OMB's FY14 Exhibit 53/300 guidance: "Day-to-day management of an asset i the production environment including, but not limited to, activities that operate data centers, help desks, operational centers, telecommunications centers, and end-user support services." Limiting the definition of maintenance to these items potentially provides support to agencies to capitalize all development costs, whether for enhancements or repairing bugs. 3. In a similar manner as Technical Release 15, Appendix B, provide illustrations of the way the agencies representing this working group (plus others) have successfully addressed this issue.	Is the thought here that cap costs equal "go" on module/spiral 1 through "go live" on the last module?
		Cyclical	Cyclical development results in developers performing multiple phases (planning, developing, testing, maintaining, enhancing) simultaneously. The ability to distinguish capitalizable vs. non-capitalizable activities is not cost-effective.	1. Capture all costs incurred after management makes "go" decision through "go-live" decision. These costs may include planning for additional increments or maintaining, enhancing prior increments. No change to existing guidance; can be addressed and supported utilizing existing standards. 2. Through a technical release, broaden the definition of "final user acceptance testing" in implementation guidance to determine instances when the capitalization period should commence. 3. In a similar manner as Technical Release 15, Appendix B, provide illustrations of the way the agencies representing this working group (plus others) have successfully addressed this issue.	
		Target	Targeted-use software typically follows cyclical development models, however great uncertainties over useful life, viability, and operational use are great.	1. Expense targeted use software and disclose total investment in RSI. 2. Expense target use software. Better define Target-use software in a Technical release to support individual agency decisions to expense such software (i.e. because the definition does not meet the capital criteria set forth in SFFAS 10). No change to existing guidance; can be addressed and supported utilizing existing standards.	

Process	Reference in current standard	Development Technique	Issues	Proposed Solutions	Comments
Step 3: Determine when placed in service	SFFAS 10, Paragraph 33 For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing.	Linear/Sequential	None	NA	
		Cyclical	Software is placed in service at IOC (initial operating capability). This could include only a small portion of the software's capabilities. Thereafter, additional deployments occur; however, the FOC (final operating capability) is not always defined.	1 Capitalize costs up to initial deployment, and disclose in RSI additional costs related to the software lifecycle (to include development and maintenance) thereafter. 2. Capitalize costs and begin amortizing at initial deployment. Continue to accumulate all costs until software is substantially complete. This might include maintenance and minor enhancements to prior deployments; however, costs are not easily distinguishable. Subsequent to substantial completion, annually disclose in RSI additional costs related to the software lifecycle thereafter and consider significant enhancements for capitalization. No change to existing guidance; can be addressed and supported utilizing existing standards.	
		Target	Software may not be placed into service or may be placed into service and taken out of service. Software may also be placed into service in its Beta form and then continued, rapid development will happen to modify the software specific to the changing target.	1. Expense targeted use software and disclose total investment in RSI. 2. Expense target use software. Better define Target-use software in a Technical release to support individual agency decisions to expense such software (i.e. because the definition does not meet the capital criteria set forth in SFFAS 10). No change to existing guidance; can be addressed and supported utilizing existing standards.	
Step 4: Determine additional capitalizable enhancements	SFFAS 10, Paragraph 25-27 The acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities. For example, in an instance where the federal entity adds a capability or function to existing software for making ad hoc queries, the cost would be capitalized. Enhancements normally require new software specifications and may require a change of all or part of the existing software specifications as well. The cost of minor enhancements resulting from ongoing systems maintenance should be expensed in the period incurred. Also, the purchase of enhanced versions of software for a nominal charge are properly expensed in the period incurred. Costs incurred solely to repair a design flaw or to perform minor upgrades that may extend the useful life of the software without adding capabilities should be expensed.	Linear/Sequential	None	NA	
		Cyclical	1. Distinguishing an enhancement from part of the ongoing cyclical development. New releases typically include bug fixes, minor upgrades, user-enhancements, as well as changes to functionality. 2. Enhancements continue for a number of years (typically beyond the initial useful life given to the software).	1. Disclose (in RSI or footnote) total amount spent related to software lifecycle in current year. Provides information to the user without having to distinguish enhancement type. 2. Capitalize all program costs from "go" decision through program completion. 3. Follow the objective of the contract; Language in FASB ASC 350-40-25-11 refers to external costs (i.e. contracts) related to specific upgrades and enhancements: If maintenance is combined with specified upgrades and enhancements in a single contract, the cost shall be allocated and the maintenance costs shall be expensed over the contract period. However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements shall be recognized in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received. No change to existing guidance; can be addressed and supported utilizing existing standards. 4. Consider significant enhancements that extend the useful life and provide significant additional capabilities / functionality as capitalizable. Or, consider assigning longer useful lives to software assets when it is expected that development will be necessary to keep the asset up-to-date and performing its intended function. No change to existing guidance; can be addressed and supported utilizing	For solution 1, disclosure could be annual expenditures for CY plus four prior years or could be comparative broken out by software program and further by O&M vs. DME. For solution 2, need to determine if costs would remain in WIP through project completion or if additional asset value would be added annually. What would be the related impact to depreciation?
		Target	Target-use software typically follows cyclical development model. Software is deployed and enhancements are made frequently to meet target needs.	1. Expense targeted use software and disclose total investment in RSI. 2. Expense target use software. Better define Target-use software in a Technical release to support individual agency decisions to expense such software (i.e. because the definition does not meet the capital criteria set forth in SFFAS 10). No change to existing guidance; can be addressed and supported utilizing existing standards.	
Step 5: Determine non-capitalizable software related costs	SFFAS 10, Paragraph 20 Costs incurred after final acceptance testing has been successfully completed should be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site.	Linear/Sequential	None	NA	
		Cyclical	Final acceptance testing does not always occur.	1. Identify a "substantially" complete point (see definitions below) and then disclose in RSI amount spent related to software lifecycle in currently year after that point occurs.	
		Target	Final acceptance testing does not occur. The beta software is deployed into operations to see if it works. Then it is pulled back and additional development occurs based on user feedback and changing target specifications.	1. Expense targeted use software and disclose total investment in RSI. 2. Expense target use software. Better define Target-use software in a Technical release to support individual agency decisions to expense such software (i.e. because the definition does not meet the capital criteria set forth in SFFAS 10). No change to existing guidance; can be addressed and supported utilizing existing standards.	

General note: If RSI disclosure is made for total life-cycle of project, need to clearly define/distinguish types of costs that should be included in the disclosure; i.e. all costs related to the programs' life cycle (excludes costs of users and analysts).

Definitions

Linear/Sequential Development Models	Each phase must be completed fully before the next phase begins. This can also include modular development where the phases and deployments are clearly delineated.
Cyclical Development Models	In cyclical development, the project goal is pursued in several short, successive consecutive cycles. Each cycle is relatively short and within each cycle, a portion of the project is carried out. Analysis, design, implementation and testing occur within each cycle. Cyclical development slices system functionality into increments (portions). In incremental development, different parts of the system are developed at various times or rates and are integrated based on their completion. In iterative development, teams plan to revisit parts of the system in order to revise and improve them.
Targeted-Use Software	Software developed in response to short-fused requirements to meet specific target-needs. Target-use software is customized to meet specific requirements and have some of the following characteristics: A) Operational Significance is unknown at the time of development B) It is unknown if the software will be ever be deployed or if deployed it is unknown as to the length of time (hours to years) to reach the target; C) Software is deployed directly into operations before testing is complete with no formal user-acceptance test work performed. D) Deployment of the software is dependent on the targets technology; therefore, multiple versions are developed and maintained to meet various technological stages. E) No alternative future use.
Life Cycle Support / Maintenance	The act of keeping software in a usable condition, including preventative maintenance, normal repairs, development to keep the software relevant, and other activities needed to preserve the asset so that it continues to achieve its intended capability.
Substantially Complete	Capture costs until the technology is available for its intended use. Deployed software meets a substantial portion of high-level and/or critical requirements and functionality.

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April 29, 2014

Memorandum

To: Accounting and Auditing Policy Committee

From: Domenic N. Savini, Assistant Director

Through: Wendy M. Payne, Executive Director

Subject: **Implementation Guidance Survey Results: SFFAS 44: *Accounting For Impairment of General Property, Plant, and Equipment Remaining In Use***

As a result of informal input suggesting that implementation guidance may be needed, we conducted a survey between February 24th and April 4th to identify potential implementation issues that might arise as a result of SFFAS 44 which becomes effective in fiscal year 2015. The survey period was extended to April 11th due to inclement weather experienced during the earlier part of the survey period.

The survey was sent directly to the following two groups: DM&R Task Force and the SGL/IRC Group. In addition, OMB and Treasury representatives were requested to circulate the survey to the CFO Council and Treasury's FMS. Please refer to Attachment 1 for a copy of the survey form.

In addition to the survey, two field visits were conducted:

- Department of Transportation Headquarters, Office of Real, Personal Property, and Asset Management on March 12th.
- Department of Energy Headquarters, Office of Financial Risk, Policy, and Controls on April 17th.

A total of 8 responses were received and half of or 4 of the responses were "negative" – noting that no implementation issues were identified for FASAB's consideration. We did receive 4 "positive" replies and they are detailed in Attachment 2. A summary of those responding to the survey follows on page 5.

Based on my review of the "positive" replies, there are 2 matters that could have broad implications that the AAPC may wish to consider:

1. Assets under construction and,
2. Clarifying the circumstances when TR-14 and SFFAS 44 each apply.

Assets Under Construction – we had 2 respondents who sought clarification in this area. One respondent (Interior) made a generalized request for clarification whereas the other (U.S. Mint) respondent was more specific. As such, I have listed the following U.S Mint questions and related unofficial, sense-of-staff answers:

1. The U.S. Mint is not exactly sure how we would impair a "Construction-In-Process" (CIP) asset. What would qualify a CIP asset as one that should be impaired?

> Ans. Because CIP assets are different from assets that are in service, not all of the indicators would apply. However, some still could. For example, changes in laws, economic factors or even environmental factors could basically put a complete stop to a CIP. In some respects to best answer your question, anything that could preclude the CIP from being placed in service is an indicator that could trigger an impairment test.

2. How would you know how much of a difference an impaired CIP asset will have on operations when it has not yet been placed into operations?

> Ans. For example, if there is a partial impairment to a CIP that will be placed in service say in 3 months, this means that you have identified an indicator such as a changed law or changed environmental factors, etc. As such, one could measure what the CIP's originally designed function was supposed to be and compare it to its now reduced function. Illustration 4a may help.

3. How do you determine the "expected" permanent decline of service utility of a CIP asset that has not yet been placed into service?

> Ans. I think that my above answer helps to answer this as well.

4. How would you know what the service utility level is for a CIP asset that has not yet been placed into daily operations?

> Ans. Your facilities people or engineers should be able to help. In any event, if you are building an asset it must be to some output or service specification like 100 widgets a day or being able to house 500 patients at any given time. So, once you have the baseline you expect to get from the new capacity you are building, any degradation from that expected level is the lost service utility.

5. In terms of recording an impairment loss, what would the Mint need to do if there was a CIP asset that didn't pass testing? The Mint would not accept this particular CIP asset, and therefore, it would not appear on the Mint's books as a PP&E.

> Ans. That is true but SFFAS 44 would still apply. Usually, if an asset, especially an IT asset is "impaired", it will get remediated fairly quickly. In any event, if an asset didn't pass testing but the Mint has intentions of getting it readied to the point of passing that test and deploying the asset sometime in the near future – you have a

temporary impairment on your hands and as such, nothing to recognize. On the other hand, if the asset is never going into service, the CIP costs that have been capitalized would be subject to impairment[1].

6. How would the Net Book Value be determined for a CIP asset that has not yet been placed in service and has not yet started depreciation?

Ans. To my knowledge, CIP costs are usually capitalized[2].

7. If the U.S. Mint's policy is to repair or replace G-PP&E that no longer provides adequate service utility within a reasonable time, and remove from service those G-PP&E assets that will no longer be used in operations, would this "impairments" Standard still apply to the Mint?

Ans. Correct, not for these assets because you have a temporary impairment on PP&E that you intend fixing within a reasonable timeframe and the other assets would be subject to SFFAS 6 and TR-14 because they are being removed from service.

8. Would the U.S. Mint still have to make any kind of entry into the Financial Statements if we do not have any [potential] impairments loss?

Ans. That depends. Normally that answer would be no. However, let's say you have an immaterial impairment but one that is nonetheless noticeable or documented by an inspection report. Just because it's immaterial doesn't mean you can't adjust its remaining useful life or depreciation method to try and reflect the lost service utility. What I think is important here is that you hopefully want parity between your asset ledgers and asset management systems. So, if an engineer says that a piece of equipment is impaired but the CFO says it's immaterial – you still might want to book the impairment or adjust the useful life, etc.[3]

[1] The CIP costs would also be subject to full write off.
[2] That is, the net book value would be the CIP balance.
[3] At Paragraph A26 the Board states that users understand that they are not required to search out impairments or to apply the SFFAS 44 to immaterial items. Entities should consider G-PP&E impairments in the context of their existing practices and apply this SFFAS 44 only when there is an indicator of significant impairment present.

Clarifying the circumstances when TR-14 and SFFAS 44 each apply – although only 1 respondent (GSA) sought clarification in this matter, staff suggests that the AAPC consider clarifying the instances when the subject guidance applies. Staff suspects that part of the confusion is that users are not distinguishing between TR-14's applicability to (impaired) assets totally removed from service compared to SFFAS 44's applicability to only those (partially-impaired) assets remaining in service.

Please note that several DM&R Task Force representatives have expressed an interest in volunteering to assist with the development of any forthcoming implementation guidance. They include: Mr. Ivan Graff, DoE; Mr. Robert Lange, DoD; and Mr. Jim Clayton, Institute for Responsible Infrastructure Stewardship.

Table 1.0
Summary of Survey Respondents

#	Date	Agency/Bureau	Negative Reply	Positive Reply
1.	March 12 Field Visit	Department of Transportation / Office of Real, Personal Property, and Asset Management	X	
2.	March 14	Department of the Treasury / Office of the Public Debt	X	
3.	March 21	Environmental Protection Agency / Office of the CFO		X
4.	March 25	Department of Interior / Office of Financial Management		X
5.	March 31	Department of Commerce / Office of Financial Management	X	
6.	April 4	Department of the Treasury / Department of the Mint		X
7.	April 4	General Services Administration / Office of the CFO		X
8.	April 17 Field Visit	Department of Energy / Office of Financial Risk, Policy, and Controls	X	

ATTACHMENTS

1. **Attachment 1 –** Copy of Asset Impairment Implementation Guidance Survey form.
2. **Attachment 2 –** Positive Asset Impairment Implementation Guidance Replies.

If the AAPC requires additional information please contact me at your convenience by telephone at 202.512.6841 or by e-mail at savinid@fasab.gov.

Thank you.

Statement of Federal Financial Accounting Standards 44: *Accounting For Impairment Of General Property, Plant, And Equipment Remaining In Use*

Status

Issued	January 3, 2013
Effective Date	For fiscal periods beginning after September 30, 2014 with early implementation encouraged
Interpretations and Technical Releases	None.
Affects	None.
Affected by	None.

Summary

This Statement establishes accounting and financial reporting standards for impairment of general property, plant, and equipment (G-PP&E) remaining in use, except for internal use software. G-PP&E is considered impaired when there is a significant and permanent decline in the service utility of G-PP&E or expected service utility for construction work in progress. A decline is permanent when management has no reasonable expectation that the lost service utility will be replaced or restored.[1]

This Statement does not anticipate that entities will have to establish additional or separate procedures beyond those that may already exist, such as those related to deferred maintenance and repairs, to search for impairments. Impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonably assure identification and communication of potential material impairments, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. Management may determine that existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments and implement appropriate additional processes and internal controls.

Entity management should consider documenting the decisions it makes while determining how to implement the requirements of this Statement. Such decisions should include consideration of materiality. Materiality considerations should include an assessment of the impact to the cost of service(s) before and after the impairment.

[1] This Statement should not be directed to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

Recognition of impairment losses is dependent upon a two-step process that entails (a) identifying potential impairments and (b) testing for impairment. The losses should be reasonably estimated by determining the portion of the decline in the net book value of the G-PP&E attributable to the lost service utility.

This Statement improves financial reporting by requiring entities to report the effects of G-PP&E impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the G-PP&E or upon disposal of the G-PP&E. This will enable users of financial statements to discern the cost of impairments when they occur, the financial impact on the reporting entity, and the cost of services provided following the impairment. This Statement also enhances comparability of financial statements between entities by requiring all entities to account for impairments in a similar manner.

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Introduction

Purpose

1. Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*, contains principles-based guidance concerning **general property, plant, and equipment (G-PP&E)**[2] that is removed from service due to **total (full) impairment** of G-PP&E or other reasons. SFFAS 6 requires that G-PP&E be removed from G-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.[3] SFFAS 6 does not address situations where there is less than total (full) impairment of G-PP&E.

2. SFFAS 10, *Accounting for Internal Use Software*, provides guidance for the impairment of **internal use software**.[4] This Statement does not alter existing requirements regarding internal use software.

3. This Statement provides accounting and reporting requirements for **partial impairments** of G-PP&E remaining in use and construction work-in-process.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person

[2] Terms defined in the Glossary are shown in **bold-face** the first time they appear.

[3] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

[4] SFFAS 10, at paragraphs 28 through 31, provides additional procedures for recognizing and measuring impairment related to internal use software. The provisions in SFFAS 10 and SFFAS 6 are the same regarding situations where the software or G-PP&E is impaired and will be removed from service in its entirety. Both standards provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, SFFAS 10 also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

relying on the information would have been changed or influenced by the omission or the misstatement.

Effective Date

5. The standards are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

Standards

Scope and Applicability

6. This Statement applies to federal entities that present general purpose federal financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with generally accepted accounting principles, as defined by paragraphs 5 through 8 of Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

7. This Statement applies to G-PP&E[5] except internal use software. This Statement establishes guidance on accounting for the impairment of G-PP&E remaining in use, including construction work in process. The provisions of this Statement are to be applied when indicators of potential impairment, as specified in this Statement, are identified by the entity. The entity is not required to conduct an annual or other periodic survey solely for the purpose of applying these standards. Existing processes that may identify indicators for potential impairment include routine assessments regarding the continued operational and functional capacity of G-PP&E, entity mission requirements, impacts of significant events or changes in circumstances, and deferred maintenance and repairs. The results of such processes may serve as the basis for applying these standards.

[5] G-PP&E is any property, plant, and equipment (PP&E) used in providing goods or services and includes, among other types of PP&E, multi-use heritage assets, capitalized improvements to stewardship land, and construction work-in-process. PP&E includes land and land rights that are acquired for or in connection with items of G-PP&E used to provide government services or goods. G-PP&E does not include heritage assets, such as historic and national landmarks, and stewardship land; reporting for these assets should be in accordance with SFFAS 29, *Heritage Assets and Stewardship Land*. The cost of G-PP&E is capitalized, i.e., recorded as assets on the balance sheet. For detailed characteristics of and accounting for G-PP&E, see SFFAS 6, par. 23 through 45.

Definition of Impairment

8. Impairment is a significant[6] and permanent decline in the service utility of G-PP&E, or expected service utility for construction work in process. Entities generally hold G-PP&E because of the services they provide or will provide in the future; consequently, impairments affect the service utility of the G-PP&E. The events or changes in circumstances that lead to impairments are not considered normal and ordinary.[7] That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating its useful life.

9. The service utility of G-PP&E is the usable capacity that at acquisition was expected to be used to provide service, as distinguished from the level of utilization, which is the portion of the usable capacity currently being used. The current usable capacity of G-PP&E may be less than its original usable capacity due to the normal or expected decline in useful life or to impairing events or changes in circumstances, such as physical damage, obsolescence, enactment or approval of laws, or regulations or other changes in environmental or economic factors, or change in the manner or duration of use. Usable capacity may be different from maximum capacity[8] in circumstances in which surplus capacity (the excess capacity over the usable capacity) is needed for safety, economic, operational readiness or other reasons. G-PP&E that experience decreases in utilization, and the simultaneous existence of or increases in surplus capacity not associated with a decline in service utility are not considered impaired.

Identification of Potential Impairment Loss – A Two-step Process

10. Generally, G-PP&E remaining in use is impaired if the decline in the service utility of the G-PP&E is significant and deemed permanent.

[6] The determination of whether or not an item is significant is a matter of professional judgment. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations. Determining if a decline in service utility is significant is separate and distinct from materiality considerations that include considering the likely influence that such disclosure could have on judgments or decisions of financial statement users.

[7] Normal and ordinary are defined as events or circumstances that fall within the expected useful life of the PP&E such as standard maintenance and repair requirements.

[8] Maximum capacity is the usable capacity plus any surplus capacity.

11. The determination of whether G-PP&E remaining in use is impaired, as defined in paragraph 8 above, includes (a) identifying potential impairment indicators and (b) testing for impairment. G-PP&E would be identified as potentially impaired as a result of the occurrence of significant events or changes in circumstances, or routine asset management processes.

Step 1 – Identify Indicators of Potential Impairment

12. Some common indicators of potential impairment include those listed below. The indicators identified are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment is necessary given the circumstances.

    a. evidence of physical damage

    b. enactment or approval of laws or regulations which limit or restrict G-PP&E usage

    c. changes in environmental or economic factors

    d. technological changes or evidence of obsolescence[9]

    e. changes in the manner or duration of use of G-PP&E

    f. construction stoppage or contract termination

    g. G-PP&E idled or unserviceable for excessively long periods[10]

[9] Technological changes or evidence of obsolescence should be considered along with other factors when assessing impairment. For example, if obsolete G-PP&E continues to be used, the service utility expected at acquisition may not be diminished. Further, when obsolescence is expected, the declining service utility of G-PP&E subject to obsolescence can be addressed through depreciation, particularly by using accelerated methods that yield a lower capital cost per year as its utility diminishes when compared to that of later versions of the same asset.

[10] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

G-PP&E Identified From Significant Events or Changes in Circumstances

13. Events or changes in circumstances affecting G-PP&E that may indicate impairment are sometimes significant. Significant events or changes in circumstances are conspicuous or known to the entity's management or oversight entities. This Statement does not require entities to conduct an annual or periodic survey solely to identify potential impairments of G-PP&E. Rather, significant events or changes in circumstances affecting G-PP&E that may indicate impairment are conspicuous or known to the entity's management or oversight entities and are generally expected to have prompted consideration[11] by management, oversight entities, or others (e. g., the media).

G-PP&E Identified from Asset Management Reviews (e.g., portfolio surveys)

14. Existing asset management processes may include portfolio surveys that consider matters such as the continued operational and functional capacity of G-PP&E, entity mission requirements, or deferred maintenance and repairs assessments. Potentially impaired G-PP&E may be identified from such surveys and further evaluated through the two-step process.

Reduced Demand Should Not Be Considered a Discrete or Sole indicator of Impairment

15. As explained in paragraph 9 above, reduced demand for the services of G-PP&E should not be considered a discrete or sole indicator of impairment. Instead, there should also be evidence of an underlying potential impairment resulting in the reduced demand. In these circumstances, the causes behind such changes in demand should be evaluated in light of the indicators listed in paragraph 12 and the G-PP&E should be tested for impairment.

Step 2 - Impairment Test

16. G-PP&E identified through the processes described in paragraphs 10 through 15 should be tested for impairment by determining whether the following two factors are present:

[11] Consideration might include but is not limited to management discussions, internal managerial analyses or reviews, conferences or consultations with experts, media or public relations interviews, or external industry scrutiny.

a. **The magnitude of the decline in service utility (as defined in par. 9) is significant**. The costs are now disproportionate to the new expected service utility. Such costs should include operational and maintenance costs. Judgment is required to determine whether the decline is significant. Such judgments may be based on: (1) the relative costs of providing the service before and after the decline, (2) the percentage decline in service utility, or (3) other considerations.

b. **The decline in service utility is expected to be permanent.** The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored. That is, management expects that the G-PP&E will remain in service so that its remaining service utility will be utilized. In contrast, reasonable expectation that the lost service utility will be replaced or restored may exist when management has: (1) specific plans to replace or restore the lost service utility of this G-PP&E, (2) committed or obligated funding for remediation efforts, or (3) a history of remediating lost service utility in similar cases or for similar G-PP&E.

17. For construction work in process, the testing of impairment discussed in paragraph 16 above should be performed over the period of expected future service utility rather than current service utility.

Determining the Appropriate Measurement Approach

18. Impairment losses on G-PP&E that will continue to be used by the entity[12] should be estimated using a measurement method that reasonably[13] reflects the diminished service utility of the G-PP&E. The goal of the measurement methods discussed below is to reasonably estimate the portion of the net book value associated with the diminished service utility of the G-PP&E. A specific method, including one of the methods listed below, would not be considered appropriate if it would result in an unreasonable net book value associated with the remaining service utility of the G-PP&E. Within an entity, one method may not be appropriate for measuring all impairments. Also, a reasonable method may nonetheless result in no impairment loss to be recognized. Regardless of the method used, recognition of the loss should be limited to the asset's net book value at the time of impairment. Widely recognized methods for measuring impairment include:

[12] See SFFAS 6, *Accounting for Property, Plant, and Equipment,* paragraphs 38 and 39 for guidance regarding G-PP&E that will not continue to be used by the entity.

[13] Given a choice among comparable methods, entities should adopt the most efficient and practical method available under the circumstances.

a. **Replacement approach.** Impairment of G-PP&E with physical damage generally may be measured using a replacement approach. This approach uses the estimated cost to replace the lost service utility of the G-PP&E at today's standards[14] to identify the portion of the historical cost of the G-PP&E that should be written off. For federal real property purposes, this cost can be derived from the plant replacement value (PRV). This estimate can be converted to historical cost by restating (i.e., deflating) the estimated cost to replace the diminished service utility using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of the estimated cost to replace the diminished service utility over total estimated cost to replace the G-PP&E, to the net book value of the G-PP&E.

b. **Restoration approach.** Impairment of improvements made to stewardship land and multi-use heritage assets with physical damage may generally be measured by using a restoration approach. This approach uses the estimated cost to restore the diminished service utility of the G-PP&E to identify the portion of the historical cost of the G-PP&E that should be written off. This approach does not include any amounts attributable to improvements and additions to meet today's standards. The estimated restoration cost can be converted to historical cost by restating (i.e., deflating) the estimated restoration cost using an appropriate cost index. Alternatively, it may be appropriate to apply the ratio of estimated restoration cost to restore the diminished service utility over total estimated restoration cost to the net book value of the G-PP&E.

c. **Service units approach**. Impairment of G-PP&E that are affected by enactment or approval of laws or regulations or other changes in environmental/economic factors or are subject to technological changes or obsolescence generally may be measured using a service units approach. This approach compares the service units provided by the G-PP&E before and after the impairment event or change in circumstance to isolate the historical cost of the service utility of the G-PP&E that cannot be used due to the impairment event or change in circumstance. The amount of impairment is determined by evaluating the service provided by the G-PP&E - either maximum estimated service units or total estimated service units throughout the life of the G-PP&E - before and after the event or change in circumstance.

d. **Deflated depreciated current cost approach.** Impairment of G-PP&E that are subject to a change in manner or duration of use generally may be measured using a deflated depreciated current cost approach. This approach quantifies the cost of the service currently being provided by the G-PP&E and converts that cost to historical

[14] For example, *"at today's standards"* would generally mean the use of current market prices for materials, labor, manufactured items and equipment using current building, manufacturing, or fabrication techniques in compliance with current statutory, regulatory, or industry standards.

cost. A current cost for a G-PP&E to replace the current level of service is estimated. This estimated current cost is then depreciated to reflect the fact that the G-PP&E is not new, and then is subsequently deflated to convert it to historical cost dollars. A potential impairment loss results if the net book value of the G-PP&E exceeds the estimated historical cost of the current service utility (i.e., deflated depreciated current cost).

e. **Cash flow approach**. Impairment of cash or revenue generating G-PP&E, such as those used for business or proprietary-type activities, may be assessed using a cash flow approach. Under this approach, an impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value[15] or value-in-use estimate.[16] The net book value of the G-PP&E is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the G-PP&E. That assessment should be based on the net book value of the G-PP&E at the date it is tested for recoverability, whether in use or under development. If the net book value is not recoverable, the impairment loss is the amount by which the net book value of the G-PP&E exceeds the higher of its net realizable value or value-in-use estimate. No impairment loss exists if the net book value is less than the higher of the G-PP&E's net realizable value or value-in-use estimate.

f. **Lower of (1) Net Book Value or (2) Higher of Net Realizable Value or Value-in-Use Approach**. G-PP&E impaired from either construction stoppages or contract terminations, which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate. Impaired G-PP&E, which are not expected to provide service, should be accounted for and reported in accordance with SFFAS 6.

[15] Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal.

[16] Statement of Federal Financial Accounting Concepts (SFFAC) 7, *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

Recognizing and Reporting Impairment Losses

19. The loss from impairment should be recognized and reported in the statement of net cost when management concludes that the impairment is (1) a significant decline in service utility and (2) expected to be permanent. Such loss may be included in program cost(s) or cost(s) not assigned to programs consistent with SFFAS 4, *Managerial Cost Accounting Standards and Concepts*. However, in cases where an entity decides that an impairment loss should not be recognized, it could consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates, as appropriate.

20. The impairment loss should be recognized and reported regardless of whether the G-PP&E remaining in use is being depreciated individually or as part of a composite group. The impairment loss may be reported as a separate line item or line items on the statement of net cost. Deciding to display a separate line item or items on the statement of net cost requires judgment. The preparer should consider quantitative and qualitative criteria. Acceptable criteria include but are not limited to quantitative factors such as the percentage of the reporting entity's cost that resulted from the impairment and the size of the impairment loss relative to the G-PP&E; and qualitative factors including whether the loss would be of interest to decision makers and other users.

21. A general description of the G-PP&E remaining in use for which an impairment loss is recognized, the nature (e.g., damage or obsolescence) and amount of the impairment, and the financial statement classification of the impairment loss should be disclosed in the notes to the financial statements. Such disclosures should be made in the period the impairment loss is recognized.

Diminished Service Utility Without Recognized Impairment Loss

22. Events, changes in circumstances, or asset management reviews might indicate that the future service utility of G-PP&E remaining in use has been adversely affected. However, if future service utility has been adversely affected but the impairment test determines that a loss need not be recognized, a change to the estimates used in depreciation calculations such as estimated useful life and salvage value should be considered.

G-PP&E That No Longer Provides Service

23. G-PP&E that no longer provides service or in the case of construction work in process where there is no expectation of future service by the entity, should be accounted for in accordance

with SFFAS 6, paragraphs 38 and 39, and Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property Plant, & Equipment.*

Remediating Previously Reported Impairments

24. Subject to the entity's capitalization policies, if an entity later remediates the previously impaired G-PP&E remaining in use, the costs incurred to replace or restore the lost service utility should be accounted for in accordance with applicable standards. For example, costs to prepare the site and install replacement facilities would be recognized in accordance with SFFAS 6, *Accounting for Property, Plant, and Equipment.*

Recoveries

25. The impairment loss should be reported net of any associated recovery when the recovery and loss occur in the same year. Recoveries reported in subsequent years should be reported as revenue or other financing source as appropriate. If not otherwise apparent in the financial statements, the amount and financial statement classification of recoveries should be disclosed in the notes. The accounting for recoveries should be in accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting.*

Consolidated Financial Report of the U.S. Government

26. The U.S. government-wide financial statements should disclose the following if an impairment loss for G-PP&E remaining in use is recognized:

    a. a general description of what constitutes G-PP&E impairment,

    b. the consolidated G-PP&E impairment losses recognized by component entities, and

    c. a reference(s) to component entity report(s) for additional information.

Effective Date

27. The requirements of this Statement are effective for reporting periods beginning after September 30, 2014. Earlier implementation is encouraged.

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

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In Statement of Federal Financial Accounting Standards (SFFAS) 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, issued in May 2003, the Board identified impairment as one of three areas (the other two being depreciation and deferred maintenance) that it desired to consider integrating into a comprehensive project. Complete impairment was addressed in SFFAS 6, *Accounting for Property, Plant, and Equipment*, through the requirements that general PP&E "*…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.*" However, SFFAS 6 does not address partial impairment, even though the effects of partial impairment may be material in some cases. The Board decided to address asset impairment at the time it addressed deferred maintenance. Subsequent to the issuance of ?Statement of Federal Financial Accounting Standards 40: *Definitional Changes Related to Deferred Maintenance and Repairs: Amending Statement of Federal Financial Accounting Standards 6, Accounting for Property, Plant, and Equipment* in May 2011, the Board initiated work on addressing potential enhancements to existing FASAB guidance regarding impairment.

A2. In evaluating an approach applicable to federal G-PP&E, the Board considered the approaches used in the following documents:

- Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) 144, Accounting for the Impairment or Disposal of Long-Lived Assets (Superseded by FASB Accounting Standards Codification (ASC) 360)

- Governmental Accounting Standards Board (GASB) Statement (GASBS) 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*[17]

- International Public Sector Accounting Standard (IPSAS) 21, *Impairment of Non-Cash Generating Assets*

- IPSAS 26, *Impairment of Cash-Generating Assets*

A working group was organized to assist the Board in analyzing the impairment standards promulgated by the FASB, GASB, and the International Public Sector Accounting Standards Board (IPSASB). The working group's analysis was initially screened by the Deferred Maintenance and Asset Impairment (DM-AI) Task Force and subsequently tested with a broader community beyond the task force to obtain other points of view. The consensus recommendation was to use the GASBS 42 approach as a baseline for the development of a federal asset impairment standard.

Significant and Permanent Decline in Service Utility

A3. This Statement requires recognizing a potential impairment loss only when there is a significant and permanent decline in the G-PP&E's service utility. In reaching this decision, the Board considered and weighed (a) the need for relevant, reliable, and consistent financial reporting and (b) entity burden.

a. For financial reporting to be:

(i) relevant - a logical relationship must exist between the information provided and the purpose for which it is needed. G-PP&E impairment information is relevant because it is capable of making a difference in a user's assessment of how well the entity is meeting its federal asset stewardship responsibilities.

[17] GASBS 42, November 2003.

(ii) reliable - information needs to be comprehensive and nothing material should be omitted nor should anything be included that would likely cause the information to be misleading. The reporting of G-PP&E impairments significantly adds to the informational value and reliability of amounts presented in the entity's balance sheet and statement of net cost.

(iii) consistent over time - an accounting principle or reporting method should be used for all similar transactions and events unless there is good cause to change. Establishing G-PP&E impairment standards significantly adds to consistent financial reporting.

b. The Board is aware of the increased demands that entities confront due to initiatives that attempt to better align and integrate entity mission, budget, and performance objectives. As such, the Board desires to issue a G-PP&E impairment standard that entities can effectively adopt without undue administrative burden while still satisfying the objectives of federal financial reporting.

Recognizing Impairments

A4. As discussed in paragraphs 13 and 14, impairments can be identified and brought to management's attention in a variety of ways. Although a presumption exists that there are existing processes and internal controls in place to reasonable assure such identification and communication, this Statement does not require entities to conduct an annual or other periodic survey solely for the purpose of applying these standards. In the event management determines existing processes and internal controls are not sufficient to reasonably assure identification of potential material impairments, additional processes and internal controls may be necessary.

A5. The Board notes that not all significant events and/or changes in circumstances discussed by oversight bodies, management, or the media would necessarily be considered material to an entity's financial statements. Consequently, an entity must exercise judgment in this regard considering whether omitting or misstating information about the significant event and/or changes in circumstances makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or the misstatement. However, in cases where an entity decides that a significant event or change in circumstance is immaterial, it should consider the need for adjustments to the G-PP&E's depreciation methods, useful life or salvage value estimates.

The Board also notes that common indicators of potential impairment can be discovered during different types of asset management reviews that include the following types of G-PP&E assessments:

a. Condition assessments revealing evidence of physical damage, deterioration, and/or distresses such as for a building (1) damaged by fire or flood, (2) not adequately maintained or repaired, (3) associated with significant amounts of deferred maintenance and repairs and/or (4) exhibiting signs of advanced degradation that might adversely impact expected duration of use, each requiring remedial or replacement/restoration efforts to restore service utility

b. Functionality assessments revealing evidence of reduced capacity, inadequate configuration, change in entity mission, change in the manner or expected use, and enactment or approval of laws, regulations, codes or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet)

c. Obsolescence assessments revealing evidence of technological development or obsolescence, such as that related to a major piece of diagnostic or research equipment (for example, a magnetic resonance imaging machine or a scanning electron microscope) that is rarely or never used because newly acquired equipment provides better service

Common Indicators of Potential Impairment

A6. The Board considered the general approaches used by other standards-setters regarding the issues of impairment identification and testing. The DM-AI Task Force identified the GASB approach as being the most germane for federal application and recommended adopting its use with appropriate modifications. As a result, this Statement consists of a two-step process of (a) identifying potentially impaired G-PP&E through indictors of impairment and (b) testing to determine whether a potential impairment exists by comparing the net book value of the G-PP&E to a valuation reflecting the current state of the G-PP&E.

A7. Recognizing the administrative burden and costs involved in applying a test of potential impairment, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Entities should carefully consider the surrounding circumstances to determine if a test of potential impairment may be unnecessary given the circumstances.

A8. In order to limit the universe of G-PP&E tested for potential impairment because of cost-benefit considerations, the Board proposes two modifiers to the indicators: (a) the magnitude of the decline in service utility is significant and (b) the decline in service utility is permanent. The first modifier would limit testing for potential impairment to only G-PP&E that have experienced a significant decline in service utility. The second modifier would limit testing to only those G-PP&E where the decline in service utility is expected to be

permanent. The decline is considered permanent when management has no reasonable expectation that the lost service utility will be replaced or restored and that the G-PP&E's remaining service utility can continue providing value.

A9. G-PP&E is to be considered impaired only when both of these two modifiers are present. When either of these conditions is not present, the decline in the service utility of the G-PP&E may be recognized through other methods such as changing useful life or salvage value estimates.

Determining if Magnitude of Decline in Service Utility is Significant

A10. Because measurement of a potential impairment is not required unless a significant decline in service utility occurs, management should assess the magnitude of the service decline. In cases where there is physical damage to G-PP&E, the significance can often be objectively assessed because the costs of remediation (i.e., replacement or restoration) may be relatively easy to determine, at least within a range of estimates. In circumstances other than those involving physical damage, significance may be discerned by less objective assessments such as:

(1) Whether management acts to address the situation. Management decisions may be indicative of a potential decline in service utility. For example, a specific action taken by management after a service decline may confirm that expenses exceed future benefit. Likewise, a decision by management to not address a service decline may be an indication the decline is not significant and a test of impairment is not required.

(2) The costs are disproportionate with the new expected service utility. For example, when comparing the benefits and related costs associated with the new expected service utility after the potential impairment with those benefits and related costs existing prior to the impairment, management may confirm that costs significantly exceed future benefit. As a result, the decline is significant and a test of impairment is required.

Selecting a Measurement Approach

A11. Professional judgment should be used when selecting a method to measure the decline in service utility of G-PP&E. Generally, potential impairments:

a. reflecting degradation or physical damage may be measured using a replacement approach or, for multi-use heritage assets, a restoration approach.

b. reflecting a change resulting from enactment or approval of laws or regulations or other changes in environmental/economic factors or from technological development or obsolescence generally may be measured using a service units approach.

c. reflecting a change in manner or duration of use or change in mission generally may be measured using deflated depreciated current cost approach.

d. for cash or revenue-generating G-PP&E may be measured using the cash flow approach.

e. arising from construction stoppages or contract terminations for assets which are expected to provide service, should be reported at their recoverable amount; the lower of (1) the G-PP&E's net book value or (2) the higher of its net realizable value or value-in-use estimate.

A12. The Board emphasizes that in estimating the diminished service utility of the G-PP&E, the measurement approach chosen should yield a reasonable estimate reflecting the diminished service capacity of the G-PP&E. Before using a specific method a determination should be made that it will result in (1) a reasonable estimate of diminished service capacity for the specific asset and (2) a reasonable net book value associated with the remaining service utility of the G-PP&E. There should not be a presumption of reasonableness attached to the use of any of these methods if the resultant calculations reflect an unreasonable estimate of the remaining service utility of the G-PP&E. For example, if using the replacement approach, a cost estimate to remediate the damage to an asset is equal to or greater than the asset's total replacement cost, the resultant calculation would lead to a full write-down of the carrying value. However, if the asset is to remain in use, the full write-down would be inappropriate because some service potential remains. In such a case, management should look to another method such as the deflated depreciated current cost approach to estimate the historical cost of the asset's residual service capacity that will continue to be used. Additionally, within an entity, one method may not be appropriate for measuring asset impairments across all categories or classes of assets. The Board notes that a reasonable methodology may not result in the recognition of an impairment loss.

Among Comparable Methods – Choose the Most Efficient

A13. The Board recognizes that there may be cases where more than one comparable method could be used to measure the decline in an asset's service utility. In such cases, the entity should use whichever method most reasonably reflects the diminished service utility. In

cases where the methods under consideration are expected to yield similar results, management should adopt the most efficient method available given the circumstances.

Reduced Demand

A14. The Board notes that reduced demand for the services of G-PP&E should not be considered as a discrete or sole indicator of potential impairment. That is, reduced demand absent evidence of an underlying potential impairment resulting in that reduced demand is not an indicator of impairment. For example, decreased demand for the processing services of a mainframe computer because former users of the mainframe have transitioned to PC and server-based systems should be considered a change in demand not requiring impairment testing. However, if associated with an indicator of potential impairment such as evidence of obsolescence, then the mainframe should be tested for potential impairment.

A15. In addition, a decrease in demand solely resulting from the conclusion of a special project requiring large amounts of processing time on a mainframe computer that runs other applications should not be considered for impairment testing.

A16. A decrease in occupancy is another example of a change in demand. If a decrease in the occupancy of hospital beds prompts management to close a hospital, a change in manner or duration of use has also resulted and a test for impairment should be performed. However, a test for impairment is not required if the decrease in hospital beds results solely because the hospital is changing from an overcrowded condition to one in which occupancy rates are now below the maximum allowed. However, care should be taken to ensure that there is not a potential indicator of impairment that could require testing.

Estimating Potential Impairment Losses

A17. Measuring the cost of the lost service utility generally requires the use of estimates or approximations. According to Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, to be recognized an item must be measurable, meaning that a monetary amount can be determined with reasonable certainty or is reasonably estimable (underscoring added for emphasis). For this reason, the Board notes that it (1) does not seek exact precision in determining the lost service utility of the asset and (2) does not intend to direct or prescribe the use of any particular approach listed in paragraph 18.

A18. However, the Board notes that care should be taken when estimating potential impairment losses. For example, if a multi-use heritage asset requires testing for potential impairment, the restoration approach and not the replacement approach would generally provide for

more accurate estimates. Although these approaches may appear to be identical, they are not. The replacement approach estimates the cost to replace the lost service utility of the G-PP&E at today's standards whereas the restoration approach does not. In either case, the required estimates used for the calculation inputs are different and can significantly affect the potential impairment loss measurement. Differences will arise because the replacement approach uses estimates reflecting today's current labor and material options and costs, modern standards, and installation methods whereas the restoration approach uses estimates that generally require using historically accurate (e.g., aesthetic or historic) materials and construction methods approved by an historic architect or historic preservationist to preserve the historic nature and value of the multi-use heritage asset.

A19. Entities should also ensure that impairment loss calculations exclude improvements or betterments. For example, assume that a portion of an old warehouse currently not being used suffers roof damage due to heavy snowfall. The entity decides not to repair the roof and to contain the damage by securing the adjoining area ensuring that there are no safety hazards. In this case, estimates for the construction of a new warehouse, including its roof should not include amounts for new types of roof ventilation systems, solar panel features, or green energy improvements, etc. Including such improvements or betterments might significantly affect the potential impairment loss measurement.

G-PP&E Impairment Loss Reversals and Remediation

A20. Impairments may be subsequently remediated or otherwise restored or may be reduced in future periods. The Board concluded that reversals of G-PP&E impairment losses should not be recognized. In reaching the decision not to allow for reversals of G-PP&E impairment losses, the Board concluded that because reversal events are expected to be rare occurrences, there is no compelling need for complexity or increased burden as benefits do not appear to justify costs.

A21. The Board concluded remediation of a previously reported impairment loss, is a change that results in an addition to the cost basis. Specifically, should management later decide to replace or restore an asset's lost service utility the costs incurred to do so become part of the G-PP&E's new cost basis. It is the Board's opinion that such a practice is consistent with the operating performance objective of federal financial reporting; users will be able to evaluate the service efforts, costs, and accomplishments of the reporting entity based on the revised cost basis.

Recoveries

A22. Recoveries may be accounted for as either exchange or non-exchange transactions, depending on the nature of the related revenue that would be recorded. In accordance with SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting:*

a. Exchange revenues should be recognized when goods or services are provided to the public or another government entity at a price. An example would be commercial insurance purchased in connection with G-PP&E belonging to a public-private arrangement.

b. Non-exchange revenues should be recognized when a specifically identifiable, legally enforceable claim to resources arises, to the extent that collection is probable (more likely than not) and the amount is reasonably estimable. An example would be a donor's pledged contribution associated with a capital project restoration effort. In cases where the collecting and reporting entities are different, it is important to note that non-exchange revenue amounts should be measured by the collecting entities and recognized for financial statement reporting by the entities legally entitled to the revenue.

Distinguishing between Depreciation and Impairment

A23. Depreciation systematically and rationally allocates the historical cost of the G-PP&E's service utility to the benefitting periods. The asset's costs are allocated (i.e., the asset is depreciated) across multiple periods based on asset management plans and formulas, including such variables as expected useful life of the asset, usage patterns, and residual or salvage value, if any. Costs are allocated because: (1) the G-PP&E is expected to benefit more than one period and (2) generally, there is no other practical or efficient way to directly assign or associate cause (i.e., entity activity or event) and effect (i.e., service utility consumption). That is, depreciation is allocated, because specific causation cannot be ascertained.

A24. On the other hand, impairment occurs when there is a significant and permanent decline in the service utility during the depreciation period of G-PP&E remaining in use, and that decline is reasonably estimable in monetary terms. Essentially, an event or circumstance alters the utility and/or value of the asset such that the systematic and rational allocation process noted in paragraph A23 directly above can no longer be reasonably applied and must be also altered accordingly. Moreover, primarily due to the significant nature of the event or changed circumstances, an entity can directly assign or associate cause (the event or

circumstance) and effect (change in anticipated utility and/or value of the asset). As a result, the lost or diminished service utility (arising from the impairment) can be directly assigned in a practical and efficient manner.

A25. To the extent that an entity's depreciation policies and practices reflect a pattern of service utility consumption that reasonably accounts for discrete events and/or changed circumstances, impairment losses may not apply. For example, if an entity operates in multiple climates within a country or maintains a global presence, its regular and on-going depreciation may account for lost or diminished service utility resulting from damages likely to arise from reasonably anticipated climate or other environmental conditions. This could be evidenced by an entity deriving its useful life estimates from current and historical fixed asset records or maintenance and repair accounts, which include such events and/or circumstances. In such cases, the entity might shorten the useful life estimate, alter the anticipated consumption pattern, or reduce its salvage value estimate. Consequently, depreciation would inherently consider the conditions giving rise to the impairment, thus avoiding the need to recognize an impairment loss.

Perceived costs versus benefits

A26. The Board believes that the benefits of implementing this Statement outweigh its administrative costs of implementation. The Board has clarified the Statement so that users understand that they are not required to search out impairments or to apply the Statement to immaterial items. Entities should consider G-PP&E impairments in the context of their existing practices and apply this Statement only when there is an indicator of significant impairment present. Although GASB, IPSASB, and FASB pronouncements are available to provide federal preparers with guidance relative to impairments, issuance of a Statement by FASAB will eliminate the need, time, and effort to search principles from another standard-setter or consider analogous entity transactions. Other perceived benefits include: reporting impairments when they occur rather than through depreciation expense or disposal, providing management with information useful for capital investment decisions, discerning the cost of impairments and impact on the entity and the cost of services provided following the impairment, and lastly, enhancing comparability between entities.

Summary of Outreach Efforts

A27. The Exposure Draft (ED), *Accounting for Impairment of General Property, Plant, and Equipment Remaining in Use*, was released on February 28, 2012, with comments requested by May 28, 2012.

A28. Upon release of the ED, notices and press releases were provided to the FASAB email listserv, the Federal Register, *The Journal of Accountancy*, *AGA Today*, *the CPA Journal*, *Government Executive*, *the CPA Letter*, *Government Accounting and Auditing Update*, the CFO Council, the Council of Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network, and committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

A29. This broad announcement was followed by direct e-mailings of the press release to:

a. Relevant congressional committees: Senate Committee on Homeland Security and Governmental Affairs and House Committee on Oversight and Government Reform;

b. Public interest groups: The *Institute for Responsible Infrastructure Stewardship* and the *National Academy of Sciences' Federal Facilities Council*;

c. Respondents to SFFAS 42, *Deferred Maintenance and Repairs Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32*.

A30. Twenty-three (23) responses were received. Table 1.0 summarizes responses by respondent type.

Table 1.0 - Summary of Respondent Types to Exposure Draft

RESPONDENT TYPE	FEDERAL (Internal)	NON-FEDERAL (External)	TOTAL
Preparers and financial managers	16	0	16
Users, academics, others	2	2	4
Auditors	2	1	3
Total	**20**	**3**	**23**

A31. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised. The following paragraphs discuss significant issues identified by respondents followed by Board decisions.

Respondents' Comments on the Exposure Draft

A32. Respondents generally favored the Exposure Draft. By a 9-to-1 ratio respondents agreed with the Board's proposal to recognize impairment losses. Additionally, 22 of the 23 respondents agreed with the Board that entities are not expected to alter existing assessment methods as a direct consequence of this Statement. Some respondents offered suggestions that the Board adopted and revised the Exposure Draft accordingly. The most significant changes made to the proposed standards include: (1) simplifying the definition of impairment by not referencing either "gradual or sudden" and (2) clarifying entity reporting requirements. The most significant additions made to the Basis for Conclusions include (1) clarifying that recoveries take the form of exchange or non-exchange revenues and (2) a discussion concerning what distinguishes depreciation from impairment. Highlighted below are some respondent concerns that the Board decided to address.

Identifying Indicators of Potential Impairment

A33. Some respondents expressed concern over the indicators. Concerns ranged from the indicators being viewed as conclusive evidence of impairment necessitating an impairment loss test to the indicators being too vague and in need of expansion to address magnitude, permanence, and materiality. As stated at paragraph A7, the Board desires to make clear that the indicators identified at paragraph 12 in and of themselves are not conclusive evidence that a measurable or reportable impairment exists. Furthermore, they are the first step in a two-step process and as a result cannot be deemed conclusive. Entities should carefully consider the surrounding circumstances to determine whether a test of potential impairment may be unnecessary given the circumstances. Furthermore, as stated at paragraphs A6 through A9 in the section entitled *Common Indicators of Potential Impairment*, the paragraph 12 indicators are not meant to be definitive in nature nor a fully inclusive list. Therefore, management must exercise discretion and judgment when assessing potential impairment losses.

A34. Other respondents shared a concern that their auditors would require specific reviews or that the audit community could not determine the extent of additional audit procedures that could result from this Statement. The Board believes that this issue gets back to internal controls and processes. The Board is of the opinion that in most cases management would not have to apply additional or separate procedures to identify potential impairments. Rather, management might have to document (1) linkage to asset management systems (refer to paragraphs A4 and A5) that identify and communicate potential impairments and (2) materiality so that auditors would accept that the financial statements are presented fairly. At a minimum, management can be expected to document how it interprets and expects to apply this Statement.

Materiality

A35. Some respondents sought clarification concerning materiality. The Board has made clear that this matter depends on the degree to which omitted or missing information could influence a reasonable person's judgment and that this Statement is not to be applied to immaterial items. The Board notes two important matters in this regard. First, when assessing materiality management should consider the impact of the potential impairment to the entity's cost of service(s). It is not the Board's intent to direct application of this Statement to those G-PP&E assets (e.g., lower operating level assets, administrative support equipment, etc.) that have an immaterial impact on cost of service(s). Second, entities that determine they have an amount of G-PP&E such that no impairment could have a material effect would not have to be concerned with the implementation of the Statement. Each entity should undertake some advanced consideration to tailor and justify its implementation in light of materiality considerations specific to the entity.

Measurement

A36. Some respondents expressed concern over the measurement approaches. Concerns ranged from the approaches not being appropriate for real property asset classes to the Statement having too many methods from which to select. As stated at paragraphs 18 and A17, entities should use an approach that reasonably estimates the asset's diminished service utility. The Board has made clear that it seeks reasonable impairment loss estimates and is not prescribing any particular approach. Preparers are not restricted to the approaches shown at paragraph 18 and may use other approaches that accomplish the following two objectives: (1) reasonably estimate the diminished service utility and (2) reasonably estimate net book value associated with the remaining service utility.

G-PP&E Exemptions

A37. Some respondents noted provisions of this Statement should not apply to certain G-PP&E categories, classes, or base units. The Board explored the respondents' rationales for seeking to waive the requirements and determined that no exemptions would be warranted. A careful reading and implementation of the Statement would preclude application of this Statement to some G-PP&E classes. Specifically, as stated at paragraph 8, the events or changes in circumstances that lead to impairments are not considered normal and ordinary. That is, at the time the G-PP&E was acquired, the event or change in circumstance would not have been (a) expected to occur during the useful life of the G-PP&E or, (b) if expected, sufficiently predictable to be considered in estimating the useful life. For example, in the case of military equipment "normal and ordinary" would come with the expectation that the

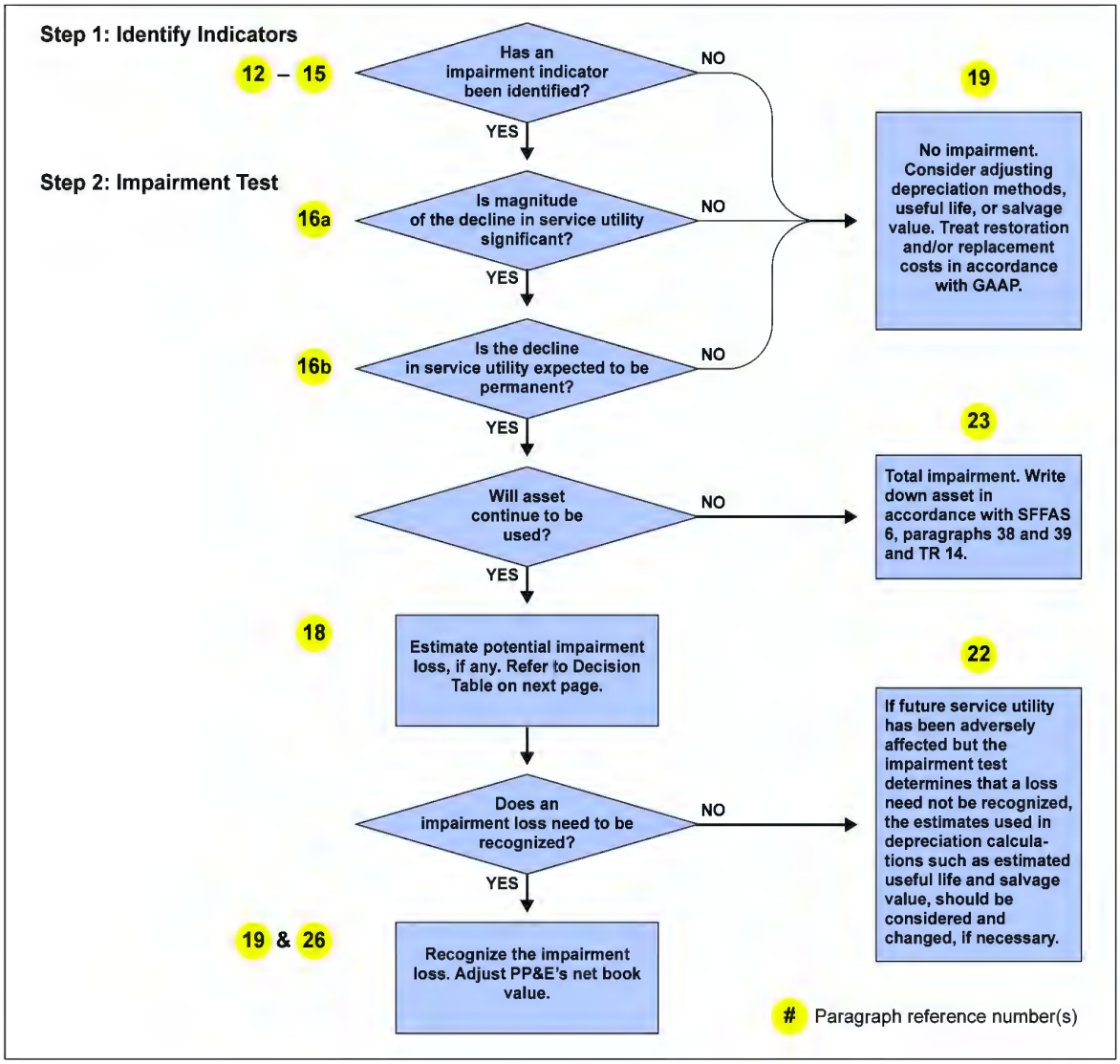
G-PP&E would be responding to contingencies and entering into combat operations at some future time. As a result, lost service utility arising from such events or circumstances could not be considered unanticipated and would fall outside the realm of this Statement. Additionally, G-PP&E classified as mission critical will rarely be partially and permanently impaired as its service utility would generally be replaced or restored and if not, the asset would be removed from active service because it would no longer be mission capable.

A38. The Board notes that in those cases where an entity considers certain G-PP&E to be non-mission critical or immaterial, management can (1) read the views of the Board concerning materiality as detailed in paragraph A35 above, and (2) reevaluate its capitalization threshold and depreciation policies and procedures. For example, under the requirements of this Statement, office furniture and fixtures that have been capitalized could become impaired. However, management may determine that any resultant impact to its cost of service(s) would be immaterial. In such cases, an entity may elect to prospectively change its capitalization criteria and/or alter its depreciation policies.

Board Approval

A39. This Statement was approved for issuance by all members of the Board. The written ballots are available for public inspection at the FASAB's offices.

Appendix B: Flowchart, Decision Table and Illustrations



Select a method that reasonably represents diminished service utility by considering potential indicators and type of PP&E.

If more than one method is reasonable, select the most efficient and practicable method.

Measurement Methods*	Potential Indicators	Type of PP&E **	Reference	Illustrations that may be appropriate
Replacement Approach	• Physical Damage	All G-PP&E	Par. 18 a	1c
Restoration Approach	• Physical Damage	Multi-use Heritage PP&E	Par. 18 b	2b
Service Units Approach	• Physical Damage • Enactment or approval of laws/regulations • Changes in environmental or economic factors • Technological changes or obsolescence	All G-PP&E	Par. 18 c	1d, 3a, 3b
Deflated Depreciated Current Cost Approach	• Change in manner or duration of use.	All G-PP&E	Par. 18 d	4a
Cash Flow Approach	• Any of the indicators as listed at Paragraph 12 (a through g)	Cash or Revenue Generating G-PP&E	Par. 18 e	7a, 7b, 7c, 7d
Lower of (1) Net Book value or (2) Higher of Net Realizable Value or Value-in-Use Approach	• Construction stoppage / Contract terminations	All G-PP&E	Par. 17 & 18 f	5, 6a, 6b, 7b

*Other industry-accepted methods may be appropriate

** = excluding internal use software

ILLUSTRATIONS

This remainder of this appendix illustrates the application of the provisions of this Statement to assist in clarifying their meaning. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Additionally, these illustrations are not

intended to provide guidance on determining the application of materiality; as such, estimated impairment losses are labeled as "potential" in each illustration because they would still require a further assessment as to whether the estimated loss is material and should be recognized. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here and require reference to other applicable Standards to ensure each situation is considered in the appropriate context.

Illustration 1a

Temporary Declines in Service Utility: *Physical Damage to an Office Building with Mold Contamination* [18]

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed. The mold remediation involves removing and rebuilding the interior walls and improving site drainage at a total cost of $4 million.

Management develops specific plans to begin remediation efforts as soon as possible and replace the lost service utility. In addition, funding has been identified and set-aside.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. However, because management has specific plans to replace the lost service utility of the building and has identified and set-aside funding, there is reasonable expectation that the damage is temporary and no potential estimated impairment loss is recognized.

[18] Illustrations 1a through 1d have been adapted from GASB 42, Illustration 1, *Physical Damage – School with Mold Contamination.*

Illustration 1b

Complete Removal from Service: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. Facilities management personnel advised that the building be closed due to health and safety concerns. Shortly afterwards, the office building was vacated and closed.

Due to the extent of the damage, management does not believe that remediation efforts will begin and that the lost service utility of the building is not temporary. As a result, management has decided to remove this building from service and prepare it for disposal.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., closure of the building) is a significant decline in service utility. Because management does not believe that remediation efforts will begin, the lost service utility of the building is permanent. However, because the entire office building will be taken out of service and prepared for disposal purposes, no potential estimated impairment loss is recognized. Instead, the provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment*, paragraphs 38 and 39 are applicable.

Illustration 1c

Replacement Approach - Permanent Declines in Service Utility: *Physical Damage to an Office Building due to an Earthquake*

Assumptions

In 2012, entity officials became aware of extensive masonry wall and building foundation damage at one of its office buildings as a result of a recent earthquake. The damage to the masonry walls was spread throughout the five-story building and the building foundation was damaged at non-critical vertical-load points. Facilities management personnel and engineers advised that despite a decline in service utility, the damaged building would still be capable of meeting reasonable, but reduced performance objectives in its damaged state, making major repairs and costly upgrading unnecessary. Limited and minor repairs, both cosmetic and structural, could be made to improve visual appearance and component damage at nominal cost. Facilities managers and engineers

have estimated that the major repairs and upgrades (involving removal and rebuilding of the interior walls and improving site drainage) would cost $2 million.

After a detailed review, management decided to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million. Accumulated depreciation related to the building and to the improvements were $600,000 and $320,000, respectively.

Evaluation of potential estimated impairment loss

The masonry wall and building foundation damage is evidence of physical damage – an impairment indicator. Also, the magnitude of the decline in the lost service utility is significant because its remediation would involve major repairs and costly upgrades. Because management decides to accept the reduced performance objectives of the building and not make the major repairs and costly upgrades, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and engineers estimated that the major repairs and upgrades would have cost if incurred, $2 million. In accordance with the entity's capitalization policies, 10 percent of the remediation cost would be allocable to site clean-up and treated as a period expense, and 90 percent would be allocable to remediating the masonry wall and building foundation damage. As recorded in the entity's asset management system, the estimated plant replacement value (PRV) of the office building is $8.5 million.

Calculate Net Book Value			
	Historical Cost	Accumulated Depreciation, 2012	Net Book Value, 2012
Land	**$100,000**		**$100,000**
Building acquisition, 1982	$1,200,000	$600,000	$600,000
Improvements	1,235,000	320,000	915,000
Total - Building & Improvements	**$2,435,000**	**$920,000**	**$1,515,000**

Calculate estimated cost to replace lost service utility:	
Total remediation cost	$2,000,000
Percentage wall & foundation cost	90%
Wall & Foundation Remediation cost	**$1,800,000**

Calculate percentage of lost service utility in current dollars:	
Wall & Foundation Remediation (estimate of lost service utility in current dollars)	$1,800,000
Plant Replacement Value (estimate to replace building in current dollars)	$8,500,000
Wall & Foundation Remediation cost percentage	21.18%

Calculate potential estimated impairment loss:	
Net book value (historical cost)	$1,515,000
Multiplied by: Wall & Foundation Remediation cost percentage	21.18%
Potential estimated impairment loss	$320,877

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $320,877.

Illustration 1d

Choice Among Methods - Permanent Declines in Lost Service Utility: *Physical Damage to an Office Building with Mold Contamination*

Assumptions

In 2012, entity officials became aware of extensive mold contamination at one of its office buildings. The mold contamination in the walls of the building was limited to the top two floors of the five-story building and could be safely contained and encapsulated. Facilities management personnel advised that the first three floors of the building could continue to be safely used.

Management does not believe that the loss of service utility will impede their operations and consequently, do not plan to remediate the mold contamination. Management has decided to discontinue the use of the top two floors and commence containment and encapsulation efforts. The remainder of the building will be kept in service.

The office building was constructed in 1982 at a cost of $1.3 million, including $100,000 for acquisition of the building site. The building had an expected useful life of sixty years. During its life, the entity made improvements to the building totaling $1.235 million.

Evaluation of potential estimated impairment loss

The mold contamination is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., contamination of two of the five floors of the building) is a significant decline in service utility. Because management does not plan to replace the lost service utility of these floors, the lost service utility of the building is permanent. Because the loss of service utility is permanent, any potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities management personnel in consultation with the Comptroller's office advise management to use the service units approach instead of the replacement cost approach because using construction cost estimates are not likely to result in a materially different potential estimated impairment loss amount. Management agrees to select the service units approach because it reasonably represents diminished service utility and given the circumstances, it is the most efficient and practicable method to use.

Calculate percentage of lost service utility in terms of units:	
Lost service utility in terms of floor units	2 floors
Total service utility prior to damage in terms of floor units	5 floors
Percentage of lost service utility in terms of units	40.00%

Calculate potential estimated impairment loss:	
Net Book Value (historical cost)	**$1,515,000**
Multiplied by: percentage of lost service utility - units	**40.00%**
Potential estimated impairment loss	$606,000

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $606,000.

Illustration 2a

Normal and Ordinary Lost Service Utility: *Physical Damage to a Multi-use Heritage Asset* [19,20]

Assumptions

Recent media reports have noted that acid precipitation (often called acid rain) is of increasing concern in the metropolitan area and, in particular to many of the area's historic and national landmarks including multi-use heritage assets. The entity's conservation scientists confirm the media reports and note that although normally rain is slightly acid, current rainfall has an average pH of more than 10 times normal levels.

[19] Illustration 2a adapted from: Department of the Interior, *Acid Rain in Washington*, http://pubs.usgs.gov/gip/stones/acid-rain.html.

[20] Heritage Assets are PP&E that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic (e.g., aesthetic) importance; or, significant architectural characteristics. Multi-use Heritage Assets are heritage assets whose predominant use is general government operations. FASAB Appendix E: Consolidated Glossary,

Limestone and marble, the stones that form many of the buildings and monuments in the metropolitan area are especially vulnerable to acid precipitation because they are predominantly made of the mineral calcite (calcium carbonate), which dissolves (i.e., erosion) easily in acid. Capitalized alterations made over the years to accommodate the heavy traffic brought about by administrative and visitor use of one of the more prominent multi-use heritage assets has drawn management's attention. The entity's Inspector General (IG) has begun a review and in an interim draft report has noted the following,

> "The marble balustrade on the south side, main entrance of the administrative building shows damage from acid rain posing a serious threat to the hundreds of visitors and employees who walk by this concourse daily. Management must take immediate corrective action in order to avoid potential bodily harm and liability."

Management in consultation with the conservation scientists and facilities managers determines that (1) erosion (deterioration caused by exposure to the environment) is a natural part of the normal geologic cycle and was reasonably expected to occur, and (2) temporary braces and steel under-girding currently in-place are sufficient for the current year. Management plans to restore the balustrade during the next fiscal year.

Evaluation of potential estimated impairment loss

The erosion is evidence of physical damage – an impairment indicator. Also, the prominence of the event (i.e., coverage by the media and the IG's recommendation) would be evaluated as a potential impairment indicator of significant loss in service utility. However, no potential estimated impairment loss is recognized because (1) the decline in lost service utility is "normal and ordinary" as it arises from a cyclical act of nature and (2) restoration efforts to cure the damage are planned to begin next fiscal year. Management should consider evaluating its depreciation policies and methods to reflect the adverse effect of the acid rain on buildings and monuments made of limestone and marble.

Illustration 2b

Restoration Approach - Permanent Declines in Service Utility: *Physical Damage to a Multi-use Heritage Asset*

Assumptions

A fire recently destroyed most of a three-story wing addition of an historic building. The building addition housed senior administrative offices. The foundation and portions of the first level were not seriously damaged and considered salvageable.

The Secretary's proposal to the Board of Regents (Regents) requested a minimum of $4.5 million to restore the three-story administrative wing. The Regents questioned the reasonableness of the cost estimate noting that typical office building construction in the metropolitan area costs about $160.00 per square foot (psf). The Secretary advised that the $160.00 psf estimate was not appropriate to use because it represented a "replacement" estimate using today's current labor, materials, standards and methods and not a "restoration" estimate that required using historically accurate materials and methods, as well as historic preservation and conservation methods as appropriate to preserve the historic nature and value of the multi-use heritage asset.

As an example, the Secretary noted the limited supply of the red Seneca sandstone used to construct the building in the 19th century and the added wing in the 20th century. The local quarry could only supply sufficient quantities to restore one level. As a result, complete restoration could not begin until a second quarry could be located to supply the additional quantities. Furthermore, experienced masons would have to be used for the restoration effort.

As a result of this information, the Regents modified the Secretary's request to restore one level of the wing noting that subsequent levels should not be restored in the future and that no such plans should be undertaken nor should any monies be committed. Displaced staff was moved to nearby vacant office space.

Evaluation of potential estimated impairment loss

The destruction to the three-story wing is evidence of physical damage – an impairment indicator. Also, the magnitude of the event (i.e., loss of senior administrative office space) would be evaluated as a significant decline in service utility. Because the Regents provided for partial restoration (one level) of the multi-use heritage asset, the lost service utility of the other two levels of the administrative wing is deemed permanent. As a result, because the lost service utility from these two levels is not reasonably expected to be restored, the potential estimated impairment loss is considered permanent and any resultant potential estimated impairment loss may need to be recognized.

Measurement of potential estimated impairment loss

Facilities managers and reconstruction specialists have estimated that (1) the total remediation of the three-story wing would cost $4.5 million and (2) restoring the first level would cost $2.0 million. The net book value of the administrative portion of the building prior to the fire damage was $1.75 million. In accordance with the Restoration Approach, the following estimates and calculations were presented to management:

Calculate estimated cost to restore lost service utility:	
Total restoration cost (all 3 levels)	$4,500,000
Less: portion to be restored (first level)	$2,000,000
Cost to restore lost service utility (2nd and 3rd levels)	$2,500,000

Calculate percentage of restored lost service utility in current dollars:	
Cost to restore lost service utility of the 2nd and 3rd levels of the wing (estimate of lost service utility in current dollars)	$2,500,000
Total restoration cost (all 3 levels)	$4,500,000
Restoration cost percentage	**55.5%**

Calculate potential estimated impairment loss	
Net Book Value (historical cost of wing)	$1,750,000
Multiplied by: Restoration cost percentage	55.5%
Potential estimated impairment loss	**$971,250**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the building is $971,250.

Illustration 3a

Service Units Approach - Recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine* [21]

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an "open" MRI system to the hospital. The transferred MRI system began to be used more frequently than the original "closed" MRI system because the "open" MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged six images per day; a decrease to 60 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance (O&M) of the "closed" MRI system continues to be incurred and management is evaluating the asset's continued service use and whether or not to book an impairment loss.

Upon inspection of the "closed" MRI system and closer examination of the related O&M costs, hospital administrators have determined that it is cost-beneficial to keep the system operational and that there is no impairment loss. They estimate that the system can be expected to last at least three years longer than originally estimated and achieve its expected service output. Furthermore, hospital administrators contend that a significant portion of the costs are (1) considered "sunk" due to the fixed-price nature of the long-term maintenance contracts and (2) fixed inasmuch as they will be incurred regardless of the closed MRI system's operating levels.

Evaluation of potential estimated impairment loss

Management initially identified that the change in technology was an indicator of potential impairment because it had resulted in a permanent reduction in the usage of the "closed" MRI system. Also, they believed that the magnitude test (i.e., decline in service utility relative to operating costs) had also been met due to the fact that the cost of operating the "closed" MRI system has remained the same while the service provided has decreased to 60 percent of prior levels. However, management has concluded that there is no potential estimated impairment loss

[21] Illustrations 3a and 3b adapted from: GASBS 42, Illustration 4, *Technological Development or Evidence of Obsolescence -Underutilized Magnetic Resonance Imaging Machine.*

(i.e., the MRI system did not meet Step 2 – Impairment test) because the asset can achieve its expected service output by being kept in service three years longer than originally planned. Using the service units approach, management determines the followings:

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	Net Book Value, 2013	**$1,285,714**

Calculate Acquisition cost per service unit		
a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	Acquisition cost per service unit (a divided by c) (rounded)	$124.00

Calculate Remaining Number of Service Units & Related Costs to be recovered:		
d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining number of service units = (4 years plus 3 extended years × 52 weeks per year × 5 days per week × 6 uses per day)	10,920
f	Remaining service costs to be recovered (d multiplied by e)	**$1,354,080**

Calculate Potential Estimated Impairment Loss:	
Net Book Value, 2013 (b)	**$1,285,714**
Remaining service costs to be recovered (f)	$1,354,080
Potential estimated impairment loss (b minus f)	**N/A**

Reporting Considerations

Although there is no potential estimated impairment loss to consider or recognize because the remaining service costs to be recovered is greater than the PP&E's net book value, management should consider re-evaluating its depreciation policies and methods to reflect the additional 3 years of extended service.

Illustration 3b

Service Units Approach - Non-recoverable Service Utility: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*

Assumptions

In 2010, a hospital purchased a magnetic resonance imaging (MRI) system at a cost of $2.25 million. The hospital estimated that the system would have an estimated useful life of seven years and that on average the system would be used for ten tests per day for five days per week. After installation, the utilization of the system was approximately at the levels estimated.

In 2013, an affiliated entity transferred an "open" MRI system to the hospital. The transferred MRI system began to be used more frequently than the original "closed" MRI system because the "open" MRI was more comfortable for patients and provided a superior image. Instead of providing ten images a day, the original MRI system was being used only on an overflow basis and averaged one image per day; a decrease to 10 percent of prior levels. Furthermore, the expenses associated with the continued operation and maintenance of the "closed" MRI system continue to be incurred and has drawn management's attention to evaluate the asset's continued service use.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in technology, which has resulted in a permanent reduction in the usage of the "closed" MRI system. The magnitude test (i.e., decline in service utility relative to operating costs) has also been met due to the fact that the cost of operating the "closed" MRI system has remained the same while the service provided has decreased to 10 percent of prior levels. Potential estimated impairment loss using the service units approach would be determined as follows:

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2010	$2,250,000
	Accumulated depreciation, 2013 (3 / 7 years)	964,286
b	**Net Book Value, 2013**	**$1,285,714**

Calculate Acquisition cost per service unit		
a	Acquisition cost, 2010	$2,250,000
c	Originally expected service units (7 years × 52 weeks per year × 5 days per week × 10 uses per day)	18,200
d	Acquisition cost per service unit (a divided by c)	$124.00 (rounded)

Calculate Remaining Number of Service Units & Related Costs to be recovered:		
d	Acquisition cost per service unit (a divided by c)	$124.00
e	Remaining service number of units = (4 years × 52 weeks per year × 5 days per week × 1 use per day)	1,040
f	Remaining service costs to be recovered (d multiplied by e)	$128,960

Calculate Potential Estimated Impairment Loss:		
	Net Book Value, 2013 (b)	**$1,285,714**
	Remaining service costs to be recovered (f)	$128,960
	Potential Estimated Impairment loss (b minus f)	**$1,156,754**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $1,156,754.

Illustration 4

Deflated Depreciated Current Cost Approach: Change in Manner or Duration of Use – *Training Facility Used for Storage*[22]

Assumptions

In 2013, management decided to close a training facility because enrollments declined due to outsourcing initiatives brought about as a result of Office of Management and Budget (OMB) Circular No. A–76, *"Performance of Commercial Activities."* The closed training facility has been converted for use as a storage warehouse.

This training facility was constructed in 2001 at a cost of $10 million. The estimated useful life of the facility is fifty years. Entity management has (1) no evidence that enrollments will increase in the future such that the building would be reopened for use as a training facility and (2) concerns with the significantly high operating costs – maintenance and repair, depreciation, insurance, utilities, security, etc.

Because no physical damage occurred that would require detailed cost repair estimates, management decides to use the deflated-depreciated current cost approach to measure the potential estimated impairment loss. Facilities managers have been able to readily identify current plant replacement value (PRV) for a comparable warehouse of the same size as $4.2 million and commercial construction indices of 100 and 150 for years 2001 and 2013, respectively.

Evaluation of potential estimated impairment loss

Impairment is indicated because the manner of use of the training facility has changed from training students to storage. The situation passes the magnitude test (i.e., decline in service utility relative to operating costs) because the ongoing costs of the training facility would likely be considered high in relation to the benefit it is providing - storage. Potential estimated impairment loss using the deflated depreciated current cost approach would be determined as follows:

[22] Illustration 4a adapted from: GASB 42, Illustration 5, *Change in Manner or Duration of Use – School Used for Storage.*

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
	Historical cost, 2001	$10,000,000
	Accumulated depreciation (12 / 50 years)	2,400,000
a	**Net Book Value, 2013**	**$7,600,000**

Calculate Depreciated current cost (current dollars)		
	Replacement cost of warehouse, 2013	$4,200,000
	Accumulated depreciation (12 / 50 years)	1,008,000
b	**Depreciated current cost**	**$3,192,000**

Calculate Deflation factor:		
c	Commercial construction index, 2001	100
d	Commercial construction index, 2013	150
e	**Deflation factor (c divided by d)**	**0.67**

Apply deflation factor to depreciated current cost		
b	Depreciated current cost	$3,192,000
e	Deflation factor (c divided by d)	0.67
f	**Deflated depreciated current cost (b × e)**	**$2,138,640**

Calculate Potential estimated impairment loss:		
a	Net Book Value, 2013	$7,600,000
f	Deflated depreciated current cost (b × e)	2,138,640
	Potential estimated impairment loss (a - f)	**$5,461,360**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $5,461,360.

Illustration 5

Construction Stoppage—*Special Purpose Test Equipment* [23]

Assumptions

In 2012, in response to a Congressional order canceling a major program, management stopped all construction activities related to the fabrication of program-related special purpose test equipment. The entity conducts numerous design and build projects for military and scientific purposes all of which have potential commercial application. The entity's program manager advised management that the special purpose test equipment was substantially complete at the time of stoppage and could be considered available for commercial use. The entity had accumulated costs totaling $10 million and was approximately 75 percent complete with the project.

Upon further inquiry, management determined that despite initial interest from two commercial firms, early in 2012, one of them filed for bankruptcy and the other withdrew its interest citing that the costs-to-complete are too high. There is no evidence to demonstrate that the construction stoppage is temporary or that other potential commercial interests can be found. Also, the program manager advises that there is no potential government use for this asset and that it should be disposed.

Evaluation of potential estimated impairment loss

The indicator of impairment is the construction stoppage. It appears to meet the test of impairment in that management would not have initiated the project if it had expected either program cancellation or lack of any potential commercial use. The situation passes the magnitude test because the costs-to-date (75% or $10 million) are significant in both percentage and monetary terms. However, there is no potential estimated impairment loss to report in accordance with this standard because the asset is totally impaired as it has no commercial or government use and cannot provide service. As such, the requirements in SFFAS 6, paragraph 38[24] should be followed. Specifically, in the period of disposal accumulated costs should be removed

[23] Illustration 5 adapted from: GASB 42, Illustration 9, *Construction Stoppage—Airport Pavements.*

[24] Refer to Technical Release 14, *Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment*, which provides implementation guidance that clarifies existing SFFAS 6 requirements and is intended to help differentiate between permanent and other than permanent removal from service of G-PP&E. The implementation guidance also recognizes the many complexities involved in the disposal of G-PP&E, as well as delineates events that trigger discontinuation of depreciation and removal of G-PP&E from accounting records.

from the asset accounts and any difference between the book value of the equipment and amounts realized shall be recognized as a gain or a loss.

Illustration 6a

Contract Termination - *Transferable Equipment Technology*

Assumptions

In 2012, the entity's chief contracting officer terminated a contract pursuant to the Federal Acquisition Regulations because the entity experienced substantial cost increases, schedule delays, and performance shortfalls. The terminated contract was to build the entity's next-generation surveillance equipment capable of covertly operating in adverse weather conditions. Despite several cure notices, the entity terminated the contract for default. The contractor has stated that it will not protest the termination. At the time of termination, the entity had incurred $150 million in contract costs.

In the meantime, the program manager determined that the operating environment had changed and that remaining funds would be better spent on other priorities and was able to transfer the system technology to other entity projects. The manner and use of the systems are not expected to change.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the event is significant and the termination decision will not be protested; i.e., permanent. However, because the entity was able to transfer the system technology to other entity projects, no potential estimated impairment loss exists.

Illustration 6b

Contract Termination - *Partially-Transferable Equipment Technology*

Assumptions

Same assumptions used in Illustration 6a except that the program manager was unable to transfer the entire system technology to other entity projects. After an inspection and engineering review, it was determined that 70 percent of hardware and software could be transferred to existing

projects. There is no potential use or application for the remaining 30 percent of equipment technology.

Evaluation of potential estimated impairment loss

The indicator of impairment is the contract termination. It appears to meet the test of potential impairment because the termination decision is a significant event and is considered permanent because the decision will not be protested. As a result of the entity being unable to transfer the entire system technology to other entity projects, an impairment exists.

Measurement of potential estimated impairment loss

Because 30 percent of the system technology cannot be transferred to other entity projects, a potential estimated impairment loss of $45 million exists (30.0% X $150 million).

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $45 million.

Illustration 7a

Cash flow approach – *Grouped Assets*

Assumptions

An entity manages and operates a shared-services center on a post-wide basis that provides administrative and information technology support. The entity groups the individual services separately into two distinct categories rather than on an individual basis. The net book values are $12 million and $11 million for the administrative and information technology (IT) groups, respectively.

In December 2012 the entity's management decided to implement a public-private strategic initiative that could eventually over several years transition these shared-services operations to private ownership. Both national and local private interests have asked their respective political representatives to accelerate the entity's implementation time-table and influence a favorable outcome. Management was directed to (1) immediately estimate the amount that could be recovered from selling the operations and (2) identify to the lowest level identifiable, operating information to include cash flows for each category. An appraisal was conducted to ascertain the amount that could be recovered from selling each of the groups. The appraisal report noted (1) that net realizable value (NRV) amounts were greater than value-in-use estimates and (2) the NRV

amounts of $13 million and $8 million for the administrative and IT groups, respectively. The Chief Financial Officer identified the following cash flow information: (a) cash from continuing operations of $12 million and $9 million for the administrative and IT groups, respectively and (b) cash flows from disposal activities of $2 million and $1 million for the administrative and IT groups, respectively.

As a result of complying with this directive and evaluating the resultant financial information and appraisal analysis, management became concerned that its assets might be impaired and adversely impact its public-private strategic initiative.

Evaluation of potential estimated impairment loss

If an impairment indicator exists, an impairment analysis should be considered. In this case, the entity's public-private initiative includes a significant change in the manner or duration in which the assets will be used. This represents an impairment indicator that would trigger an impairment analysis. Furthermore, management's concern that its assets might be impaired passes the magnitude test.

Management is concerned that the presence of an impairment indicator might affect its plan regarding the future use of the shared-services if the analysis indicates that the net book value of the assets are not recoverable. To apply the cash flow approach, the entity will need to estimate the future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. The future cash flows are the expected cash inflows to be generated by the asset net of any expected future cash outflows that are needed to produce the inflows.

Measurement of potential estimated impairment loss

This approach requires that an entity recognize a potential estimated impairment loss if (1) the undiscounted cash flows are less than the net book value of the assets (the net book value is not recoverable) and (2) the net book value exceeds the higher of the assets NRV [25] or value-in-use

[25] Net realizable value is the estimated amount that can be recovered from selling, or any other method of disposing of an item less estimated costs of completion, holding and disposal. Source: FASAB Glossary, Appendix E.

estimate.[26] A potential estimated impairment loss would be measured as the amount by which the net book value of the grouped assets exceed the higher of their net NRV or value-in-use estimate(s).

When identifying cash flows, assets should be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

Calculate Net book value:		
Net book value:	**Asset Group: Administrative**	**Asset Group: IT**
Assets' net book values at 12/31/2012 (a)	**$12,000,000 (a)**	**$11,000,000 (a)**
Calculate undiscounted cash flows		
Undiscounted cash flows from future operations	$12,000,000	$9,000,000
Undiscounted cash flows from future disposal of assets	2,000,000	1,000,000
Total - undiscounted cash flows (b)	**$14,000,000 (b)**	**$10,000,000 (b)**
Calculate Recoverability:		
Recoverability: (b minus a)	**Asset Group: Administrative**	**Asset Group: IT**
Total - undiscounted cash flows (b)	**$14,000,000**	**$10,000,000**
Assets' net book values at 12/31/2012 (a)	**12,000,000**	**11,000,000**
Recoverability (b minus a)	**$2,000,000**	**$(1,000,000)**
Is net book value recoverable?	Yes	No
Is asset subject to potential impairment?	No	Yes

[26] Statement of Federal Financial Accounting Concepts (SFFAC 7), *Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording*, at paragraph 50, defines value-in-use as "…the benefit to be obtained by an entity from the continuing use of an asset and from its disposal at the end of its useful life." Paragraph 51 further states that "Value in use is a remeasured amount for assets used to provide services. It can be measured at the present value of future cash flows that the entity expects to derive from the asset, including cash flows from use of the asset and eventual disposition. Value in use is entity specific and differs from fair value. Fair value is intended to be an objective, market-based estimate of the exchange price of an asset between willing parties. Value in use is an entity's own estimation of the service potential of an asset that it holds to provide a specific service." (underscoring added for emphasis)

Calculate potential estimated impairment loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable **and** (2) exceeds the higher of its net realizable value or value-in-use estimate. Because the administrative group has undiscounted cash flows greater than related net book values, recoverability is met and there is no potential impairment. However, because the IT group has undiscounted cash flows lower than related net book values, recoverability is not met and the potential for impairment exists. The calculation below shows that a $3 million potential estimated impairment loss exists because the $11 million net book value of the IT group's G-PP&E exceeds the higher of its net realizable value or value-in-use estimate (in this case we are told that the $8 million NRV amount is higher than the value-in-use estimate).

Potential estimated impairment loss:	Asset Group: Administrative	Asset Group: Information Technology
Net Realizable Value of assets at 12/31/2012	N/A	$ 8,000,000
Less: Assets' net book values at 12/31/2012	N/A	**$11,000,000**
Excess of net book value over Net Realizable Value	N/A	**$3,000,000**
Potential estimated impairment loss	N/A	**$3,000,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the IT asset group is $3.0 million.

Illustration 7b

Cash flow approach – Equipment: Technological Development or Evidence of Obsolescence - *Underutilized Magnetic Resonance Imaging Machine*[27]

Assumptions

In 2009, a hospital operating in a major metropolitan area purchased a "closed" magnetic resonance imaging (MRI) system at a cost of $2.25 million to be used exclusively for non-service

[27] Illustration 7b adapted from: GASB 42, Illustration 4, *Technological Development or Evidence of Obsolescence - Underutilized Magnetic Resonance Imaging Machine.*

connected procedures. The hospital, which charges fees for non-service connected care estimated that the system would have an estimated useful life of seven years and that on average the system would be used for twenty tests per day for five days per week. The average user fee for MRI services is $20.00 per use. Shortly after installation, utilization levels dropped to ten tests per day because of reduced demand for the services attributable to the "closed" nature of the MRI system.

In 2012, the manufacturer introduced an "open" MRI system that was advertised as being more comfortable for patients and provided a superior image. Furthermore, the expenses associated with the continued operation and maintenance of the "closed" MRI system continue to be incurred and has drawn management's attention to evaluate the asset's continued service use. Because similarly used MRI machines in the open market can be purchased from authorized dealers for $750,000 (their mark-up percentages are unknown), management is considering the possibility of selling the old machine and using its proceeds to help purchase the "open" MRI system.

Hospital administrators and technicians believe that the "closed" system can continue being used at the current utilization level for at least 3 years beyond the originally estimated service life. Also, they believe that the "open" system provides for only marginal benefits that do not exceed their cost. In light of this information, management decides not to sell the "closed" system. However, because the service utility expected at acquisition (20 tests per day) can no longer be achieved and is accompanied by an underlying cause; reduced demand arising from the less comfortable "closed" system, a potential impairment loss exists.[28]

Evaluation of potential estimated impairment loss

The indicators of potential impairment are (1) the change in technology and (2) reduced demand accompanied by an underlying cause; the less comfortable "closed" system. The magnitude test has also been met due to the fact that the cost of operating the "closed" MRI system has drawn management's attention to evaluate the asset's continued service use. Potential estimated impairment loss using the cash flow approach would be determined as follows:

[28] It is important to note that (1) the reduced demand alone is not a discrete or sole indicator of impairment and (2) technological changes or obsolescence should be considered along with other factors when assessing impairment. Regarding the former, had there been no underlying potential impairment (refer to the paragraph 12 indicators), no impairment test would have been required. Concerning the latter, had the utilization level (20 tests per day) and remaining service life (3 years) of the equipment stayed the same, no impairment test would have been required because the equipment's service utility that was expected at acquisition would be deemed recoverable.

Measurement of potential estimated impairment loss

Calculate Net Book Value:		
a	Acquisition cost, 2009	$2,250,000
	Accumulated depreciation, 2012 (3 / 7 years)	964,286
b	**Net Book Value, 2012**	**$1,285,714**

Calculate undiscounted cash flows:		
c	Average service fee per use	$20.00
d	Remaining service units (4 years plus 3 extra years × 52 weeks per year × 5 days per week × 10 use per day)	18,200
e	**Undiscounted cash flows (c multiplied by d)**	**$364,000**

Calculate Recoverability: (b minus a)		
		MRI
	Total - undiscounted cash flows (e)	$364,000
	Asset's net book values at 9/30/12 (b)	$1,285,714
	Recoverability (e minus b)	**$(921,714)**

Is Net book value Recoverable?	No
Is asset subject to potential impairment?	Yes

Calculate Potential Estimated Impairment Loss:

A potential estimated impairment loss should be recognized only if the net book value of the G-PP&E (1) is not recoverable and (2) exceeds the higher of its net realizable value or value-in-use estimate. Because management believes that the open market price of $750,000 is a reasonable estimate of the asset's net realizable value, it is compared to the asset's value-in-use estimate to determine which amount is higher. However, because the $364,000 undiscounted cash flows amount (prior to calculating the net present value to determine a value-in-use estimate) is lower than net realizable value amount of $750,000, there is no need to present value the cash flows to calculate a value-in-use estimate.

Because management believes that the open market price of $750,000 is a reasonable estimate, it is used as the "recoverable basis". Had the net realizable value estimate been unavailable to management, a value-in-use estimate (net present value of the future cash flows) could have been used as the "recoverable basis".

	MRI
Net Realizable value of asset	$750,000
Less: Asset's net book value	$1,285,714
Excess of net book value over fair value	**$ (535,714)**
Potential estimated impairment loss	**$ (535,714)**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the equipment is $535,714.

Illustration 7c

Cash flow approach – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[29]

Assumptions

An entity operates a government owned-contractor operated (GOCO) manufacturing facility in an economically depressed area fabricating various commodities with commercial applicability. The facility's current net book value is $22,500,000 with an estimated salvage value of $5,000,000 and has a 25 year estimated remaining useful life. Under the terms of the contract, the government provides the contractor with exclusive use of the facility in exchange for negotiated lease payments in the amount of $150,000 per year. The contractor is responsible for all maintenance and operating costs.

Recently this unique partnership has come under federal and state scrutiny as many legislators and environmentalists have expressed concerns that the contractor whose operations have caused contamination found in and around the facility is not being held financially responsible for the cleanup costs.

[29]Illustration 7c adapted from: Military Law Review, Volume 131 Winter 1991; - Government Owned – Contractor Operated Munitions Facilities*: Are they appropriate in the age of strict environmental compliance and liability?;* Major Mark J. Connor.

Outrage which has surfaced during congressional hearings on environmental cleanups has become the focus of print and cable-news outlets.

Further complicating management's "crisis response" is that (1) the contract effectively prohibits modifying the facility to achieve greater environmental compliance without legislative relief and (2) the contracting officer has initiated debarment procedures that effectively would shut down the facility in 90-days for an indeterminable amount of time.

Facilities managers and engineers believe that a prospective buyer can be found but that it will take significant time to pass all necessary sale requirements. Until then, they advise that the facility can be quickly reconfigured and partitioned into commercially viable long-term storage space. The required modifications would cost $500,000 and lease agreements are estimated to generate approximately $35,000 in annual revenues. A fairly recent analysis completed 9 months ago reveals that the property's net realizable value (NRV) was at that time, $30,000,000; 20 percent of which is attributable to land.

Management has approved the reconfiguration and partition plan and believes that it will take a minimum of 5 years before all approvals are in place and disposal efforts can begin and an additional 2 years to ultimately dispose of the property. Because management is concerned with the proper financial reporting of this event, it has asked its comptroller for advice.

Evaluation of potential estimated impairment loss

The indicator of potential impairment is the change in manner of use. The magnitude test has also been met due to (1) federal and state scrutiny, (2) media coverage, and (3) the fact that the cost of operating the facility has drawn management's attention to evaluate the asset's continued service use and seek the comptroller's advice. Because the entity is seeking appropriate approvals to commence disposal efforts and does not know when such permission will be granted, management intends to convert a portion of the facility for public storage; a change in the manner of use.

Measurement of potential estimated impairment loss

Calculate Net book value:	Facility
Assets' net book value at 12/31/X1 (a) (excluding land)	$22,500,000 (a)

Calculate undiscounted cash flows	
Required modifications (outflow)	($500,000)
Undiscounted cash in-flows from future rental lease payments (7 x $35K)	$245,000
Undiscounted cash in-flows from disposal of assets (1.0 -0.2 X $30Mil)	24,000,000
Total - undiscounted cash flows (b)	**$23,745,000 (b)**

Calculate Recoverability: (b minus a)	Facility
Total - undiscounted cash flows (b)	$23,745,000
Assets' net book values at 12/31/X1 (a)	22,500,000
Recoverability (b minus a)	$1,245,000
Is Net book value Recoverable?	Yes
Is asset subject to potential impairment?	No

Reporting Considerations

There is no potential estimated impairment loss to consider or recognize because the undiscounted cash flows to be recovered are greater than the G-PP&E's net book value.

Illustration 7d

Cash flow Approach (Calculating value-in-use using discounted cash flows) – Facility: Changes in manner or duration of use - *Government owned-contractor operated (GOCO) manufacturing facility*[30]

Assumptions

Same facts as Illustration 7c above except that (1) management has decided to reconfigure the facility and lease available storage space for the remaining life of the facility, (2) the net realizable value estimate is $2 million, and (3) the salvage value is $500,000. Furthermore, because

[30] Adapted from: Military Law Review, Volume 131 Winter 1991 - Government Owned – Contractor Operated Munitions Facilities: Are they appropriate in the age of strict environmental compliance and liability? Major Mark J. Connor

management does not believe that a prospective buyer can be found it decides not to seek disposal authority. The entity's comptroller advises management that to assess whether or not a potential impairment exists a value-in-use estimate would be appropriate to use because it is higher than the net realizable value estimate. A risk-free discount rate of 3 percent is used.

Evaluation of potential estimated impairment loss

In this case the entity should (1) use the undiscounted cash flows to calculate recoverability and (2) present value (i.e., discount) the undiscounted cash flows to calculate the value-in-use estimate. In so doing, a potential estimated impairment loss is realized. Calculations follow:

Calculate cash flows:			
	Undiscounted	**PV Factor**	**Discounted**
Required modifications (outflow)	($500,000)	1.00	($500,000)
Undiscounted cash in-flows from future rental lease payments (25 x $35K)	$875,000	17.41315	$609,460
Undiscounted cash in-flows from disposal of assets)	$500,000	0.47761	$238,805
Total - cash flows (b)	**$875,000**		**$348,265**

Calculate Recoverability: (b minus a)	
Recoverability: (b minus a)	**Facility**
Total - undiscounted cash flows (b)	**$875,000**
Assets' net book values at 12/31/X1 (a)	**22,500,000**
Recoverability (b minus a)	**($21,625,000)**
Is net book value recoverable?	**No**
Is asset subject to potential impairment?	**Yes**

Calculate potential estimated impairment loss:	
Potential impairment:	**Facility**
Higher of NRV or Value-in-Use: NRV = $2,000,000 (given) Value-in-Use = $348,265 (discounted Cash Flows)	
Use the higher - Net Realizable Value	**$2,000,000**
Less: Assets' net book value at 12/31/X1	**$22,500,000**
Excess of net book value over recoverable value (in use)	**$20,500,000**
Potential estimated impairment loss	**$20,500,000**

Reporting Considerations

The potential estimated impairment loss and corresponding reduction of the book value of the facility is $20,500,000.

Appendix C: Abbreviations

ASC	Accounting Standards Codification (FASB)
CFR	Consolidated financial report of the U.S. government
DM-AI	Deferred Maintenance and Asset Impairment (task force)
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GASBS	Governmental Accounting Standards Board Statement
G-PP&E	General property, plant, and equipment
IG	Inspector General
IPSASB	International Public Sector Accounting Standards Board
IPSAS	International Public Sector Accounting Standards
IT	Information technology
MRI	Magnetic resonance imaging
NRV	Net realizable value
O&M	Operation and maintenance
OMB	Office of Management and Budget
PP&E	Property, plant and equipment
PRV	Plant replacement value
psf	Per square foot
SFAS	Statement of Financial Accounting Standards (FASB)
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 7C13
1:00 to 2:30 p.m.

February 19, 2015

Project Agenda:

- FASAB Three-Year Plan
- Internal Use Software Working Group Status
- Early Implementation Discussion on SFFAS 42: *Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29, and 32*

Administrative Matters

- Next AAPC Meeting - May 14, 2015

****

Administrative Information:
Observers – To ensure access, please pre-register by 8 AM February 17th at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Charles Jackson at 202 512-7352 or jacksoncw1@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1 - 866-453-4503. Please enter 1662696 #.

Internal Use Software Working Group Status Update

February 19, 2015

Recap of Events

- Feb / Mar 2014: Presented Working Group's findings and recommendation to AAPC and FASAB
- Board requested that the WG peruse two concurrent avenues:
  1. Perform research on information relevant to the Users of the Financial Statements to determine if a change to the standard would be appropriate
  2. Draft implementation guidance for IUS

Changes to the Standard

- Met with OMB to understand budgetary reporting requirements
  - Requirements align to the standard in that costs associated with each software development phase should be reported
  - OMB and GSA moving toward agile development acquisition practices focused on short-term software capability deliveries
- Interviewed Program Managers from select agencies to understand goals and software investment decisions
  - PMs and leadership typically focus on total program / project costs, not just the development (capital) portion
- Working Group believes that a change to the standard that does not completely remove the reporting requirement within the financial statements and notes would cause agencies to incur costs that would exceed the expected benefit

Implementation Guidance

- February 2015: The IUS Working Group will hold a re-entrance meeting to re-engage agencies in drafting Implementation Guidance
- Guidance will consist of two major topic areas:
  1. Standard clarification
  2. Practical examples of implementation
- Requires input from agencies who have successfully undergone an audit of their IUS balances
- DoD initiated IUS policy review and will work in concert with initiative to draft Implementation Guidance

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

Annual Report

Fiscal Year Ended September 30, 2014

Three-Year Plan

Fiscal Years 2015-2017

Comments Requested by January 31, 2015

Issued November 18, 2014

Members

Tom Allen, Chairman

Robert Dacey, Government Accountability Office

Michael Granof

Christina Ho, Deprtment of the Treasury

Sam McCall

Mark Reger, Office of Management and Budget

D. Scott Showalter

Graylin Smith

Harold Steinberg

Organization

The Federal Accounting Standards Advisory Board ("FASAB" or "the board") was established in October, 1990, by three federal officials responsible for federal financial reporting—the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Comptroller General of the United States. These three officials possess legal authority under various laws to establish accounting and financial reporting standards for the federal government. Together, they entered into and have periodically modified a memorandum of understanding creating the board as a federal advisory committee.

Membership comprises individuals from each of the three federal agencies that established the board ("the sponsors") and six non-federal individuals. The board has been designated by the American Institute of CPAs as the body that establishes generally accepted accounting principles for federal reporting entities.

Mission

The FASAB serves the public interest by improving federal financial reporting through issuing federal financial accounting standards and providing guidance after considering the needs of external and internal users of federal financial information.

The Mission Supports Public Accountability

Financial reports, which include financial statements prepared in conformity with generally accepted accounting principles, are essential for public accountability and for an efficient and effective functioning of our democratic system of government. Thus, the board plays a major role in fulfilling the government's responsibility to be publicly accountable. Federal financial reports should be useful in assessing (1) the government's accountability and its efficiency and effectiveness, and (2) the economic, political, and social consequences, whether positive or negative, of the allocation and various uses of federal resources.

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Annual Report

From the Chairperson

The board began its twenty-fifth year on October 10th of 2014. Looking back, the remarks of members upon the board's tenth anniversary point to challenges still relevant today:

— increasing awareness, understanding, and use of financial information by citizens, elected officials, and executives; and

— linking financial information with performance results to better inform decision-making by citizens and other users.

> *Only when all who prepare, audit, and use Federal financial statements understand the nature of the information, the need to review and question what such information means, and the potential of the information for improving the resource management and stewardship of the Government, will FASAB's efforts be fully actualized.*
>
> David Mosso, FASAB Chairman 1997-2006, *FASAB News*, Tenth Anniversary Edition, October/ November 2000

Continuing Need for Integration

Our ongoing work reveals users are interested in more detailed financial and non-financial performance information but seek information that is integrated and reliable.

The board's products—generally accepted accounting principles—address the financial information needed in external reports. This makes guiding integration of information from diverse sources a challenge. Integration requires coordination across disciplines.

Because of user input calling for a focus on managerial cost accounting standards, the board engaged the National Academy of Public Administration (NAPA) to study internal user needs. The board hoped learning more about managers' use of financial and related information would reveal whether the needed integration exists.

The study showed that granular and accurate data are available but not transformed into readily-understood, actionable data for decision-making through analytics (including forward-looking information). There was great interest in financial information detailing the cost of program outcomes—this requires a focus on the cost of government services rather than government agencies. The study found key gaps in both culture and capacity.

The NAPA study panel offered recommendations to fill these gaps. One recommendation was for the President's Management Council to lead an effort to link budgeted resources to costs, outputs, and performance information with the board and others assisting the broad effort. If undertaken, this effort would likely focus on collaboration across government and disciplines to both integrate and analyze data. Such an effort could serve both internal and external users needs by making information more understandable and accessible.

Collaboration

Evidence that granular and accurate data are available to internal users demonstrates the importance of the financial management initiatives undertaken in the early 1990s and the success of the resulting collaborative efforts within the federal financial management community. Our collaboration with stakeholders has been critical to our success. We rely heavily on the participation of both federal and non-federal stakeholders in task forces and through formal due process such as responding to requests for comment.

As we plan for future activities, your input regarding our updated three-year plan – which also identifies potential projects not prioritized for action during the next three-years – is needed. The board's continued success in completing the reporting entity project and making substantial headway on all remaining projects was due in large part to robust collaboration. Each major project benefited greatly from the commitment of task force members. Our work with the Governmental Accounting Standards Board on the challenging topic of lease accounting allowed us to quickly consider issues unique to government. The work of NAPA allowed us to quickly assess the merits of revisiting the managerial cost accounting standards; as a result of the study we refocused our efforts on higher priorities.

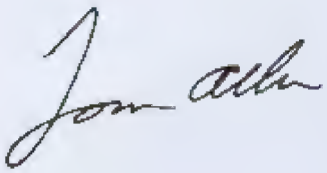
Your input will ensure we continue to focus our resources on the highest priorities. We have included the three-year plan in this report beginning at page 11. We encourage you to provide feedback on the plan so that we can consider your views during our review of the plan in February 2015. Please send your comments to fasab@fasab.gov.

> *We have only begun the process of communicating vital, reliable information in heavier doses to citizens, Congress, and management. Each will benefit and each will be able to make better, more informed decisions in the future. We have thus far focused mainly on financial reporting. As we combine detailed financial information with performance results and use the resulting information in the process of formulating future plans, the decision-making process will benefit.*
>
> Philip T. Calder, FASAB member 1997-2004, FASAB News, Tenth Anniversary Edition, October/ November 2000

Closing—Opportunities and Thanks

Opportunities to improve federal financial accounting and reporting remain. The sustained call for integration of financial and non-financial performance information combined with the growing reliance on electronic reporting make the work of standards-setting even more important and challenging than ever. The board will be considering how to present cost and budget information in greater detail, in clearer formats, and with better explanations. We hope this supports integration efforts so that decision-makers' information needs are met.

In closing, I would like to express my gratitude to all those engaged in the board's work—my fellow board members, the staff, the members of the Appointments Panel, the volunteers serving on FASAB task forces, and all who read and respond to our requests for input. The hard work and commitment of these many people make the board's work possible.



TOM ALLEN

BOARD TECHNICAL ACTIVITIES

Standards-setting Activities

The board completed a long-standing project on the **reporting entity** to address the complex relationships established by the federal government. Standards will help ensure financial reports cover the organizations for which elected officials are accountable. In April 2013, the board proposed principles to guide preparers of financial statements in determining what organizations should be included in federal financial reports as well as how to present information about those organizations. During FY2014, the board worked closely with stakeholders to clarify certain aspects of the standards and appreciated this close collaboration. The board finalized the standards in September 2014 and anticipates their issuance in the first quarter of fiscal year 2015.

The **reporting model** project objective is to identify financial information helpful for decision-making, demonstrating accountability, and achieving the reporting objectives. The board identified user needs after extensive outreach to various types of users and solicited recommendations from multiple task forces as well as roundtable participants. Users have consistently expressed interest in understanding the composition of cost information through enhanced disaggregation. Users also seek a better understanding of the relationship between cost and budget information.

Gaps exist between the information users seek and that provided in current financial reports. During 2014, board members presented their individual thoughts about how the ideal reporting model might fill these gaps. Based on these presentations, the board identified flow information (for example, budgetary and operating cost data) as the logical starting point. This initial approach aligns with user-identified interests in obtaining a better understanding of the composition of and relationship between cost and budget information.

Members recognize that flow information is just one of many components of the reporting model project. Once the Board addresses flow information, the reporting model discussion will consider other aspects of an ideal reporting model such as non-financial performance information and electronic reporting. In the long term, after the ideal model has been conceptualized, the board will need to identify specific standards projects so that manageable segments are addressed in priority order.

The board made substantial progress regarding accounting for **public-private partnerships** (P3s) by seeking comments on proposed accounting standards. P3s are increasingly being used to provide much needed capital resources and government services. The proposal seeks comments on definitions and required disclosures to aid in understanding P3s and related risks. The board plans to address recognition and measurement guidance after the proposed disclosures become available in 2018. This phase of the P3 project will be informed by those disclosures and related standards such as reporting entity, leases, and risk assumed which may address relevant recognition and measurement issues. Knowing more about the need for such guidance will help the board assess its decision to defer the recognition and measurement phase of its P3 work. We specifically ask for your input on the deferral in the three-year plan (see pages 11 and 22).

The board is also addressing **risk assumed** reporting because existing risk assumed information requirements apply only to insurance contracts and explicit guarantees of transactions other than loans (hereafter “non-loan guarantees”). Presently, there is no guidance for other types of risk assumed reporting and there is inconsistent presentation of information for insurance contracts and non-loan guarantees. Comprehensive and consistent reporting on significant risks assumed by the federal

government, not just risks related to insurance contracts and explicit guarantees, is important to meeting federal financial reporting objectives. During 2014, the board focused on insurance and non-loan guarantee programs. A task force provided needed input to the board regarding the relevant programs, as well as existing reporting practices, and options for improved reporting. The board anticipates seeking comments on a proposal regarding insurance and non-loan guarantees in FY 2015. Also, beginning in FY 2015, the board will start its evaluation of other major risks assumed by the federal government such as natural disaster relief.

The Financial Accounting Standards Board (FASB) is expected to issue major revisions to its accounting standards for **leases** during 2015. Prior and existing FASB standards formed the basis for federal accounting standards. Consequently, changes in FASB standards will create a void in the federal guidance. The board is working closely with the Governmental Accounting Standards Board (GASB) on appropriate standards for governmental entities. The boards met jointly in March 2014 to share their views. The FASAB hopes to seek comments on a proposal in 2015. Particular emphasis is being afforded to federal intragovernmental leasing activity.

In February 2014, the Department of Defense (DoD) requested that the board address six areas of concern. The board identified the **DoD implementation guidance request** as a priority given the long-standing nature of the issues. Plans are to address each of these areas through ongoing efforts, the Accounting and Auditing Policy Committee (AAPC), and a new active project. In September 2014, the board contracted for research support regarding two of the issue areas—estimating values of inventory and operating materials and supplies, and reporting on deployed property, plant, and equipment. The board will act as quickly as possible within its existing resources to address these long-standing DoD concerns.

During the fiscal year, the board also completed Statement of Federal Financial Accounting Standards 46 allowing an additional year for auditors to prepare needed audit guidance regarding **long-term fiscal projections**. Such long-term fiscal projections have been included in financial reports since 2010 as required supplementary information. Accordingly, the information has not been subject to the same level of audit scrutiny as basic financial information. With this action, information about the present value of projected receipts and non-interest spending under current policy without change will be presented as a basic financial statement with accompanying disclosures in FY2015. This information supports one of users' most important assessments - "whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due."[1] The board finalized the statement in July 2014 and issued them in the first quarter of fiscal year 2015.

Implementation Guidance

Implementation guidance was provided to federal agencies through the AAPC. The AAPC is a committee comprising representatives from the Chief Financial Officers Council, the Council of Inspectors General on Integrity and Efficiency, the U. S. Department of the Treasury (Treasury), the Office of Management and Budget (OMB), and the U. S. Government Accountability Office (GAO). The board's executive director serves as chairperson of the committee. While the board provides staff support, the committee accomplishes its mission largely through the efforts of volunteers serving on task forces. Volunteers come from federal agencies, independent public accounting firms, and nonprofit organizations. In early FY 2014, the AAPC finalized guidance for identifying the costs incurred to place G-PP&E into service. The committee also agreed to address the DoD request for guidance regarding contract financing payments.

[1] Statement of Federal Financial Accounting Concepts (SFFAC) 1, paragraphs 135 and 139.

Collaboration

The board continues to work collaboratively with other standards-setting boards including the GASB, the board that establishes accounting and financial reporting standards for state and local governmental entities in the United States; the FASB, the Board that establishes accounting and financial reporting standards for non-governmental entities in the Unites States; and the International Public Sector Accounting Standards Board (IPSASB), the board that establishes international accounting and financial reporting standards for governmental entities. Generally, such collaboration is at the staff level. However, the project on leases is a collaborative project for which the board holds periodic joint meetings with GASB to allow members to exchange ideas.

Presentations and Other Assistance

The board and its staff continue to actively support the federal financial management community by providing education, facilitating collaboration among agencies, presenting information and ideas in journal articles, and providing advice to others regarding federal financial accounting. Educational training was provided by members and staff through their participation in numerous international, national, regional and local conferences sponsored by groups such as the AICPA, the Association of Government Accountants, and state CPA societies.

Staff continued to offer its annual half-day training event. The event provides four hours of continuing professional education free of charge and informs the federal accounting and auditing community about FASAB's progress on key issues. In addition, staff members routinely assist accounting textbook authors and answer questions regarding federal accounting.

Governance, Operations and Budgetary Resources

Governance

The board did not revise its mission statement (adopted in 2012) or its rules of procedure (adopted in 2010) during FY 2014.

The Steering Committee members continued to emphasize the budget constraints faced by all federal agencies, including their own, but nevertheless affirmed their commitment to supporting the needs of the board. One of the two staff vacancies was filled as of the start of FY 2014. To address the remaining vacancy and mitigate the effect of these losses on the technical agenda, the committee approved:

- creating an analyst level staff position to be filled in FY 2015, and
- contracting for support on the DoD implementation guidance request.

Budgetary resources are reported on page 10. Final FY 2015 resources are dependent upon appropriations established through the federal legislative process. The committee also provided the executive director's annual performance appraisal and established expectations.

The Appointments Panel, in addition to its routine support to the Steering Committee, endorsed plans to recruit two new members whose terms will begin January 1, 2016. As a result of prior panel actions, Michael Granof and D. Scott Showalter were appointed to serve second terms.

FASAB general counsel, Jacquelyn Hamilton, provided members with training on the board's ethics requirements. Such training is helpful to remind members of these important requirements and to answer questions. The training will be provided annually and cover both ethics and Federal Advisory Committee Act requirements.

In April, Ms. Hamilton stepped down as FASAB general counsel and Gregory Marchand was appointed. Ms. Hamilton and Mr. Marchand collaborated during the transition period so that FASAB needs were well supported. The board will miss Ms. Hamilton's wise counsel and welcomes the opportunity to work with Mr. Marchand.

OUR GOVERNANCE TEAM

The Steering Committee is composed of the chairman and the members representing our sponsors. The committee annually reviews the operating budget, approves contracting activities, and provides the executive director's annual performance appraisal and expectations. The committee also participates actively in the Appointments Panel.

The Appointments Panel, established in 1999, assists the board's sponsors in recruiting and selecting non-federal members and advises the board regarding improvement efforts. The panel comprises the members of the Steering Committee, two representatives of the AICPA, and one representative of the Financial Accounting Foundation (FAF). The panel's assistance contributes greatly to the board's independence and continued conformance to the criteria for a GAAP standards-setting body. The panel assists in preparing this annual report and monitors annual performance survey results. The panel would convey any concerns to the AICPA in a timely manner.

Appointments Panel Members

Tom Allen, Chairman
Robert Dacey, GAO
Daniel Ebersole, FAF
F. Carter Heim, AICPA
Christina Ho, Treasury
Harold Monk, AICPA
Mark Reger, OMB

FASAB General Counsel

Gregory Marchand

FASAB Executive Director and Designated Federal Official

Wendy Payne

AICPA Criteria for a GAAP Standards-Setting Body

Independence: The body should be independent from the undue influence of its constituency.

Due Process and Standards: The body should follow a due process that is documented and open to all relevant aspects or alternatives. The body's aim should be to produce standards that are timely and that provide for full, fair, and comparable disclosure.

Domain and Authority: The body should have a unique constituency not served by another existing Rule 203 standards-setting body. Its standards should be generally accepted by its constituencies.

Human and Financial Resources: The body should have sufficient funds to support its work. Its members and staff should be highly knowledgeable in all relevant areas.

Comprehensiveness and Consistency: The body should approach its processes comprehensively and follow concepts consistent with those of existing Rule 203 standards-setting bodies for analogous circumstances.

ANNUAL CONFIRMATION PROVIDED BY MEMBERS

Independence: I acknowledge that I have neither personal nor external impairments that will keep me from objectively reaching independent conclusions on matters under consideration by FASAB, nor did I during the preceding fiscal year. I will promptly notify the Chairperson if my independence is or may be impaired.

Ethics: I have reviewed the FASAB ethics policy and confirm that I satisfied all requirements and limitations established under the policy during the preceding fiscal year.

Undue Influence: I have notified the Chairperson of any and all matters that I judge to be undue influence. "Undue influence" is defined as external influences or pressures that impact a member's ability to objectively reach and/or communicate independent conclusions.

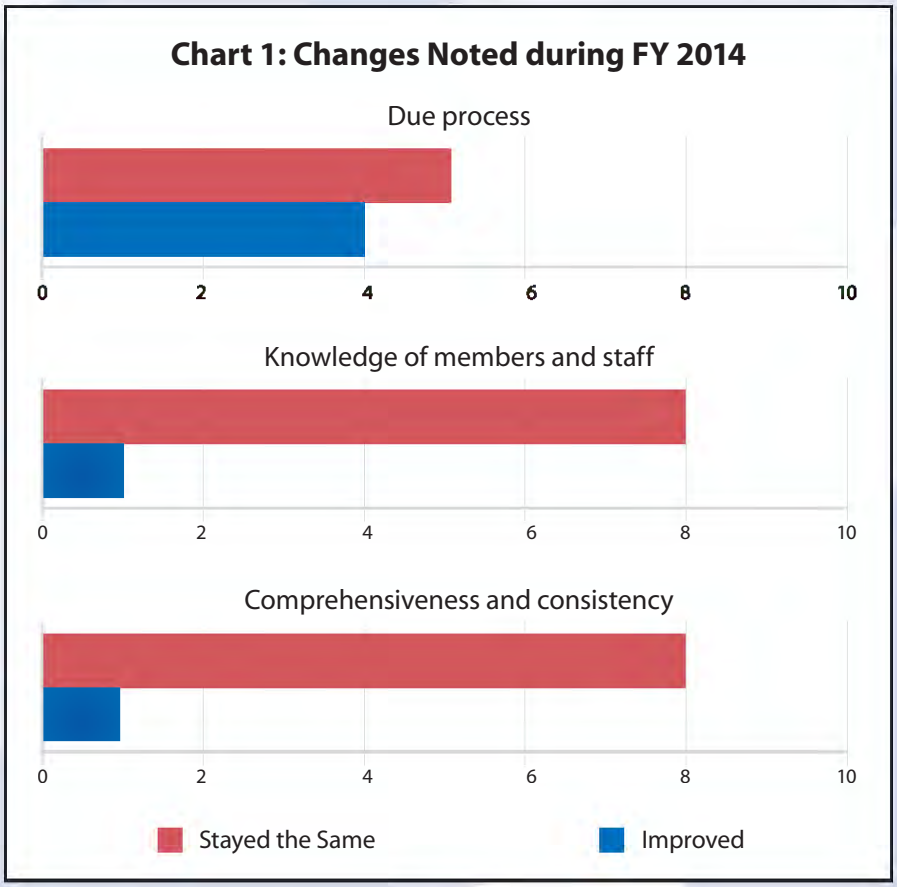
Operations

Members confirm their independence and adherence to the ethics policy, and complete a board performance survey in an annual assessment of conformance to the five AICPA criteria essential for a GAAP standards-setting body. Through the survey, each member identifies changes – positive or negative – in the board's performance relative to the criteria (see graphic above for a list of the criteria). Members are encouraged to explain their views as well as offer suggestions for improvement. Members consider all views and suggestions during the development of the annual report. This annual report summarizes the consensus results so that member views are made publicly available on a timely basis.

In addition to these annual processes, members agree that the AICPA will be notified of any reportable events of undue influence if and when they occur. Together, these efforts serve to alert the AICPA to significant changes relevant to the established criteria and ongoing recognition as the GAAP standards-setting body for federal governmental entities. To date, no reportable events have occurred. Again, this year all members confirmed they conformed to the requirements regarding independence, ethics, and reporting undue influence.

Further, the survey results identified some areas of improvement from last year and no significant new areas of concern arising during the year. A concern remaining from the prior year relates to future resources.

As noted in Chart 1 at right, the majority of members believe there was no change when considering: (1) due process, (2) knowledge of staff and members (a component of human resources), and (3) comprehensiveness and consistency. Four members noted improvement in due process.



The improvement in due process was attributed to the following:

- task force member participation in meetings,
- educational briefings directly from experts in areas such as tax expenditures and leasing,
- updates on GASB and IPSASB efforts,
- collaboration with GASB on the lease project,
- Congressional outreach, and
- input received on the three-year plan.

Members noted that increased direct interaction between members and their stakeholders was excellent. In addition, members noted that staff provided excellent support to the board including communication with members between meetings.

This year's survey results are generally consistent with the previous four years. The board's most notable five-year trend was sustained quality in the areas of comprehensiveness and consistency, knowledge of members and staff, and due process notwithstanding reductions in resources and turnover among staff and members. Members agreed recent actions should not be viewed solely as efficiency measures because of the benefits gained. The board plans to continue direct interaction with stakeholders and other efficiency measures.

For the remaining two criteria (domain and authority, and financial resources), the survey solicits narrative responses. This facilitates identification of ideas for improvement. Improvement efforts begun in FY2012 have continued and been successful.

Members expressed concerns regarding resources both for the current fiscal year and in the future (see the budgetary resources section below for detailed information). In each of the past five years, members have noted resource constraints while lauding efforts to operate efficiently. Most expressed the view that having one or two additional permanent staff would allow the board to provide timely guidance needed on complex matters. Members expressing these concerns noted:

- the significance and complexity of current projects are high and will require extensive research
- the board's opportunistic action to address issues by broadening the scope of current projects may not be sustainable
- the smaller staff size and broadening of individual projects has translated into slower progress on issues
- permanent staff are preferable to contractors

To address members' concerns, the board suggested finding opportunities to use new technology to support providing editorial feedback to staff between regularly scheduled meetings. In addition, the Steering Committee approved plans to hire one additional staff member in early fiscal year 2015.

Budget Resources

Actual funding levels are dependent on final FY 2015 appropriations and will be determined after appropriations are provided to each of the board's sponsors. Table 1, *Budget 2012-2015*, presents budget resources used from FY 2012 through FY 2014 as well as anticipated resources for FY 2015.

Table 1: Budget 2012 – 2015
(dollars in thousands)

	2012	2013	2014	2015
Salaries and Benefits	$1,612.4	$1,432.3	$1,482.5	$1,647.1
Member Compensation	149.0	148.6	151.6	154.6
Travel	48.0	41.3	41.3	52.0
Education & Training	10.8	14.0	14.5	14.5
Consultants and other	58.7	218.0 [2]	173.5	72.7
Total	**$1,878.8**	**$1,854.2**	**$1,863.4**	**$1,930.2**

[2] Note that contractor support was obtained in FY 2013 and 2014 in light of staff vacancies.

Three-Year Plan for the Technical Agenda

The board's three-year plan should help those who use, prepare, and audit financial reports to participate fully in the standards-setting process, and plan for changes in generally accepted accounting principles (GAAP).

In February 2015, the board will discuss priorities and make needed adjustments to this plan. Your assistance in identifying areas needing attention would be very helpful in that discussion. We would greatly appreciate receiving such input before January 31, 2015.

The board prioritizes projects based on the following factors:

a) the likelihood a potential project will significantly contribute to meeting the operating performance and stewardship reporting objectives established in Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting*;

b) the significance of the issue relative to meeting reporting objectives;

c) the pervasiveness of the issue among federal entities; and

d) the potential project's technical outlook and resource needs.

Additional factors considered significant by individual members in planning the technical agenda include (1) a focus on citizens and citizen intermediaries as the primary users of the financial report of the U. S. government, (2) attention to the needs of Congress and program managers, (3) impacts on preparers and auditors due to declining real budgets, (4) increasing risks due to fiscal uncertainty and operational complexity, and (5) more electronic reporting.

With each annual review, the board identifies its priorities so that research can begin as time is available. Projects identified as priorities but not yet active on the board's agenda are "research projects." Your input regarding the scope of each research project and key issues is welcome.

This document presents the three-year plan in brief on page 13. A project plan for each active project follows. The board's research projects are then identified with a brief description. The final item in the technical agenda section is a list of potential projects considered by the board.

You are welcome to submit suggestions on any aspect of this material or any ideas not presented herein. Note that the board plans to defer the recognition and measurement phase of the public-private partnership (P3) project so that the P3 disclosures resulting from earlier efforts can be considered along with recognition and measurement guidance in relevant standards such as reporting entity, leases and risk assumed. This means guidance will not be provided until late 2019. Your input regarding the impact of deferring P3 recognition and measurement guidance is needed. In particular, knowing whether preparers, auditors, or users of information are encountering challenges in applying the general standards given the absence of specific P3 guidance would be most helpful.

If you have suggestions regarding the three-year plan, please submit them by email to: *fasab@fasab.gov*

or in hard copy to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street NW
Suite 6814
Washington, DC 20548

Table 2: Three-Year Plan in Brief

Project and Objective	FY 2014 Actions	Plans		
		FY 2015	FY 2016	FY 2017
The Federal Reporting Entity: Consider what organizations and relationships should be included in federal entity reports and how information is to be presented	Finalize Standards	Issue Standards following 90-day review		
Financial Reporting Model: Consider whether the existing model meets user needs and reporting objectives Segments may include consideration of improvements in: - Cost information - Performance reporting - Budget presentation - Other areas such as the articulation of the financial statements	Develop ideal model (concepts statement) Consider results of Spending Pilots led by CFO Council	Continue developing ideal model (concepts statement)	Finalize ideal model concepts statement in FY 2016 Identify discrete projects needed to support ideal model and decide vehicle(s) for guidance.	
Leases: Evaluate existing standards to improve comparability and completeness of reporting	Consider issues and options	Issue Exposure Draft	Redeliberation Finalize Standards	
Risk Assumed: Develop standards so that information about risks assumed by the federal government and their potential financial impacts are available	Consider issues and options for phase I	Issue Phase I Exposure Draft	Finalize Phase I Standards Develop Drafts for Phase II	Phases I Implementation Guidance as Needed Issue Phase II Exposure Draft Finalize Phase II Standards
Public Private Partnerships: Consider how financial reporting objectives are met with regard to public private partnerships	Develop and Issue Exposure Draft	Finalize Disclosure Standards		Phase II Deferred
Department of Defense Request for Guidance	Develop project plan		Complete guidance	

Research Projects

Research projects are not assigned full-time staff but research may occur as resources become available. Projects are listed in order of priority. Anticipated date for assignment to staff indicated where possible.

Project and Objective	FY 2014 Actions	Plans		
		FY 2015	FY 2016	FY 2017
Reconciling Budget and Accrual Information – Alignment between Agency and Government-wide Requirements (This project is related to the reporting model project. Incremental changes will be considered first. Decisions regarding next steps will be taken as the ideal model is developed.)		Research		
Tax Expenditures		Research		

.Current Projects

Reporting Entity

Purpose: FASAB addresses the reporting entity issue in its Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*. SFFAC 2 addresses:

- Reasons for Defining Reporting Entities
- Structure of the Federal Government
- Identifying the Reporting Entities for General Purpose Financial Reporting
- Criteria for Including Components in a Reporting Entity
- Other Issues Concerning the Completeness of the Entity

While SFFAC 2 provides criteria for determining if an entity should be included in the federal reporting entity, questions continued regarding whether certain organizations should be included. The Federal Reporting Entity project addressed both the conceptual framework and standards issues.

Applicability: This project applied to the government-wide reporting entity and to component reporting entities that prepare and present general purpose federal financial reports in conformance with Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Objectives: TTo provide principles that guide preparers of financial statements in determining what organizations should be included in the financial reports of the government-wide reporting entity and each component reporting entity to meet federal financial reporting objectives.

Guide preparers of general purpose federal financial reports (GPFFR) in determining whether included entities are entities to be consolidated or entities to be disclosed, and what information should be presented. This guidance will ensure that users of GPFFR are provided with comprehensive financial information about entities and their involvements with organizations so that federal financial reporting objectives are met.

Develop a definition of 'related party' and establish relevant disclosure requirements.

Assigned staff: Melissa Loughan

Other resources: Staff has engaged a task force to help accomplish the project objectives.

Project page: *http://www.fasab.gov/projects/active-projects/concepts-federal-entity/*

Timeline: **October 2014 - December 2014**

- Complete the 90-day review period

The Financial Reporting Model

Purpose: This project is being undertaken because of increased demands for financial information to facilitate decision-making and demonstrate accountability, and the changes in how users expect financial information to be delivered. For example, our research has noted that:

- Decision-makers are seeking information on the full cost of programs and citizens are accessing detailed information on spending, such as who received federal funds and what was accomplished with those funds.[3]

[3] Preparers Focus Group Discussion, February 10, 2009.

- Decision-makers also want additional information about the budget, comparisons of full costs with the budget, and projections of future receipts and expenditures.
- Citizens expect financial information about component entities but they have difficulty understanding current financial reports.[4]
- The public is relying increasingly on electronic media (digital devices, complex networks, and interactivity) to obtain information on demand.[5]

In addition, component reporting entities are experimenting with a schedule of spending and the board may consider whether that schedule has a role as a basic financial statement. If so, guidance may be needed to help ensure that users understand the information presented and how it relates to existing financial statements.

Applicability: This project applies to the government-wide reporting entity and to component reporting entities that prepare and present general purpose federal financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.

Also, any conceptual guidance developed as a result of the project would guide the board's development of accounting and reporting standards. Knowledge of the concepts that the board considers should help users and others who are affected by or interested in federal financial accounting and reporting standards understand the purposes, content, and qualitative characteristics of information provided by federal financial accounting and reporting.

Objectives: The primary objectives of this project are to:

a. Determine what financial information would be helpful for decision-making, demonstrating accountability, and achieving the reporting objectives given findings that users:
   i. are seeking less aggregated cost information and are interested in the value being provided for the costs incurred.
   ii. would like to know what has been budgeted and spent and how expenditures compare to accrual costs.
   iii. users are highly interested in the budget deficit and how it compares with net cost of government operations

b. Given the focus on external user needs for integrated budget, cost, and performance information, the effort will focus on external financial reports and may address matters such as:
   i. Improvements in the usefulness—including the understandability—of cost and budget information as well as the relationship between cost and budget information
   ii. Factors to consider in:
      i. identifying the type and level of disaggregation (organizational, program, goals, objectives, functions) of most interest to external users
      ii. determining where trend information is needed and for how long a trend
      iii. selecting among a variety of presentation types or formats including consideration of the relationship of cost and budget information

[4] FASAB, *User Needs Study: Citizens*, April 2010.
[5] FASAB Reporting Model Task Force, *Report to the FASAB*, December 22, 2010.

iii. Identification of cost and budget information useful for performance reporting (That is, identify optimum points for connecting budget, cost, and performance information)

iv. Understandability of terminology and presentations including the relationship among statements

v. Identification of key terms and establishment of plain language explanations.

Assigned staff: Ross Simms

Other resources: Staff has been engaging a task force to help accomplish the project objectives. Also, staff plans to consider the schedule of spending pilot efforts. Optional resources include access to Web-based meeting software like Webex to reduce meeting logistics issues and permit wide participation..

Project page: *http://www.fasab.gov/projects/active-projects/concepts-the-financial-report/*

Timeline:

October and December 2014 Meetings

- Consider improvements to reporting of flow information such as cost, revenue, and budget information
- Begin developing a draft concepts statement regarding presentation of flow information

February – August 2015 Meetings

- Consider other needed improvements to the reporting model
- Finalize and issue an exposure draft of a concepts statement

October 2015 – April 2016 Meetings

- Consider responses to the exposure draft and identify needed revisions
- Finalize concepts statement and consider next steps

Leases

Purpose: This project is being undertaken by the board primarily because the current lease accounting standards, SFFAS 5, *Accounting for Liabilities of the Federal Government, and 6, Accounting for Property, Plant, and Equipment*, have been criticized as ineffective because they do not make meaningful distinctions between capital and operating leases regarding the substance of lease transactions. In addition, the lease accounting standards in SFFAS 5 and 6 are based on Financial Accounting Standards Board (FASB) lease accounting standards which are likely to be revised. The FASB and International Accounting Standards Board (IASB) have proposed changes that focus on the conveyance of rights to future economic benefits (such as the right of use). In addition, the Governmental Accounting Standards Board is addressing lease standards. Staff of the FASAB and GASB will collaborate in developing issues and options. Joint meetings of the boards will be held periodically to discuss options including differences between the state/local and federal environments.

Applicability: This project applies to the government-wide reporting entity and to component reporting entities that prepare and present general purpose federal financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board.*

Objectives: The primary objectives of this project are to:

a. Develop an approach to lease accounting that would ensure that all assets and liabilities [consistent with SFFAC 5 definitions] arising under lease contracts are recognized in the statement of financial position and related costs are recognized in the statement of net cost.

b. Evaluate and revise as needed the current lease-related definitions and recognition guidance in SFFAS 5 and 6, including consideration of the advantages and disadvantages of applying the potential FASB/IASB lease standard in the federal environment.

c. Ensure that the standards to be developed fully address the various lease transactions/activities currently being used in the federal community (e.g. enhanced use leases) as well as intragovernmental occupancy agreements.

d. Consider how the budgetary treatment of lease-purchases and leases of capital assets as outlined in Office of Management and Budget (OMB) Circular No. A-11 relates to financial statements and disclosures.

Assigned staff: Monica R. Valentine

Other resources: Staff will consult with both FASB and GASB staff members assigned to their board's respective lease accounting projects. Staff will also organize a task force of knowledgeable federal and non-federal participants who have relevant experience or interest in lease accounting within the federal government.

Project page: *http://www.fasab.gov/projects/active-projects/leases/*

Timeline:

October - December 2014 Meeting

- Review draft due process document provided by GASB

January - June 2015

- Finalize and issue exposure draft for public comment

July - December 2015

- Consider responses and revisions
- Develop final Statement

January – April 2016

- Finalize and issue Statement

Risk Assumed

Purpose: This project is being undertaken by the board because existing FASAB standards on risk assumed are limited to insurance contracts and explicit guarantees (other than loan guarantees). Because the federal government has a variety of responsibilities and consequently assumes a range of risks, it is important that FASAB revisit its existing standards. For example, when implementing policy initiatives to stabilize financial markets and the economy, the federal government explicitly assumed risks previously considered by some to have implied backing of the federal government (GSE).

In order to meet the stewardship and operating performance objectives of federal financial reporting,[6] it is important that the federal government report all significant risks assumed, not just risks related to insurance contracts and explicit guarantees.

Applicability: This project applies to the government-wide reporting entity and to component entities that prepare and present general purpose federal financial reports in conformance

[6] SFFAC 1, *Objectives of Federal Financial Reporting*, pars. 100, 122, and 141

with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles (GAAP), Including the Application of Standards Issued by the Financial Accounting Standards Board (FASB).*

Objectives: The primary objective of this project is to study the significant risks assumed by the federal government and develop (a) definitions of risk assumed, (b) related recognition and measurement criteria, and (c) disclosure and / or required supplementary information (RSI) guidance that federal agencies can apply consistently in accordance with GAAP.

Assigned staff: Robin Gilliam

Other resources: Multi-disciplinary task force, including sub-groups to address specific topics.

Project page: *http://www.fasab.gov/projects/active-projects/risk-assumed/*

Timeline:

Phase I: Explicit Indemnification Arrangements (insurance and guarantees other than loans):

- Identify alternative measures of loss exposure (value at risk)
- Consider recognition of elements in accrual financial statements (measurement and recognition guidance)
- Consider needed disclosures and/or RSI

October 2014 – December 2014

- Develop Phase I exposure draft

December 2014 – June 2015

- Issue Phase I ED or other request for feedback
- Conduct pilot testing on Phase I
- Begin Phase II research: Consider applicability to other types of risks assumed for entitlement programs other than social insurance, including national defense, security and disaster response; and other potential effects on future outflows such as regulatory actions, government sponsored enterprises (GSE) and other implicit or other explicit risks

June 2015 – September 2015

- Hold public hearing as needed on Phase I
- Continue research on Phase II

FY 2016

- Finalize Phase I Statement
- Complete research and develop exposure draft on Phase II

FY 2017

- Develop implementation guidance for Phase I, if necessary
- Issue Phase II exposure draft and hold public hearing
- Complete Phase II standards

Public Private Partnerships

Purpose: This project was added to the agenda because federal agencies have increasingly turned to public-private partnerships (e.g., PPPs, P3s) to accomplish goals. Budget pressures are likely to further increase the use of P3s. Making the full costs and risks of such partnerships transparent would be the overall objective of the project.

The board decided to address definitions and disclosures regarding risk before providing recognition and measurement guidance.

Applicability: This project applies to the government-wide reporting entity and to component reporting entities that prepare and present general purpose federal financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles* (GAAP), *Including the Application of Standards Issued by the Financial Accounting Standards Board* (FASB).

Objectives: Objectives of Phase 1 – Risk Disclosures - include:

- Defining terms
- Establishing disclosure requirements regarding the nature of and risks embodied in P3 arrangements

Objectives of Phase II – Recognition and Measurement – include:

- Providing guidance for the recognition and measurement of:
  - assets and liabilities
  - revenues and expenses
- Considering implications for other arrangements related to P3s (sale-leaseback or other long-term arrangements).

Assigned staff: Domenic Savini

Other resources: A multi-disciplinary task force, including sub-groups to address specific topics

Project page: *http://www.fasab.gov/projects/active-projects/public-private-partnerships/*

Timeline:

October – December 2013

- Present individual issues to task force and board

October – December 2014

- Consider responses to exposure draft regarding P3 disclosures
- Continue development of Technical Bulletin on recognition and measurement

February – April 2015

- Finalize standards for P3 disclosures

PHASE II:

April / May 2018 – December 2018

- Convene Task Force to confirm, analyze and address major P3 accounting practice issues requiring guidance
- Coordinate progress and results with the Reporting Entity, Leases and Risk Assumed Project Managers
- Review entity P3 Disclosures

January 2019 – June 2019

- Develop and Issue Exposure Draft(s)

July – December 2019

- Finalize Guidance or Standards

Department of Defense Implementation Guidance Request

Purpose: The Department of Defense (DoD) identified six areas of concern for the board's consideration. The purpose of this project is to address three areas the board believes may warrant FASAB action separate from other ongoing projects. These areas are (1) use of reasonable baseline estimates of the cost of inventory and related property (SFFAS 3), (2) accounting for deployed assets, and (3) timing of capitalization of

research and development efforts given spiral development efforts. The DoD also requested guidance on the treatment of (1) in-kind lease payments, (2) contract financing payments, and (3) revolving fund activities. In-kind lease payments will be addressed through the ongoing project on lease accounting. Contract financing payments may be addressed through implementation guidance by the Accounting and Auditing Policy Committee. DoD questions regarding revolving fund activities relate to budgetary reporting and can be addressed through consultation with the Office of Management and Budget.

Applicability: This project applies to the government-wide reporting entity and to component reporting entities that prepare and present general purpose federal financial reports in conformance with SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles* (GAAP), *Including the Application of Standards Issued by the Financial Accounting Standards Board* (FASB).

Objectives: Provide practical guidance to resolve long-standing issues.

Assigned staff: Melissa Loughan

Other resources: Contractor support for certain aspects as well as a task force. The board recognizes that active DoD participation is needed to address these long-standing concerns.

Timeline:

September 2014 through April 2015

- Research phase
- Deliberate issues and options

May 2015 – October 2015

- Develop due process documents and seek input

Research Projects

Reconciling Budget and Accrual Information - Alignment between Agency and Government-wide Requirements

SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, requires information to explain the differences between budgetary and financial accounting information. The requirement results in a reconciliation of obligations incurred and net cost and is presented as a note.

The detailed provisions are:

> 80. Budgetary and financial accounting information are complementary, but both the types of information and the timing of their recognition are different, causing differences in the basis of accounting. To better understand these differences, a reconciliation should explain the relationship between budgetary resources obligated by the entity during the period and the net cost of operations. It should reference the reported "obligations incurred" and related adjustments as defined by OMB Circular A-34. It also should include other financing sources not included in "obligations incurred" such as imputed financing, transfers of assets, and donations of assets not included in budget receipts. [Text deleted by SFFAS No. 22] The total of these items comprises obligations and nonbudgetary resources.
>
> 81. This total should then be adjusted by:
>
> (a) Resources that do not fund net cost of operations (e.g., changes in undelivered orders, appropriations received to pay for prior period costs, capitalized assets),
>
> (b) Costs included in net cost of operations that do not require resources (e.g., depreciation and amortization expenses of assets previously capitalized), and
>
> (c) Financing sources yet to be provided (those becoming available in future periods which will be used to finance costs recognized in determining net cost for the present reporting period).
>
> 82. The adjustments should be presented and explained in appropriate detail and in a manner that best clarifies the relationship between the obligations basis used in the budget and the accrual basis used in financial (proprietary) accounting.

A July 2012 AGA research report (Government-wide Financial Reporting) suggested improvements in process as well as standards. They stated "Our research indicated interest in the Unified Budget Deficit not only on the budgetary basis but also on the accrual basis and, more important, the reasons for the differences between the two perspectives." The government-wide financial report includes a basic financial statement reconciling the Unified Budget Deficit (deficit) and Net Cost. The deficit is based on receipts and outlays rather than obligations. So, the board may wish to consider whether revising the SFFAS 7, par. 80-82, requirements so that each component reporting entity reconciles net cost to amounts contributing to the government-wide deficit calculation would be:

1. An improvement in the information provided to users, and

2. Supportive of the government-wide reporting process improvements underway.

In contrast to the AGA report, many have suggested that the required reconciliation be eliminated while others recognize its usefulness (both as a control and as information helpful in understanding differences in perspectives). An effort to revise the reconciliation is likely to be controversial.

The board will address the most immediate concern regarding the reconciliation through this project—the potential need to support the government-wide reconciliation by aligning the component level disclosures with the government-wide requirements. This may be accomplished before the related reporting model effort is complete. The reporting model project will address other matters relating to the reconciliation such as meeting users needs for understandable information regarding the relationship between budget and accrual information.

Input regarding user needs in this area and key questions from preparers and auditors would be helpful in planning this project. Your input would be most welcome.

Tax Expenditures

Presently, accounting standards do not require information regarding tax expenditures. SFFAS 7 provides that:

> Information on tax expenditures that a reporting entity considers relevant to the performance of its programs may be presented, but should be qualified and explained appropriately to help the reader assess the possible impact of specific tax expenditures on the success of the related programs.

Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974, as amended, (the "Budget Act") as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Thus, tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers. Special income tax provisions are referred to as tax expenditures because they may be considered to be analogous to direct outlay programs, and the two can be considered as alternative means of accomplishing similar budget policy objectives. Tax expenditures are similar to those direct spending programs that are available as entitlements to those who meet the statutory criteria established for the programs. Tax expenditure analysis can help both policymakers and the public to understand the actual size of government, the uses to which government resources are put, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation. (Source: Joint Committee on Taxation, Report JCX-15-11, March 9, 2011)

Tax expenditure information is also available by budget function. In some cases, tax expenditures are significant when considered in comparison to direct spending (outlays) for a particular budget function. In addition, The GPRA Modernization Act of 2010 (GPRAMA) (Public Law 111-352) requires identification of tax expenditures contributing to performance goals and consideration of their performance. Absent information about tax expenditures, it may be difficult to assess the full cost of government actions.

In planning this project, it would be helpful to hear from users about the information they would find most useful and any challenges they anticipate in communicating information on this complex topic. The board does not presuppose any particular reporting practice. Your input would be most welcome.

Potential Projects

After considering factors that may influence project priorities, the board begins its planning by reviewing potential projects identified by the Executive Director (see Figure 1 for the rules of procedure governing agenda setting). Note that the list accumulates over time. Generally, potential projects are only removed if the issue has clearly been addressed through other projects.

Stakeholders are encouraged to contact the Executive Director to suggest potential projects or to provide insight regarding the projects identified here. Instructions for submitting comments are presented on page 12.

Index of Potential Projects

Rules of Procedure Regarding Agenda Setting

The FASAB consults with the Executive Director to prioritize its potential projects. New projects are added to the active agenda based on periodic prioritization by the board. The Executive Director ensures that agenda decisions are initiated in advance of staff becoming available to take on new work so that pre-agenda research will be conducted. All agenda decisions are made at meetings of the FASAB by oral polling with agreement of at least a majority of members polled required for approval.

To prepare for the FASAB consultation, the Executive Director solicits timely suggestions from other individuals and organizations. The Executive Director, after consultation with the Chairperson, may publish brief descriptions of potential projects and request input from selected individuals and groups on the potential projects and other emerging issues. In addition, the Chairperson may decide to convene an agenda hearing to discuss potential projects with stakeholders.

In addition to agenda setting initiated by FASAB, any individual or organization may request in writing or at an open meeting that the FASAB address a new issue, or review or reexamine any effective Statement of Federal Financial Accounting Standards, Statement of Federal Financial Accounting Concepts, or other effective provision of federal accounting principles. The FASAB will respond to such communications and explain its disposition of the request.

Asset Retirement Obligations

IIn some circumstances entities may be required to incur costs to retire assets. The board has established general standards for liability recognition and specific standards for liabilities associated with environmental cleanup (in SFFAS 5, *Accounting for Liabilities of the Federal Government*, and SFFAS 6, *Accounting for Property, Plant and Equipment*, respectively). However, there is no specific guidance regarding asset retirement obligations other than cleanup costs (e.g., hazardous materials required by law to be cleaned up). GAAP for the private sector includes specific guidance regarding asset retirement obligations developed since issuance of SFFAS 6. Financial Accounting Standards Statement No. 143, Accounting for Asset Retirement Obligations (issued 6/01) requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This creates three inconsistencies between entities following federal GAAP and those following FASB GAAP. One, certain liabilities recognized under FASB standards would not be recognized in the federal sector. Two, FASB standards require that liabilities be recognized in full when the obligation occurs while FASAB standards provide for incremental recognition so that the full liability is recognized at the end of the useful life of the asset requiring environmental cleanup. Three, the asset retirement costs are added to the total cost of the asset under FASB standards and are not in the federal sector; instead these costs are expensed as the liability is recognized.

Cleanup Costs - Evaluating Existing Standards

SFFAS 6, Accounting for Property, Plant and Equipment, addresses cleanup costs. Issues regarding existing standards for cleanup costs include:

1) Whether the existing liability recognition provisions are consistent with element definitions established in SFFAC 5.

a) The liability may be understated because the obligation is to clean up the entire hazardous waste but SFFAS 6 provides for a gradual build up of the liability balance as the related PP&E is consumed in service (the full cleanup cost is disclosed in a note).

b) The cost of PP&E may be understated because the SFFAS 6 requirement is to capitalize its acquisition cost; the later cost to retire the asset is excluded.

c) The scope of liability recognition is limited to costs to clean up hazardous substances rather than the full asset retirement obligation.

2) Cost-benefit issues relating to the level of precision required for estimates and ongoing concerns regarding the timing of recognition of asbestos liabilities (generally when asbestos exists rather than when it is to be removed) have been raised.

Conceptual Framework – Review and Finalization

The board undertook a project to refresh its conceptual framework. Work began in 2006 and the stated objectives were a framework to:

- provide structure by describing the nature and limits of federal financial reporting including the boundaries of the federal reporting entity,
- identify objectives that give direction to standard setters,
- define the elements critical to meeting financial reporting objectives and describe the statements used to present elements,
- identify means of communicating information necessary to meeting objectives and describe when a particular means should be used, and
- enable those affected by or interested in standards to understand better the purposes, content, and characteristics of information provided in federal financial reports.

The board established a phased approach and in the case of the reporting entity phase the effort led to development of standards concurrent with amendments to existing concepts. The board envisioned a final review of the resulting concepts to ensure consistency across the framework and to confirm its coverage is comprehensive. The board has issued new concepts on elements of accrual bases financial statements and measurement of those elements as well as placement of information (basic, RSI and OAI).

During the project, other standards-setting bodies, including GASB, FASB, IASB and the IPSASB, undertook similar efforts. Some of their efforts will go farther than the board's. For example, the FASB is considering a disclosure framework and the IASB is discussing principles for selecting among measurement approaches (e.g., relevance, giving priority to how the measurement approach affects the statement of comprehensive income, and cost-benefit). Coverage of topics by these standards-setting bodies may be more comprehensive than the board's coverage and the board may benefit from considering their efforts.

If this project were undertaken, the board would review its framework (including the results of the reporting entity and reporting model projects) and ensure the framework covers the topics it should and is internally consistent.

Cost of Capital

The opportunity cost of making an investment in assets is not recognized in the financial statements of agencies using the assets. Some other national governments have incorporated a capital use charge into the determination of the cost of agency operations as a management tool. The board considered this issue in connection with SFFAS 6 and issued an invitation to comment. Ultimately the board deferred further work on this project. In doing so, the board noted that there was interest in incorporating a cost of capital in the budget and that progress in this area would benefit the board's work. If this project were undertaken, the board would need to consider the likely effectiveness of incorporating a capital charge in agency financial statements, the appropriate capital base on which to assess the charge, and the selection of an interest rate to apply.

Derivatives

Staff has not researched the use of derivatives by federal agencies and has not had any inquiries by agencies or their auditors regarding appropriate accounting for derivatives. This is an area generally addressed in other domains.[7] The GASB issued Statement No 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*, on the topic. Selected material from the GASB's plain language explanation is presented below.

What is a Derivative?

A derivative is a unique and often complex financial arrangement that a government may enter into with another party, typically a private-sector financial firm. The value of a derivative or the cash it provides to a government (or that it requires a government to pay) is based on changes in the market prices of an item that is being hedged, such as interest rates on long term bonds or commodity prices. In other words, the value or cash flows of a derivative are derived from (are determined by) how the market prices of the hedged item change.

Governments enter into derivatives for at least four reasons:

- Governments often intend derivatives to be *hedges*. This type of derivative is an attempt to significantly reduce a specific financial risk that a government identifies, such as the risk of increasing commodity costs.
- Some governments find that they can *lower their borrowing costs* by entering into a derivative in connection with debt they issue.
- Some governments engage in derivatives that are investments—governments are trying to *generate income*, as they would by buying other financial instruments.
- Some governments enter into derivatives to *manage their cash flows*. These derivatives may include an up-front cash payment to the government from the other party. The payment arrangements or terms of the derivative agreement essentially provide for the repayment of the up-front cash.

[7] Presently, derivatives are reported in federal financial reports in conformance with private-sector standards.

Electromagnetic Spectrum

The Federal Communications Commission (FCC) manages the electromagnetic spectrum – a renewable natural resource excluded from coverage in Technical Bulletin 2011-1. The technical bulletin requires entities to report the federal government's estimated royalties and other revenue from federal natural resources that are (1) under lease, contract or other long-term agreement and (2) reasonably estimable as of the reporting date in required supplementary information.

The FCC's goal is to:

> Ensure efficient allocation and management of assets that government controls or influences, such as spectrum, poles, and rights-of-way, to encourage network upgrades and competitive entry.

This project would consider what information may be needed to allow citizens to monitor the management of this asset. It is not addressed by other accounting standards at this time. Based on the Fiscal Year 2013 Budget Estimates submitted by the FCC to Congress in February 2012, receipts in excess of $30 billion are anticipated over the next ten years.

Excerpt from Congressional Research Service Report: *Spectrum Policy in the Age of Broadband: Issues for Congress* (Linda K. Moore, Specialist in Telecommunications Policy, August 29, 2012 (R40674))

Electronic Reporting

Electronic reporting is increasingly viewed as a means to convey financial information about government. This is evidenced not only by sites such as USAspending.gov and Recovery.gov but also by the universal practice of posting annual financial reports to federal websites and the emerging practice of providing a written highlights document accompanied by an electronic copy of the full report. More recently, a requirement that performance reports be provided electronically rather than in printed form was established in law (GPRAMA). Also, the DATA Act of 2014 demonstrates a growing expectation that machine readable data be provided that links specific transactions with programs and other classifications.

This is an area of great interest to the profession and the Association of Government Accountants issued Research Series Report No. 32 on *e-Reporting* in July 2012. The full report is available at http://www.agacgfm.org/Research-(1)/Research-Publications.aspx. The AGA report revealed a desire for common definitions, formats, and content among survey participants. Useful information regarding desired reporting and the need for standards and/or best practice guidance was provided through the research report.

The AGA report recommends, among other actions, the following actions relevant to standards-setting:

> 1. "An organization, group or taskforce of stakeholders should be appointed from the standard-setting community, federal, state and local government preparers, representatives from various public interest groups, and citizen-users — all with the collective charge to develop guidelines through an open dialogue and with a shared vision for data formatting and common reporting. This group should also encourage the discovery and recommendation of and reward for best practices in government financial, non-financial and performance information reporting."

2. The above group should "set definitions and strategies and create uniform standards for data content, database design and logical data model constructs for easier extraction, transformation and processing. Integrating federal, state and local information is critical. Standardization must be stable and able to survive challenges from preparers, data providers, systems vendors and users among others who are wedded to their existing systems and approaches."[8]

Given these trends and concerns, the board plans to consider concepts for electronic reporting in its reporting model project. Respondents may wish to consider whether a separate effort would be beneficial and provide insights regarding needed guidance.

Evaluating Existing Standards

A general concern expressed by members of the board and the federal financial management community has been that resources are increasingly constrained. Because of competing demands, existing requirements should be evaluated and any unnecessary requirements eliminated. This has been a long-standing concern that the board considers carefully in existing projects.

To explore burden reduction in a targeted fashion, project objectives could include:

1. provide forums for preparers, auditors, and users to identify requirements they believe are unnecessary (this could be done through an open-ended written request for input or roundtable discussions)

2. evaluate the requirements identified against the reporting objectives

3. prepare an omnibus exposure draft to adjust or eliminate requirements

The challenge in this approach is that the relevance of requirements varies among agencies. For example, agencies for which certain requirements are immaterial may not find the information relevant but may find the steps necessary to omit the required information based on materiality too burdensome. They may simply comply with the requirement. To reduce the burden on this agency would mean that the requirement also would be eliminated at an agency for which the information is material. In addition, the burden is likely different between agencies with and without strong systems and controls.

Financial/Economic Condition

The board provided standards regarding fiscal sustainability reporting. However, a broader focus on financial condition reporting might result in additional reporting such as key indicators of financial condition at the agency or government-wide level. GASB has addressed key indicators and is currently undertaking a project to address financial projections.

Questions such as the following could be addressed in the project:

- What key financial ratios are useful in assessing the financial health of the entity?
- What information about the tax system is viewed as an indicator of financial health? (e.g., tax gap, tax expenditures, changes in the tax base/structure)

[8] Association of Government Accountants, *e-Reporting*, July 2012, pages 20-21.

- Is cost trend information needed at disaggregated levels? (e.g., trends in construction costs for capital intensive operations or personnel costs for labor intensive operations)
- Are there external reports/measures that should be reported such as rating agency reports regarding sovereign nations?
- Are benchmarks against other nations/departments needed?
- Are measures of risk assumed due to inter-governmental financial dependency needed?

Intangibles

The FASAB standards do not address intangible assets other than internal use software. Staff has been contacted by a few individuals with respect to intangibles such as census data and rights to use of inventions. The GASB issued *Accounting and Financial Reporting for Intangible Assets*. The issuance is described as follows on the GASB website:

Statement No. 51 identifies an intangible asset as having the following three required characteristics:

- It lacks physical substance—in other words, you cannot touch it, except in cases where the intangible is carried on a tangible item (for example, software on a DVD).
- It is nonfinancial in nature—that is, it has value, but is not in a monetary form like cash or securities, nor is it a claim or right to assets in a monetary form like receivables, nor a prepayment for goods or services.
- Its initial useful life extends beyond a single reporting period.

The standard generally requires intangible assets to be treated as capital assets, following existing authoritative guidance for capital assets, although certain intangible assets are specifically excluded from the scope of the statement. One key exclusion relates to intangible assets that are acquired or created primarily for the purpose of directly obtaining income or profit. Such intangible assets should be treated as investments. The standard also provides guidance for issues specific to intangible assets. For instance, to report the historical cost of an intangible asset in the financial statements, the asset has to be *identifiable*. That means that the asset is *separable*—the government can sell, rent, or otherwise transfer it to another party. If it is not separable, the asset has to arise from contractual or other legal rights, such as water rights acquired from another government through a contract that cannot be transferred to another party.

Internal Use Software

SFFAS 10 provides standards for internal use software. Since its implementation, federal preparers have expressed concerns regarding (1) the relevance of capitalized costs which are limited to the development phase (both OMB guidance and GAO's cost estimating guide focus broadly on project – or life-cycle – costs), (2) the need to assign full costs – which include general and administrative costs – to software, and (3) the ability to identify phases under current IT practices. The objectives of the project would be to:

- Evaluate whether restricting capitalized costs to the development phases is useful and, if not, consider changes such as allowing capitalization from project inception to completion or expensing costs.

- Consider alternatives to the current full cost requirements and/or guidance to support efficient agency implementation

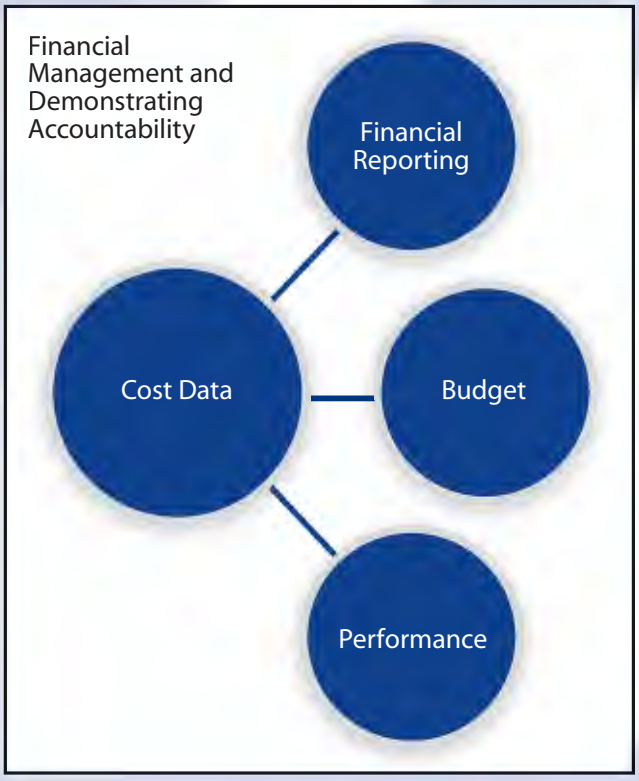
Long-Term Construction/Development/Procurement Contracts

In its work on National Defense PP&E (ND PP&E), the board considered the need for disclosures regarding complex, long duration contracts for the development and acquisition of weapons systems. One proposal included a disclosure of the ten largest acquisition programs showing budgeted amounts, expected amounts, cost to date and progress to date. Exposure of this proposed disclosure requirement revealed a number of technical areas that required clarification as well as resistance to this non-traditional disclosure among some commentators. The board elected to move forward to eliminate the special category ND PP&E and any disclosures unique to the category. As a result, the board set aside its work in this area. However, the board noted (in the Basis for Conclusions to a subsequent ED and SFFAS 23 – *Eliminating the Category National Defense PP&E*) its intention to return to this proposal on a government-wide basis in the future.

Managerial Cost Accounting

The CFO Act calls for the development of cost information and the integration of accounting, program, and budget systems and information. Also, subsequent legislation such as the Government Performance and Results Act (GPRA) and the GPRA Modernization Act established the expectation that cost measurement would be an important part of reporting on results. Accordingly, as illustrated in Table 1, cost data is vital to financial reporting, budget decision-making, and performance management and reporting and, ultimately, cost data is a key ingredient for fiscal management and demonstrating accountability.

Figure 1: Role of Cost Data



The board's focus is on external financial reporting and it does not typically address management information needs. In 1995, to support the goals of the CFO Act and the GPRA, the board established managerial cost accounting standards at the request of then Vice President Gore. While these standards address external reporting needs such as full cost information, they also provide broad goals for managerial cost accounting to support internal users.

Despite this guidance, the board continues to be advised of a need to improve the internal availability of cost information and its linkage to performance information. In 2010, FASAB staff surveyed agencies regarding managerial cost accounting. Results indicated that a guide to using, developing, and reporting cost information might be helpful. Also, research in the reporting model project identified cost accounting as critical to meeting a need to integrate cost, budget, and other performance information. The ideal model under development in the reporting model

project will inform this project regarding long-term goals for disaggregating and linking information to improve external financial reporting but will not address guidance for meeting needs for managerial information.

In 2013, the board contracted with the National Academy of Public Administration (NAPA) to study questions such as (1) are good financial and related data available to senior managers, (2) how effectively are managers using such data, (3) what gaps may exist, and (4) what options are most likely to be helpful in closing any gaps. The study found – among other things – that data are granular and accurate but challenges remain in analyzing and transforming data into readily understood actionable information. In particular, the ability to identify the cost of programs and outcomes is lacking but desired.

The NAPA panel recommended that the President's Management Council (PMC) take a leadership role in linking budgeted resources to costs, outputs, and performance. The NAPA panel further recommended that FASAB "support the PMC by utilizing FASAB's staff expertise in conceptualizing frameworks for integrating budget, costs, and service performance information developed through the creation of SFFAS 4, *Managerial Cost Accounting Concepts and Standards*. While SFFAS 4 already provides guidance to agencies on the principles of managerial cost accounting, significant unmet availability of such information was described by agency leaders. Taking the concepts and standards to the next level to meet the needs of agency decision-makers will require direction by the PMC. FASAB has already been proactive with soliciting user needs for financial information. Accordingly, FASAB should leverage its three sponsors—Treasury, OMB, and GAO—in elaborating on details of user needs. One potential approach for long-term consideration would be the development of a taxonomy of auditable accounting codes that tie each expense journal entry to a type of benefit or outcome."

The NAPA study results recognize the importance of engaging senior leaders across government to improve availability and use of managerial cost accounting information. Given the board's mandate—providing generally accepted accounting principles for external reporting--and its limited resources, the board does not envision addressing managerial cost accounting unless it is one component of a government-wide initiative.

Natural Resources

SFFAS 38, *Accounting for Federal Oil and Gas Resources*, was issued as final on April 13, 2010. It requires the value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves to be reported in a schedule of estimated federal oil and gas petroleum royalties. In addition, it requires the value of estimated petroleum royalty revenue designated for others to be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others. These schedules are to be presented in required supplementary information (RSI) as part of a discussion of all significant federal oil and gas resources under management by the entity. Due to a deferral (SFFAS 41), the Statement is effective as RSI for periods beginning after September 30, 2012.

It is the board's intent that the information required by the Statement transition to basic information after being reported as RSI for a period of three years. Prior to the conclusion of the three-year RSI period, the board plans to decide whether such information should be recognized in the financial statements or disclosed in notes. This Statement will remain in effect until such time a determination is made.

The purpose of this project is to consider the results of the three-year RSI period and develop standards regarding any transition of information to basic information.

Property with Reversionary Interest

The federal government sometimes retains an interest in PP&E acquired by grantees with grant money. In the event that the grant recipient no longer uses the PP&E in the activity for which the grant was provided, the PP&E reverts to the federal government. These arrangements are specifically excluded from PP&E accounting. Some have suggested that a review of this exclusion is needed to ensure that similar arrangements are accounted for similarly and that adequate information is reported in such circumstances.

Research and Development

Research and development (R&D) costs are presented as required supplementary stewardship information (RSSI) and include both direct R&D spending by agencies and spending which supports non-federal research and development. Generally, staff has found that FASB standards for R&D are referenced to determine what spending qualifies as R&D (for example, to identify when to begin capitalizing costs as new assets are developed). Given the significant federal investment in R&D ($130.3 billion in 2012[9]) and the possible differences between sectors, a review of practices in this area may be warranted. Alternatively, R&D reporting may be explored as a component of an overall project focusing on Stewardship Investments.

Revenue (Exchange and NonExchange)

SFFAS 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting,* provides guidance for recognition of exchange and non-exchange revenue. In FY2012, $350.8 billion of exchange revenue and $2,518.2 billion of non-exchange revenue was reported government-wide. SFFAS 7 requires disclosures and required supplementary information as well as suggests other accompanying information on the following topics:

- A perspective on the income tax burden.
- Available information on the size of the tax gap.
- Tax expenditures related to entity programs.
- Directed flows of resources related to entity programs.

SFFAS 7 has not been reviewed. Feedback suggests that some agencies are relying on FASB standards for more detailed guidance regarding revenue recognition and these standards have been revised since the issuance of SFFAS 7. When SFFAS 7 was established, the board acknowledged both inherent and practical limitations that made full accrual accounting for tax revenues unattainable. The basis for conclusions for SFFAS 7 notes:

> 171. At the time the Board began deliberations on this standard, accounting systems necessary to determine even the limited revenue accruals that are now required for taxes did not exist. The changes in systems required by this standard are limited to those necessary to mirror the established assessment processes. The Board understands that the Internal Revenue Service is attempting to improve its collection function and the related management information systems. Because such systems must also provide accounting information, the Board decided not to impose accounting standards at this time that might conflict with systems changes needed to improve the efficiency and effectiveness of the collection process or go beyond the minimum changes considered necessary to enable the collecting entities to properly discharge their responsibilities.

[11] Consolidated Financial Report of the U. S. Government, FY 2012, Table 11.

173. In the future, the general standard for accrual as it applies to taxes and duties could be tightened to produce a fuller application of the accrual concept. For fines, penalties and donations, no accountable event precedes the recognition point established by this standard. Therefore, the general standard for recognition as it applies to these sources of revenue results in full accrual accounting for them.

A review of the revenue standards might consider general improvements that could better meet the reporting objectives as well as how to improve the understandability of the presentation of information about taxes.

Stewardship Investments

The board undertook the effort to reclassify all required supplementary stewardship information (RSSI) several years ago. RSSI is not a category recognized in auditing standards. Audit coverage of the information may not meet the board's expectations unless the board reclassifies the information in an established category. Hence, the reclassification would resolve questions regarding the desired audit status of the information. The board completed work on two of three types of information – stewardship responsibilities and stewardship property, plant and equipment. The remaining RSSI type is stewardship investments including human capital, research and development, and non-federal physical property. The board deferred addressing this type so that it could devote additional resources to higher priority projects. The consequence is that this information remains as required supplementary information.

Summary or Popular Reporting

Agencies are issuing summary reports of financial and performance information and some view these as the primary report for citizen users. The need for guidance or standards has not been explored by staff. However, citizens participating in focus groups provided valuable insights regarding their interests and expectations.

We want to hear from you.

Do you like this report? Do you believe it should include any other information?

Please let us know by contacting the Chairman at *FASAB@FASAB.GOV* or 202.512.7350.

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ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 5N30
1:00 to 2:30 p.m.

May 14, 2015

Project Agenda:

- DoD Implementation Guidance
- Internal Use Software Implementation Guide Outline

Administrative Matters

- Next AAPC Meeting – July 16, 2015

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Administrative Information:
Observers – To ensure access, please pre-register by 8 AM May 12th at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Charles Jackson at 202 512-7352 or jacksoncw1@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1-866-453-4503. Please enter 1662696 #.

Internal Use Software Implementation Guide Draft Outline

Summary

The implementation guidance promotes an understanding of organizational considerations that affect the application accounting standards to internal use software (IUS). The implementation guidance relates to:

a) Definition of IUS, component/module based IUS assets, software development phases, IUS recognition, measurement and disclosure related items such as capitalization threshold, capitalized cost, capitalization cut off, enhancement, impairment and related matters.

b) New IUS challenges brought by changes in the IUS environment since the issuance of Statement of Federal Financial Accounting Standards (SFFAS) 10, and

c) Management's role in applying SFFAS 10.

One of the objectives of this Technical Release is to enable federal reporting entities to use a consistent framework to apply existing standards to the fast changing IUS environment. The guidance also supports the objectives of ensuring that:

1. Transactions involving IUS are recorded in accordance with federal accounting standards, and
2. The cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, does not outweigh the benefits derived by the users of the financial information.

Lastly, it provides a discussion of new IUS items and challenges brought by the current software environment. It clarifies them in light of application of SFFAS 10 and the principles described throughout the Technical Release.

Proposed Major Sections:

I. Purpose
II. Background
III. Accounting Literature References
IV. Summary of Existing Standards
V. Q&A
VI. Summary of Illustrations
VII. Effective Date
Appendix A: Basis for Conclusion
Appendix B: Illustrations
Appendix C: Abbreviations

I. Purpose

- Address SFFAS 10 implementation challenges associated with the current internal use software development environment.

II. Background

- Present the discussion of the matching principle requirement from OMB; how the IUS working group formed; financial management responsibility and the challenges brought by the new software development methodology such as share service, spiral development, etc.

Illustration:

Position: *Reference SFFAC 1 to emphasize the matching principle which is consistent with OMB requirement*

Talking Points: *Statement of Federal Financial Accounting Concepts (SFFAC) 1: Objectives of Federal Financial Reporting*, Par 14. **Operating Performance** Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

• The costs of providing specific programs and activities and the compositions of, and changes in, these costs;

• The efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs; and

• The efficiency and effectiveness of the Government's management of its assets and liabilities.

III. Accounting Literature References

- Discuss the accounting literature used/referenced by this implementation guide including SFFAS 10, TR5, TR15, FASB, GASB etc.

IV. Summary of Existing Standards

- Based on the SFFAS 10, expand existing guidance or introduce new concept to cover the latest software development standard clarification needs such as development phases' cost recognition, significant enhancement & final user acceptance, etc. Major topics as below:

1. Illustration: Software Definition

Position: *clarify the internal use software definition by using some of the FASB & GASB concepts and modify it to fit the federal environment. Since it is impossible to count all existing and future IUS types, we could clarify what is not IUS in the current environment including shared and cloud service. Due to agencies' request, there is a need to clarify how to treat software used/developed in the R&D environment.*

Talking Points: SFFAS 10 Par. 2 stated: "This statement establishes accounting standards for the cost of software developed or obtained for internal use." IUS must be acquired, internally developed, or **modified solely to** meet an entity's needs. The IUS development or modification could be done in-house by the government's personnel or by a third-party contractor **on behalf of the entity**. **IUS assets do not include**:

a. Software to be used in research and development (see below)

b. Software developed for others under a contractual arrangement Software that a customer obtains access to in a hosting arrangement unless the entity has the contractual right to take possession of the software at any time during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software such as cloud service

c. Integrated Hardware/Software where the software is integrated into and necessary to operate the hardware or is incidental in the procurement of general equipment (i.e. photocopiers, operating software in computers, and other matters)

d. Software that is owned and operated by a vendor for the furtherance of an entity's objective yet no final ownership transferred to the entity by the end of the contract

The following costs of internal-use software are included in research and development and should be accounted for in accordance with the provisions of XXX:
a. Purchased or leased computer software used in research and development activities where the software does not have alternative future uses
b. All internally developed internal-use software (including software developed by third parties, for example, programmer consultants) in either of the following circumstances:
1. The software is a pilot project
2. The software is used in a particular research and development project, regardless of whether the software has alternative future uses.

2. Other Clarification Items Positions:

Multiple Deployments of Different Modules: *Based on OMB A-11 guidance, it is desirable to have modular or spiral development type acquisition for IUS project. As such, there is a need to introduce component or module based IUS asset concept.*

Development Phases: *Because development of internal-use software may not follow the sequence order as stated in the SFFAS 10 software development phases (for example, coding and testing are often performed iteratively), the accounting treatment should be based on the nature of the costs incurred, not the timing of their occurrence.*
It also could be useful to provide examples of development phases control points/ predetermined milestone such as the acquisition agreements and requirements that need to be in place to help agency especially the CIO to understand the requirement and trigger event for each development phase. It could be a table format and presented in the appendix illustration section.

Capitalization Threshold: *Use OMB Circular A–11, Part 7 concept to emphasize the importance of the IUS towards agency's mission: "major acquisitions are capital assets that require special management attention because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources. Major acquisitions should be separately identified in the agency's budget. For small dollar investments relative to the agency's budget, the agency may wish to develop a less detailed programming process based on the basic tenets presented in this Guide. A stratified capital programming process involving more or less detail and review based on the size or strategic importance of proposed investments may be appropriate, particularly in large agencies. Agencies should have well documented thresholds clearly disseminated and implemented across the organization."*

Capitalized Cost: *The clarification of the capitalized cost could be accomplished through the following items in this implementation guidance: 1. Appendix A real examples of how agencies capitalize their cost; 2. Appendix A table of typical IUS phase trigger event and control point for expense or capitalization; and 3. Potentially introduce a labor rate cost estimate method.*

Final User Acceptance (Cut Off for Capitalization): *There is a need to expand the final acceptance testing as a cut off/final step for capitalization since each iteration within an IUS development has its own acceptance testing before moving forward to the next iteration and sometimes final acceptance test may not incur due to cost benefit consideration. So it is important to set up a pre-determined agency milestone (substantially completed and ready for its intended use) associated with final user acceptance test as a cut- off point such as in service date. It is also needed to understand that final acceptance test could happen multiple times during an iterative IUS development approach.*

Software License/Bulk Software: *SFFAS 10 Par. 2 stated: "The Board believes that it would be appropriate for the federal entity to apply lease accounting concepts and the entity's existing policy for capitalization thresholds and for bulk purchases to licenses. Immaterial costs would be expensed, but the entity should consider whether period costs would be distorted by expensing the license." To consistent with SFFAS 6: software licenses greater than two-years would be recognized by a federal lessee as a lease liability and leased asset and the federal lessor would recognize the unearned revenue along with the lease receivable to recognize future lease income at the beginning of a license term. When capitalize Bulk Software (i.e., Enterprise Microsoft Office), it is not recommend based on number of licenses procured, but the bulk threshold of the organization and the licensing term.*

Enhancement: *Need to define "significant" in current standard. It could be defined as modifications to existing internal use software that result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing and meets the capitalized threshold. Also could consider to discuss OMB concept that the enhancement is significant because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources. If one module is dependent upon another to function, then they must be evaluated together as one enhancement. The estimated useful life of a product enhancement is not the remaining life of the original*

product, all costs of a product enhancement, including any costs carried over or allocated from the original product, should be amortized over the enhancement's estimated useful life.

Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements should expense such costs as incurred.

V. Q&A

- Discuss new IUS development items such as cloud service, share service, spiral development, impairment, etc. The discussion will concentrate on definition, accounting treatment and real samples for those new development items.

Discussions/Positions:

Cloud Service and Shared Service: *After defining both, we should distinguish between the provider and receiver relationship. What is the definition of cloud computing? May use the NIST definition. For capitalization purposes, we should focus on licensing and whether or not the organization paying the licensing fee owns it, or will ever own it. Similarly, we need to make sure that the organization providing the service would be considered as the owner of the software that is licensed and they would retain ownership.*
Shared service – we may want to pull information from the Federal Shared Service Implementation Guide issued by EOP, dated April 16, 2013, and the embedded documents. Within the guide, it defines Shared Services two ways, but very similar. First "Shared Service means a mission or support function provided by one business unit to other business units within or between organizations" The second definition is "Shared Service: A function that is provided for consumption by multiple organizations within or between Federal Agencies." Similar to Cloud Computing, we need to focus on who owns (receives funding/responsible for maintaining) the software and make the determination what part of the services constitutes software, and how to address the hosting costs.

Agile Development: *releases are developed so quickly, that they are less likely to meet the capitalization thresholds. We can define Agile development but the challenge lies in what constitutes a release to be able to set a point in time in which the software can be considered deployed. We need to be able to establish either a costing methodology, such as grouping various releases together to be considered one, or a way of eliminating software developed under Agile model from capitalization.*
o Example: If a 'system' has 4 core modules that are fully integrated and work together as one, then the 4 should likely be capitalized together because that would be the ultimate requirement.
o Example: Initial operating capability (IOC) was XX dollars, and now version 1.1, 1.2, 1.3 are all being worked together, would the three combine into one for costing purposes? If it is all at the same time, how could costs be allocated to each piece – would it make sense to allocate to each piece or as one.

Spiral development: *Need to define what could be considered a release since the normal gates (of linear or waterfall) are passed through several times. Without the ability to define a release,*

or even an enhancement to a release, the costing for IUS under spiral development will be difficult to determine. Again, we may need to consider some form of cost pooling. Of course there has to be a logical basis for doing so similar to Agile above.

Cyclical and Iterative Development: *would also fall under the same buckets as Agile and Spiral where determining what potentially makes up an IUS asset and how the components could be grouped effectively.*

Targeted Use Software: *Short-lead software developed for a specific use with an unknown useful life at time of development that may be deployed at any time during the development cycles. Target-use software has a very high uncertainty over useful life due to one or many of the following circumstances:*

A. Operational Significance is unknown at the time of development

B. It is unknown if the software will be ever be deployed or if deployed it is unknown as to the length of time (hours to years) to fulfill its purpose or reach its target;

C. Software is deployed directly into operations before testing is complete with no formal user-acceptance test work performed.

D. Deployment of the software is dependent on the target's technology; therefore, multiple versions are developed and maintained to meet various technological stages.

E. No alternative future use.

Each Agency should work with its program experts to get projections for the useful life. This may require an analysis of the historical useful lives or like-kind assets. If there is too much unknown, each Agency could assess the risk of accumulating the costs as an capital asset and writing those costs off if the final product does not meet the SFFAS 6 PP&E definition versus expensing the cost with the chance that it may result in under-capitalizing.

Impairment: *Paragraphs 28-30 of SFFAS 10 address how to determine if software is impaired during the post-implementation phase or when it is operational. It provided two bullets. The recommendation would be to mirror some of the language in SFFAS 44 (Impairment of GPP&E) and the related implementation guidance, as the process would be similar. Under #44, organizations are not required to look for impairments, but the recommendation would be for organizations to review on at least an annual basis for IUS as technology changes so fast. Then we would need to elaborate on the how to check for impairment – whether it is a sample checklist or some other means. We could still want to leave #10 alone regarding how to record the impairment, it says adjust NBV, which can be accomplished a few ways.*

- *Impairment may also need to address a change in useful life (mainly reduce). For example the software was expected to be in service 5 years, then something changed, whether it is a regulation or law, that now would reduce the length of time and therefore affect how amortization would be reported.*

VI. Summary of Illustrations

- Introduce best practice appendix items for common practice issues.

Sample Talking Points:

- The decision framework supports development of accounting policies and practices appropriate to each organization's characteristics in accordance with GAAP. The framework is meant to provide parameters or principles for reporting entities to consider in developing organizational accounting policies and practices that will best support their operating models, provide the financial information necessary to manage programs, and report in accordance with GAAP. Reporting entities should report the full costs of outputs in the general purpose financial reports. Full costs may be expensed or capitalized in accordance with GAAP and based on each entity's accounting policies and practices.
- This Technical Release provides examples of several different agencies applying the GAAP compliant policies and processes (see Appendix B for examples) for unique organizational characteristics including operating models.

VII. Effective Date

- To be determined

Appendix A: Basis for Conclusion

- Discuss project history, responses to the proposal (we will do a survey among ourselves since we covered 17 agencies and 4 private companies in the working group & perform a public comment period), AAPC & Board Approval.

Appendix B: Illustrations

- Have two tables: the first table covers typical IUS phase trigger event and control point for expense or capitalization and the second table covers specific samples to address current agencies' common implementation issues.

Illustration Sample: Trace Development Cost

The examples in this Appendix are illustrative only; they do not represent authoritative guidance. These illustrations only depict a portion of the entities' operations and the inclusion of an illustration in this Technical Release does not mean the acceptance of the entities' policies by the FASAB or the AAPC.

Problem Statement: Tracing development costs to specific invoices.		
Problem Contributing Factors	Task Force Member Agency	Summary of Solution
Cyclical development methodologies make differentiating between development and maintenance difficult	A	Direct tracing or allocation
	B	Contractual requirement for vendor to provide estimate of costs between development and non-development activities
	C	Mostly internally developed; labor reports provided by program offices
	D	Separate accounting lines used on purchase request and obligation documents for development and non-

		development costs

Agency Specific Examples:
The Agency A has developed a methodology to review IUS transactions, evaluate them to ensure the transaction is either capitalizable or expense, when there are questions regarding the timing of the transaction (i.e. an invoice covers the time a IUS project moves from Software development phase to Post-Implementation/operational phase) we contact the appropriate business unit to determine if there is a status report documenting when an IUS project moved from Software development phase to Post-Implementation/operational phase. If a status report is not available, we are developing an allocation methodology to allocate costs between capitalizable and expense.

Agency B: Instituted a contractual requirement for software vendors to provide a data item description (DID) deliverable along with each invoice submitted. It establishes the requirement that the contractor provide a standardized reporting worksheet each month that will effectively allocate all software development costs billed under the contract, regardless of contract type, to the Government each month according to the specified phases of the software development life cycle.

Agency C: Most of our IUS is attributable to labor hours. We receive a quarterly report from the program areas detailing each employee who worked on the project and the number of hours they worked. If contractors work on the software, the program area has to match the contract hours worked with the line item on the contract.

Agency D: Every software project is coded on a requisition and the requisition is reviewed by our property accounting team. If the project meets the capitalization threshold/criteria, the requisition must be coded with g/l 1832 in the accounting string (which drives the PO and invoices). The property accounting team reviews the backup to requisition to ensure that its development costs (and not include maintenance, training, etc.). An internal Capitalization worksheet is created by the property accounting team, required for each capitalized requisition. This sheet reflects only capitalized cost. Maintenance and training must be separately broken out and expensed. The requisition must have a separate line of accounting for expensed costs. The vendor is required to provide/identify up front any maintenance costs. Once the lines of accounting are differentiated on the requisition, the PO and invoices will automatically follow the breakout. OFM has trained internally the CORS within the agency on these requirements as well as Office of Administration.

Appendix C: Abbreviations

FASAB UPDATE: DoD Implementation Guidance Request Project

May 14, 2015

Disclaimer

- Views expressed are those of the speaker.
- The Board expresses its views in official publications.

OVERVIEW

- Project History- Letter from DCFO
  - Valuation of legacy inventory and operating material & supplies
  - Deployed Assets- closed with no need for FASAB action
  - Research & Development Costs (now focus w/AAPC Internal Use Software)
  - As needed with DoD FIAR (Financial Improvement and Audit Readiness)
- Draft Exposure Draft & Draft Interpretation
- Questions

Project History

- Shared goal - **practical cost effective guidance**
- Determined **status of implementation of SFFAS 3 compliant systems**
- From the information gathered, it was determined that **alternative valuation methods for establishing opening balances** would be needed to move DoD forward

Draft Exposure Draft (ED)

- Applied: when presenting FASAB GAAP financial statements (f/s) for the first time or after a period when systems could not provide information to produce such f/s (**available once**)
- Permits alternative valuation methods in **establishing opening balances** for the reporting period the reporting entity makes an unreserved assertion that its f/s or this element are presented fairly in accordance with GAAP
- **Deemed cost** = amount used as a surrogate for initial amounts. It is the opening balance and is thereafter considered consistent with SFFAS 3 requirements. No distinction or segregation of deemed cost is required going forward.
- **Disclosure** is required when the reporting entity as a whole makes an unreserved assertion. This **allows** Military Departments to transition to SFFAS 3 compliant systems to assert first. Then DoD can make a DoD wide assertion.
- ED addresses **valuation** for opening balances; it does not address supporting documentation.

Timeline

April 2015:Presented Draft ED to Board

Projected (subject to change)

- June-July 2015:ED open for Comments
- August 2015: Consideration of Comments & Public Hearing
- October 2015: Board approval of final SFFAS
- January 2016: Final SFFAS issued after 90-day review by sponsors

Staff Draft Interpretation – G-PP&E

- Clarifies principles within SFFAS 6 and 23:
  - estimated current cost of similar assets includes all past capital improvements
  - separately estimating the cost of capital improvements is permitted but not necessary and such costs may be included in a single estimate
  - may be applied to all classes of G-PP&E
- Estimates may be applied to construction work in process in accordance with SFFAS 35

Questions?
Contact and Website Information

- Melissa Loughan
  202-512-5976
  loughanm@fasab.gov
- General inquiries can be directed to fasab@fasab.gov
- Phone: 202 512-7350
  www.FASAB.gov
  - Listserv (sign up for emails)
  - Exposure Drafts
  - Active Projects – see assigned staff

ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 4N30
1:00 to 2:30 p.m.

July 16, 2015

Welcome New Members:

Brett Baker
Assistant Inspector General for Audit
Office of Inspector General
National Science Foundation

Elliot Lewis
Assistant Inspector General for Audit
Office of Inspector General
Department of Labor

Project Agenda:

- Draft Internal Use Software Implementation Guide

Administrative Matters:

- Next AAPC Meeting – November 19, 2015

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Administrative Information:
Observers – To ensure access, please pre-register by 8 AM July 14th at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Charles Jackson at 202 512-7352 or jacksoncw1@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1-866-453-4503. Please enter 1662696 #.

Internal Use Software Implementation Guide Draft

Summary

This Technical Release (TR) assists reporting entities in implementing SFFAS 10, *Accounting for Internal Use Software*. Since FASAB issued SFFAS 10 in 1998, software development practices have changed dramatically and reporting entities have experienced challenges applying the standards given the new terminology and techniques that have evolved.
This guidance explains how to apply existing standards to the fast changing Internal Use Software (IUS) environment and helps ensure that:

1. Transactions involving IUS are recorded in accordance with federal accounting standards.
2. The cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, does not outweigh the benefits derived by the users of the financial information.

Table of Contents

I. Purpose

1. This Technical Release (TR) assists agencies in applying SFFAS 10, Accounting for Internal Use Software, to the new software development practices that have evolved since FASAB issued the standard in October 1998. The TR considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. Specifically, the TR provides guidance regarding:

    a. The definition of IUS, component/module based IUS assets, software development practices including approaches that involve phases, and clarifying IUS recognition, measurement, and disclosure items (such as capitalized cost, capitalization cut off, capitalization threshold, enhancement, impairment, and related matters);

    b. New IUS challenges brought by changes in IUS development practices since the issuance of SFFAS 10; and

    c. Management's role in applying SFFAS 10.

2. This TR introduces new terms from the current development practices and defines them in light of the application of this guidance. It provides a discussion of issues and examples to assist entity management in applying the principles described throughout the TR. The examples were selected because they were derived from underlying transactions or organizational characteristics rather than being attributable to preferences.

3. The accounting standards and related basis for conclusions consistently recognize management's role in interpreting and applying generally accepted accounting principles (GAAP) within its operational environment. This TR recognizes that management is responsible for establishing IUS accounting policies, methodologies, and for maintaining adequate documentation on the sources of data. It also recognizes that the cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, should not outweigh the benefits derived by the users of the financial information.

II. Background

4. The software development life cycle has dramatically changed since the issuance of SFFAS 10, *Accounting for Internal Use Software,* in 1998. SFFAS 10 was written when the linear/waterfall[1] software development practices were prevalent and characterized by three distinct life-cycle phases and long development cycles. Given the changes in development practices, technological advances, and significant new development techniques and architectures[2], guidance for implementation and sustainment of SFFAS 10 became critical.

5. This TR introduces new IUS development terms and defines them to aid in applying existing standards. The definitions provided are not all encompassing but are included to promote greater

[1] The waterfall model is a sequential design process, used in software development processes, in which progress is seen as flowing steadily downwards (like a waterfall) through the software development phases.
[2] Such as cloud service, shared service, agile development and spiral development with a focus on module based development and shorter development cycles.

understanding, and more consistent application and implementation of the standards. The same principles used to develop the guidance on the current IUS development practices could be used for future IUS development practices. The business events and deliverables table and agency practice examples are provided in Appendix B. These examples are intended to illustrate use of professional judgement in the development and application of policy and practices to account for IUS in accordance with GAAP. The examples are not all encompassing and agencies may identify other more useful and relevant methodologies. Users of this guidance should use these examples to develop their own reasonable business processes.

6. This TR was developed to aid in meeting the operating performance reporting objective identified in SFFAC 1, *Objectives of Federal Financial Reporting,* paragraph 14[3]: Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

    a. The costs of providing specific programs and activities and the compositions of, and changes in, these costs;
    b. The efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs; and
    c. The efficiency and effectiveness of the Government's management of its assets and liabilities.

III. Related Accounting Literature

7. The related accounting standards are as follows:
    a. SFFAS 4*, Managerial Cost Accounting Concepts and Standards for the Federal Government*
    b. SFFAS 6*, Accounting for Property, Plant, and Equipment*
    c. SFFAS 10*, Accounting for Internal Use Software*
    d. SFFAS 35*, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Standards of Federal Financial Accounting Standards 6 and 23*

IV. Scope

8. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles*, *including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 4, SFFAS 6, SFFAS 10, and SFFAS 35.

[3] This principle was also relied upon in Office of Management and Budget (OMB) Circular *A-11 Preparation, Submission, and Execution of the Budget;* Supplement to Circular A-11*, Capital Programming Guide* (July 2014)*,* Page 61.

9. This TR applies to all internal use software that meet the definition of an IUS as described in SFFAS 10, except for the following:
    a. Software to be used in research and development where the software will not have an alternate future use, and
    b. Integrated software as stated in SFFAS10, paragraph 22 unless the software is developed separately and could be installed on hardware multiple times.[4]

V. Clarification of Existing Standards

10. **IUS Definition:** SFFAS 10, paragraphs 8 – 9, defines "internal use software" as software that is "purchased from commercial vendors off-the-shelf (COTS), internally developed, or contractor-developed solely to meet the entity's internal or operational needs." The IUS development or modification can be performed by employees of the entity or contractors that the federal entity is paying to design program, install, and implement. Software assets need to be evaluated for ownership to determine which entity is ultimately responsible for reporting the asset.

11. **Development Phases**: SFFAS 10 presents three phases of software development that follow a linear approach to an IUS project: the preliminary design phase, the software development phase, and the post-implementation/operational phase. Generally, costs incurred during the development phase are to be capitalized and costs incurred in other phases are to be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized based on their substance rather than their phase.

12. **Capitalized Cost**: Capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage (SFFAS 10 paragraph 16). Costs incurred during the preliminary design phase and the operational phase would be expensed in the period incurred. Considering economic feasibility, a cost estimation technique could be developed to trace the costs to outputs based on the SFFAS 4, paragraph 124, provision that "[in] principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

    a. Directly tracing costs wherever economically feasible;

    b. Assigning costs on a cause-and-effect basis; and

    c. Allocating costs on a reasonable and consistent basis."

13. A specific software development project may include expenditures for improvements and maintenance that cannot be easily separated but may be reasonably and consistently allocated. One approach that can be used is a ratio based on the projected work hours for development activities relative to other type of work. Such a ratio can be applied to determine the expenditures that should be capitalized. The basis for allocating costs should be defensible.

[4] SFFAS10, par. 22 provides that computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly. However, computer software could be developed alone and applied to several hardware multiple times. For example, anti-ballistic missile software installed on multiple radar systems can be treated as a separate IUS asset if the software meets the capitalization threshold.

14. **Capitalization Cut Off**: SFFAS 10 paragraph 20 states, "Costs incurred after final acceptance testing has been successfully completed should be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site." In some development practices, each iteration[5] within an IUS development has its own acceptance testing before moving forward to the next iteration and final acceptance test may not always be performed. The entity should associate final user acceptance test with a pre-determined agency milestone such as the go-live or in-service date.

15. **Component Based IUS Asset**: SFFAS 10 paragraph 33 states, "For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing." For example, an entity may develop an accounting software system containing three modules: a general ledger, an accounts payable sub-ledger, and an accounts receivable sub-ledger. In this example, each module could be analyzed to determine whether it could be treated as a separate asset. Specifically, if the module provides economic benefit through distinct, substantive functionality; and meets the tests for capitalization threshold, ownership, and eligibility for capital treatment, then the module could be treated as a separate IUS asset for the purposes of recognition, measurement including amortization, and disclosure in accordance with SFFAS 10.

16. **Capitalization Threshold:** SFFAS 10 paragraph 24 states, "Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system." When establishing the capitalization threshold for IUS, the federal entity should include both qualitative and quantitative considerations. Qualitative considerations could be applied to IUS assets that require special management attention because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources.[6]

17. When establishing a capitalization threshold for bulk software purchases, the threshold should not be based on unit price. The organization should consider the bulk value and useful life established by the organization to avoid materially distorting period costs and understating asset values.

18. OMB notes that a stratified capital programming process involving more or less detail and review based on the size or strategic importance of proposed investments may be appropriate, particularly in large agencies.[7] Similarly, more than one capitalization threshold could be established for different components of a large agency. Agencies should have well documented thresholds clearly disseminated and implemented across the organization.

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[5] Iteration is the act of repeating a process with the aim of approaching a desired goal, target or result. Each repetition of the process is also called an "iteration", and the results of one iteration are used as the starting point for the next iteration.

[6] Office of Management and Budget (OMB) Circular A-11 *Preparation, Submission, and Execution of the Budget; Supplement to Circular A-11, Capital Programming Guide, Threshold for Capital Programming*, page 2, July 2014.

[7] OMB Circular A-11.

19. **Enhancement:** SFFAS 10 paragraph 25 states, "The acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities." Significant additional capabilities are modifications to existing IUS that result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing. As stated in SFFAS 10 paragraph 26, capitalizable enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. Examples of enhancements could include augmenting existing business functions with new features and functions, developing additional new business functions, and/or adding new functionality and capability.

20. If one module is dependent upon another to function, then those modules should be evaluated together as one enhancement. All costs of an enhancement, including any costs carried over or allocated from the original software, should be amortized over the enhancement's estimated useful life.

21. **Impairment:** SFFAS 10 paragraphs 28-30 address how to determine if software is impaired during the post-implementation operational phases and the measurement of the impairment for the impaired software remaining in use or to be removed. Significant events or changes in operating circumstances warrant a review to determine whether the carrying value of an existing software asset is not recoverable and should be impaired. An assessment should be performed to determine the remaining useful life of the impaired software for amortization purposes.

22. When it is more likely than not that a software project will not be completed, no further costs should be capitalized and any costs that have been capitalized should be written off in accordance with SFFAS10, paragraph 31. Indications that the software may no longer be completed include:

    - The expenditures are neither budgeted nor incurred to fund further development;
    - The discontinuance of the business segment the software was designed for;
    - The inability to resolve programming difficulties timely;
    - Significant cost overruns; or
    - A decision to obtain COTS instead and abandon the current software development

23. Sometimes, a software project is suspended pending management's evaluation on whether to resume or terminate the project, the software development cost may remain capitalized as long as a reasonable chance[8] exists that the software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold. The status of the project should be reevaluated periodically and the capitalized cost should be written off as incomplete software project if management concludes that it is more likely than not that the software will not be placed into service in the future.

24. **Software License:** If the term of software license(s) is 2 years or more, the licenses should be scored against lease criteria as stated in SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating lease. If the license(s) is perpetual with one-time payment to use the software in its lifetime, then the entity's existing policy for capitalization thresholds should be applied to determine if it should be capitalized or expensed.

[8] See SFFAS10. par. 31 provides for write off if it is more likely than not that the project will not be completed and placed in service.

VI. Examples of New IUS Development

Cloud Computing

25. A cloud computing service is any resource that is provided over the Internet. It has the following essential characteristics: on-demand self-service, broad network access, resource pooling, rapid elasticity and measured service. The most common cloud service resources are: software as a service, platform as a service and infrastructure as a service.[9]

26. If a cloud computing arrangement includes a software license, then the customer would account for the software license element of the arrangement consistent with the acquisition of other software licenses, as discussed in this TR paragraph 24. If a cloud computing arrangement does not include a software license, then the customer would account for the arrangement as a service contract. The entity that develops and owns the software, platform or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform or infrastructure should account for the software in accordance with SFFAS 10.

Shared Services

27. Shared Service means a mission or support function provided by one business unit to other business units within or between organizations. The funding and resourcing of the service is shared and the providing entity effectively becomes an internal/external service provider. There are two types of shared service structures in the Federal Government: intra-agency and interagency. Intra-agency shared services include those provided within the boundaries of a specific organization such as a Federal department or agency, to that organization's internal units. Interagency shared services are those provided by one Federal organization to other Federal organizations that are outside of the provider's organizational boundaries.[10]

28. For intra-agency shared services, a cost allocation methodology could be developed in accordance with SFFAS 4, paragraphs 120-125. For interagency shared services, the service provider entity that owns (receives funding/responsible for maintaining) the software should account for the software in accordance with SFFAS 10. In the event that the entity receiving the service (the customer) has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software, then the customer should account for the software in accordance with SFFAS 10.

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[9] The National Institute of Standards and Technology: *The NIST Definition of Cloud Computing,* Special Publication 800-145, September 2011.
[10] Chief Information Office Council: *Federal Shared Service Implementation Guide*, April 2013.

29. If the shared service arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of their other software licenses, as discussed in this TR paragraph 24. If a shared service arrangement does not include a software license, then the customer should account for the arrangement as a service contract.

Agile Software Development Method

30. Agile software development method is a group of software development methods in which requirements and solutions evolve through collaboration between self-organizing, cross-functional teams. In an agile project, working software is deployed in iterations of typically one to eight weeks in duration, each of which provides a segment of functionality.[11] Initial planning regarding cost, scope, and timing is usually conducted at a high level, and the project status is primarily evaluated based on software demonstrations.

31. The IUS development phases listed in SFFAS 10 paragraphs 10 -14 and within this TR could be applied to agile development project on an iterative basis (see below table for an example of agile development activities[12]). If an iteration developed meets the module or component asset definition as outlined in this TR paragraph15, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the numbers of iterations are dependent on the outcomes of multiple processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that results in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

Agile Method		
Stage of Each Iteration	**Activity**	**Treatment**
Kickoff	Requirements gathering during each iteration	Expense
Development	Design, coding	Capitalize
Test	Quality testing, discrepancy fix	Capitalize
Deployment	Transition to operations	Capitalize/Expense
Evaluation	Customer on-going evaluation (acceptance or rejection)	Capitalize/Expense
Operation	General & sustainment maintenance, and training	Expense

Spiral Software Development Method

32. Spiral software development method combines the features of the waterfall and prototyping[13] incremental models, but with more emphasis placed on risk analysis and management. The spiral

[11] Government Accountability Office: *Software Development Effective Practices and Federal Challenges in Applying Agile Methods*, July 2012.

[12] This table is for illustration purpose only, is not intended to be comprehensive. Each Agency is responsible for developing policies and procedures that are appropriate for its specific environment and needs, and may differ in content and order from the table listed.

[13] The Prototyping Model is a systems development method in which a prototype (an early approximation of a final system or product) is built, tested, and then reworked as necessary until an acceptable prototype is finally achieved from which the complete system or product can now be developed. This model works best in scenarios

methodology projects are typically separated into phases like the waterfall method: planning, risk analysis, engineering, and evaluation. However, they are broken up into incremental releases of the product, or incremental refinement through each time around the spiral and through continuously analyzing the requirements and improving the definition and implementation. At each iteration around the cycle, the project is improved and extended. The release could be to an external or internal client, or to a partner.

33. The IUS development phases listed in SFFAS 10 paragraphs 10-14 and within this TR could be applied to a spiral development project on a process iteration basis (see the table below for an example of spiral development activities[14]). If an iteration developed meets the module or component asset definition as outlined in this TR, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the numbers of iterations are dependent on the outcomes of multiple spiral processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that results in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

Spiral Model		
Stage of Each Process Iteration	**Activity**	**Treatment**
Planning	Requirements gathering during each version	Expense
Risk Analysis/Prototyping	R&D-only prototype	Expense
	Prototype to be used for operations after risk analysis	Capitalize
Engineering	Coding, testing, transitioning	Capitalize/Expense
Evaluation	Customer evaluation of risk &product	Capitalize/Expense
Operation	General & sustainment maintenance, and training	Expense

Software with Uncertainty

34. Software with uncertainty is short-lead software developed for a specific use with an unknown useful life at the time of development. Such software may not be deployed because deployment is dependent on the target's technology. Therefore, multiple versions may be developed and maintained to meet various technological stages. Also, if deployment is likely, the following condition may exist:

    a. The operational significance and usefulness of the software may not be known at the time of development.
    b. The length of time (hours to years) to fulfill the software's purpose or reach its target is uncertain.
    c. The software is deployed directly into operations before its testing is complete and no formal user-acceptance test work is performed.

where not all of the project requirements are known in detail ahead of time. It is an iterative, trial-and-error process that takes place between the developers and the users.

[14] See reference # 9.

d. There is no alternative future use for the software.

35. If it is more likely than not that the software will not have an estimated useful life of 2 years or more,[15] then the software may not qualify for capitalization as an asset.

36. If the level of uncertainty is too great to determine if the developed software meets the basic definition of the asset,[16] the software development cost may be held in a temporary account without capitalization. This approach may be used as long as there is a reasonable chance that the software project will be completed and the cost incurred will meet the IUS capitalization threshold. The status of the project should be reevaluated periodically and the cost should be capitalized or written off as the condition becomes clear.

37. If the software developed meets the basic definition of IUS for capitalization but the useful life cannot be reasonably determined, the organization should work with its program experts to get projections for the useful life. This may require an analysis of the historical useful lives or like-kind assets.

VII. Summary of Illustrations

38. The Business Events & Deliverables for Software Development Phases and the Common Agency Practice tables listed in the Appendix B support development of accounting policies and practices appropriate to each organization's characteristics in accordance with GAAP. The tables are meant to provide examples for reporting entities to consider in developing organizational accounting policies and practices that will best support their operating models, provide the financial information necessary to manage programs, and report in accordance with GAAP. Reporting entities should report the IUS in the general purpose financial reports. Full costs of IUS development should be expensed or capitalized in accordance with GAAP and n each entity's accounting policies and practices should support cost beneficial implementation.

VIII. Effective Date

39. This Technical Release is effective upon issuance.

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

[15] See SFFAS 6, par.17.
[16] See SFFAC 5, par.18.

Appendix A: Basis for Conclusions

This Appendix discusses some factors considered significant by AAPC members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this TR not the material in this Appendix should govern the accounting for specific transactions, events, or conditions.

Project History

A1. In June 2013, FASAB's Accounting and Audit Policy Committee (AAPC) established the IUS Task Force to assist in developing implementation guidance for IUS as it relates to the Statement of Federal Financial Accounting Standards (SFFAS) 10, *Accounting for Internal Use Software* and other related IUS guidance developed by the FASAB. The task force includes federal agency representatives who are experiencing issues with implementing SFFAS 10 and those who have implemented workable common practices to share with the federal community as well as industry representatives from several public accounting and consulting firms.

A2. During the initial phase of the project, the IUS task force divided into three subgroups to conduct research and explore the best approach for addressing the current IUS issues within the federal community, including whether a TR should be developed, or revisions should be made to SFFAS 10. The subgroups in the project task force met separately to discuss their assigned issues and reported their research findings. The three subgroups were:

- IUS Mapping Team
- IUS Benchmarking Team
- Standards Team

A3. After presenting the results of their research, the task force concluded that implementation guidance would be the appropriate method to address the current IUS issues within the federal community. As a result, the AAPC endorsed the approach. The group held a re-entrance meeting on February 27, 2015 to re-engage agencies in drafting implementation guidance. This guidance focused on highlighting the common issues identified across the federal government IUS process, clarifying terminology, introducing new terms from the recent software development methodologies in light of application of the SFFAS 10 and providing sample IUS practices adopted by the agencies. Based on the research, a TR would equip federal agencies with the knowledge and information needed to identify effective IUS practices that would in turn strengthen the financial reporting in IUS area. It consists of two major topic areas:

- Standards Clarification
- Practical Examples of Implementation

A4. The IUS FASAB Task Force, which included industry representatives from several public accounting and consulting firms, as well as representatives from the following federal agencies, developed this proposed guidance:

- Department of Commerce (DOC)

- Department of Defense (DOD) (including the individual military departments)
- Department of Health and Human Services (HHS)
- Department of Homeland Security (DHS)
- Department of Labor (DOL)
- Department of Transportation (DOT)
- Department of Treasury (Treasury)
- Environmental Protection Agency (EPA)
- Office of the Director of National Intelligence (ODNI)
- United States Securities and Exchange Commission (SEC)

A5. Two subgroups were formed for standards clarification and best practices. The subgroups developed two data calls that provided a forum through which members from federal agencies could highlight the commonalities across the federal IUS process. The first data call aided federal agencies in clarifying terminology and identified popular new IUS development items. The second data call highlighted IUS current practices adopted by the agencies and identified the IUS development phase activities across the IUS development phases. The second data call also collected detail business events and typical deliverables during the IUS development phases. Both data calls equip federal agencies with the knowledge and information needed to identify effective IUS practices that will strengthen financial reporting.

A7. In reaching its conclusions, the subgroup recognized the need to develop implementation guidance to promote an understanding of rapid changes related to software development practices that have evolved since the inception of SFFAS 10. The IUS task force views clarification of implementation and sustainment issues as critical given the new IUS challenges related to environmental changes and technological advances. There are several cost-beneficial and reasonable changes (e.g., policies, systems, and processes) that federal entities can make to facilitate better financial management and reporting of IUS. However, entity management must be allowed to navigate within the parameters of GAAP to determine the point at which the costs of improving or providing financial information outweigh the derived benefits.

A8. This TR recognizes that the financial management information needs of stakeholders, both internal and external, vary by entity. The agency-specific examples (detailed in Appendix B) demonstrate how tracking costs to specific invoices may be tailored to different operating models and comply with GAAP. The implementation guidance does not provide a 'one-size-fits-all' solution; instead, it is designed to give management a tool on which to base stakeholder financial management information needs.

A9. When applying the principles listed in the SFFAS 10, management should develop formalized policies and procedures documenting their decisions. Management is responsible for maintaining adequate documentation on the sources of data and the application of methodologies used when estimating cost.

A10. Implementation of SFFAS 10 and this guidance is a joint effort from of both an entity's Chief Finance Office and Chief Information Office. It is management's responsibility to provide for smooth communication between these two offices to foster an efficient and effective IUS implementation process.

Appendix B: Illustrations

The examples in this Appendix are for illustration only; they do not represent authoritative guidance. These illustrations depict only a portion of the reported entities' operations and their inclusion in this TR does not equate to policy acceptance, in whole or part, by the FASAB or the AAPC.

Illustrations B-1 - Business Events and Deliverables for Software Development Phases

The table below provides examples on business events and deliverables which agencies may see within a typical software development life-cycle. The table is structured to follow the three software development phases as defined in SFFAS 10 paragraphs 11-14. When applying examples in this table to software development phases, the decision to capitalize or expense an item should be determined based on the nature of the cost activity when it is incurred, as discussed in this TR paragraph 12: "Generally, costs incurred during the development phase are to be capitalized and costs incurred in other phases are to be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized based on their substance rather than their phase."

The table may be used as a sample guide for categorizing business events and deliverables during IUS phases, but it is not intended to be comprehensive. Each agency is responsible for developing policies and procedures that are appropriate for its specific environment and needs and may differ in content and order from the table below.

Business Event	Typical Deliverables
Preliminary Design Phase	
Formulation of Alternatives[17]	
-Justification of investment need -Conceptual formulation of alternatives -Evaluation and testing of alternatives -Determination of existence of needed technology -Final selection of alternatives	Major IT Business Cases, Capital Investment Decision Paper, Information Resources Management Strategic Plan, Enterprise Architecture Roadmap, IT Capital Asset Summary, Agency IT Portfolio Summary submissions, Alternative of Analysis
Establish Project Governance	
-Identify and incorporate vision, roles, responsibilities, governance, organizations and authorizations in project charter -Identify and document risks specific to project, including security risks -Establish and document quality control practices -Develop high-level estimates and schedule -Update discoveries and additional information	Project Charter, Project Action/Risk Register, Quality Management Plan, Project Schedule, Project Plan, Work Breakdown Structure

[17] OMB Circular A-11 provides more information for alignment of agency IT investments with agency strategic plans.

Business Event	Typical Deliverables
Determine Requirements	
-Develop high level list of functional and non-functional requirements -Obtain, review and document detailed business specifications for business requirements -Determine and document general data flows and interactions with other systems -Determine detail business/system specifications to support requirements	Vision documents, Requirement Specification Document, Requirement Traceability Matrix, Process Flow Diagrams, Supplementary Specifications, Use Cases, User Workflow
Develop Software Development Plan	
-Create initial plan to define major releases of project and phases -Define configuration management practices -Define testing strategy for user acceptance, quality assurance and other necessary testing	Project Schedule, Release Specifications, Software Development Plan, Test Strategy, QA Test Plan Risk Management Plan, UI Design Documents, Solution Design Document
Procurement	
-Create RFI or RFP for external vendor services or products -Evaluate and select externally provided services or products	RFI/RFP, Procurement Management Plan, Contract Statement of Work
Rapid Prototype/Pilot	
-Rapid prototype development and evaluation to refine requirements and prove concept -Pilot of proposed solution on small scale and over limited timeframe to prove concept and refine requirements -Update schedule and cost baseline base on discoveries from elaboration phase	Prototype (executable version of function and interface); Requirements Survey, Pilot program, Evaluation of Pilot, Scope Management Plan
Development Phase	
Software Development Initiation	
-Refine and execute practices for artifacts & configuration -Review work performed in prior iterative period, prioritizes and assigns work to be done in next iterative period -Coordinate updates to system inter-dependencies -Develop operation plan -Define and document architecture specifications -Develop and validate high value/high risk requirements of architecture components	Software Architecture Description Document, Software Development Plan, Iteration Plan, Operational Plan, Software Design Description
Rapid Development Risk Evaluation	
-Studies and analysis are performed during development environment to identify potential risks based on requirements & developed iteration	Risk identification and Mitigation Plan, Contingency Plan
Coding and System Design	

Business Event	Typical Deliverables
- Execute practices for version control of all software development artifacts - Create, design and modify system and associated hardware; coding and continuous refining. -Update project plan & business case -Add software development issues to the Issue Log to be prioritized and addressed -Conduct critical design review -Establish and document quality control practices	Software Architecture Document, Development Plan, Updated Project Management Documents, Issue Log, Critical Design Review Memorandum, Quality Management Plan
Testing	
-Identify tests and write test cases or scripts -Install hardware. Conduct unit and integration testing -Create operators manual and requirement documents for users -Document strategy and approach for system implementation (what will be deployed, where, and when) - Prepare turnover package to migration turnover and test readiness review and issue memo -Detailed notes that describe the specific contents of a release for customer or outside testing party -Develop security test report and issue security certification and accreditation -Conduct user acceptance testing	Test Plan, Test Cases Scripts, Test Results, Operations Manual, Implementation Plan, Test Readiness Memorandum, Release Notes, Turnover Package, Transition Plan, Security Test Report, Security Certification and Accreditation, Security Test & Evaluation Plan, Software Architecture Document, Acceptance Test Plan, Acceptance Test Script
Readiness Review and Release	
-Conduct production readiness review and issue memo -Audit and project completion reports finalized -Issue operational readiness memo, certification of production, an final user acceptance testing memorandum	Production Readiness Review Memo, Transition Plan, Operational Readiness Memorandum, Audit and Project Completion Reports, Certification of Production, Final User Acceptance Testing Memorandum, User Manual, Operational Support Plan, Installation Plan
Post-implementation/ Operational Phase	
Deployment	
-Determine criteria for exiting transition phase controls have been identified and met -Stakeholder provides written approval that product meets documented business requirements -Revise and finalize detail Deployment/implementation plan	Update Project Management Documents, Scope Verification, Deployment/implementation plan
Training	
-Develop training delivery method, schedule and plan -Develop training materials -Deliver training, record and deliver webinars and communicate on-demand training	Training Plan, Training Materials, Training Delivery
Data Conversion	

Business Event	Typical Deliverables
-Development of software to facilitate data transfer or conversion -Develop data cleansing and transfer plan, including protocols for archiving legacy data -Perform activities to cleanse data and format for transfer -Perform mock migrations of data and analyze results -Perform final data migration and validation	Data Transfer Software, Data Transfer Plan, Formatted Data, Mock Migration Results and Analysis Report, Data Migration Validation Report
Operation and Maintenance Activities	
-Subsequent security accreditations (not included in user acceptance testing) -Software diagnostics -Repair processing and/or performance failures -Update documentation -Minor software updates -Minor corrections to design flaws	Accreditation Certification, Diagnostic Reports, Software and Process Documentation
Retirement of Software	
-Information Preservation -Configuration Management and control -Media sanitization -Hardware and software disposal	Disposal Certification

Illustration B-2 – Common Agency Practice

The common agency practice table highlights IUS practices adopted by the agencies in the areas identified by the IUS working group as common problems. It intends to equip federal agencies with the knowledge and information needed to identify effective IUS practices and does not provide a 'one-size-fits-all' solution; instead, it is designed to give management some practical examples. Users of this TR should use the information provided in these examples to develop their own reasonable business processes. This table covers four areas of IUS development: 1) identifying cost, 2) software amortization, 3) enhancement to IUS, and 4) impairment to IUS.

Illustration Sample #1: Identifying Cost

Problem Statement: Trace Development Cost to Specific Invoice		
Problem Contributing Factor	**Task Force Member Agency**	**Agency Practice**
Cyclical development methodologies make differentiating between development and maintenance costs within an invoice difficult	A	Direct tracing or allocating the invoiced cost with the basis of estimate documented. Use status report or program/project documentation to evaluate activities and identify those that are development activities.
	B	Contractual requirement for vendor to provide a data item description deliverable with the estimate of costs between development and non-development activities along with each monthly invoice submitted.
	C	IUS cost primarily attributable to government labor hours. Quarterly report from the program offices detailing the employee or contract hours for each IUS project phase (preliminary design, development, or operational).
	D	Separate accounting lines used on purchase request and obligation document for development and non-development activity cost by coding every software project on a requisition. The captalizable requisition must be coded with general ledger account IUS-In Development in the accounting string which drives the purchase order and vouchers, thereby requiring the vendor to invoice in accordance with the activity breakouts.

Illustration Sample #2: Software Amortization

Problem Statement: Timing of Commencement of Depreciation/Amortization		
Problem Contributing Factors	**Task Force Member Agency**	**Agency Practice**
Obtaining evidence to support the determination of commencement of amortization	A	Open inter departmental communication facilitates decision to begin depreciation of software.
	B	A sign off document confirming key development milestones such as acceptance test are met.
	C	A certificate of production is issued communicating the software is in production and being utilized.

Illustration Sample #3: Enhancement to IUS

Problem Statement: Define Enhancement to Internal Use Software		
Problem Contributing Factors	**Task Force Member Agency**	**Agency Practice**

Determination of the significance of an enhancement to the IUS; incremental enhancement of capability; and the enhancement associated with new IUS development model	A	Defines enhancement to be the replacement, upgrade, modification, or addition of new features or capabilities to an existing system, product, tool, service or infrastructure to improve its functionality. It involves a change in the capabilities, requirements, design, and/or architecture.
	B	Add additional capabilities and the enhancement costs are above agency's capitalization threshold. Repair a design flaw or perform minor upgrades that extend the useful life without adding capabilities, the costs are expensed and the useful life of the original asset is adjusted, as necessary.
	C	Enhancement cost exceed capitalization threshold, and when it is more likely than not that such enhancements will result in a significant increase in functionality that is apparent to the user. The cost of routine or minor changes or modernizations that do not significantly add functionality should be expensed in the period incurred. Examples of minor enhancement include updating data tables, web-enabling, customizing reports, or changing graphic user interfaces. Enhancements that may extend the useful life of the software without adding significant capabilities are to be considered minor and expensed.
	D	In Agile development model, enhancement follows the same capitalization criteria threshold for each release separately and tracks each version individually.

Illustration Sample #4: Impairment to IUS

Problem Statement: Determination of Impairment for Internal Use Software		
Problem Contributing Factors	**Task Force Member Agency**	**Agency Practice**
Determination of when the impairment is incurred without sufficient knowledge on the IUS operating status	A	Scenario-based impairment checklist reviewed on a quarterly basis to monitor impairment. The checklist examines the following scenarios: cessation of demand for the IUS asset, changes with an adverse effect on the IUS asset have occurred within the policy, legal or technological environment, plans to discontinue or restructure the IUS asset, the IUS asset is not performing as intended, and elements of the IUS asset functionality are not used as intended.

Appendix C: Abbreviations

ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 5N30
1:00 to 2:30 p.m.

November 19, 2015

Project Agenda:

- Responses to Internal Use Software Implementation Guide Exposure Draft
- Final Vote on Internal Use Software Implementation Guide

Administrative Matters:

- Next AAPC Meeting – February 18, 2016

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Administrative Information:
Observers – To ensure access, please pre-register by 8 AM November 17 at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Terri Pinkney at 202 512-7678 or PinkneyT@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1-866-453-4503. Please enter 1662696 #.

Federal Accounting Standards Advisory Board

October 29, 2015

Memorandum

To: Members of the Committee

From: Grace Wu, Project Manager

Through: Wendy M. Payne, Executive Director

Subject: Implementation Guidance for Internal Use Software Comment Letters Received through November 12 [1]

MEETING OBJECTIVE

To review responses to the exposure draft, *Implementation Guidance for Internal Use Software* and make decisions on issues raised.

BRIEFING MATERIAL

Staff Summary: This memorandum provides the staff summary. The staff's summary is intended to support your consideration of the comments and not to substitute for reading the individual letters. The summary presents:

Attachment 1 provides the full text of each comment letter.
Attachment 2 provides the original Exposure Draft with suggested edits based upon comments received and staff recommendations.

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

SUMMARY OF OUTREACH EFFORTS

The exposure draft, *Implementation Guidance for Internal Use Software*, was issued September 16, 2015 with comments requested by October 28, 2015. Upon release of the exposure draft, notices and press releases were provided to:

a) The Federal Register;
b) *FASAB News;*
c) The *Journal of Accountancy, the CPA Journal, Government Executive, and the CPA Letter;*
d) The Financial Statement Audit Network; and
e) Committees of professional associations generally commenting on exposure drafts in the past.

To encourage responses, a reminder notice was provided on October 22, 2015 to our Listserv.

RESULT

As of November 12, we have received 12 responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		1
Auditors		1
Preparers and financial managers	10	

The full text of the comment letters is provided as Attachment 1. Attachment 1 includes a table of contents and identifies respondents in the order their responses were received. The comment letters appear as an attachment to facilitate compilation and pagination. However, staff encourages you to read the letters in their entirety before you read the staff summary below.

A. Tally of Responses By Question

QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
Question 1: In the Clarification of Existing Standards section (paragraphs 10-24), this Technical Release (TR) considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. **Do you agree with the clarification and the new concepts, such as Component Based IUS Asset, presented? If not, please explain your reason.**	9		3
Question 2: In the Guidance on Applying SFFAS 10 to Certain New IUS Developments section (paragraphs 25-33), this TR introduces new terms and defines them in light of the application of this guidance. **Do you agree that the definitions reflect typical current new software development items and the associated guidance is reasonable? If not, please explain your reason.**	9		3
Question 3: In Appendix B starting on page 16, this TR provides two tables illustrating business events and deliverables which agencies may see within a software development life-cycle and some common agency practice examples to assist entity management in applying the principles described throughout the TR. **Do you think that both illustration tables will help**	8		4

STAFF SUMMARY OF RESPONSES – Table A: Tally Of Responses By Question

QUESTION	YES/AGREE	NO/DISAGREE	NO COMMENT
agencies? If not, please explain your reason.			
Question 4: Are there additional common issues or illustrations across agencies that should be considered? **If so, what are they, and how would you describe them?**	6 provided additional comments for potential consideration		

B. Quick Table of Responses By Question

RESPONDENT	**Question 1:** In the Clarification of Existing Standards section (paragraphs 10-24), this Technical Release (TR) considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. **Do you agree with the clarification and the new concepts, such as Component Based IUS Asset, presented? If not, please explain your reason.**
#1 DOC	Agree
#2 DHS	Agree (but provided several comments)
#3 DoD NSA	Did not specify agreement or disagreement (but provided several comments)
#4 DoD OCFO	Agree
#5 DoD ODNI	Did not specify agreement or disagreement (but provided several comments)
#6 EPA	Agree
#7 GWSCPA	Agree
#8 HUD	Agree
#9 KPMG	Agree (but provided several comments)
#10 NRCS	Agree (but provided one comment)
#11 SEC	Agree

STAFF SUMMARY OF RESPONSES – Table B: Quick Table Of Responses By Question

RESPONDENT	**Question 1:** In the Clarification of Existing Standards section (paragraphs 10-24), this Technical Release (TR) considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. **Do you agree with the clarification and the new concepts, such as Component Based IUS Asset, presented? If not, please explain your reason.**
#12 SSA	Did not specify agreement or disagreement

STAFF SUMMARY OF RESPONSES – Table B: Quick Table Of Responses By Question

RESPONDENT	**Question 2:** In the Guidance on Applying SFFAS 10 to Certain New IUS Developments section (paragraphs 25-33), this TR introduces new terms and defines them in light of the application of this guidance. **Do you agree that the definitions reflect typical current new software development items and the associated guidance is reasonable? If not, please explain your reason.**
#1 DOC	Agree
#2 DHS	Agree (but provided several comments)
#3 DoD NSA	Did not specify agreement or disagreement (but provided several comments)
#4 DoD OCFO	Agree
#5 DoD ODNI	Agree (but provided several comments)
#6 EPA	Agree
#7 GWSCPA	Agree
#8 HUD	Agree
#9 KPMG	Agree (but provided several comments)
#10 NRCS	Did not specify agreement or disagreement (but provided one comment)
#11 SEC	Agree
#12 SSA	Did not specify agreement or disagreement

STAFF SUMMARY OF RESPONSES – Table B: Quick Table Of Responses By Question

RESPONDENT	**Question 3:** In Appendix B starting on page 16, this TR provides two tables illustrating business events and deliverables which agencies may see within a software development life-cycle and some common agency practice examples to assist entity management in applying the principles described throughout the TR. **Do you think that both illustration tables will help agencies? If not, please explain your reason.**
#1 DOC	Agree
#2 DHS	Agree (but provided several comments)
#3 DoD NSA	No comment
#4 DoD OCFO	Agree
#5 DoD ODNI	No comment
#6 EPA	Agree
#7 GWSCPA	Agree (but provided one comment)
#8 HUD	Agree
#9 KPMG	No Comment
#10 NRCS	Agree
#11 SEC	Agree
#12 SSA	Did not specify agreement or disagreement

STAFF SUMMARY OF RESPONSES – Table B: Quick Table Of Responses By Question

RESPONDENT	**Question 4**: Are there additional common issues or illustrations across agencies that should be considered? **If so, what are they, and how would you describe them?**
#1 DOC	No comment
#2 DHS	Several topic suggestions
#3 DoD NSA	Several topic suggestions
#4 DoD OCFO	No comment
#5 DoD ODNI	Several topic suggestions
#6 EPA	One topic suggestion
#7 GWSCPA	Several topic suggestions
#8 HUD	No comment
#9 KPMG	No comment
#10 NRCS	Several topic suggestions
#11 SEC	No comment
#12 SSA	No comment

C. Major Answers and Comments by Question and by Respondent

Below table extracted the major responses which potentially affect the content of the exposure draft. As such, not every comment from the respondent was included in the table. See minor/editorial or agency policy related comments at each letter listed in attachment 1 *Comment Letters*.

Question 1: In the Clarification of Existing Standards section (paragraphs 10-24), this Technical Release (TR) considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. **Do you agree with the clarification and the new concepts, such as Component Based IUS Asset, presented? If not, please explain your reason.**	
#1 EPA	Page 7, paragraph 13: The Board mentions the full cost (direct and indirect cost) in the exposure draft as costs incurred during the software development phase. EPA would like to see some additional details on full costs highlighted and/or a reference to SFFAS #4 paras. 89-91. *Staff Response: Added reference to SFFAS #4.*
#2 GWSCPA	The terms "software project" (paragraphs 23 and 24) and "reasonable chance" (paragraph 24) are not defined in a manner that would enable consistent application. We suggest that the ED expand on the definition of these terms, provide linkage to a definition of these terms within generally accepted accounting principles (GAAP), or replace with terms already defined in GAAP. *Staff Response: Changed to "more likely than not" to be consistent with SFFAS 10 language. No change related to the definition of "software project."*
#3 GWSCPA	In the second sentence of paragraph 17, the discussion of capitalization thresholds for IUS does not reference the applicable GAAP for determining the quantitative thresholds applicable to capitalization thresholds, nor does it reference the applicable GAAP for evaluating quantitative and qualitative thresholds. Absent these references, the qualitative factors identified in paragraph 17 of the ED, which are

STAFF SUMMARY OF RESPONSES – Table C

	derived from the July 2014 version of OMB Circular A-11, may be interpreted by some as more authoritative than intended by the Board. *Staff Response: Reference to SFFAC 2 was added to emphasize the quantitative and qualitative considerations.*
#4 GWSCPA	In paragraph 23d, "significant cost overruns" is listed as an indicator that a software project may no longer be completed. Such a phase may not provide sufficient enough precision for consistent application across the financial management community. Significant cost overruns could exist and not result in the cancellation or abandonment of a project. The indicator that "the expenditures are neither budgeted nor incurred to fund further development" provides a more persuasive indicator than "significant cost overruns." Therefore, we suggest that the Board remove "significant cost overruns" as a separate indicator. *Staff Response: Agreed. "Significant cost overruns" was deleted.*
#5 GWSCPA	In paragraph 24, the ED does not address how an agency should respond to the scenario if a write-off is performed, but the software project is later recovered and brought to completion. *Staff Response: Write-off recovery is not a specific issue only related to software, it would be a common practice based on each agency's policy. As such it is not addressed specifically in this implementation guide.*
#6 GWSCPA	In the first sentence of paragraph 25, the ED provides guidance that software licenses with terms of two years or more should be evaluated against capital and operating lease criteria. The second sentence, however, states that the evaluation of a leased perpetual license with an upfront cost should be evaluated to determine if the leased perpetual license is "capitalized or expensed." We suggest that the ED address whether the perpetual lease should be evaluated against capital or operating lease criteria, and also whether different treatment would be required for leased perpetual licenses without an upfront cost.

STAFF SUMMARY OF RESPONSES – Table C

	Staff Response: language was modified to address above concern.
#7 KPMG	Paragraph 10 of the ED suggests that research and development and integrated software are within the scope of internal use software (IUS), as defined in SFFAS 10, but are excluded from this ED. However, these topics are already excluded from the scope of SFFAS 10. Software research and development is accounted for under SFFAS 8, Supplementary Stewardship Reporting, as noted in the Basis for Conclusions (paragraph 40) of SFFAS 10 and integrated software is accounted for under SFFAS 6, Accounting for Property, Plant, and Equipment, as noted in paragraph 22 of SFFAS 10. Therefore, to avoid confusion regarding the scope of the ED, as defined in paragraph 10, we recommend the following adjustment (deleted content struck-through): *10. ~~This TR applies to all internal use software that meet the definition of IUS as described in SFFAS 10., except for the following:~~* *~~a. Software to be used in research and development where the software will not have an alternate future use, and~~* *~~b. Integrated software (SFFAS10 paragraph 22) unless the software is developed separately and could be installed on a number of different general property, plant, and equipment (PP&E) assets at different times.~~* *Staff Response: SFFAS 10 & SFFAS 8 only addresses stewardship investment aspects of R&D (and not decisions to capitalize or expense costs), this implementation guide addresses treatment of IUS related R&D per request from DoD and guidance for distinguishing software related to PP&E but not qualifying as integrated software. The scope statement was revised to positively state what is covered by the TR rather than what is excluded.*
#8 KPMG	Paragraph 13 of the ED describes cost estimation techniques that may be developed to trace the costs to outputs in accordance with SFFAS 4, Managerial Cost Accounting Standards and Concepts. We believe that it would be useful to also reference TR 15, Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment, and Allocation, and state that the

	guidance contained in TR 15 can be applied to IUS. *Staff Response: The implementation guide language is the same as TR15, as such no need to reference again.*
#9 KPMG	The second sentence of paragraph 17 of the ED states (emphasis added), "When establishing the capitalization threshold for IUS, the federal entity should include both qualitative and quantitative considerations." The requirements in paragraph 24 (Capitalization Thresholds) of SFFAS 10 reference the importance of establishing capitalization thresholds that avoid understating asset values. Therefore, we believe that the intent of SFFAS 10 paragraph 24 was to consider quantitative matters when establishing capitalization thresholds. However, we also appreciate the importance of qualitative considerations and, therefore to avoid an unintended change to the standards, recommend the following revisions to paragraph 17(new content underscored; deleted content struck-through): Capitalization Threshold: SFFAS 10 paragraph 24 states, "Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system." When establishing the capitalization threshold for IUS, the federal entity should ~~include both qualitative and quantitative considerations~~ consider whether period cost would be distorted or asset values understated by expensing the purchase of such IUS assets. This consideration may include both qualitative and quantitative considerations. Qualitative considerations could be applied to IUS assets that require special management attention because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources. *Staff Response: Added reference to SFFAC 2 to emphasize the qualitative and quantitative concept when establishing a threshold.*

STAFF SUMMARY OF RESPONSES – Table C

#10 DoD NRCS	Page 7, paragraph 16: the accounting standard and TR indicate that the amortization should commence when the modules/components have successfully been tested. The general rule for PPE is that the deployment or in service date is the basis for the start of amortization / depreciation. And there is no discussion or indication as to why there is this shift from deployment/in service date to the point of the successfully tested date. Or is successfully tested synonymous with being placed in service? *Staff Response: What stated in this implementation guide that "the amortization should commence when the modules/components have successfully been tested." is a SFFAS 10 reference not a new concept. See implementation guide Appendix B-2 for agency common amortization examples on this area.*

Question 2: In the Guidance on Applying SFFAS 10 to Certain New IUS Developments section (paragraphs 25-33), this TR introduces new terms and defines them in light of the application of this guidance. **Do you agree that the definitions reflect typical current new software development items and the associated guidance is reasonable? If not, please explain your reason.**	
#1 DHS	Shared Services-We noticed that the concept of outsourcing to commercial Vendors was not specifically mentioned as they can also be a shared services provider. Per OMB M-13-08, OMB will consider the use of commercial shared service providers if they can provide a better value. Assumption is that the Federal entity (customer) would have a contractual right to take possession of the software during the hosting period and SFFAS 10 would be applicable in this case. Further clarification would be beneficial regarding any IUS implications when outsourcing to commercial shared service providers. *Staff Response: OMB reference was added.*
#2 NSA	Believe that the guidance on Cloud Computing and Shared Services implements new reporting requirements and is not implementation guidance to the existing requirements within SSFAS 10. Additionally, the new requirements set forth for Cloud Computing and

STAFF SUMMARY OF RESPONSES – Table C

	Shared Services are too narrow and do not consider all of the components of these types of software and the accounting treatment implications. We suggest removing this guidance from the TR and performing additional research over the construct of clouds so that guidance given is all encompassing. *Staff Response: As pointed out in the implementation guide paragraph 5: "This TR introduces new IUS development terms and defines them to aid in applying existing standards. The definitions provided are not all encompassing but are included to promote greater understanding, and more consistent application and implementation of the standards. The same principles used to develop the guidance on the current IUS development practices could be used for future IUS development practices."*
#3 KPMG	We believe that the guidance provided in the last sentence of paragraph 27 is incomplete. For example, if the funding to develop cloud computing is shared among 5 entities with Entity A being assigned overall responsibility for maintaining the software, platform, or infrastructure, Entity A would account for the cloud computing in accordance with SFFAS 10. However, it is unclear what costs Entity A should capitalize. Would such costs equate to the amount that Entity A funded or would it also include the costs funded by the other 4 entities to capture the full cost of the cloud computing development? To avoid inconsistent application of the guidance, we recommend the following revision to the last sentence of paragraph 27 (new content underscored): If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform or infrastructure should account for the software in accordance with SFFAS 10 <u>and the full cost/inter-entity cost requirements of SFFAS 4, Managerial Cost Accounting Standards and Concepts</u>. *Staff Response: Change was made accordingly.*

Question 3: In Appendix B starting on page 16, this TR provides two tables illustrating business events and deliverables which agencies may see within a software development life-cycle and some common agency practice	

STAFF SUMMARY OF RESPONSES – Table C

examples to assist entity management in applying the principles described throughout the TR. **Do you think that both illustration tables will help agencies? If not, please explain your reason.**	
#1 GWSCPA	The FISC recommends that the terms included in the "typical deliverables" column be referenced to an authoritative source that provides a definition or industry-standard description of each item. Absent such a reference, agencies may not be able to take full advantage of the information presented in these two tables if different terminology is used. *Staff Response: Those were agency contributed examples as such no authoritative source can be referenced.*
# 2 DoD DQNI	The illustrative tables in Appendix B will assist Agencies in improving accounting consistency for the business events and deliverables; however we recommend emphasizing the importance of the illustrative nature of business events and deliverables that may or may not be employed by Agency processes during the software lifecycle. Additionally, we recommend enhancing the linkage of the "Rapid Development and Risk Evaluation activities" to include a description of how these activities contribute to the form and location suitable for use. *Staff Response: The nature of the business is discussed in the implementation guide as stated: "The table may be used as a sample guide for categorizing business events and deliverables during IUS phases, but it is not intended to be comprehensive. Each agency is responsible for developing policies and procedures that are appropriate for its specific environment and needs and may differ in content and order from the table below." In addition, it is up to agency to set up a policy to identify "Rapid Development and Risk Evaluation activities" since the implementation guide is helping agency on accounting related policy and it is not an operating guidance.*

STAFF SUMMARY OF RESPONSES – Table C

Question 4: Are there additional common issues or illustrations across agencies that should be considered? **If so, what are they, and how would you describe them?**	
#1 DHS	Additional illustrations in Appendix B would enable agencies to understand the implication of existing standards and new IUS concepts as they update their accounting policies and procedures. Although we understand that examples are not all encompassing, additional examples would certainly benefit agencies in light of new technological developments /issued guidance since the last IUS TR publication. We noted that policies and procedures at several agencies do not specifically address software as part of a package of product and services that could result in erroneous expensing of capitalizable costs. For example, IUS on planes, boats, and other equipment may erroneously be expensed instead of capitalized. Another risk is that those costs could be capitalized as part of the equipment rather than be capitalized as IUS. Additionally, providing linkages from the guidance to the illustrations would also be beneficial. *Staff Response: 1. Appendix B were the most samples could be collected during the implementation guide working group and draft period. 2. Integrated software concept was covered in TR 5 and now moved to this implementation guide paragraph 16.*
#2 GWSCPA	Allowable cost methodologies when direct tracing is not available: Additional guidance could be useful to the financial management community on allowable cost allocation methodologies for newer technology applications when an agency uses a "cause-and-effect" or a "reasonable and consistent" approach (SFFAS 4, paragraph 124, and ED paragraph 13), or when an agency's investment in legacy IUS does not rise to the level of discrete presentation in budget estimates. *Staff Response: Could be a future project topic.*
#3 GWSCPA	Identification of discrete pieces of IUS or COTS for inventory purposes: Although certain guidance is available in SFFAS No. 35, and Technical Release Nos. 13 and 15, some additional guidance could be useful to the financial management community on defining the appropriate application of GAAP in the following scenarios:

STAFF SUMMARY OF RESPONSES – Table C

	– One piece of discrete software with multiple users; – Multiple instances of the same software implanted with different configurations at multiple sites; – Software with a site-specific license, and the impact of multiple users; – Software with an enterprise-wide license, and the impact of multiple users; – Software with individual licenses, but combined within a bulk purchase; and – Capital upgrades on all above software types. *Staff Response: Could be a future project topic.*
#4 NRCS	Using the example in paragraph 16, when we have a baseline software app, such as a G/L, which has the a/p and a/r subsidiaries as complimentary components that could be deployed in 3 different periods/years; what are the thoughts on the useful lives of the 3 apps? Should the useful lives of the complimentary apps end on the same date as G/L app? Or should they each have their own useful life? I would be interested to hear their thoughts, but not necessarily tied to their opinions on the question. *Staff Response: This is up to agency to set up its own policy based on SFFAS 10 and this implementation guide.*
# 5 NRCS	Our agency generally uses a 5 year useful life for its software (default); it would be interesting to know and understand how other agencies determine the useful lives for their software apps. *Staff Response: This is up to agency to set up its own policy based on SFFAS 10 and this implementation guide.*

D. Listing Of Additional Comments from Respondents

Respondent	**Comment**
#1 KPMG	Paragraph 9 of the ED states that paragraphs 12, 13, 14, 17, and 18 of TR 5, Implementation Guidance on Statement of Federal Financial Accounting Standards 10, are rescinded. TR 5 contains six questions regarding the implementation of SFFAS 10. We believe that the concepts included in the responses for questions 1, 2, 4, and 6 (paragraphs 5-8, 12-14, and 17-18) from TR 5 are incorporated in the ED. Because TR 5 and the ED have similar titles and four of the six questions included in TR 5 are also addressed in the ED, we recommend that the ED supersede TR 5 in its entirety. We also recommend that the guidance included with questions 3 and 5 from TR 5 be evaluated for continuing relevance and, if appropriate, incorporated into the ED. *Staff Response: Two paragraphs from TR 5 were moved to this implementation guide and TR 5 was superseded as suggested.*

Federal Accounting Standards Advisory Board

IMPLEMENTATION GUIDANCE FOR INTERNAL USE SOFTWARE

Federal Financial Accounting Technical Release

~~**Exposure Draft**~~

~~Written comments are requested by October 28, 2015~~

~~September 16, 2015~~

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

Section III. I (3) of FASAB's Rules of Procedure authorizes the AAPC to issue Technical Releases related to existing federal accounting standards. Technical releases are intended to provide guidance on the specific application of Statements of Federal Financial Accounting Standards (SFFASs), Interpretations of SFFASs, and Technical Bulletins. AAPC's Technical Releases are in the third category of authoritative guidance in the Federal GAAP hierarchy as stated in the SFFAS 34, The Hierarchy of Generally Accepted Accounting Principles. AAPC may not amend existing standards or promulgate new standards.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

Contact us:

Federal Accounting Standards Advisory Board
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The Accounting and Auditing Policy Committee

The Accounting and Auditing Policy Committee (AAPC) was organized in May 1997 by the Department of the Treasury, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), the Chief Financial Officers' Council (CFOC), and the Council of the Inspectors General on Integrity and Efficiency (CIGIE) [formally the President's Council on Integrity and Efficiency (PCIE)], as a body to research accounting and auditing issues requiring guidance.

The AAPC serves as a permanent committee established by the Federal Accounting Standards Advisory Board (FASAB). The mission of the FASAB is to develop accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of Federal financial information. The mission of the AAPC is to assist the Federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues as they relate to the specific application of existing authoritative literature.

The AAPC is intended to address issues that arise in implementation, which are not specifically or fully discussed in Federal accounting and auditing standards. The AAPC's guidance is cleared by FASAB before being published.

Additional background information on the AAPC is available from the FASAB or its website:

- Charter of the Accounting and Auditing Policy Committee
- Accounting and Auditing Policy Committee Operating Procedures

Federal Accounting Standards Advisory Board

September 16, 2015

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Federal Financial Accounting Technical Release, *Implementation Guidance for Internal Use Software*, are requested. Specific questions for your consideration appear on page 3 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Committee if you explain the reasons for your position and any alternative you propose. Responses are requested by **October 28, 2015**.

All comments received are considered public information. Those comments may be posted to the AAPC's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW
Washington, DC 20548

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

We may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in the FASAB's newsletter.

Sincerely,

Wendy M. Payne

AAPC Chairperson

EXECUTIVE SUMMARY

This Technical Release (TR) assists reporting entities in implementing Statement of Federal Financial Accounting Standards (SFFAS) 10, *Accounting for Internal Use Software*. Since FASAB issued SFFAS 10 in 1998, software development practices have changed dramatically and reporting entities have experienced challenges applying the standards given the new terminology and techniques that have evolved. The TR provides implementation guidance regarding:

a. The definition of IUS, component/module based IUS assets, software development practices including approaches that involve phases, and clarifying IUS recognition, measurement, and disclosure items (such as capitalized cost, capitalization cut off, capitalization threshold, enhancement, impairment, and related matters);
b. New IUS challenges brought by changes in IUS development practices since the issuance of SFFAS 10; and
c. Management's role in applying SFFAS 10.

This objective of this guidance is to explain how to apply existing standards to the fast changing Internal Use Software (IUS) environment and help ensure that:

a. Transactions involving IUS are recorded in accordance with federal accounting standards.
b. The cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, does not outweigh the benefits derived by the users of the financial information.

TABLE OF CONTENTS

QUESTIONS FOR RESPONDENTS

The AAPC encourages you to become familiar with all proposals in the technical release before responding to the questions in this section. In addition to the questions below, the AAPC also would welcome your comments on other aspects of the proposed technical release.

The AAPC believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The AAPC has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW
Washington, DC 20548

All responses are requested by **October 15, 2015**

Q1. In the Clarification of Existing Standards section (paragraphs 10-24), this Technical Release (TR) considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. Do you agree with the clarification and the new concepts, such as Component Based IUS Asset, presented? If not, please explain your reason.

Q2. In the Guidance on Applying SFFAS 10 to Certain New IUS Developments section (paragraphs 25-33), this TR introduces new terms and defines them in light of the application of this guidance. Do you agree that the definitions reflect typical current new software development items and the associated guidance is reasonable? If not, please explain your reason.

Q3. In Appendix B starting on page 16, this TR provides two tables illustrating business events and deliverables which agencies may see within a software development life-cycle and some common agency practice examples to assist entity management in applying the principles described throughout the TR. Do you think that both illustration tables will help agencies? If not, please explain your reason.

Q4. Are there additional common issues or illustrations across agencies that should be considered? If so, what are they, and how would you describe them?

INTRODUCTION

PURPOSE

1. This Technical Release (TR) assists agencies in applying SFFAS 10, *Accounting for Internal Use Software*, to the new software development practices that have evolved since FASAB issued the standard in October 1998. The TR considers the software development terms and practices that reporting entities utilize currently and helps clarify the standards in light of those terms and practices. Specifically, the TR provides guidance regarding:

    a. The definition of internal use software (IUS), component/module based IUS assets, software development practices including approaches that involve phases, and clarifying IUS recognition, measurement, and disclosure items (such as capitalized cost, capitalization cut off, capitalization threshold, enhancement, impairment, and related matters);

    b. New IUS challenges brought by changes in IUS development practices since the issuance of SFFAS 10; and

    c. Management's role in applying SFFAS 10.

2. This TR introduces new terms used in current development practices and defines them in light of the application of this guidance. It provides a discussion of issues and examples to assist entity management in applying the principles described throughout the TR. The examples were selected because they were derived from underlying transactions or organizational characteristics rather than being attributable to preferences.

3. The accounting standards and related basis for conclusions consistently recognize management's role in interpreting and applying generally accepted accounting principles (GAAP) within its operational environment. This TR recognizes that management is responsible for establishing IUS accounting policies, methodologies, and for maintaining adequate documentation on the sources of data. It also recognizes that the cost of producing federal financial information, as it relates to capitalization or expense of IUS cost, should not outweigh the benefits derived by the users of the financial information.

BACKGROUND

4. The software development life cycle has dramatically changed since the issuance of SFFAS 10 in 1998. At that time the linear/waterfall[1] software development practices were prevalent and characterized by three distinct life-cycle phases and long development cycles. Given the changes in development practices, technological

[1] The waterfall model is a sequential design process, used in software development processes, in which progress is seen as flowing steadily downwards (like a waterfall) through the software development phases.

advances, and significant new development techniques and architectures,[2] guidance for implementation and sustainment of SFFAS 10 became critical.

5. This TR introduces new IUS development terms and defines them to aid in applying existing standards. The definitions provided are not all encompassing but are included to promote greater understanding, and more consistent application and implementation of the standards. The same principles used to develop the guidance on the current IUS development practices could be used for future IUS development practices. The business events and deliverables table and agency practice examples are provided in Appendix B. These examples are intended to illustrate use of professional judgment in the development and application of policy and practices to account for IUS in accordance with GAAP. The examples are not all encompassing and ~~agencies~~ reporting entity may identify other more useful and relevant methodologies. Users of this guidance should use these examples to develop their own reasonable business processes.

6. This TR was developed to aid in meeting the operating performance reporting objective identified in Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* paragraph 14[3]: Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine:

    a. The costs of providing specific programs and activities and the compositions of, and changes in, these costs;
    b. The efforts and accomplishments associated with Federal programs and the changes over time and in relation to costs; and
    c. The efficiency and effectiveness of the Government's management of its assets and liabilities.

RELATED ACCOUNTING LITERATURE

7. The related accounting standards are as follows:
    a. SFFAC 2, *Entity and Display*
    ~~a.~~b. SFFAS 4*, Managerial Cost Accounting Concepts and Standards for the Federal Government*
    ~~b.~~c. SFFAS ~~5~~6*, Accounting for Liabilities of the Federal Government ~~Accounting for Property, Plant, and Equipment~~*
    ~~c.~~d. SFFAS ~~6~~5, *Accounting for Property, Plant, and Equipment ~~Accounting for Liabilities of the Federal Government~~*
    ~~d.~~e. SFFAS 10*, Accounting for Internal Use Software*

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[2] Such as cloud service, shared service, agile development and spiral development with a focus on module based development and shorter development cycles.
[3] This principle was also relied upon in Office of Management and Budget (OMB) Circular *A-11 Preparation, Submission, and Execution of the Budget;* Supplement to Circular A-11*, Capital Programming Guide* (July 2014), Page 61.

~~e.~~ f. SFFAS 35*, Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Standards of Federal Financial Accounting Standards 6 and 23*

TECHNICAL GUIDANCE

SCOPE

8. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 4, SFFAS 5, SFFAS 6, SFFAS 10, and SFFAS 35.

9. This TR ~~affects supersede~~rescindsTR5 *Implementation Guidance on Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software*. ~~In specific, paragraphs 12, 13, 14, 17 and 18 are rescinded.~~

10. This TR applies to all internal use software that meet the definition of IUS as described in SFFAS 10 including ~~, except for~~ the following:
    a. Software to be used in research and development where the software will ~~not~~ have an alternate future use~~, and~~
    b. ~~Integrated software (SFFAS10 paragraph 22) unless the s~~Software ~~is~~ developed separately and ~~could be~~ installed on a number of different general property, plant, and equipment (PP&E) assets at different times~~.~~[4]

APPLYING EXISTING STANDARDS TO CURRENT DEVELOPMENT MODELS

11. **IUS Definition:** SFFAS 10, paragraphs 8 – 9, defines "internal use software" as software that is "purchased from commercial vendors off-the-shelf (COTS), internally developed, or contractor-developed solely to meet the entity's internal or operational needs." The IUS development or modification can be performed by employees of the entity or contractors that the ~~federal~~ entity is paying to design program, install, and implement. Software assets need to be evaluated for ownership to determine which entity is ultimately responsible for reporting the asset.

[4] SFFAS 10, par. 22 provides that computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly. However, computer software could be developed separately and installed on several general PP&E assets at different times. For example, anti-ballistic missile software installed on multiple radar systems at different times can be treated as a separate IUS asset if the software meets the capitalization threshold.

12. **Development Phases**: SFFAS 10 presents three phases of software development that follow a linear approach to an IUS project: the preliminary design phase, the software development phase, and the post-implementation/operational phase. ~~Generally,~~It states that ~~-~~costs incurred during the development phase ~~are to~~should ~~-~~be capitalized, while the ~~and~~ costs incurred in other phases ~~are to~~should ~~-~~be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized or expensed based on provisions of SFFAS 10 and considering the~~ir~~ substance of the activity~~rather than their phase~~.

13. **Capitalized Cost**: The full cost (direct and indirect cost as stated in SFFAS 4, paragraph 89, 90. and 91) incurred during the software development phases should be capitalized (SFFAS 10 paragraph 16 thru 18). Considering economic feasibility, a cost estimation technique could be developed to trace the costs to outputs based on the SFFAS 4, paragraph 124, provision that "[in] principle, costs should be assigned to outputs in one of the methods listed below in the order of preference:

    a. Directly tracing costs wherever economically feasible;

    b. Assigning costs on a cause-and-effect basis; and

    c. Allocating costs on a reasonable and consistent basis."

14. A specific software development project may include expenditures for improvements and maintenance that cannot be easily separated but may be reasonably and consistently allocated. One approach that can be used is a ratio based on the projected work hours for development phase activities relative to other types of work. Such a ratio can be applied to determine the expenditures that should be capitalized. The basis for allocating costs should be consistent with applicable standards and defensible.

15. **Capitalization Cut Off**: SFFAS 10 paragraph 20 states, "Costs incurred after final acceptance testing has been successfully completed should be expensed. Where the software is to be installed at multiple sites, capitalization should cease at each site after testing is complete at that site." In some development practices, each iteration[5] within an IUS development has its own acceptance testing before moving forward to the next iteration and final acceptance testing may not always be performed. The entity should identify a pre-determined agency milestone such as the go-live or in-service date which is equivalent to a final acceptance test for capitalization cut off purposes.

~~15.~~16. **Integrated Software:** SFFAS 10 paragraph 22 states, "Computer software that is integrated into and necessary to operate general PP&E, rather than perform an application, should be considered part of the PP&E of which it is an integral part and capitalized and depreciated accordingly (e.g., airport radar and computer-operated lathes). The aggregate cost of the hardware and software should be used to determine whether to capitalize or expense the costs." In situations where software and the hardware on which it runs have independent service lives, the determination of the

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Comment [WP1]: TR 5 guidance added so that TR 5 can be rescinded.

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[5] Iteration is the act of repeating a process with the aim of approaching a desired goal, target or result. Each repetition of the process is also called an "iteration", and the results of one iteration are used as the starting point for the next iteration.

useful life of the software should be viewed independently of the useful life of the hardware. This determination should be made on a case by case basis for each Federal agency and is at the discretion of management of the agency. The rationale for this determination should be documented.

~~16.~~17. **Component Based IUS Asset**: SFFAS 10 paragraph 33 states, "For each module or component of a software project, amortization should begin when that module or component has been successfully tested. If the use of a module is dependent on completion of another module(s), the amortization of that module should begin when both that module and the other module(s) have successfully completed testing." For example, an entity may develop an accounting software system containing three modules: a general ledger, an accounts payable sub-ledger, and an accounts receivable sub-ledger. In this example, each module could be analyzed to determine whether it could be treated as a separate asset. Specifically, if the module provides economic benefit through distinct, substantive functionality; and meets the tests for capitalization threshold, ownership, and eligibility for capital treatment, then the module could be treated as a separate IUS asset for the purposes of recognition, measurement including amortization, and disclosure in accordance with SFFAS 10.

~~17.~~18. **Capitalization Threshold:** SFFAS 10 paragraph 24 states, "Each federal entity should establish its own threshold as well as guidance on applying the threshold to bulk purchases of software programs (e.g., spreadsheets, word-processing programs, etc.) and to modules or components of a total software system." When establishing the capitalization threshold for IUS, the federal entity should include both qualitative and quantitative considerations as stated in SFFAC 2 paragraph 46. Qualitative considerations could be applied to IUS assets that require special management attention because of their importance to the agency mission; high development, operating, or maintenance costs; high risk; high return; or their significant role in the administration of agency programs, finances, property, or other resources.[6]

~~18.~~19. When establishing a capitalization threshold for bulk software purchases, the threshold should not be based on unit price. The organization should consider the bulk value and useful life established by the organization to avoid materially distorting period costs and understating asset values.

~~19.~~20. OMB notes that a stratified capital programming process involving more or less detail and review based on the size or strategic importance of proposed investments may be appropriate, particularly in large agencies.[7] Similarly, more than one capitalization threshold could be established for different components of a large agency. Agencies should have well documented thresholds clearly disseminated and implemented across the organization.

~~20.~~21. **Enhancement:** SFFAS 10 paragraph 25 states, "The acquisition cost of enhancements to existing internal use software (and modules thereof) should be capitalized when it is more likely than not that they will result in significant additional capabilities." Significant additional capabilities are modifications to existing IUS that

[6] OMB Circular A-11 *Preparation, Submission, and Execution of the Budget; Supplement to Circular A-11, Capital Programming Guide, Threshold for Capital Programming*, page 2, July 2014.
[7] See note 6.

result in additional functionality—that is, modifications to enable the software to perform tasks that it was previously incapable of performing. As stated in SFFAS 10 paragraph 26, capitalizable enhancements normally require new software specifications and may also require a change to all or part of the existing software specifications. Examples of enhancements could include augmenting existing business functions with new features and functions, developing additional new business functions, and/or adding new functionality and capability.

~~21.~~22. If one module is dependent upon another to function, then those modules should be evaluated together as one enhancement. All costs of an enhancement, including any costs carried over or allocated from the original software, should be amortized over the enhancement's estimated useful life.

~~22.~~23. **Impairment:** SFFAS 10 paragraphs 28-30 address how to determine if software is impaired during the post-implementation operational phases and the measurement of the impairment for the impaired software remaining in use or to be removed. Significant events or changes in operating circumstances warrant a review to determine whether the carrying value of an existing software asset is not recoverable and should be impaired. An assessment should be performed to determine the remaining useful life of the impaired software for amortization purposes.

~~23.~~24. When it is more likely than not that a software project will not be completed, no further costs should be capitalized and any costs that have been capitalized should be written off in accordance with SFFAS10, paragraph 31. Indications that the software may no longer be completed include:

a. The expenditures are neither budgeted nor incurred to fund further development;
b. The discontinuance of the business segment the software was designed for;
c. The inability to resolve programming difficulties timely; or
~~d. Significant cost overruns; or~~
~~e.~~d. A decision to obtain COTS instead and abandon the current software development

~~24.~~25. When a developmental software project is suspended pending management's evaluation as to whether to resume or terminate the project, the software development cost may remain capitalized as long as ~~a reasonable chance~~it is more likely than not[8] ~~exists~~ that the developmental software project will eventually be completed and the cost incurred or expected to be incurred meets the capitalization threshold. The status of the project should be reevaluated periodically and the capitalized cost should be written off if management concludes that it is more likely than not that the software will not be placed into service in the future.

26. **Software License:** If the term of software license(s) is 2 years or more with periodic payments, the license~~s~~ should be evaluated against lease criteria as stated in SFFAS 5 paragraphs 43-46 and SFFAS 6 paragraph 20 to determine if it is a capital or operating

[8] See SFFAS10. par. 31 provides for write off if it is more likely than not that the project will not be completed and placed in service.

lease. If the license(s) is perpetual with an upfront cost[9] to use the software for its entire lifetime, then the entity is purchasing IUS and should apply its ~~'s~~ existing policy for capitalization thresholds ~~could be applied~~ to determine if ~~it~~ the license should be capitalized or expensed.

~~25.~~27. A license agreement that may include executory costs for maintenance and technical support. Agency judgment should apply in determining what portions of license fees are attributable to software capitalizable costs versus executory costs. Assuming lease capitalization criteria and thresholds are met, software license capitalization amounts[10] may be derived from the payment schedule contained in the license agreement. As stated in SFFAS 5, if the portion of the minimum lease payments representing executory cost is not determinable from the lease provisions, the amount should be estimated. Agencies may also want to consider having each license agreement specifically identify the various costs throughout the license lifecycle, for example, initial license, maintenance and enhancement.

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Comment [WP2]: TR 5 guidance added so that TR 5 can be rescinded.

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GUIDANCE ON APPLYING SFFAS 10 TO CERTAIN NEW IUS DEVELOPMENTS

Cloud Computing

~~26.~~28. A cloud computing service is any resource that is provided over the Internet. It has the following essential characteristics: on-demand self-service, broad network access, resource pooling, rapid elasticity, and measured service. The most common cloud service resources are: software as a service, platform as a service, and infrastructure as a service.[11]

~~27.~~29. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses in accordance with the lease criteria stated in SFFAS 5 and SFFAS 6, and as discussed in paragraph ~~24~~ 26 of this TR. SFFAS 10 is not applicable to a cloud computing arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license. The entity that develops and owns the software, platform or infrastructure that is used in the cloud computing arrangement would account for the software development in accordance with SFFAS 10. If the funding to develop cloud computing is shared among entities without clear ownership, the service provider entity that receives funding and is responsible for maintaining the software, platform or infrastructure should account for the software in accordance with SFFAS 10 and the full cost/inter-entity cost requirements of SFFAS 4.

[9] The cost could be charged as a one-time payment or financed over a set period of time.

[10] SFFAS 5, paragraph 44.

[11] The full definition is available at The National Institute of Standards and Technology: *The NIST Definition of Cloud Computing,* Special Publication 800-145, September 2011.

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Shared Services

~~28.~~30. Shared Service means a mission or support function provided by one business unit to other business units within or between organizations. The funding and resourcing of the service is shared and the providing entity effectively becomes an internal/external service provider. There are ~~two~~ three types of shared service structures in the Federal Government: intra-agency, ~~and~~ interagency and commercial. Intra-agency shared services include those provided within the boundaries of a specific organization such as a Federal department or agency, to that organization's internal units. Interagency shared services are those provided by one Federal organization to other Federal organizations that are outside of the provider's organizational boundaries. Commercial shared services are those provided by private vendors[12]

~~29.~~31. For intra-agency shared services, a cost allocation methodology could be developed in accordance with SFFAS 4, paragraphs 120-125. For interagency shared services and commercial shared services, the service provider entity that owns (receives funding/responsible for maintaining) the software should account for the software in accordance with SFFAS 10. In the event that the entity receiving the service (the customer) has the contractual right to take possession of the software at any time during the hosting period without significant penalty, and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software, then the customer should account for the software in accordance with SFFAS 10.

~~30.~~32. If the shared service arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of their other software licenses, as discussed in this TR paragraph 24. SFFAS 10 is not applicable to a shared service arrangement that does not convey a contractual right to the IUS or to ones that do not include an IUS license.

Agile Software Development Method

~~31.~~33. Agile software development method is a group of software development methods in which requirements and solutions evolve through collaboration between self-organizing, cross-functional teams. In an agile project, working software is deployed in iterations of typically one to eight weeks in duration, each of which provides a segment of functionality.[13] Initial planning regarding cost, scope, and timing is usually conducted at a high level, and the project status is primarily evaluated based on software demonstrations.

[12] Chief Information Office Council: *Federal Shared Service Implementation Guide*, April 2013, ~~A~~and OMB M-13-08: *Improving Financial Systems Through Shared Services*, March 25, 2013.

[13] Government Accountability Office: *Software Development Effective Practices and Federal Challenges in Applying Agile Methods*, July 2012.

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~~32.~~34. The IUS development phases listed in SFFAS 10 paragraphs 10 -14 and within this TR could be applied to agile development projects on an iteration basis. If an iteration developed meets the module or component asset definition in accordance with SFFAS 10, paragraph 33 and as discussed in paragraph15 of this TR, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the numbers of iterations are dependent on the outcomes of multiple processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

Spiral Software Development Method

~~33.~~35. Spiral software development method combines the features of the waterfall and prototyping[14] incremental models, but with more emphasis placed on risk analysis and management. The spiral methodology projects are typically separated into phases like the waterfall method: planning, risk analysis, engineering, and evaluation. However, they are broken up into incremental releases of the product, or incremental refinement through each time around the spiral and through continuously analyzing the requirements and improving the definition and implementation. At each iteration around the cycle, the project is improved and extended. The release could be to an external or internal client, or to a partner.

36. The IUS development phases listed in SFFAS 10 paragraphs 10-14 and within this TR could be applied to a spiral development project on a process iteration basis. If an iteration developed meets the module or component asset definition in accordance with SFFAS 10 and as discussed in paragraph 15 of this TR, then it could be treated as an individual IUS project and would be accounted for in accordance with SFFAS 10. If the number of iterations are dependent on the outcomes of multiple spiral processes for a complete function, the cost incurred in these iterations should be grouped together based on the nature of the activities (capital or expense) and treated as one project for the purposes of recognition, measurement, and disclosure in accordance with SFFAS 10. Any future incremental releases that result in additional functionality can be treated as an enhancement of the original IUS project and accounted for in accordance with SFFAS 10.

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~~34.~~

[14] The Prototyping Model is a system development method in which a prototype (an early approximation of a final system or product) is built, tested, and then reworked as necessary until an acceptable prototype is finally achieved from which the complete system or product can now be developed. This model works best in scenarios where not all of the project requirements are known in detail ahead of time. It is an iterative, trial-and-error process that takes place between the developers and the users.

SUMMARY OF ILLUSTRATIONS

~~35.~~37. The Business Events & Deliverables for Software Development Phases and the Common Agency Practice tables listed in Appendix B support development of accounting policies and practices appropriate to each organization's characteristics in accordance with GAAP. The tables are meant to provide examples for reporting entities to consider in developing organizational accounting policies and practices that will best support their operating models, provide the financial information necessary to manage programs, and report in accordance with GAAP. Reporting entities should report the IUS in the general purpose financial reports. Full costs of IUS development should be expensed or capitalized in accordance with GAAP and each entity's accounting policies and practices should support cost beneficial implementation.

EFFECTIVE DATE

~~36.~~38. This Technical Release is effective upon issuance.

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

APPENDIX

APPENDIX A: BASIS FOR CONCLUSIONS

This Appendix discusses some factors considered significant by AAPC members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this TR not the material in this Appendix should govern the accounting for specific transactions, events, or conditions.

PROJECT HISTORY

A1. In June 2013, FASAB's AAPC established the IUS Task Force to assist in developing implementation guidance for IUS as it relates to SFFAS 10, *Accounting for Internal Use Software* and other related IUS guidance developed by the FASAB. The task force includes federal agency representatives who are experiencing issues with implementing SFFAS 10 and those who have implemented workable common practices to share with the federal community as well as industry representatives from several public accounting and consulting firms.

A2. During the initial phase of the project, the IUS task force divided into three subgroups to conduct research and explore the best approach for addressing current IUS issues within the federal community, including whether a TR should be developed, or revisions should be made to SFFAS 10. The subgroups met separately to discuss their assigned issues and report their research findings. The three subgroups were:

- **a.** IUS Mapping Team
- **b.** IUS Benchmarking Team
- **c.** Standards Team

A3. After presenting the results of their research to the FASAB and AAPC, the task force concluded that implementation guidance would address the current IUS issues within the federal community. As a result, the AAPC endorsed the approach. The group held a re-entrance meeting on February 27, 2015 to re-engage agencies in drafting implementation guidance. This guidance focused on highlighting the common issues identified across the federal government IUS process, clarifying terminology, introducing new terms from the recent software development methodologies in light of application of SFFAS 10, and providing sample IUS practices adopted by the agencies. Based on the research, a TR would equip federal agencies with the knowledge and information needed to identify effective IUS practices that would in turn strengthen financial reporting in IUS area. It consists of two major topic areas:

- **a.** Standards Clarification
- **b.** Practical Examples of Implementation

A4. The IUS FASAB Task Force, which included industry representatives from several public accounting and consulting firms, as well as representatives from the following federal agencies, developed this proposed guidance:

a. Department of Commerce (DOC)
b. Department of Defense (DOD) (including the individual military departments)
c. Department of Health and Human Services (HHS)
d. Department of Homeland Security (DHS)
e. Department of Labor (DOL)
f. Department of Transportation (DOT)
g. Department of Treasury (Treasury)
h. Environmental Protection Agency (EPA)
i. Office of the Director of National Intelligence (ODNI)
j. United States Securities and Exchange Commission (SEC)

A5. Two subgroups were formed for standards clarification and best practices. The subgroups developed two data calls to highlight the commonalities across the federal IUS process. The first data call aided federal agencies in clarifying terminology and identified popular new IUS development items. The second data call highlighted IUS current practices adopted by the agencies and identified IUS development phase activities across the IUS development phases. The second data call also collected detail business events and typical deliverables during IUS development phases. Both data calls equip federal agencies with the knowledge and information needed to strengthen financial reporting.

A6. In reaching ~~its~~ conclusions, the subgroups recognized the need to develop implementation guidance to promote an understanding of rapid changes related to software development practices that have evolved since the inception of SFFAS 10. The IUS task force views clarification of implementation and sustainment issues as critical given the new IUS challenges related to environmental changes and technological advances. There are several cost-beneficial and reasonable changes (for example, policies, systems, and processes) that federal entities can make to facilitate better financial management and reporting of IUS. However, entity management must be allowed to navigate within the parameters of GAAP to determine the point at which the costs of improving or providing financial information outweigh the derived benefits.

A7. This TR recognizes that the financial management information needs of stakeholders, both internal and external, vary by entity. The agency-specific examples (detailed in Appendix B) demonstrate how tracking costs to specific invoices may be tailored to different operating models and comply with GAAP. The implementation guidance does not provide a 'one-size-fits-all' solution; instead, it is designed to give management a tool on which to base stakeholder financial management information needs.

A8. When applying the principles listed in the SFFAS 10, management should develop formalized policies and procedures documenting their decisions. Management is responsible for maintaining adequate documentation on the sources of data and the application of methodologies used when estimating cost.

A9. Implementation of SFFAS 10 and this guidance is a joint effort of an entity's Chief Finance Office and Chief Information Office. It is management's responsibility to provide for smooth communication between these two offices to foster an efficient and effective IUS implementation process.

APPENDIX B: ILLUSTRATIONS

The examples in this Appendix are for illustration only; they do not represent authoritative guidance. These illustrations depict only a portion of the reporting entities' operations and their inclusion in this TR does not equate to policy acceptance, in whole or part, by the FASAB or the AAPC.

ILLUSTRATIONS B-1: BUSINESS EVENTS AND DELIVERABLES FOR SOFTWARE DEVELOPMENT PHASES

The table below provides examples of business events and deliverables which agencies may see within a typical software development life-cycle. The table is structured to follow the three software development phases as defined in SFFAS 10 paragraphs 11-14. When applying examples in this table to software development phases, the decision to capitalize or expense an item should be determined based on the nature of the cost activity when it is incurred, in accordance with SFFAS 10 paragraph 16 and as discussed in this TR paragraph 121: "It states that costs incurred during the development phase should be capitalized, while the costs incurred in other phases should be expensed. However, software may not always be developed under this linear approach and capitalization decisions absent distinct phases are more difficult. Regardless of timing, the cost incurred for development phase activities should be capitalized or expensed based on provisions of SFFAS 10 and considering their substance rather than their phase."

The table may be used as a sample guide for categorizing business events and deliverables during IUS phases, but it is not intended to be comprehensive. Each agency is responsible for developing policies and procedures that are appropriate for its specific environment and needs and may differ in content and order from the table below.

Business Event	Typical Deliverables
Preliminary Design Phase	
Formulation of Alternatives[15]	
-Justification of investment need -Conceptual formulation of alternatives -Evaluation and testing of alternatives -Determination of existence of needed technology -Final selection of alternatives	Major Information Technology (IT) Business Cases, Capital Investment Decision Paper, Information Resources Management Strategic Plan, Enterprise Architecture Roadmap, IT Capital Asset Summary, Agency IT Portfolio Summary Submissions, Alternative of Analysis Report

[15] OMB Circular A-11 provides more information for alignment of agency IT investments with agency strategic plans.

Business Event	Typical Deliverables
Establish Project Governance	
-Identify and incorporate vision, roles, responsibilities, governance, organizations and authorizations in project charter -Identify and document risks specific to project, including security risks -Establish and document quality control practices -Develop high-level estimates and schedule -Update discoveries and additional information	Project Charter, Project Action/Risk Register, Quality Management Plan, Project Schedule, Project Plan, Work Breakdown Structure
Determine Requirements	
-Develop high level list of functional and non-functional requirements -Obtain, review and document detailed business specifications for business requirements -Determine and document general data flows and interactions with other systems -Determine detailed business/system specifications to support requirements	Vision documents, Requirement Specification Document, Requirement Traceability Matrix, Process Flow Diagrams, Supplementary Specifications, Use Cases, User Workflow
Develop Software Development Plan	
-Create initial plan to define major releases of project and phases -Define configuration management practices -Define testing strategy for user acceptance, quality assurance and other necessary testing	Project Schedule, Release Specifications, Software Development Plan, Test Strategy, Quality Assurance (QA) Test Plan Risk Management Plan, User Interface Design Documents, Solution Design Document
Procurement	
-Create Request for Information (RFI) or Request for Proposal (RFP) for external vendor services or products -Evaluate and select externally provided services or products	RFI/RFP, Procurement Management Plan, Contract Statement of Work
Rapid Prototype/Pilot	
-Rapid prototype development and evaluation to refine requirements and prove concept -Pilot of proposed solution on small scale and over limited timeframe to prove concept and refine requirements -Update schedule and cost baseline based on discoveries from elaboration phase	Prototype (executable version of function and interface), Requirements Survey, Pilot program, Evaluation of Pilot, Scope Management Plan

Business Event	Typical Deliverables
Development Phase	
Software Development Initiation	
-Refine and execute practices for artifacts & configuration -Review work performed in prior iterative period, prioritize and assign work to be done in next iterative period -Coordinate updates to system inter-dependencies -Develop operations plan -Define and document architecture specifications -Develop and validate high value/high risk requirements of architecture components	Software Architecture Description Document, Software Development Plan, Iteration Plan, Operational Plan, Software Design Description
Rapid Development Risk Evaluation	
-Studies and analysis are performed during development environment to identify potential risks based on requirements & developed iteration	Risk identification and Mitigation Plan, Contingency Plan
Coding and System Design	
- Execute practices for version control of all software development artifacts - Create, design and modify system and associated hardware; coding and continuous refining. -Update project plan & business case -Add software development issues to the Issue Log to be prioritized and addressed -Conduct critical design review -Establish and document quality control practices	Software Architecture Document, Development Plan, Updated Project Management Documents, Issue Log, Critical Design Review Memorandum, Quality Management Plan
Testing	
-Identify tests and write test cases or scripts -Install hardware. Conduct unit and integration testing -Create operations manual and requirement documents for users -Document strategy and approach for system implementation (what will be deployed, where, and when) - Prepare turnover package to migration turnover and test readiness review and issue memo -Prepare detailed notes that describe the specific contents of a release for customer or outside testing party -Develop security test report and issue security certification and accreditation -Conduct user acceptance testing	Test Plan, Test Cases Scripts, Test Results, Operations Manual, Implementation Plan, Test Readiness Memorandum, Release Notes, Turnover Package, Transition Plan, Security Test Report, Security Certification and Accreditation, Security Test & Evaluation Plan, Software Architecture Document, Acceptance Test Plan, Acceptance Test Script
Readiness Review and Release	
-Conduct production readiness review and issue memo	Production Readiness Review Memo, Transition Plan, Operational Readiness

Business Event	Typical Deliverables
-Audit and project completion reports finalized -Issue operational readiness memo, certification of production, and final user acceptance testing memorandum	Memorandum, Audit and Project Completion Reports, Certification of Production, Final User Acceptance Testing Memorandum, User Manual, Operational Support Plan, Installation Plan
Post-implementation/ Operational Phase	
Deployment	
-Determine criteria for exiting transition phase controls have been identified and met -Stakeholder provides written approval that product meets documented business requirements -Revise and finalize detail Deployment/implementation plan	Update Project Management Documents, Scope Verification, Deployment/implementation plan
Training	
-Develop training delivery method, schedule, and plan -Develop training materials -Deliver training, record, and deliver webinars and communicate on-demand training	Training Plan, Training Materials, Training Delivery
Data Conversion	
-Development of software to facilitate data transfer or conversion -Develop data cleansing and transfer plan, including protocols for archiving legacy data -Perform activities to cleanse data and format for transfer -Perform mock migrations of data and analyze results -Perform final data migration and validation	Data Transfer Software, Data Transfer Plan, Formatted Data, Mock Migration Results and Analysis Report, Data Migration Validation Report
Operation and Maintenance Activities	
-Subsequent security accreditations (not included in user acceptance testing) -Software diagnostics -Repair processing and/or performance failures -Update documentation -Minor software updates -Minor corrections to design flaws	Accreditation Certification, Diagnostic Reports, Software and Process Documentation
Retirement of Software	
-Information preservation -Configuration management and control -Media sanitization -Hardware and software disposal	Disposal Certification

The common agency practice table highlights IUS practices adopted by the agencies in the areas identified by the IUS working group as common ~~problems~~challenges. It intends to equip federal agencies with the knowledge and information needed to identify effective IUS practices and does not provide a 'one-size-fits-all' solution; instead, it is designed to give management some practical examples. Users of this TR should use the information provided in these examples to develop their own reasonable business processes. This table covers four areas of IUS development: 1) Identifying Cost, 2) Software Amortization, 3) Enhancement to IUS, and 4) Impairment to IUS.

Illustration Sample #1: Identifying Cost

~~Problem~~Challenge Statement: Trace Development Cost to Specific Invoice		
~~Problem~~Challenge Contributing Factors	***Task Force Member Agency***	***Agency Practice***
Cyclical development methodologies make differentiating between development and maintenance costs within an invoice difficult	A	Direct tracing or allocating the invoiced cost with the basis of estimate documented. Use status report or program/project documentation to evaluate activities and identify those that are development activities.
	B	Contractual requirement for vendor to provide a data item description deliverable with the estimate of costs between development and non-development activities along with each monthly invoice submitted.
	C	IUS cost primarily attributable to government labor hours. Quarterly report from the program offices detailing the employee or contract hours for each IUS project phase (preliminary design, development, or operational).
	D	Separate accounting lines used on purchase request and obligation document for development and non-development activity cost by coding every software project on a requisition. The captalizable requisition must be coded with general ledger account IUS-In Development in the accounting string which drives the purchase order and vouchers, thereby requiring the vendor to invoice in accordance with the activity breakouts.

Illustration Sample #2: Software Amortization

~~Problem~~Challenge Statement: Timing of Commencement of Depreciation/Amortization		
~~Problem~~ Challenge Contributing Factors	***Task Force Member Agency***	***Agency Practice***
Obtaining evidence to support the determination of commencement of amortization	A	Open inter departmental communication facilitates decision to begin depreciation of software.
	B	A sign off document confirming key development milestones such as acceptance test are met.
	C	A certificate of production is issued communicating the software is in production and being utilized.

Illustration Sample #3: Enhancement to IUS

~~Problem~~Challenge Statement: Define Enhancement to Internal Use Software		
~~Problem~~Challenge Contributing Factors	***Task Force Member Agency***	***Agency Practice***
Determination of the significance of an enhancement to the IUS; incremental enhancement of capability; and the enhancement associated with new IUS development model	A	Defines enhancement to be the replacement, upgrade, modification, or addition of new features or capabilities to an existing system, product, tool, service, or infrastructure to improve its functionality. It involves a change in the capabilities, requirements, design, and/or architecture.
	B	Add additional capabilities and the enhancement costs are above agency's capitalization threshold. Repair a design flaw or perform minor upgrades that extend the useful life without adding capabilities, the costs are expensed and the useful life of the original asset is adjusted, as necessary.
	C	Enhancement cost exceed capitalization threshold, and when it is more likely than not that such enhancements will result in a significant increase in functionality that is apparent to the user. The cost of routine or minor changes or modernizations that do not significantly add functionality should be expensed in the period incurred. Examples of minor enhancement include updating data tables, web-enabling, customizing reports, or changing graphic user interfaces. Enhancements that may extend the useful life of the software without adding significant capabilities are to be considered minor and expensed.
	D	In Agile development model, enhancement follows the same capitalization criteria threshold for each release separately and tracks each version individually.

Illustration Sample #4: Impairment to IUS

~~Problem~~Challenge Statement: Determination of Impairment for Internal Use Software		
~~Problem~~Challenge Contributing Factors	***Task Force Member Agency***	***Agency Practice***
Determination of when the impairment is incurred without sufficient knowledge on the IUS operating status	A	Scenario-based impairment checklist reviewed on a quarterly basis to monitor impairment. The checklist examines the following scenarios: cessation of demand for the IUS asset, changes with an adverse effect on the IUS asset have occurred within the policy, legal or technological environment, plans to discontinue or restructure the IUS asset, the IUS asset is not performing as intended, and elements of the IUS asset functionality are not used as intended.

APPENDIX C: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
COTS	Commercial off The Shelf
DHS	Department of Homeland Security
DOC	Department of Commerce
DOD	Department of Defense
DOL	Department of Labor
DOT	Department of Transportation
EPA	Environmental Protection Agency
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
HHS	Department of Health and Human Services
IT	Information Technology
IUS	Internal Use Software
NIST	National Institute of Standards and Technology
ODNI	Office of the Director of National Intelligence
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
QA	Quality Assurance
RFI	Request for Information
RFP	Request for Proposal
SEC	United States Securities and Exchange Commission
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release
Treasury	Department of Treasury

AAPC General IUS Task Force

Becca Shiller, Department of Defense, Task Force Chairperson
Curt Nusbaum, Transportation Security Administration, Task Force Co-Chairperson

Susan Jennings, CACI, Task Force Subgroup Leader
Tim Mainguy, Deloitte., Task Force Subgroup Leader
Margie Oates, Commerce/Census, Task Force Subgroup Leader
Fola Ojumu, Kearney & Co., Task Force Subgroup Leader
Jackie Olewack, PWC, Task Force Subgroup Leader
Katherine Reed, DNI, Task Force Subgroup Leader
Wendy Nesbitt, TSA, Task Force Subgroup Leader
Annmarie Schumacher, NIST, Task Force Subgroup Leader

Task Force Member Agencies

Department of Commerce (DOC)
Department of Defense (DOD) (including the individual military departments)
Department of Health and Human Services (HHS)
Department of Homeland Security (DHS)
Department of Labor (DOL)
Department of Transportation (DOT)
Department of Treasury (Treasury)
Environmental Protection Agency (EPA)
Office of the Director of National Intelligence (ODNI)
United States Securities and Exchange Commission (SEC)

Task Force Member Firms

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ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 7C13
1:00 to 2:30 p.m.

August 18, 2016

Project Agenda:

- Approval of plans to amend the implementation guide for estimating the historical cost of general property, plant & equipment due to rescinding SFFAS 35 *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*

- Approval for a project to develop new implementation guidance related to SFFAS 50 *Establishing Opening Balances for General Property, Plant, and Equipment*

Administrative Matters:

- Next AAPC Meeting – November 17, 2016

****

Administrative Information:
Observers – To ensure access, please pre-register by 8 AM August 15 at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Grace Wu at 202 512-7377 or Wug@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1-866-453-4503. Please enter 1662696 #.

SFFAS 50 Overview & Proposed Project/TR Guidance

AAPC MEETING
AUGUST 18, 2016

MELISSA BATCHELOR

DISCLAIMER

- Views expressed are those of the speaker.

Opening Balances for General PP&E

- SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*
  - Alternative methods in establishing opening balances for general PP&E accomplished through comprehensive implementation guidance in SFFAS 6
  - Amends SFFAS 6, SFFAS 10, SFFAS 23 and rescinds SFFAS 35

Opening Balances for General PP&E

- Using Deemed Cost for establishing opening balances of all general PP&E.
  - Several valuation methods permitted (same as SFFAS 48-replacement cost, estimated historical cost, and fair value)
  - Flexible dates to allow components to establish opening balances at different dates
  - Once established, considered GAAP
- Selecting between deemed cost and prospective capitalization of internal use software
- Allowing an exclusion of land and land rights with disclosure of acreage information and expensing of future acquisitions

Opening Balances for General PP&E

- Quick Recap of Due Process Issues
  - Respondents disagreed with land proposal
    - Key reasons- inconsistency & added cost
    - FASAB to begin project related to land & land rights
  - Reasonable estimates and the rescission of SFFAS 35.
    - SFFAS 6 was revised to include the following in par. 26:

26. All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E….

    - Similar change made in SFFAS 10
  - Other areas- in- service dates, land rights, fully depreciated assets, and audit support

Opening Balances for General PP&E

- Disclosures
  - Component Reporting Entity Disclosures
    - Similar to SFFAS 48-describe the method used, but no disclosure of amounts of deemed cost
    - Election to exclude land and land rights should be disclosed, with acreage information
    - Election to apply prospective capitalization of IUS should be disclosed
    - Different alternative methods (for land & land rights and prospective capitalization of IUS) applied by sub-component reporting entities consolidated into a larger reporting should be disclosed
  - Financial Report of the U.S. Government Disclosures
    - Identify component reporting entities that apply deemed cost, elected to exclude land & land rights (also the number of acres), elected prospective capitalization of IUS and include a reference to the component reporting entity's financial report
- Issued August 4, 2016
  - Effective FY17, but earlier implementation encouraged

SFFAS 50-Proposed Project/TR Guidance

- Approval of Amendments to TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant & Equipment* and TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
- Approval for a project to develop implementation guidance related to SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment*

Approval of Amendments to TR 13 & TR15

- Conforming Amendments to Technical Releases (TR)
  - The TR amendments in **TR 13 and TR 15** will acknowledge the rescission of SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23* and remove the reference.
  - Important to update TRs because this was brought up during due process. Based on the comments, users rely on the TRs.
  - TR guidance would update that all standards-level implementation guidance for general PP& E (with the exception of certain provisions applicable to internal use software) resides in SFFAS 6 (versus SFFAS 23 and SFFAS 35.)

Approval for a project to develop implementation guidance related to SFFAS 50

- Project goal: Assist with Implementation issues surrounding SFFAS 50 by providing timely guidance.
  - Suggest forming a working group to address the issues and develop illustrates.
  - Suggest establishing a **date certain** for DoD and other reporting entities to request areas for inclusion in the TR. SFFAS 50 allows **early implementation**, so some may need/want the guidance earlier.

SFFAS 50- Potential Issues

- Capital Improvements – In-Service Date- Clarification of intent with examples.
  - It is not necessary to separately identify the in-service date for material improvements included in the opening balance of a base unit. All improvements included in the opening balances at deemed cost may be treated as if they were placed in-service at the date the base unit was placed in-service. [SFFAS 50 para. 13.e.ii]
    - Intent was to allow funding/monies to be grouped and not necessary to be tracked separately. One must still consider useful life.
    - SFFAS 50 did not amend SFFAS 6 par. 37 “Costs which either extend the useful life…over the remaining useful life of the associated general PP&E.

SFFAS 50- Potential Issues

- Land rights – clarification of disclosures by incorporating a reference as explained in the BfC
  - ….A component reporting entity electing to exclude land and land rights from its general PP&E opening balances must disclose, with a reference on the balance sheet to the related disclosure, the number of acres held at the beginning of each reporting period, the number of acres added during the period, the number of acres disposed of during the period, and the number of acres held at the end of each reporting period….[SFFAS 50 par. 13 h. ii]
  - … The Board recognizes that land rights are diverse, situation specific, and may not always result in disclosures required by this Statement. In fact, SFFAS 6 provides that land rights that are for a specified period of time shall be depreciated or amortized over that time period. The Board believes this is a cost effective approach for opening balances of land rights and completion of the land project would more fully research the issues and provide comprehensive standards…[SFFAS 50 par. A19.]
    - Intent was to recognize there may be situations with land rights when disclosures may not be required by this Statement. One must always determine if disclosures for land rights are required and appropriate considering guidance in SFFAS 6 and materiality always applies.

SFFAS 50- Potential Issues

- Recording Fully Depreciated Assets (NBV $0) that are still in use. Clarification with examples.
  - SFFAS 50 did not change SFFAS 6 pars. 41- 42
  - Auditors voiced concerns in this area- can't ignore assets that are being used
  - Relates back to capitalization thresholds and useful lives
  - Needs to be a process that is documented & embedded
  - Needs to consider capital improvements

SFFAS 50- Potential Issues

- Prospective Capitalization of Internal Use Software (IUS), more specifically the issue is with prospective capitalization of IUS Under Development, SFFAS 50 allows
  - Opening balance for existing IUS based on deemed cost
  - Opening balance of $0 and apply SFFAS 10 prospectively
  - Opening balance of $0 for IUS in service and to establish an opening balance for IUS in development based on deemed cost, and to apply SFFAS 10 prospectively.
- Some question how future costs relating to IUS-UD should be treated.

QUESTIONS

Melissa Batchelor

batchelorm@fasab.gov

- See the projects discussed on FASAB's active project website at http://fasab.gov/active-projects/

ACCOUNTING AND AUDITING POLICY COMMITTEE
MEETING AGENDA
441 G Street, NW, Washington, D.C.
Room 7C13
1:00 to 2:30 p.m.

November 17, 2016

Project Agenda:

- Review and approval of the draft Technical Release, *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment*

- Discuss Department of Housing and Urban Development grant documentation issue

- Discuss on two recent exposure drafts:

    - *Federal Financial Reporting*
    - *Leases: An Amendment of SFFAS 5, Accounting for Liabilities of the Federal Government and SFFAS 6, Accounting for Property, Plant, and Equipment*

Administrative Matters:

- Next AAPC Meeting – February 9, 2017

****

Administrative Information:
Observers – To ensure access, please pre-register by 8 AM November 14 at:

http://www.fasab.gov/board-activities/meeting/information-for-observers/pre-registration/

If you have any difficulties, please contact Grace Wu at 202 512-7377 or Wug@fasab.gov.

Minutes will be posted to the website following approval. In addition, a recording will be made part of the public record. The recording is available for use by the public upon request.

INCLEMENT WEATHER POLICY: If the Office of Personnel Management (OPM) announces that federal employees may take **unscheduled leave** AAPC meetings will begin on time. In such cases, a decision regarding further delay or cancellation will be made no later than the originally announced meeting time (generally, 1 PM). Please call 202 512-7350 to hear a recorded announcement about the meeting status.

If federal offices are **closed** by OPM, the meeting is canceled.

OPM announcements are carried on most local radio and television news shows. The OPM website (www.opm.gov) also displays the operating status for federal agencies.

Observers have the option of listening to the meeting via teleconference line. The conference number is 1-866-453-4503. Please enter 1662696 #.

Federal Accounting Standards Advisory Board

CONFORMING AMENDMENTS TO TECHNICAL RELEASES FOR SFFAS 50, *ESTABLISHING OPENING BALANCES FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT*

Federal Financial Accounting Technical Release

DRAFT Exposure Draft

Written comments are requested by TBD 15 - 30 days

Month day, year

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB is responsible for promulgating accounting standards for the United States government. These standards are recognized as generally accepted accounting principles (GAAP) for the federal government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, federal executives, federal program managers, and other users of federal financial information. The proposed standards are published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for federal accounting and reporting.

Additional background information is available from FASAB or its website:

- "Memorandum of Understanding among the Government Accountability Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."
- "Mission Statement: Federal Accounting Standards Advisory Board", exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov .

Contact us:

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6H19
Washington, DC 20548
Telephone 202-512-7350
Fax 202-512-7366
www.fasab.gov

The Accounting and Auditing Policy Committee

The Accounting and Auditing Policy Committee (AAPC) was organized in May 1997 by the Department of the Treasury, the Office of Management and Budget (OMB), the Government Accountability Office (GAO), the Chief Financial Officers' Council (CFOC), and the Council of the Inspectors General on Integrity and Efficiency (CIGIE—formally the President's Council on Integrity and Efficiency) as a body to research accounting and auditing issues requiring guidance.

The AAPC serves as a permanent committee established by the Federal Accounting Standards Advisory Board (FASAB). The mission of FASAB is to develop accounting standards after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information. The mission of the AAPC is to assist the federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues as they relate to the specific application of existing authoritative literature.

The AAPC is intended to address issues that arise in implementation, which are not specifically or fully discussed in federal accounting and auditing standards. The AAPC's guidance is cleared by FASAB before being published.

Additional background information on the AAPC is available from FASAB or its website:

- "Charter of the Accounting and Auditing Policy Committee"
- Accounting and Auditing Policy Committee Operating Procedures

Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

Your comments on the exposure draft of a proposed Federal Financial Accounting Technical Release, *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment* are requested. Specific questions for your consideration appear on page three, but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Committee if you explain the reasons for your position and any alternative you propose. Responses are requested by **TBD**.

All comments received are considered public information. Those comments may be posted to the AAPC's website and will be included in the project's public record.

Mail delivery is delayed by screening procedures. Therefore, please provide your comments in electronic form by e-mail to fasab@fasab.gov. If you are unable to e-mail your responses, we encourage you to fax the comments to (202) 512-7366. Alternatively, you may mail your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW
Washington, DC 20548

We will confirm receipt of your comments. If you do not receive confirmation, please contact our office at 202.512.7350 to determine if your comments were received.

We may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the Federal Register and in FASAB's newsletter.

Sincerely,

Wendy M. Payne

AAPC Chairperson

EXECUTIVE SUMMARY

Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment* amended SFFAS 6, *Accounting for Property, Plant, and Equipment*; and SFFAS 10, *Accounting for Internal Use Software;* and rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending SFFAS 6 and 23*.

This Technical Release (TR) would provide amendments to previously issued TRs to acknowledge the rescission of SFFAS 35. It would also clarify that all standards-level implementation guidance for general property, plant, and equipment (with the exception of certain provisions applicable to internal use software) now resides in SFFAS 6, as amended.

Specifically, this TR would provide conforming amendments to the following documents:

- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
- Technical Release 16, *Implementation Guidance For Internal Use Software*

The provisions of this TR need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the 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.

TABLE OF CONTENTS

QUESTIONS FOR RESPONDENTS

The Committee encourages you to become familiar with all proposals in the Technical Release (TR) before responding to the questions in this section. In addition to the questions below, the Committee also would welcome your comments on other aspects of the proposed TR. Because the proposals may be modified before a final TR is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The Committee believes that this proposal would improve federal financial reporting and contribute to meeting the federal financial reporting objectives. The Committee has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

The questions in this section are available in a Word file for your use at http://www.fasab.gov/documents-for-comment/. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366. Alternatively, you may mail your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6H19
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by [insert date].

Q1. In light of the recently issued Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, this Technical Release clarifies existing Technical Releases by providing conforming amendments (**see paragraph 3-11 and paragraph A5-A8**). These amendments acknowledge the rescission of SFFAS 35 and that all standards-level implementation guidance for general property, plant, and equipment (with the exception of certain provisions applicable to internal use software) now resides in SFFAS 6.

Do you agree or disagree that this Technical Release clarifies the technical guidance? Please provide the rationale for your answer.

Q2. Are there additional amendments or issues that should be considered in this Technical Release? If so, what are they, and how would you describe them? Please provide the rationale for your answer.

PROPOSED TECHNICAL GUIDANCE

SCOPE

1. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles*, *Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

2. The amendments addressed in this TR conform the following documents to the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*:

   - Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
   - Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
   - Technical Release 16, *Implementation Guidance For Internal Use Software*

AMENDMENTS TO EXISTING TECHNICAL RELEASES

TECHNICAL RELEASE 13, *IMPLEMENTATION GUIDE FOR ESTIMATING THE HISTORICAL COST OF GENERAL PROPERTY, PLANT, AND EQUIPMENT*

3. This paragraph rescinds paragraphs 1-10 (including all section titles and subsection titles contained within the introduction and background sections) of Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment,* to eliminate potentially confusing references to the rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*, and amended portions of other Statements.

   [[1] Footnote 1 was rescinded by TR XX, *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment*.]

4. This paragraph amends the technical guidance section of TR 13 by adding the subheading “scope” and inserting paragraphs 10a-10c directly under “technical guidance.”

Technical Guidance

Scope

10a. Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards.

10b. SFFAS 6, *Accounting for Property, Plant, and Equipment,* (as amended) provides that reasonable estimates may be used to establish historical cost of general property, plant, and equipment (PP&E) in accordance with the asset recognition and measurement provisions within SFFAS 6. This is also applicable to internal use software when the software meets the criteria for general PP&E in accordance with SFFAS 10, *Accounting for Internal Use Software*.

10c. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, amended SFFAS 6 to allow a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for general PP&E.

5. This paragraph further amends the technical guidance in TR 13 by adding the subheading "effective date" and inserting the following paragraph directly under the scope section added in paragraph 6 above as follows:

Effective Date

10d. This Technical Release is effective upon issuance.

6. This paragraph amends the examples of practice provided in TR 13 by replacing paragraphs 11 and 12 with the following text:

11. The examples outlined in this guide illustrate the use of various estimating methodologies to derive the historical cost of general PP&E in accordance with SFFAS 6, as amended. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions of SFFAS 6, as amended.[1A]

12. Reasonable estimates may be based on
    a. cost of similar assets at the time of acquisition;

[1A] SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, provides for deemed cost to be used for opening balances in some cases. Estimating historical cost is one of several deemed cost valuation methods. This TR addresses the estimation of historical cost and does not address other acceptable deemed cost methods.

b. current cost of similar assets discounted for inflation since the time of acquisition (that is, deflating current costs to costs at the time of acquisition by general price index); or
c. other reasonable methods, including latest acquisition cost and estimation methods based on information such as, but not limited to, budget, appropriations, engineering documents, contracts, or other reports reflecting amounts to be expended.

[2, 3, 4 Footnotes 2-4 were rescinded by TR XX, *Conforming Amendments to Technical Releases for SFFAS 50, Establishing Opening Balances for General Property, Plant, and Equipment*.]

12a. In some cases, the in-service date must be estimated. In estimating the year that the base unit was placed in service, if only a range of years can be identified, then the midpoint of the range is an acceptable estimate of the in-service date.

TECHNICAL RELEASE 15, *IMPLEMENTATION GUIDANCE FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT COST ACCUMULATION, ASSIGNMENT AND ALLOCATION*

7. This paragraph amends Technical Release (TR) 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*, by revising the last sentence of paragraph 12 as follows: “This Technical Release clarifies but does not change guidance provided in SFFAS 4 or SFFAS 6 (as amended). ~~,SFFAS 23, or SFFAS 35.~~

   The revised paragraph 12 of TR 15 is:

   Readers of this Technical Release should first refer to the hierarchy of accounting standards in SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This Technical Release supplements the relevant accounting standards, but is not a substitute for and does not take precedence over the standards. This Technical Release clarifies but does not change guidance provided in SFFAS 4 or SFFAS 6 (as amended).

8. This paragraph amends TR 15, paragraphs 1 and 14, by updating it for the amended SFFAS 6, paragraph 26, language and adding “as amended” after SFFAS 6. The following language was added as the second sentence of SFFAS 6, paragraph 26: “Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein.”

   The revised paragraph 1 of TR 15 is:

   1. Statement of Federal Financial Accounting Standards 6 (SFFAS 6), Accounting for Property, Plant, and Equipment, (as amended) outlines the recognition requirements for

general property, plant, and equipment (G-PP&E) except for internal use software. Paragraph 26 states that,

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

The AAPC G-PP&E cost accounting issues subgroup was developed to address a request for implementation guidance for these requirements.

The revised paragraph 14 of TR 15 is:

14. SFFAS 6 (as amended), paragraph 26 states:

All general PP&E shall be recorded at cost. Although the measurement basis for valuing general PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of general PP&E, in accordance with the asset recognition and measurement provisions herein. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. For example, the cost of acquiring property, plant, and equipment may include…

9. This paragraph rescinds paragraph 10 (and the preceding title 'Related Accounting Literature') of TR 15.

TECHNICAL RELEASE 16, *IMPLEMENTATION GUIDANCE FOR INTERNAL USE SOFTWARE*

10. This paragraph rescinds paragraph 7 (and the preceding title 'Related Accounting Literature') of TR 16, *Implementation Guidance for Internal Use Software*.

11. This paragraph amends Technical Release 16, paragraph 8, by revising the last sentence as follows: "This TR clarifies but does not change guidance provided in SFFAS 4, 5, 6 (as amended), or 10.~~, and 35.~~"

The revised paragraph 8 of TR 16 is:

Readers of this Technical Release (TR) should first refer to the hierarchy of accounting standards in Statement of Federal Financial Accounting Standards (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*. This TR supplements the relevant accounting standards but is not a substitute for and does not take precedence over the standards. This TR clarifies but does not change guidance provided in SFFAS 4, 5, 6 (as amended), or 10.

EFFECTIVE DATE

12. This Technical Release is effective upon issuance.

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

APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Committee members in reaching the conclusions in this Technical Release. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The guidance enunciated in this Technical Release–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

This Technical Release may be affected by later Statements or other pronouncements. The Handbook is updated annually and includes a status section directing the reader to any pronouncement that changed this Technical Release. Within the text of the Technical Release, the guidance sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statements or other pronouncements for the rationale for each amendment.

PROJECT HISTORY

A1. SFFAS 50, *Establishing Opening Balances for General Property, Plant, and Equipment: Amending Statement of Federal Financial Accounting Standards (SFFAS) 6, SFFAS 10, SFFAS 23, and Rescinding SFFAS 35*, was issued August 4, 2016. SFFAS 50 amended several Statements and rescinded SFFAS 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23.*

A2. As a result of these amendments and rescission, all standards-level implementation guidance for general PP&E, with the exception of specific provisions applicable to internal use software, now resides in SFFAS 6, *Accounting for Property, Plant, and Equipment* (as amended). The Board concluded that providing implementation guidance for general PP&E other than internal use software in SFFAS 6 provides a comprehensive guide for users in a single Statement.

A3. During the due process of SFFAS 50, exposure draft respondents expressed concern about the rescission of SFFAS 35. These respondents relied on the guidance it provided and worried about audit issues that might result upon its rescission. TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*, remains in effect regardless of these amendments. In addition, each significant provision of SFFAS 35 was incorporated in the amendments of TR 13, 15, and 16—including the ability to use estimates in the future.

A4. Comments received during due process made it apparent that users rely on the technical guidance provided in TR 13 when developing reasonable estimates. Further, TR 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*, provides illustrations and implementation guidance related to recognition requirements for programmatic, managerial, administrative, and other elements

of program costs incurred during the general PP&E lifecycle, as well as decisions regarding the granularity of cost information and acceptable methods for recognizing those costs.

AMENDMENTS TO EXISTING TECHNICAL RELEASES

A5. It was appropriate to update previously issued TRs to acknowledge the rescission of SFFAS 35 and that all standards-level implementation guidance for general PP&E (with the exception of certain provisions applicable to internal use software) resides in SFFAS 6 (as amended).

A6. The conforming amendments apply to the following documents:

- Technical Release 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
- Technical Release 15, *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation*
- Technical Release 16, *Implementation Guidance For Internal Use Software*

A7. The Committee believed it appropriate to amend relevant sections of the TRs that discussed SFFAS 35 and other sections that referenced implementation guidance for general PP&E. The Committee removed language (from areas such as the introduction and background) because of the lengthy discussion and reference to the rescinded SFFAS 35 and portions of amended Statements. The Committee believed allowing the paragraphs to remain would be inconsistent with current GAAP references and lead to potential misapplication of the technical guidance.

A8. SFFAS 50 allows a reporting entity, under specific conditions, to apply alternative valuation methods in establishing opening balances for general PP&E. A separate TR will be issued that addresses SFFAS 50 implementation issues associated with the alternative methods of arriving at deemed cost.

APPENDIX B: ABBREVIATIONS

AAPC	Accounting and Auditing Policy Committee
CFOC	Chief Financial Officers' Council
CIGIE	Council of the Inspectors General on Integrity and Efficiency
FASAB	Federal Accounting Standards Advisory Board
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
G-PP&E	General Property, Plant, and Equipment
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
TR	Technical Release

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