U.S. Department of Housing and Urban Development

Office of the Chief Financial Officer

Special Attention of:

OCFO Accounting

Transmittal for Handbook No.: 1980.1, Chapter 5

Issued: September 6, 2016

1. **This Transmits**:

Revision of 1980.1 Accounting Policies Handbook, Chapter 5: Goods and Services Received but Not Invoiced and the addition of Appendix 10: Goods and Services Received but Not Invoiced Procedures and Responsibilities.

This revision and addition reflect changes in policy and procedure necessitated by the use of Treasury's Accounting Resource Center (ARC) as the Shared Service Provider for HUD. The appendix identifies the responsibilities and procedures pertaining to this document and may be updated as needed.

Distribution: W-3-1

U.S. Department of Housing and Urban Development

Office of the Chief Financial Officer

Special Attention of:
OCFO Accounting

Transmittal for Handbook No.: 1980.1, Chapter 4

Issued: July 28, 2016

1. **This Transmits**:

Revision of 1980.1 Accounting Policies Handbook, Chapter 4: Purchase Card Accrual Policies and the addition of Appendix 9: Purchase Card Accrual Procedures and Responsibilities.

This revision and addition reflect changes in policy and procedure necessitated by the use of Treasury's Accounting Resource Center (ARC) as the Shared Service Provider for HUD. The appendix identifies the responsibilities and procedures pertaining to this document and may be updated as needed.

Distribution: W-3-1

Accounting Policies Handbook

Directive Number: **1980.1**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000

OFFICE OF THE CHIEF FINANCIAL OFFICER

Special Attention of:

Transmittal: Handbook 1980.1, Change 3
Issued: June 13, 2016

1. This Transmits:

Change 3 of Handbook 1980.1, *Accounting Policies Handbook*. It includes the Table of Contents, Chapter 7, *Accounting for General Property, Plant, and Equipment (PP&E)*, Appendix 1, *Definitions*., and Appendix 3, *SFFAS 6, Accounting for Property, Plant, and Equipment*.

2. Explanation of Changes:

The Accounting Policies Handbook was initially established with one chapter on Consolidated Statements, but it was always envisioned as encompassing other policies related to accounting activities. This handbook focuses on policies requiring accrual estimates, write-offs, eliminations, depreciation, amortization, and other accounting entries required by GAAP and not ordinarily triggered by a transaction or award.

The HUD Office of the CFO maintains ledgers for General PP&E assets in accordance with the FASAB standard SFFAS 6, *Accounting for Property, Plant, and Equipment*, which guides HUD's recording and reporting of capital assets and depreciation (or amortization if appropriate) expenses for those assets.

The need for this policy arises in recognition of the importance of having a clear, accessible policy that assigns responsibility for internal control and enforcement.

3. Filing Instructions

This is a new chapter within Handbook 1980.1. This transmittal should be placed prior to the transmittal of Change 2 of the Handbook. New versions of the Change 2 transmittal, the Change 1 transmittal, and the original Transmittal should be inserted in place of the existing Change 2, Change 1, and original Transmittals, in order to reflect the revised page numbers. In addition, a new Table of Contents replaces the existing Table of Contents at pages ii and iii. The new chapter, Chapter 7, should be inserted after Chapters 6. The revised

Appendix 1, *Definitions*, replaces the old Appendix 1, and the new Appendix 3*, SFFAS 6, Accounting for Property, Plant, and Equipment*, should be inserted at the end.

Accounting Policies Handbook

Directive Number: **1980.1**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000

OFFICE OF THE CHIEF FINANCIAL OFFICER

Special Attention of:

Transmittal: Handbook 1980.1, Change 2
Issued: September 2015

1. This Transmits:

Change 2 of Handbook 1980.1, *Accounting Policies Handbook*. It includes the Table of Contents, Chapter 1, *Overview and Authority*, Chapter 2, *Consolidated Statements*, placeholders for Chapters 3 and 5, Chapter 6, *Internal Use Software*, Appendix 1, *Definitions*, and Appendix 2, SFFAS 10, *Accounting for Internal Use Software*.

2. Explanation of Changes:

The Accounting Policies Handbook was initially established with one chapter on Consolidated Statements, but it was always envisioned as encompassing other policies related to accounting activities. Prior accounting handbooks have focused on the use of the financial systems HUDCAPS, LOCCS, etc. These handbooks will change as systems change. This handbook focuses on policies requiring accrual estimates, write-offs, eliminations, depreciation, and other accounting entries required by GAAP and not ordinarily triggered by a transaction or award.

In the audit of HUD's FY 2014 financial statements, the HUD OIG identified the need to develop and implement procedures requiring OCIO to provide timely and reliable information needed to accurately account for HUD's internal use software in accordance with SFFAS 10.

With the addition of this chapter on Internal Use Software, Handbook 1980.1 provides policy guidance for implementation of FASAB SFFAS 10, *Accounting for Internal Use Software*, which was first published in October 1998.

Chapters 1 and 2 and Appendix 1 were also modified to accommodate the addition of this new chapter. Other financial policies will be created and inserted into this handbook, and filing instructions will be provided as they are developed. Chapter 3 is reserved for insertion of HUD's Grant Accrual policy. Chapter 4 was recently added and incorporates the Purchase

Card Accrual policy. Chapter 5 is reserved for HUD's policy on Goods and Services Received but Not Invoiced.

3. Filing Instructions

This is a new chapter within Handbook 1980.1. This transmittal should be placed prior to the transmittal of Change 1 of the Handbook. In addition, a new Table of Contents replaces page ii as pages ii and iii. A revised Chapter 1, *Overview and Authority*, replaces the old Chapter 1. A revised Chapter 2, *Consolidated Statements*, replaces the old Chapter 2. Placeholders should be inserted for Chapters 3 and 5. The new chapter, Chapter 6, should be inserted after the placeholder for Chapters 5. The revised Appendix 1, *Definitions*, replaces the old Appendix 1, and a new Appendix 2, *SFFAS 10, Accounting for Internal Use Software*, is to be inserted after Appendix 1.

Special Attention of:	Transmittal: Handbook No: 1980.1, Chg 1
Nita Nigam Ann Butler	Issued: May 2015

1. This Transmits: Change 1 to Handbook 1980.1, Accounting Policies

2. Summary: Handbook CFO-14-004 has been updated and incorporated into this handbook.

3. The changes are:

    a. Clarifications of responsibilities by OCFO – Accounting staff in review, monitoring, and validation of accrual estimates.
    b. Formatting policy as Chapter 4 of CFO Handbook No. 1980.1.
    c. Handbook CFO-14-004, Accrual Policy - Purchase Card Expenses is superseded by Change 1 to Handbook 1980.1.
    d. See attached file (Changes in Purchase Card Accrual Policy from original) with edits highlighted in tracked changes.

4. Filing Instructions:

    Remove : Superceded Handbook CFO-14-004, Accrual Policy - Purchase Card Expenses issued January 2015.

    Insert in Handbook 1980.1, Accounting Policies:

Table of Contents	page ii	changed – May 2015
Purchase Card Accrual Policy	pages 4-1-4-2	changed – May 2015

Note: OCFO-Accounting staff perform all activities required in the policy. The Purchase Card Accrual Policy **does NOT require** any activities to be performed by any Program Office other than OCFO.

<u>Accounting Policies Handbook</u>

Directive Number: **1980.1**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-8000

OFFICE OF THE CHIEF FINANCIAL OFFICER

Special Attention of: Ginnie Mae FHA	Transmittal: Handbook 1980.1 Issued: October 2014

1. This Transmits:

Table of Contents, Chapter 1, *Overview and Authority*, Chapter 2, *Consolidated Statements*, and Appendix 1, *Definitions*, of Handbook 1980.1, *Accounting Policies*.

2. Explanation of Changes:

Previous accounting handbooks have focused on the use of the financial systems HUDCAPS, LOCCS, etc. These handbooks will change as systems change.

This handbook establishes internal policies related to the submission of financial data for producing financial statements. Financial information is submitted by means of a template produced by the Office of the Assistant CFO for Accounting, and provided to the component offices for reporting financial data.

Some components produce their own statements, as needed to inform their stakeholders, and those statements may not always reflect the requirements of the Federal Accounting Standards Advisory Board (FASAB) or the US Standard General Ledger (USSGL).

This policy anticipates the need for crosswalks and modifications of the data in order to ensure that the agency's financial statements are in full compliance with applicable standards.

3. Filing Instructions

This is a new handbook. Other financial policies will be created and inserted into this handbook, and filing instructions will be provided as they are developed.

TABLE OF CONTENTS

CHAPTER 1. OVERVIEW AND AUTHORITY

1-1 Background and Purpose

A. The Chief Financial Officers Act of 1990 (CFO Act) sought to bring more effective general and financial management practices to the Federal Government, to provide for improvement of systems of accounting, financial management, and internal controls in each agency of the Federal Government, and to provide for the production of complete, reliable, timely, and consistent financial information for use by the executive branch and the Congress in the financing, management, and evaluation of Federal programs.

B. The CFO Act empowers CFOs to develop and maintain an integrated agency accounting and financial management system, including financial reporting and internal controls, which complies with applicable accounting principles, standards, and requirements, and internal control standards.

C. The purpose of this handbook is to establish the policies and responsibilities of the Office of the CFO and of the component entities within HUD, especially with regard to the collection, maintenance, and reporting of financial data in a manner that complies with all applicable standards and guidance.

1-2 Scope

A. The scope of this policy includes all components of HUD that generate financial data maintained in financial systems and reported in HUD's Agency Financial Report (AFR) and in the *Financial Report of the United States*.

B. The three component systems that contribute to HUD's AFR include: the core financial systems managed by the Office of the CFO (OCFO), the Federal Housing Administration (FHA), and the Government National Mortgage Association (GNMA or Ginnie Mae). All program offices contributing financial data to these financial systems are responsible for compliance with the accounting policies contained in this handbook.

1-3 Related Legislation, Regulations, and Guidance

A. The CFO Act establishes the purpose and the authority of the CFO within all CFO Act agencies.

B. The Federal Accounting Standards Advisory Board (FASAB) was created in 1990, shortly after the enactment of the CFO Act. It is the body that promulgates generally accepted accounting principles (GAAP) for federal government entities.

C. The GMRA mandates that each executive agency prepare and submit an audited financial statement covering all accounts and associated activities of each office, bureau, and activity of the agency.

D. The United States Standard General Ledger (USSGL) provides a uniform set of accounts to standardize Federal agency accounting and to support the preparation of standard external reports. The USSGL identifies and defines budgetary, proprietary, and memorandum accounts to be used in agency financial systems. All agencies are required to comply with the USSGL at the transaction level.

E. The Office of Management and Budget (OMB) provides guidance to Federal agencies for compliance with financial reporting requirements. OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, and OMB Circular A-136, *Financial Reporting Requirements*, establish OMB's guidelines for tracking and reporting Federal financial activity.

F. The Department of the Treasury (Treasury) oversees the publication of the *Financial Report of the United States*. Guidance is provided in the Treasury Financial Manual (TFM), Volume 1, Part 2, Chapter 4700, Agency Reporting Requirements for the *Financial Report of the United States*. [I TFM 2-4700]

1-4 FHA and Ginnie Mae

A. FHA and Ginnie Mae are legislatively established entities under the HUD umbrella.

B. FHA administers a wide range of activities to make mortgage financing more accessible to the home-buying public and to increase the availability of affordable housing to families and individuals, particularly to the nation's poor and disadvantaged. FHA insures private lenders against loss on mortgages which finance single family homes, multifamily projects, health care facilities, property improvements, manufactured homes, and reverse mortgages.

1. Since FHA guarantees loans, it must adhere to the Federal Credit Reform Act of 1990. FHA collects premiums, earns interest on cash balances from Treasury, recovers funds from asset sales, and receives administrative appropriations. FHA also disburses payments for claims and property and operating expenses.
2. Due to FHA's complex accounting requirements, it is practical for FHA to use separate financial systems. FHA's principal financial statements are presented in conformity with GAAP for Federal agencies as promulgated by FASAB.

C. Ginnie Mae is a government corporation which facilitates the pooling of mortgage loans into Mortgage Backed Securities for the purpose of producing liquidity of capital within the mortgage markets. Ginnie Mae's financial systems are operated independent of HUD's other financial systems.

1. The basis of accounting used for the financial statements produced by Ginnie Mae for its stakeholders is that of the Financial Accounting Standards Board

(FASB), which uses commercial GAAP standards that are different from the FASAB produced GAAP.

2. Ginnie Mae has also implemented an additional accounting protocol that complies with the requirements of the USSGL for budgetary accounting.

1-5 Roles and Responsibilities

A. In accordance with the CFO Act, the HUD CFO (or the Deputy CFO, in the absence of the CFO) is responsible for establishing and enforcing the accounting policies and standards for HUD and its component entities. This is accomplished through the promulgation of handbooks such as this one and through procedural memos for offices and personnel within the OCFO.

B. The OCFO must ensure that all HUD financial systems are recording and maintaining financial data in a way that is consistent with government policies. This is a combined effort representing two offices within OCFO.

1. The OACFO for Systems provides assurance of the integrity of the financial systems and is responsible for maintaining and reporting on financial data for all financial activity occurring in HUD operations, other than financial activity conducted and maintained by FHA and Ginnie Mae. Financial reports are provided to the OACFO for Accounting by the financial systems managed by the OACFO for Systems.

2. The OACFO for Accounting distributes templates to component entities for financial statements and notes to ensure that financial data received from component entities are reported in the consolidated statements in a manner that complies with all standards and guidance applicable to Federal executive agency reporting.

C. The Housing-FHA Comptroller in FHA and the Chief Financial Officer for Ginnie Mae are responsible and accountable to the HUD CFO for ensuring that the financial data within and reported by those component entities are secure, accurate, and reportable in compliance with applicable government standards.

1-6 Exclusions

A. The stakeholder needs of Ginnie Mae may necessitate the production of statements that are based on standards other than those promulgated by FASAB, in order to meet the needs of the governing authorities for those entities. While separate and additional accounting structures are permissible, the funds are still federal funds and the standards of the USSGL must also be adhered to.

CHAPTER 2. CONSOLIDATED STATEMENTS

2-1 Background

A. The Government Management Reform Act of 1994 (GMRA) requires that federal agencies prepare audited consolidated financial statements for all activities. A consolidated financial statement presents the results of operations and the financial position of an entity and its component units as if the group were a single enterprise. The rationale behind preparing a consolidated statement for the Department is that it disregards the distinction between separate offices, thus preventing the overstatement of transactions and balances by virtue of the Department doing business within itself. Transactions that occur between or within program offices (intra-HUD transactions; e.g. transactions between FHA and Ginnie Mae, or between an office's Working Capital Fund and the appropriated fund) must be eliminated in the Department's financial statements to properly report the financial position and results of operations of the Department. The proper recording and reconciliation of intra-HUD transactions ensures that offices record the proper classification and amount for these transactions, and that the elimination entries for the Department's financial statements are complete and accurate.

B. Other adjustments, e.g., cost allocations and balance sheet payables and receivables, are also included in the preparation of the consolidated financial statements, though they are not transactional in nature.

C. One of the uses of the consolidated financial statements is by the Department of the Treasury in publishing the *Financial Report of the United States*. Treasury determines the reporting standards for agencies' submissions of audited financial statements.

2-2 Identifying USSGL Accounts for Intragovernmental and Intra-HUD Transactions

A. The OACFO for Accounting, Financial Reporting Division (FRD), is responsible for preparing the consolidated financial statements, using data received from the component entities.

1. FRD provides templates and instructions to all component entities for reporting financial data from those entities. This includes the OACFO for Systems, the FHA Controller, and the Ginnie Mae CFO.

2. Each component entity is required to identify intra-HUD transaction involving other HUD components (intra-agency transactions). Intra-HUD transactions are to be included in the Trial Balances submitted with the component entity's templates, even though they will be eliminated during preparation of the HUD consolidated statements.

3. In accordance with the Treasury Financial Manual (TFM) regarding intragovernmental transactions, each component entity is also required to identify transactions that accrue to other Federal entities (intra-agency transactions) and that will be eliminated during preparation of the *Financial Report of the United States*.

B. In accordance with the TFM, any material differences (over $100 million) between trading partners concerning the amounts of intra-agency transactions, after due diligence in attempting to reconcile, will be resolved through a dispute resolution process involving Treasury's Bureau of the Fiscal Service (formerly FMS).

C. HUD eliminations involving FHA and/or Ginnie Mae:

1. One elimination arises when FHA approves a claim filed by Ginnie Mae, but the claim has not been disbursed.

   a. The claims filed by Ginnie Mae occur when the loss mitigation process has been completed and the loans are deemed non-curable.

   b. Once FHA approves the claims, FHA establishes an intragovernmental payable (to Ginnie Mae), and Ginnie Mae establishes an intragovernmental receivable (from FHA).

   c. The amount of outstanding claims is provided to the FRD by both components on a quarterly basis.

   d. The respective balances are eliminated in HUD's consolidated statements.

2. Another elimination pertains to the Working Capital Fund (WCF) and amounts to be applied to WCF expenses from various appropriations accounts. The elimination posted in HUD's financial statements is based on the liquidation of advances posted in the WCF.

D. The FRD must retain records of all worksheets for the consolidation process, including applicable trial balances and crosswalks from component entity submissions, to support the validity of eliminations and to ensure compliance with federal accounting standards.

2-3 Identification of Non-Eliminating Adjustments

A. Adjustment relating to the valuation of Departmental assets and liabilities.

1. The assets associated with Ginnie Mae's FHA insured portfolio are valued at 100 percent of Unpaid Principal Balance (UPB), which is the value to Ginnie Mae.

2. At the consolidated Department level, the value of Ginnie Mae's assets is the estimated net recoverable amount for the Department. The allowance for these

assets is included in FHA's liability for loan guaranty (LLG) (claim disbursement plus recovery at asset disposition).

3. The corresponding balances are reclassified based on a Journal Voucher recorded in the Department's reporting module, Hyperion Financial Management (HFM).

4. The amount of FHA's LLG attributable to Ginnie Mae will also be reduced by the calculated allowance amount.

5. The formula for the calculation of these amounts will be based on cohort data supplied by Ginnie Mae and corresponding claim rates and loss rates supplied by FHA.

6. All worksheets supporting this reclassification are to be retained by FRD.

B. Adjustment for the cost allocation. Annually, a cost allocation is performed to determine FHA's costs attributable to salaries and expenses. FHA does not receive an appropriation for salaries and expenses; instead the FHA amounts are appropriated directly to HUD. In order to recognize these costs in FHA's Statement of Net Cost, a transfer from HUD is recorded based on amounts computed by HUD.

1. An interim Journal Voucher is posted in HFM to allocate Salaries and Expenses (S&E) costs based on estimates prepared by FHA on a quarterly basis.

2. The basis for the estimated amounts to be transferred is to be retained as a supporting document by FRD.

3. The actual cost allocation study is performed at year end based on FTE data and actual expenses reported in the Department's administrative funds. The cost allocation study factors the amount of S&E costs and other indirect costs that should be reflected in FHA's stand-alone financial statements.

2-4 Accounting Procedures

A. For Intragovernmental Transactions

1. Intragovernmental transactions are regulated through the TFM, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, and revisions contained in Bulletin 2013-04 and Bulletin 2014-03.

2. As needed, a separate HUD instruction from the FRD will be provided to HUD component entities to specify application of the TFM guidance.

3. In a mid-fiscal-year communication, FRD will request that each component entity identify activities that are likely to involve intragovernmental transactions during the fiscal year. FRD will use the responses to prepare the

schedules needed for eliminating intra-office and intra-HUD transactions from the consolidated financial statements.

B. For Journal Vouchers

1. For the Consolidated Balance Sheet reclassification pertaining to Ginnie Mae Loans Receivable and FHA Liability for Loan Guarantees, the Journal Voucher will be documented by worksheets provided by FHA showing all calculations from the balances in the Ginnie Mae cohorts as affected by FHA claims and loss rates, obtained from FHA records pertaining to those cohorts.

2. For HUD's cost allocation to FHA, FHA will provide worksheets showing the allocation methodology and percentages derived for each of the allocation amounts. The data will be maintained by the FRD as an integral component of the OCFO's cost allocation study performed at year-end.

3. The amount of outstanding Ginnie Mae claims with FHA is determined for year-end reporting purposes based on updated data from the FHA and the amount previously reversed in HFM to derive the amount of actual claims outstanding at year-end.

2-5 Changes in Financial Reporting

A. All component entities are required to notify the FRD, of any significant changes in the preparation of its financial statements, including the implementation of new federal accounting standards relevant for the fiscal year.

B. If required, the component entity must submit the new posting models at the transaction level and its impact on the component's chart of accounts to the FRD. If needed, the component entity will provide the appropriate trial balances and appropriate cross-walks to the component's financial statements used by the FRD in the consolidation process.

C. FRD will evaluate each submission to assure that Federal accounting standards are met and if necessary, will notify the component entity's management of the apparent deficiency. The FRD will work with the component entity and implement necessary corrections to ensure HUD's compliance with federal accounting standards.

D. In order to facilitate the dialogue between OCFO and HUD component entities, FRD will initiate and hold quarterly meetings with financial officers of component entities. The financial reporting processes identified in this handbook will be reviewed, including any known or planned changes. Reporting timelines will be verified and any modifications to methodologies will be reviewed.

CHAPTER 3. GRANT ACCRUAL POLICY

[reserved for Grant Accrual]

CHAPTER 4. PURCHASE CARD ACCRUAL POLICY

4-1 **Purpose:** The purpose of this chapter is to establish a policy for estimating and recording accruals for purchase card expenses in the Department of Housing and Urban Development (HUD). HUD's consolidated financial statements are presented on the accrual basis in accordance with generally accepted accounting principles (GAAP) established by the Federal Accounting Standards Advisory Board (FASAB). Under the accrual methodology, HUD recognizes revenues when earned and expenses when a liability is incurred, without regard to receipt or payment of cash.

4-2 **Background:** HUD uses the GSA SmartPay® Program, also known as the Government-Wide Purchase Card (GPC) Program, to pay for goods and services up to the micro-purchase threshold (as defined in Federal Acquisition Regulation subpart 2.101) through the use of a bank-issued, Government-sponsored credit card. The Payments and Collection Division in the CFO Accounting Center (CFOAC) is responsible for receiving and paying invoices from the servicing bank.

4-3 **Scope:** At the end of each accounting period, CFOAC is responsible to estimate and record an accrual to recognize GPC expenses which have been incurred, but not yet billed.

4-4 **Effective Date of This Policy:** September 2014. The policy will be reviewed annually and updated as needed.

4-5 **Responsibilities:**

A. On a quarterly basis, the Director of the Financial Reporting Division of OCFO Accounting (FRD Director) will review and validate the accrual methodology. The FRD Director will validate accrual estimates based on documentation submitted from CFOAC on a quarterly basis.

B. CFOAC will maintain an employee as a GPC user of the servicing bank's electronic access system with capability limited to generating and downloading reports from the electronic access system. The CFOAC user will have no authorization or capability to make purchases within the GPC system.

C. CFOAC will determine the billing cycle covered by the GPC invoice, which generally is a 30 day period ending on the 5th calendar day of the month of the accounting period for which financial statements are being prepared.

D. Assuming the preceding billing cycle example, CFOAC will generate a GPC report to determine the GPC expenses that have been incurred from the 6th calendar day of the accounting period through the end of the accounting period (end of month).

E. CFOAC will prepare the following entries to recognize the GPC expenses which have been incurred, but not included in the latest GPC invoice.

1. A journal voucher (JV) will be prepared using a Transaction Type and Transaction Code (TT/TC) of SV/S5. The posting model for this is:

   Dr 3107 Unexp Appropriations-Used
   Dr 480C Undel Ords-Oblig Unpd-Accrual
   Dr 6100 Operating/Program Expenses

   Cr 5701 Expended Appropriations
   Cr 490C Del Ord-Oblig Unpaid Accrual
   Cr 211C Accounts Payable-Accrual

F. The JV will be broken down by Budget Fiscal Year and Fund using the standard Division of "CFO", Vendor Code of "MISC", Program/BOC of "2500" and Budget Organization of "F".

G. CFOAC will submit the JV to the CFOAC Supervisor for review and approval.

H. After review and approval by the CFOAC Supervisor, CFOAC will record the JV in HUDCAPS. Note: This JV will be posted as a "reversing" entry in HUDCAPS and will automatically be reversed in the new accounting period. A HUDCAPS feature on the header page of the accounting entry in the "Reversal Period" field ensures this is done automatically.

I. CFOAC is responsible to maintain adequate documentation to support the purchase card accrual.

4-6 Purchase Card Accrual Methodology

A. The purchase card accrual methodology is based upon the accuracy and timely availability of reports within the servicing bank's electronic access system. A key assumption in this methodology is a reliance on a capability of the electronic access system to capture and generate reliable reporting on purchase card expenses that have been incurred, but not billed.

4-7 Monitoring

A. The GSA Smart Pay Program monitors servicing banks and their systems.

B. In addition, on a monthly basis, CFOAC will compare the accrual estimate recorded in the prior month to the actual expenses billed in the monthly invoice. CFOAC will submit the comparison and the accrual estimates for that quarter end period to the FRD Director for validation on a quarterly basis. CFOAC will adjust the methodology as needed.

C. On a quarterly basis, the FRD Director will review and validate the accrual methodology.

CHAPTER 5. GOODS AND SERVICES RECEIVED BUT NOT INVOICED

5-1 **Purpose:** The purpose of this document is to establish a policy for estimating and recording accruals for goods and services received but not invoiced in the Department of Housing and Urban Development (HUD). HUD's consolidated financial statements are presented on the accrual basis in accordance with federal Generally Accepted Accounting Principles (GAAP) established by the Federal Accounting Standards Advisory Board (FASAB). Under the accrual methodology, HUD recognizes revenues when earned, and expenses when a liability is incurred, without regard to receipt or payment of cash.

5-2 **Background:** HUD records goods and services received but not invoiced on an accrual basis, in keeping with federal GAAP. The Bureau of the Fiscal Service's Accounting Resource Center (ARC) is the shared service provider responsible for processing and recording accrual transactions, as described in the Service Level Agreement (SLA) with HUD. HUD's Office of the Chief Financial Officer's (OCFO) Accounting Center (CFOAC) is responsible for computing and providing these accrual transactions to ARC for processing.

5-3 **Scope:** This policy applies to HUD's process for recording goods and services received but not invoiced. At the end of each quarter period, CFOAC is responsible for estimating and recording accruals to recognize expenses related to goods and services received but not invoiced.

5-4 **Effective Date of This Policy:** August 2016. The policy will be reviewed annually and updated as needed.

5-5 **Responsibilities:** Itemized procedures and responsibilities will be maintained separately by OCFO. These procedures will be reviewed annually and updated as needed. (See Appendix 10)

5-6 **Goods and Services Received but Not Invoiced Accrual Methodology:** The goods and services received but not invoiced accrual methodology is estimated based on available data.

5-7 **Monitoring:**

A. The goods and services received but not invoiced accrual methodology is monitored and evaluated for adequacy on an ongoing basis by the CFOAC.

B. On a periodic basis, CFOAC will compare the accrual estimate recorded in the prior year versus the expenses paid. CFOAC will adjust the methodology as needed.

CHAPTER 6. ACCOUNTING FOR INTERNAL USE SOFTWARE

6-1 Background

A. FASAB's Statement of Federal Financial Accounting Standards (SFFAS) 10, *Accounting for Internal Use Software*, published on October 9, 1998, modified an earlier standard, SFFAS 6, *Accounting for Property, Plant, and Equipment (PP&E)*. SFFAS 6 had prohibited the capitalization of the cost of internally developed software, unless management intended to recover the cost through user charges, and the software was to be used as general PP&E. The new standard (SFFAS 10) classified internal use software as PP&E, including software used to operate a federal entity's programs and software used to produce the entity's goods and services.

B. Internal use software can be purchased off-the-shelf from commercial vendors (COTS), developed by contractors with little technical supervision by the federal entity, or developed internally by the federal entity. SFFAS 10 requires the capitalization of the cost of internal use software whether it is COTS, contractor-developed, or internally developed.

C. SFFAS 10 provides guidance regarding the definition of software (see Appendix 1 of this policy), the phases of software development, the types of cost elements to be capitalized, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

6-2 Responsibilities

A. Except for internal use software owned by Ginnie Mae, the Director of the Financial Reporting Division (FRD), Office of the Assistant Chief Financial Officer for Accounting (OACFO-Accounting), is responsible for:

1. Assuring that the Office of the Chief Information Officer (OCIO) provides FRD with an allocation plan that a) identifies funding and staffing resources committed for the development of internal use software, b) determines the implementation timing for internal use software being developed, c) establishes the useful life of software and the net realizable value (if any), and d) determines the occurrence of and assigns value for enhancement or impairment of internal use software;

2. Obtaining from OCIO at least annually documentation of rules and assumptions regarding cost allocations, implementation dates, useful life, net realizable value, and enhancements and impairments;

3. Assuring that the OCIO allocation plan is updated at least annually and that the plan complies with SFFAS 10 and other applicable generally accepted accounting principles (GAAP);

4. For software being acquired as part of a capital lease, in addition to the accounting requirements of SFFAS 5 and SFFAS 6, assuring that the amortization of the leased software is performed in accordance with SFFAS 10, assuming the software cost meets the threshold of materiality.

5. Establishing applicable accounts and initiating the corresponding accounting entries to assure that HUD's financial reports comply with the amortization requirements of SFFAS 10 and any other applicable GAAP;

6. Updating records quarterly with data from financial transactions related to the development or acquisition of internal use software, in accordance with the allocation plan provided by OCIO;

7. Obtaining certification from OCIO that the transactions identified are as stated in the allocation plan;

8. Providing the journal entry with supporting documentation to the Fort Worth Accounting Center for entry into HUD's financial system;

9. Maintaining accounts and supporting documentation for accounting entries made pursuant to this policy; and

10. Working with the Property Management Branch (PMB), Office of Administration, to reconcile the a) pre-operational costs, b) full costs, c) materiality threshold, d) implementation date, e) useful life, f) amortization amount, g) amounts for enhancements and impairments, and h) disposal and net realizable value of internal use software records being maintained by PMB.

B. Except for internal use software owned by Ginnie Mae, the Office of the Chief Information Officer (OCIO) is responsible, in consultation with the FRD, OACFO-Accounting, as follows:

1. Providing FRD with an allocation plan that identifies funding and staffing resources for each software development project. OCIO is responsible for updating the allocation plan at least annually and for notifying FRD immediately of any changes in the allocation plan and the reasons for the change.

2. On a quarterly basis, confirming with FRD the application of the allocation plan to the internal use software development transactions occurring during that month.

3. As originators of IT contracts that may involve the acquisition or development of internal use software belonging to HUD, OCIO will work with OCPO within the constraints of the Federal Acquisition Regulations to identify the contracts or sections of contracts intended to produce internal use software.

4. For leased software, determining whether the lease is an operating lease or a capital lease. For software being acquired as part of a capital lease, the capitalization of the leased software is in accordance with this policy, assuming the software cost meets the threshold of materiality.

5. Determining the timing of implementation, useful life, net realizable value (if any), and enhancement and impairment information of the software;

6. Providing that information to the FRD and to the PMB; and

7. Certifying that the information provided complies with this policy.

C. Except for internal use software owned by Ginnie Mae, PMB is responsible, in consultation with the FRD Director, for maintaining records for internal use software reflecting pre-operational development and acquisition costs, full costs upon implementation, date of implementation, useful life, amortization period, enhancements, impairments, and disposal. PMB is to reconcile capitalization and amortization information with the OCFO FRD on a monthly basis.

D. Ginnie Mae, a government corporation, is responsible for identifying, recording, amortizing and accounting for Ginnie Mae owned software in accordance with both FASB and FASAB accounting standards. Ginnie Mae's financial statements are consolidated with HUD's.

6-3 <u>Determination of Cost</u>

A. FASAB defines the system development phases of internal use software as:

1. Preliminary Design Phase,

2. Software Development Phase, and

3. Post-Implementation or Operational Phase.

B. Capitalizable costs include:

1. For internally developed software, capitalized cost should include the full cost (direct and indirect) incurred during this phase. This amount should be limited to costs incurred after:

   a. Management authorizes and commits to a computer software project, 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 during an estimated service life of 2 years or more, and

b. The completion of the conceptual formulation, design, and testing of possible software project alternatives, which are part of the preliminary design phase.

2. Costs for new software (e.g., salaries for programmers, systems analysts, project managers, and administrative personnel; associated employee benefits; outside consultants’ fees; rent; and supplies) and documentation manuals.

3. For COTS software, the amount paid to the vendor for the software.

4. For contractor-developed software, the amount paid to the contractor to design, program, install, and implement the software.

5. Material internal costs incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use.

6. The cost of software that serves both internal and stewardship purposes.

7. The collective cost for bulk purchases of software programs and modules or components of a total software system, for which federal entities have established threshold and guidance showing that period cost would be distorted or asset values understated by expensing the purchase of numerous copies or components of the software system.

8. Acquisition cost of enhancements to existing internal use software and modules thereof, when it is more likely than not that the enhancements will result in significant additional capabilities.

9. For bundled products and services, federal entities should allocate the capitalizable and noncapitalizable costs of the package among individual elements on the basis of a reasonable estimate of their relative fair values.

10. Exclusions:

    a. Data conversion cost;

    b. Costs incurred after final acceptance testing has been successfully completed at each site where the software is to be installed;

    c. For bundled products and services, costs that are not susceptible to allocation between maintenance and relatively minor enhancements;

    d. The cost of minor enhancements resulting from ongoing systems maintenance (the purchases of enhanced versions of software for a nominal charge are properly expensed in the period incurred);

    e. Cost incurred solely to repair a design flaw or to perform minor upgrades that may extend the useful life of the software without adding capabilities; and

f. Computer software that is integrated into and necessary to operate general PP&E, rather than to perform an application (such software should be considered part of the PP&E of which it is an integral part and should be capitalized and depreciated accordingly).

C. Impairments

1. If OCIO becomes aware that the capabilities, functions, or uses of operational software have become significantly reduced, or if the software is no longer expected to provide substantive service potential and will be removed from service:

   a. The amount of impairment must be determined by OCIO, in consultation with and for approval by the FRD Director, in accordance with SFFAS 10.

   b. The timing and amount must be reported to the FRD and to the PMB in the Office of Administration (OA).

   c. For software that will be removed from use, OCIO must also determine and report the Net Realizable Value (NRV), if any, so that the amount of the loss can be recognized and the NRV transferred to an appropriate asset account by the FRD, via an adjusting entry made by the FWAC, until the software is removed and sold or disposed of.

2. For developmental software, if OCIO concludes that it is no longer more likely than not that the software (or a module thereof) will be completed and placed into service, this conclusion should be reported to the FRD and to the PMB, and the accumulated book value should be reduced to reflect the expected NRV, if any. These amounts should be reported to the FRD, and the loss should be recognized.

D. Amortization

1. OCIO shall, in consultation with the FRD Director, determine the useful life of the software in a systematic and rational manner. The estimated useful life used for amortization should be consistent with that used for planning the software's acquisition.

2. Amortization of each module or component of a software project should begin upon successful testing. OCIO is responsible for notifying the FRD Director and PMB when that testing is complete, marking the date of implementation for that software. For modules that are dependent on completion of other modules, amortization should begin when both modules have successfully completed testing.

3. OCIO should notify the FRD Director and PMB of any additions to the book value or changes in the useful life of software. No adjustments should be made

by FRD to previously recorded amortization; all changes shall be made prospectively.

E. Disclosures

1. OCIO should provide FRD with sufficient documentation to report material changes to the consolidated balance sheet and other required financial statements.

2. With regard to software as part of the general PP&E for HUD, FRD should disclose amounts related to the following categories in the financial statements:

   a. Cost, associated amortization, and book value,

   b. Estimated useful life for each major class of software, and

   c. Method of amortization.

6-4 Financial Reporting

A. Internal control

1. The FRD Director will assure that accounting entries related to internal use software are in compliance with SFFAS 10 and GAAP.

2. The FRD Director will review at least annually the assumptions and processes provided by OCIO reflecting the practices and determination by that office of costs associated with developing and implementing internal use software.

B. The FRD will prepare entries to record the various events that occur in the life cycle of software development, implementation, removal, and disposal, based on information received from the OCIO. Those entries will subsequently be entered into the HUD accounting system by the Fort Worth Accounting Center.

1. Allocation of costs to Internal Use Software in Development

   a. Assuming overhead costs have been placed in an Applied Overhead account

   b. Debit: Account 1832 Internal-Use Software in Development
      Credit: Account 6600 Applied Overhead
      Credit: Account 6610 Cost Capitalization Offset

2. Upon moving development software into production

   a. Moves appropriate amounts from Work In Progress to Asset account

   b. Debit: Account 1830 Internal-Use Software
      Credit: Account 1832 Internal-Use Software in Development

3. Amortization of capitalized software costs

a. Amortization begins when projects are moved from Work In Progress to Asset account

b. Debit: Account 6710 Depreciation, Amortization, and Depletion
   Credit: Account 1839 Accumulated Amortization on Internal Use Software

4. Impairments

a. To record the write-off of assets (other than investment)

b. Debit: Account 7210 Losses on Disposition of Assets - Other
   Debit: Account 1839 Accumulated Amortization on Internal Use Software
   Credit: Account 1830 Internal Use Software
   Credit: Account 1832 Internal Use Software in Development

5. Enhancements

a. To record added capabilities due to enhancements

b. Debit: Account 1830 Internal Use Software
   Credit: Account 1010 Fund Balance with Treasury

6. Removal of software from production

a. To recognize the removal of software from production, i.e., no longer being utilized

b. For a loss:
   Debit: Account 1839 Accumulated Amortization on Internal Use Software
   Debit: Account 7210 Losses on Disposition of Assets - Other
   Credit: Account 1830 Internal Use Software
   Credit: Account 3310 Cumulative Results of Operations

c. For a gain:
   Debit: Account 1839 Accumulated Amortization on Internal Use Software
   Debit: Account 3310 Cumulative Results of Operations
   Credit: Account 1830 Internal Use Software
   Credit: Account 7110 Gains on Disposition of Assets - Other

7. Sale of modules or components upon retirement of software

a. In addition to the accounting entries above, for retirement of software, if the software is considered to have a Net Realizable Value (NRV), an account is created to represent the software as a surplus asset to be sold.

b. At time of retirement
Debit: Account 1522 Inventory Held in Reserve for Future Sale (NRV)
Credit: Account 1830 Internal Use Software

c. At time of sale
Debit: Account 1110 Undeposited Collections
Credit: Account 1010 Fund Balance with Treasury

Debit: Account 5100 Revenue from Goods Sold
Credit: Account 1522 Inventory Held in Reserve for Future Sale

6-5 Implementation

A. This policy will become effective upon approval and publication. It is to be applied for all internal use software in development or in operation during the fiscal year in which it is approved. The following paragraphs pertain to the first time implementation of this policy.

B. Materiality

1. Because materiality is connected to other amounts reported in the financial statements, the materiality threshold for internal use software will be established by the FRD in accordance with the standards set for internal use software assets attributed to HUD.
2. Software costs that do not reach the materiality threshold will be expensed.
3. Projected acquisition costs can be used to help determine materiality. However, for cases near the threshold, it may be necessary to track the developmental costs over a period of time until the full cost is known.

C. Existing Operational Software

1. OCIO will assemble an inventory of operational software showing expected remaining useful life and NRV, if any.
2. For operational software for which some of the costs have already been capitalized, this policy should be applied to any unamortized costs.
3. For all existing operational software, the provisions of this policy with regard to enhancements and impairments will apply.

D. Developmental Software

1. OCIO will assemble an inventory of software currently being developed or acquired showing projected costs, projected implementation date, projected useful life, and estimated costs incurred, both prior to this fiscal year and during this fiscal year.

2. The FRD Director will determine the most suitable method for establishing amounts for capitalization and amortization of existing software and software in development so as to provide the most accurate accounting possible for the associated accounts. Assumptions made in order to make this determination will be reflected in the notes to the financial statements.

CHAPTER 7. ACCOUNTING FOR GENERAL PROPERTY, PLANT, AND EQUIPMENT (PP&E)

7-1. Background

A. The primary FASAB policy governing accounting standards for Property, Plant, and Equipment (PP&E) is SFFAS 6, *Accounting for Property, Plant, and Equipment*. Initially published in November of 1995, it has been modified several times, generally to provide refinements or implementation guidance.

B. The addition of SFFAS 10, *Accounting for Internal Use Software*, modified SFFAS 6 by incorporating internal use software, including software developed internally by an agency, as a category that is to be treated as part of PP&E.

C. PP&E is defined as tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity (see Appendix 1, *Definitions*). (The Capitalization Threshold is covered in Section 7-3.B.)

D. The three categories of PP&E include:

1. General PP&E, used to provide general government services or goods;
2. Heritage assets, possessing significant educational, cultural, or natural characteristics; and
3. Stewardship land, land that is not included in general PP&E.

E. This policy pertains to the accounting for general PP&E, which consists of items that:

1. Could be used for alternative purposes but are used by HUD to produce goods or services, or to support HUD's mission;
2. Are used in business-type activities; or
3. Are used in activities whose costs can be compared to other (Federal or non-Federal) entities.

F. General PP&E includes land acquired for or in connection with other general PP&E.

7-2. Responsibilities

A. Office of the ACFO-Accounting

1. Accounting Center (formerly the Fort Worth Accounting Center)

    a. The Accounting Center is responsible for maintaining auditable asset and depreciation accounts for general PP&E other than Internal Use Software (IUS).

b. The Accounting Center is responsible for reconciling account balances monthly with the Office of Administration, Property Management Branch (PMB), which tracks capital assets and maintains inventory and depreciation records for planning and accountability purposes. The Accounting Center will also reconcile with those offices that have acquired the assets, as needed.

c. The Accounting Center is responsible for creating monthly journal vouchers to reflect depreciation expenses for general PP&E.

2. Financial Reporting Division (FRD)

a. The FRD is responsible for maintaining auditable asset and amortization accounts for Internal Use Software (IUS), as described in the HUD Accounting Policies Handbook, Chapter 6, *Accounting for Internal Use Software*.

b. FRD verifies and certifies HUD's financial statements produced by ARC, including depreciation and amortization. FRD will provide instructions for program and support offices to submit financial data, as needed, for inclusion in the consolidated statements.

B. Office of the CFO, New Core contract with Department of the Treasury, Bureau of Fiscal Service, Administrative Resource Center (ARC)

1. ARC is responsible for entering transaction data into the core financial system from journal vouchers created by the FRD and the Accounting Center and for maintaining auditable information.

2. ARC is also responsible for making transaction data available to the Accounting Center in formats suitable for tracking and reporting account balances.

3. ARC prepares the financial statements, which are to be verified and certified by FRD.

C. Office of Administration, Property Management Branch (PMB)

1. The PMB is responsible for tracking all of HUD's PP&E, above a predetermined threshold, including historical cost, useful life, enhancements, impairments, discontinuance, and disposal. This tracking is for inventory and planning purposes.

2. The PMB also tracks Internal Use Software (IUS), based on information provided by the Office of the Chief Information Officer (OCIO), which is the responsible office for Internal Use Software.

3. PMB is responsible for reporting to the Accounting Center any changes in the use or value of general PP&E assets reported by the responsible program or support office so that the carrying value of the capital asset can be adjusted accordingly.

4. PMB will reconcile capital assets monthly with the Accounting Center.

D. HUD Program and Support Offices

1. For every HUD office acquiring any item, either through acquisition, lease, or financing, that falls into the category of general PP&E as defined above (not including Internal Use Software) and in Appendix 1, *Definitions*, the Allotment Holder or other responsible official shall ensure that the correct Budget Object Classification (BOC) code is used for all financial activity related to the acquisition of that item, in accordance with this policy.

2. If any office requires clarification concerning which codes apply, the Accounting Center will provide the necessary codes.

3. The acquiring office will notify the PMB of the planned acquisition at the time that budgeted funds are committed during the acquisition process. This can be accomplished through utilizing the proper BOC codes. The PMB will obtain other information from the acquiring office in order to satisfy their responsibilities for tracking and maintaining an inventory of assets.

4. In conjunction with this policy and in consultation with the Accounting Center, the acquiring office will establish the category and unit of general PP&E to be acquired.

5. Upon completion of the acquisition, the acquiring office must notify both the Accounting Center and the PMB of the date of completion. The PMB may also require additional information concerning the location and custodial responsibilities for the acquired asset.

E. Ginnie Mae

1. Ginnie Mae has separate authority and a separate financial system.

2. To the extent that Ginnie Mae acquires capital assets that are classified as general PP&E, Ginnie Mae must include those assets on its balance sheet and show depreciation as an expense.

3. Ginnie Mae must provide to the Accounting Center a description of the business process used, including the internal controls in place, for identifying and tracking general PP&E and depreciation.

F. FHA

1. FHA has separate authority and a separate financial system for certain types of transactions. However, FHA has not acquired any general PP&E through their separate authority.

2. FHA does not plan to acquire any general PP&E apart from the processes established by the HUD Office of the Chief Procurement Officer. No separate policy on general PP&E is needed for FHA. FHA has elected to be governed by this policy.

G. Office of the Chief Procurement Officer (OCPO)

1. OCPO conducts acquisitions for HUD program and support offices and oversees the use of HUD's acquisition system.

2. OCPO does not provide systems or procedures for tracking assets, since this function is performed by the Office of Administration, Property Management Branch.

3. OCPO is also not responsible for ensuring proper Budget Object Classification codes. The acquiring office is responsible for ensuring accurate coding and coordination of requirements prior to submission of requisitions.

7-3. <u>Identifying PP&E</u>

A. Categories of General PP&E

1. General PP&E includes:

a. Assets acquired through capital leases, including leasehold improvements

(1) The Program or Support Office initiating a lease will determine at the time of preparing the requisition for entering into the lease whether the lease could result in HUD ownership of general PP&E.

(2) In conjunction with the Accounting Center, the acquiring office must identify those costs associated with the capital lease that will be included in calculating the historical cost of the asset.

(3) The cost of PP&E acquired through a capital lease is equal to the amount recognized as a liability for the capital lease at its inception.

(4) This amount is equal to the net present value of the lease payments calculated as specified in the liability standard (see Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, unless the net present value exceeds the fair value of the asset).

b. Property owned by HUD in the hands of others:

(1) Others may include state and local governments, colleges and universities, or Federal contractors.

(2) Such property is part of PP&E. However, since property in this category is not being used by HUD in business-type activities, it is not part of general PP&E and is not included in this policy.

(3) HUD could have a reversionary interest in property purchased using grant funds. When the grant is closed out, if the property is still in possession by the grantee with no provision for disposing of the property, ownership could revert to HUD. Such property would be recorded upon receipt and would not be depreciated.

c. Land rights are not part of general PP&E and are not included in this policy. Land rights are interests and privileges held by HUD in land owned by others, such as:

(1) Leaseholds

(2) Easements

(3) Water and water power rights

2. Identifying the categories of general PP&E requires a determination of the base unit, or level of detail, against which the category definitions will be applied.

a. The acquiring office will make an initial determination of the base unit and provide the rationale to the Accounting Center.

b. The Accounting Center will review the initial determination made by the acquiring office and either approve or propose an alternative base unit, according to the effect the decision will have on the financial statements.

B. Capitalization Thresholds

1. Thresholds for the purpose of tracking general PP&E are determined by the PMB, in accordance with Federal regulations pertaining to property management.

2. The CFO is responsible for establishing the threshold for capitalization of general PP&E acquisitions. This threshold is based on the financial and operational conditions of the agency.

3. The CFO has determined that the capitalization threshold for general PP&E assets is $100,000, for single purchase items. For similar assets acquired as a lot or batch costing greater than $250,000, in which each item costs at least $5,000, the entire lot will be capitalized as though it were one asset, providing that the items in the lot meet the other qualifications for a general PP&E asset.

4. The Accounting Center will maintain documentation of threshold determinations and the justification and any methodologies used.

C. Acquisition of PP&E

1. Obligation

   a. Prior to the time of obligation, during the requisition, reservation, and commitment process, the acquiring office will use the Budget Object Classification (BOC) code 310901 for capitalized assets. In addition, the acquiring office will notify the PMB of the planned acquisition of a capital asset.

   b. The Accounting Center, through the accounting codes used for the acquisition, assure that the account established for the asset will aggregate associated acquisition costs.

   c. The Accounting Center will coordinate with PMB, and with the acquiring program office as needed, to establish the basis for the cost, useful life, and Net Realizable Value (NRV) for the asset. The useful life should be consistent with the projected useful life used to acquire the asset.

   d. Costs that will be included in the capitalization of the asset will be recorded in an asset account for that purpose with a corresponding offset account.

2. Asset Recognition

   a. The acquiring office will determine the date an acquired item of general PP&E is received, based on the terms of the acquisition contract.

   b. The acquiring office will notify the Accounting Center and the PMB of the date of acquisition and the location of the acquired item.

D. Enhancement and impairment of PP&E

1. Program requirements

   a. Program offices that have acquired general PP&E are responsible for identifying and reporting any enhancements or impairments that affect the useful life or the Net Realizable Value (NRV) of those assets.

   b. Program offices must report the enhancements or impairments to the PMB and to the Accounting Center. A valuation will be placed on the enhancement or impairment by the program office, and the rationale for the valuation will be provided to those offices.

2. Review requirements

   a. Each program office will conduct an annual review of all assets tracked by the PMB to establish that the asset is still physically present in the proper location and to determine whether any changes to the value of the asset have occurred that will affect the useful life or NRV.

   b. The results of the annual review will be provided to the PMB in a format specified by the PMB. PMB will notify the Accounting Center of any significant changes.

7-4. Establishing Cost of PP&E

A. Historical cost basis for asset recognition

1. When the goods have been delivered, the asset is recognized upon the receipt and payment of the vendor's invoice against the obligation line that contains the BOC code for capitalized assets; for example, 310901, Other Equipment – Capitalized.

2. Historical costs include the following expenditures:

   a. Amounts paid to vendors;

   b. Transportation charges to the point of initial use;

   c. Handling and storage costs;

   d. Labor and other direct or indirect production costs (for assets produced or constructed);

   e. Engineering, architectural, and other outside services for designs, plans, specifications, and surveys;

   f. Acquisition and preparation costs of buildings and other facilities;

   g. An appropriate share of the cost of the equipment and facilities used in construction work;

   h. Fixed equipment and related installation costs required for activities in a building or facility;

   i. Direct costs of inspection, supervision, and administration of construction contracts and construction work;

   j. Legal and recording fees and damage claims;

   k. Fair value of facilities and equipment donated to the government; and

   l. Material amounts of interest costs paid.

3. Establishing, recording, and reconciling costs

   a. The Accounting Center will assure that updates to this policy are made if there are any changes to the above list.

   b. For every capital purchase, including those expenditures that contribute to the historical cost of the asset, the acquiring office will assure that the proper BOC codes are used.

   c. The Accounting Center will reconcile historical costs with the PMB.

B. Estimating costs when historical cost is not identifiable

1. When historical cost is not identifiable, estimates may be based on:

   a. Cost of similar assets at the time of acquisition,

   b. Current cost of similar assets discounted for inflation since the time of acquisition, or

   c. Other reasonable methods, including methods specified in SFFAS 23, paragraph 12.

2. Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E asset has been in use relative to its estimated useful life.

3. Alternatively, the PP&E may be recorded at its estimated net remaining cost (original cost less accumulated depreciation to date), and depreciation/amortization charged over the remaining life based on the net remaining costs.

4. The methodology used for estimating costs must be approved by the Accounting Center, which shall retain a record of the methodology used.

7-5. <u>Determining Useful Life and Net Realizable Value</u>

A. Governmentwide standards or norms

1. The useful life and NRV for an acquired asset are determined by the acquiring office at the time of acquisition. The useful life estimate that is used for the acquisition process should be the same as the useful life used to determine the depreciation of amortization of the asset once it has been acquired.

2. The acquiring office must provide to the Accounting Center a justification if the determination is not in line with the useful life or the NRV for similar assets owned by HUD.

B. Documentation

1. The Accounting Center will maintain a record of submissions by the acquiring offices for all general PP&E acquired.

2. Methodologies for establishing useful life and NRV will be reviewed for consistency with the acquisition useful life or reasonableness, if different from the acquisition useful life, and retained by the Accounting Center.

7-6. <u>Discontinuance and Disposal</u>

A. Accounting for discontinuance

1. When a program or support office discontinues the use of a tracked general PP&E asset, the responsible official in that office must notify the PMB and the Accounting Center of the revised status of that asset.

2. The PMB will determine, based on information received from the notifying office, whether the asset will be retained for possible reactivation, transferred to another Federal office, treated as surplus for resale, or disposed of in another fashion. Future tracking of the asset by the PMB will be based on this revised status.

3. The PMB will assure that the Accounting Center has also been notified of the discontinuance and the future plans for the asset. PMB and the Accounting Center will coordinate and reconcile the book value of the asset and the basis for the future accounting treatment.

B. Accounting for disposal

1. For general PP&E assets that will be disposed of, the PMB will work with the office responsible for the asset to assure compliance with applicable Federal regulations for disposal of Federal property.

2. The date of disposal of the asset, the condition of the asset at the time of disposal, and any amounts of funds received at the time of transfer of the asset will be reported to the PMB.

3. Based on the BOC codes used for the disposal of the asset, the Accounting Center will prepare journal vouchers to reflect the disposal of the asset, with adjusting entries for accumulated depreciation, Net Realizable Value, funds received in exchange for the sale of the asset, and Net Cost of Operations.

4. The Accounting Center will retain a record of the asset from acquisition to disposal for a minimum of two years in order to assure that the financial statements reflecting the use of the asset are able to be audited.

7-7. Recording and Reporting PP&E

A. Records and documentation

1. The acquiring office will provide the PMB and the Accounting Center with documentation of cost, useful life, NRV, enhancements, impairments, discontinuance, and disposal of general PP&E assets.
2. The PMB will assure that the documentation provided by the acquiring office is satisfactory for the tracking requirements contained in Federal regulations pertaining to the inventory and protection of Federally owned assets.
3. The Accounting Center will assure that documentation provided by the acquiring office is adequate for all Federal GAAP and accounting standards.
4. The Accounting Center will maintain accurate records of determinations of cost, useful life, NRV, materiality, enhancements, impairments, discontinuance, and disposal for general PP&E.

B. The Accounting Center will prepare Journal Vouchers to reflect the acquisition, depreciation, enhancement, impairment, discontinuance, and disposal of general PP&E.

C. Reporting General PP&E

1. For each reporting period, the FRD will produce instructions and distribute a request for data to the Accounting Center, as needed, to capture financial information related to the acquisition, depreciation, enhancement, impairment, discontinuance, and disposal of general PP&E assets.
2. The Accounting Center will provide accurate data for the production of financial statements as required by the FRD, and reconciled with the records kept by the PMB.

APPENDIX 1: DEFINITIONS

Acquiring Office: the program or support office that seeks to acquire and ultimately receives the equipment. OCPO is a support office that provides acquisition services to other offices and would only become an acquiring office when acquiring equipment that is to be used by OCPO in support of its activities as a support office.

Budgetary Accounting: the system used to keep track of spending authority at various stages of budget execution, from appropriation through apportionment and allotment to obligation and eventual outlay.

Claim Rate: the ratio that expresses the historical percentage of insured loan amounts for which claims have been filed. This ratio is normally calculated for loans that originate in a given year.

Cohort: the group of loans that originate in a given year.

Component Entity: that part of a larger entity which can be distinguished by organizational or functional boundaries as separate from other parts of the larger entity.

Consolidated Financial Statements: present the transactions and balances for a reporting entity's components in a single column, with the amounts among the component entities eliminated.

Enhancements: an extension of the useful life of existing general PP&E or an enlargement or improvement of its capacity. Material enhancements for general PP&E should be capitalized, whereas, for IUS, only material expenditures that add capability or functionality would be capitalized. Those material costs that result in extending useful life or capacity of IUS would ordinarily be expensed.

General PP&E (see below for definition of Property, Plant, and Equipment): any PP&E 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.

Impairments: a significant and permanent decline in the service utility of general PP&E or of expected utility for construction work in progress. Such declines should not be considered if they are normal or ordinary, i.e., would have been expected or predictable at the time the it was acquired.

Internal Use Software: (from SFFAS 10, *Accounting for Internal Use Software*) software that is purchased from commercial vendors "off-the-shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs.

Intragovernmental Transaction: a transaction between governmental agencies in payment for goods or services provided and received.

Intra-HUD Transaction: an intragovernmental transaction in which HUD is both the providing agency and the recipient agency.

Liquidity of Capital: the ability and ease with which assets can be converted to capital for the purpose of reinvestment.

Loan Guarantee: in HUD, this is insurance to the mortgagee or lender that the outstanding loan amount will be paid, even if the mortgagor defaults on the loan.

Loss Rate: the ratio that expresses the historical percentage of claim amounts that have been paid. This ratio is normally calculated for claims filed against loans that originate in a given year.

Memorandum Accounts: supplemental USSGL accounts that are used for tracking and reconciling purposes.

Net Realizable Value (NRV): the total, non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion.

Pooling of Loans: a group of loans held in trust as collateral for the issuance of a security.

Property, Plant, and Equipment (PP&E): tangible assets, including land, that meet the following criteria:

- They have estimated useful lives of 2 years or more;
- They are not intended for sale in the ordinary coursof of operations; and
- They have been acquired or constructed with the intention of being used, or being available for use by the entity.

Proprietary Accounting: the same as financial accounting, used to record assets and liabilities not tracked in budgetary accounting and to present financial position and results of operations.

Reclassification: a Journal Voucher entry that adjusts account balances without a corresponding transaction in the accounting system.

Short Sales Claim: a claim made by the holder of a loan against the insurer for losses due to the short sale of the collateral property. A short sale occurs when a property is transferred to the mortgagee prior to foreclosure, usually without repayment of the mortgage by the mortgagor. This process allows the mortgagee to sell the property more quickly than if the mortgage had gone to foreclosure. The mortgagee may file a claim, if all other factors are in order, for any loss due to the short sale of the property.

Software: (from SFFAS 10, *Accounting for Internal Use Software*) the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program.

Unpaid Principal Balance (UPB): for loans owned by an entity, the total of the original principal amount of all loans, less any amounts of principal that have subsequently been paid.

Working Capital Fund (WCF): a financial instrument used to finance certain types of activity within an agency by transferring appropriated funds from component entities within the agency. Often the WCF is used to finance information technology (IT) projects and project maintenance.

Statement of Federal Financial Accounting Standards 10: Accounting for Internal Use Software

Status

Issued	October 9, 1998
Effective Date	For periods beginning after September 30, 2000
Interpretations and Technical Releases	None.
Affects	• SFFAS 10, paragraph 7, rescinds SFFAS 6, paragraphs 27-28, and provides a comprehensive standard for accounting for internal use software.
Affected by	• SFFAS 32 amends paragraph 35.

Summary

This statement provides accounting standards for internal use software. Under the provisions of this statement, internal use software is classified as "general property, plant, and equipment" (PP&E) as defined in Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*. This statement includes software used to operate a federal entity's programs (e.g., financial and administrative software, including that used for project management) and software used to produce the entity's goods and services (e.g., air traffic control and loan servicing).

Internal use software can be purchased off-the-shelf from commercial vendors and can be developed by contractors with little technical supervision by the federal entity or developed internally by the federal entity. SFFAS 6 specified treatment for internally developed software different from that for commercial off-the-shelf (COTS) software and contractor-developed software. SFFAS 6 addressed COTS and contractor-developed software generally, providing that they were "subject to its provisions."   On the other hand, specific provision was made for internally developed software.

SFFAS 6 prohibited the capitalization of the cost of internally developed software unless management intended to recover the cost through user charges, and the software was to be used as general PP&E. For capitalizable software, capitalization would begin after the entity completed all planning, designing, coding, and testing activities that are necessary to establish that the software can meet the design specifications.

At the conclusion of the PP&E project the Federal Accounting Standards Advisory Board discussed whether the standard for internally developed software should also apply to contractor-developed software. Also, some users of SFFAS 6 were unsure how to apply it to COTS and contractor-developed software. The Board decided, in December 1996, to review the issue and develop a separate standard for internal use software.

This standard requires the capitalization of the cost of internal use software whether it is 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 types of cost elements to capitalize, the timing and thresholds of capitalization, amortization periods, accounting for impairment, and other guidance.

Table Of Contents

Introduction

Purpose

1. This statement provides accounting standards for internal use software[1] used by federal entities. Federal entities purchase commercial "off-the-shelf" (COTS) software, 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).

Scope

2. This statement establishes accounting standards for the cost of software developed or obtained for internal use. These include the cost of

   - 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.

3. This statement provides standards on accounting for software consisting of one or more components or modules. For example, an entity may develop an accounting software system containing three elements: a general ledger, an accounts payable subledger, and an accounts receivable subledger. Each element might be viewed as a component or module of the entire accounting software system. This standard may be applied to the total cost of the software or, when appropriate, to individual components or modules. For example, one software module may be implemented before others, in which case, the provisions of this standard for capitalization, amortization, etc., would apply to it separately.

[1]The terms defined in the glossary will be in **boldface** when they first appear in the body of this document [see Appendix E, Consolidated Glossary]

Background

4. At the conclusion of the general property, plant, and equipment (PP&E) project, the Federal Accounting Standards Advisory Board (Board) discussed whether the standard for internally developed software should also apply to contractor-developed software. Also, some users of Statement of Federal Financial Accounting Standards (SFFAS) No. 6 were unsure of how to apply it to COTS and contractor-developed software. The Board decided in December 1996 to review the issue and develop a separate standard for internal use software.

5. In June 1997, the Board issued an exposure draft entitled *Accounting for Internal Use Software*. The Board received comments from 26 respondents and held a public hearing on December 18, 1997.

Materiality

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

Effective Date

7. The provisions of this statement are effective for reporting periods that begin after September 30, 2000. Paragraphs 27 and 28 of SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, which pertain to internally developed software, are rescinded upon this standard's issuance. Federal entities may continue their current accounting practices for internal use software for accounting periods beginning before October 1, 2000. Early implementation of this statement is encouraged.

Internal Use Software Accounting Standard

Definitions

8. Software includes the application and operating system programs, procedures, rules, and any associated documentation pertaining to the operation of a computer system or program. "Internal use software" means software that is purchased from commercial vendors "off-the-shelf," internally developed, or contractor-developed solely to meet the entity's internal or operational needs. Normally software is an integral part of an overall system(s) having interrelationships between software, hardware, personnel, procedures, controls, and data.

9. This definition of internal use software encompasses the following:

   a. Commercial off-the-shelf (COTS) software: COTS software refers to software that is purchased from a vendor and is ready for use with little or no changes.

   b. Developed software

      (1) Internally developed software refers to software that employees of the entity are actively developing, including new software and existing or purchased software that are being modified with or without a contractor's assistance.

      (2) Contractor-developed software refers to software that a federal entity is paying a contractor to design, program, install, and implement, including new software and the modification of existing or purchased software.

Software Development Phases

10. Software's life-cycle phases[2] 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.

11. The following table illustrates the various software phases and related processes. The steps within each phase of internal use software development may not follow the exact order

[2]There are no federal requirements regarding the phases that each software project must follow. The **life-cycle** phases of a software application described here are compatible with and generally reflect those in the Office of Management and Budget's (OMB) Circular A-130, *Management of Information Resources*, and *Capital Programming Guidance*; the Government Accountability Office's (GAO), *Measuring Performance and Demonstrating Results of Information Technology Investments* (*GAO/AIMD-98-89*, Mar. 1998); and the American Institute of CPA's Statement of Position No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (Mar. 4, 1998). Successful software projects normally would have at least an initial design phase, an application development phase, and a post-implementation/operational phase. Also, software eventually would become obsolete or otherwise be replaced and therefore have a termination phase. Circular A-130 acknowledges that the "life cycle varies by the nature of the **information system**. Only two phases are common to all information systems—a beginning and an end. As a result, 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).

shown below. This standard should be applied on the basis of the nature of the cost incurred, not the exact sequence of the work within each phase.

Preliminary design phase	Software development phase	Post-Implementation/ operational phase
Conceptual formulation of alternatives[3]	Design of chosen path, including software configuration and software interfaces[4]	Data conversion
Evaluation and testing of alternatives	Coding	Application maintenance
Determination of existence of needed technology	Installation to hardware	
Final selection of alternatives	Testing, including parallel processing phase	

12. In the *preliminary design phase*, federal entities will likely do the following:

    a. Make strategic decisions to allocate resources between alternative projects at a given time. For example, should programmers develop new software or direct their efforts toward correcting problems in existing software?

    b. Determine performance requirements (i.e., what it is that they need the software to do).

    c. Invite vendors to perform demonstrations of how their software will fulfill a federal entity's needs.

    d. Explore alternative means of achieving specified performance requirements. For example, should a federal entity make or buy the software? Should the software run on a mainframe or a client server system?

    e. Determine that the technology needed to achieve performance requirements exists.

    f. Select a vendor if a federal entity chooses to obtain COTS software.

    g. Select a consultant to assist in the software's development or installation.

13. In the *software development phase*, federal entities will likely do the following:

[3]See OMB Circular A-11, *Planning, Budgeting, and Acquisition of Capital Assets;* Supplement to Circular A-11, *Capital Programming Guide* (July 1997); and Circular A-109, *Major Systems Acquisitions*, par. 11, "Alternative Systems."

[4]See OMB Circular A-109, *Major Systems Acquisitions*, par. 13, "Full-Scale Development and Production."

a. Use a system to manage the project.

b. Track and accumulate life-cycle cost and compare it with performance indicators.

c. Determine the reasons for any deviations from the performance plan and take corrective action.

d. Test the deliverables to verify that they meet the specifications.

14. In the *post-implementation/operational phase*, federal entities will likely do the following:

a. Operate the software, undertake preventive maintenance, and provide ongoing training for users.

b. Convert data from the old to the new system.

c. Undertake post-implementation review comparing asset usage with the original plan.

d. Track and accumulate life-cycle cost and compare it with the original plan.

Recognition, Measurement, And Disclosure

Software Used As General PP&E

15. Entities should capitalize the cost of software when such software meets the criteria for general property, plant, and equipment (PP&E). General PP&E is any property, plant, and equipment used in providing goods and services.[5]

Capitalizable Cost

16. For internally developed software, capitalized cost should include the full cost (direct and indirect cost) incurred during the software development stage.[6] Such cost should be limited to cost incurred after

[5]General PP&E, as distinguished from **stewardship PP&E**, is defined in pars. 23-25, in SFFAS No. 6, *Accounting for Property, Plant, and Equipment*.

[6]For a full discussion of direct and indirect cost, see SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* (June 1995), pars. 90-92. Also see pars. 94-95, Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display.*

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 (the preliminary design stage).

17. Such costs 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.

18. For COTS software, capitalized cost should include the amount paid to the vendor for the software. 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.

Data Conversion Cost

19. All data conversion costs incurred for internally developed, contractor-developed, or COTS software should be **expensed** as incurred, including the cost to develop or obtain software that allows for access or conversion of existing data to the new software. Such cost may include the purging or cleansing of existing data, reconciliation or balancing of data, and the creation of new/additional data.

Cutoff For Capitalization

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.

Multiuse Software

21. The cost of software that serves both internal uses and stewardship purposes ("multiuse software") should be accounted for as internal use software (e.g., a global positioning system used in connection with national defense activities and general operating activities and services).

Integrated Software

22. 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.

Bundled Products And Services

23. 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 noncapitalizable 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.

Capitalization Thresholds

24. 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.

Enhancements

25. 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.

26. 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.

27. Cost 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.[7]

Impairment

POST-IMPLEMENTATION/OPERATIONAL SOFTWARE

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

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

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

30. If the impaired software is to be removed from use, the loss due to impairment should be measured as the difference between the book value and the net realizable value (NRV), if any.[8] The loss should be recognized upon impairment, and the book value of the asset reduced accordingly. The NRV, if any, should be transferred to an appropriate asset account until such time as the software is disposed of and the amount is realized.

[7]However, in instances where the useful life of the software is extended, the amortization period would be adjusted.

The Board has considered the cost associated with modifying internal use software for the year 2000 (Y2K) and has determined that such cost should be charged to expenses as incurred, since it is a repair of a design flaw that allows existing software to continue being used. However, an enhancement could presumably provide enhanced capabilities and at the same time, as an integral part of the new code and other software enhancements, cure the Y2K problem. The total cost of such an enhancement should be capitalized rather than allocated between the Y2K cost and all other cost.

[8]Presumably, NRV will be zero for software. However, in the rare case that it is not zero, NRV should be recognized.

DEVELOPMENTAL SOFTWARE

31. In instances where the managers of a federal entity conclude that it is no longer more likely than not that developmental software (or a module thereof) will be completed and placed in service, the related book value accumulated for the software (or the balance in a work in process account, if applicable) should be reduced to reflect the expected NRV, if any, and the loss recognized. The following are indications of this:

- Expenditures are neither budgeted nor incurred for the project.
- Programming difficulties cannot be resolved on a timely basis.
- Major cost overruns occur.
- Information has been obtained indicating that the cost of developing the software will significantly exceed the cost of COTS software available from third party vendors; hence, management intends to obtain the product from those vendors instead of completing the project.
- Technologies that supersede the developing software product are introduced.
- The responsibility unit for which the product was being created is being discontinued.

Amortization

32. 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.[9]

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.

34. Any additions to the book value or changes in useful life should be treated prospectively. The change should be accounted for during the period of the change and future periods. No adjustments should be made to previously recorded amortization. When an entity replaces existing internal use software with new software, the unamortized cost of the old software should be expensed when the new software has successfully completed testing.

[9]For example, federal agencies use the following planning guidance: OMB Circulars A-11, *Budget Planning, Budgeting, and Acquisition of Fixed Assets*; A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*; and A-109, *Acquisition of Major Systems*; OMB's *Capital Programming Guide* (July 1997); GAO's *Assessing Risks and Returns: A Guide for Evaluating Federal Agencies' IT Investment Decision-making* (Feb. 1997); and other federal guidance.

Disclosures

35. The disclosures required by SFFAS No. 6, paragraph 45, for general PP&E are applicable to general PP&E software. Thus, for material amounts, the following should be disclosed in the financial statements regarding the software:

- The cost, associated amortization, and book value.
- The estimated useful life for each major class of software.
- The method(s) of amortization.
- The above listed disclosure requirements are not applicable to the U.S. government-wide financial statements. SFFAS 32 provides for disclosure applicable to the U.S. government-wide financial statements for these activities.

Implementation

36. Cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred. However, the provisions of this statement concerning amortization and impairment should be applied to any unamortized cost capitalized prior to the initial application of this statement that continue to be reported as assets after the effective date.

Appendix A: Basis For Conclusions

General Property, Plant, And Equipment

37. As stated in Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 10, the Federal Accounting Standards Advisory Board (Board) believes that measuring the cost associated with using general property, plant, and equipment (PP&E), and including that cost in a federal entity's operating results will help to achieve the operating performance objective. To meet the operating performance objective, the Board seeks to provide accounting standards that will result in

- relevant and reliable cost information for decision-making by internal users,
- comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
- information to help assess the efficiency and effectiveness of asset management.

38. The Board believes that the cost of software acquired or developed for internal use that meets the SFFAS No. 6 criterion for general PP&E should be capitalized. 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.[10]

39. This standard does not apply to software that is an integral part of stewardship property, plant, and equipment. For example, if software is a part of a weapons systems, it would not be capitalized but included in the cost of investing in that weapons system. On the other hand, software used to accumulate the cost of acquiring that weapons system or to manage and account for that item would meet the criteria for general PP&E and should be capitalized.

40. Regarding any costs of internal use software acquired or developed for stewardship PP&E or stewardship investments, the Board chose to follow SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, and SFFAS No. 8, *Supplementary Stewardship Reporting*, and expense them as incurred. For example, a research project may involve new software applications for computer simulation or modeling and meet the definition of a stewardship investment in research and development. In such cases, that software should be expensed as

[10] See SFFAS No. 6, par. 17.

part of that research and development stewardship investment. However, software used to manage, account for, and report on research and development projects and activities would meet the criteria for general PP&E and should be capitalized.

Comparison With SFFAS No. 6

41. As explained in the following paragraphs and in subsequent sections of the Basis for Conclusions, the accounting standard for internal use software required some tailoring of the provisions in SFFAS No. 6. First, the criteria in this standard for determining when to start amortizing/depreciating differs from SFFAS No. 6. SFFAS No. 6 provides that for constructed PP&E, depreciation begins when the PP&E is "placed in service." However, this standard defines the start of amortization for internal use software as the point when final acceptance testing is successfully completed. This additional criteria is necessary, especially for internally developed software—but also for contractor-developed and commercial off-the-shelf (COTS) software—because (1) testing plays a major role for software assets by demonstrating that the software product can meet the requirements and (2) of the need for clear point for ending the developmental phase.

42. A second area of tailoring involves "enhancements" and other potentially capitalizable expenditures incurred after the software and/or other general PP&E is in service. SFFAS No. 6 provides a criterion for capitalizable cost for general PP&E that is different from that required here for software enhancements. SFFAS No. 6 provides that cost incurred to either extend the useful life of existing general PP&E or to enlarge or improve its capacity should be capitalized.[11]

43. By contrast, this standard, as explained below, takes a different tack for software. It provides that material expenditures to add capability/functionality would be capitalized but expenditures that result in extending useful life or capacity would be expensed.

44. Finally, it should be noted that this standard provides additional procedures for recognizing and measuring impairment. The provisions in this standard and in SFFAS No. 6 are the same regarding situations where the software/general PP&E is impaired and will be removed from service in its entirety. Both provide that the loss is measured as the difference between the book value and the net realizable value, if any. However, as explained below, this standard also provides for instances where (1) operational software is only partly impaired and (2) developmental software becomes impaired.

[11]Par. 37.

Respondent's Comments

45. The respondents to the exposure draft (ED), *Accounting for Internal Use Software*, generally agreed with the principles presented therein. Most of the respondents agreed that the cost of internal use software and enhancements thereto should be capitalized, that capitalized amounts should be written down or off when the software is impaired, and that the guidance in the ED was sufficient to identify capitalizable cost and to recognize impairment. Two-thirds of the respondents agreed with the capitalization point in the ED—after (1) management authorizes and commits to funding a project and believes that it is more likely than not that the project will be successful and (2) the preliminary design stage is complete.

46. Some respondents raised objections and concerns, similar to those expressed in response to the original PP&E exposure draft, about capitalizing software, especially internally developed software. They were concerned that distinguishing between the cost of new and/or enhanced software on the one hand and maintenance and routine improvements that do not benefit future periods on the other hand would be difficult. Other respondents noted the rapidity with which technology changes and current software becomes obsolete, and said that the risky and uncertain nature of software development makes write-off much more likely for software than for general PP&E.

47. Notwithstanding these objections, the Board continues to believe that internal use software is similar to other general PP&E and should be accounted for accordingly. Internal use software and other **information technology** products and services are important resources for government operations. They are subject to similar risks of impairment and write-off and, otherwise, have general PP&E characteristics. Moreover, some respondents said they were already capitalizing their COTS software, which represents a large and growing percentage of their software portfolio.

48. The Board believes that the difference between internal use software and other general PP&E is not sufficient to justify different accounting treatment. This standard provides guidance for determining when capitalization starts and stops, how to amortize the software, how to determine and measure impairment, and other guidance.

Cost-Benefit

49. Several of the respondents opposed the capitalization of internal use software because they do not believe that the benefits of doing so are worth the cost. The respondents are concerned about the difficulty and cost of evaluating, measuring, and tracking such information. Some respondents point especially to the difficulty of allocating federal

employees' salaries and contractors' cost in multiuse contracts (e.g., systems development and maintenance).

50. Some argue (1) that capitalized internal cost related to developing internal use software is often unrelated to the software's actual value or is irrelevant, (2) that capitalization would result in arbitrary values and amortization periods, and (3) that such cost is frequently written-off, causing readers to be misled by the initial capitalization and subsequent write-off.

51. In Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, the Board points out that recommending accounting standards necessarily involves judgments about the cost and benefits of producing information and that standards can have different effects on different users. The Board is concerned that the benefits from standards should exceed the cost of complying with them but realizes that the benefits from standards are very hard to quantify.[12]

52. The Board is persuaded that the benefits from this standard exceed the cost. The Board believes that internal use software meets the definition of general PP&E and that general PP&E ought to be capitalized as an asset and amortized to the future periods benefited.

53. Capitalizing software contributes to the effective management of federal entities' resources. The careful measurement of the cost to construct capital assets, the matching of such cost to periods and programs benefitted on the federal entity's statement of net cost, and the comparison of cost with other alternatives for achieving the entity's goal comprise good management. Moreover, the regular review of software assets for impairment provides an early warning of problems. In short, such information provides periodic feedback about the quality and competitiveness of software products and services.[13]

54. The Board believes that expensing software costs incurred (1) in the preliminary design stage, (2) for software repairs and improvements that increase efficiency and useful life (see discussion of enhancements below), and (3) under materiality considerations will ease the burden of complying with this standard. Federal entities incur cost in the preliminary design stage exploring design and technical possibilities. Expensing this cost will limit the risk of "over-capitalization."

[12]Also, see OMB Circular A-130, *Management of Federal Information Resources*, par. 7d, which establishes the goal of having benefits exceed cost but notes that "the benefits to be derived from government information may not always be quantifiable."

[13]See OMB Circular A-130, par. 8a, "Information Management Policy," and par. 9b, as well as OMB's *Capital Programming Guide*, for detailed guidance on analyzing information technology through the planning, acquisition, and management-in-use phases.

55. The Board realizes that software—in general—and internally developed internal use software—in particular—present difficult materiality considerations. However, the Board believes that federal entities will be able to use their discretion under the materiality provisions of federal accounting standards to set reasonable limits to capitalization and avoid incurring excessive cost in tracking de minimis items.

56. SFFAS No. 4 calls for the full cost of resources that directly and indirectly contribute to the production of outputs to be assigned to outputs through appropriate costing methodologies. Cost effectiveness is a key consideration in selecting a cost assignment method. As a general rule, directly tracing costs and assigning costs on a cause-and-effect basis are more expensive than cost allocations, because they require detailed analyses and record-keeping for costs and activities. However, they are preferable because they produce more reliable cost information than cost allocations.[14] In any case, the method used to trace, assign or allocate costs must produce materially correct and complete costs.

57. The Board acknowledges that the service life of software is less predictable than that for other general PP&E. However, the Board is not persuaded that the difficulties of estimation and adjustment justify an accounting treatment different from that for other general PP&E. The Board believes that the additional guidance in the standard versus that in the ED will address the concerns raised by respondents and will be sufficient for federal entities to comply with the standard.

Cost To Be Capitalized—Direct And Indirect Cost

58. Many respondents agreed with the ED position that indirect cost should be expensed. The ED provided that such cost should be expensed because of cost-benefit considerations and the risk of over-capitalization.

59. Several respondents objected to the failure of the ED to require indirect as well as direct costs to be capitalized. Most of these respondents based their objection on the full-cost requirements in SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, believing that the Board would not be consistent with this standard unless full cost accounting were adopted.

60. The Board had reserved final judgment on the issue of capitalizing indirect cost at the time the ED was published. Several of the Board's members had argued that capitalizing only direct cost was inconsistent with SFFAS No. 4. Also, some Board members felt that, if the

[14] SFFAS No. 4, par. 143.

standard not did require indirect cost to be capitalized, the cost of internally developed internal use software would not be comparable with COTS and contractor-developed software, which would include indirect cost.

61. After reconsidering the issue, the Board is persuaded that SFFAS No. 4 requires both direct and indirect costs to be capitalized. Moreover, the new federal capital programming guidelines[15] require full life-cycle cost to be tracked, which is a more extensive requirement than that required by this standard, since it includes cost that would be expensed for accounting purposes.[16] Also, software asset values will be comparable among internally developed, COTS and contractor-developed software.

Commencing Capitalization

62. Two-thirds of the respondents agreed that capitalization should begin as described in par. 21 of the ED (and par. 16 of this standard): that is, when (1) management authorizes and commits to a software project and believes that it is more likely than not that the software will be completed and (2) the preliminary design stage is complete. Two of these respondents noted that the standard was consistent in this regard with the American Institute of Certified Public Accountant's (AICPA) draft Statement of Position (SOP).[17] Six other respondents would begin to capitalize only when "technological feasibility" is demonstrated.[18] Other respondents either would not capitalize internal use software under any circumstances or only COTS software.

63. The Board has added a framework for identifying the stages of a software project. Also, the standard now draws a sharper distinction between internally developed software on the one hand and COTS and contractor-developed software on the other. However, the Board believes that flexibility is needed so that the standard can be applied governmentwide.

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[15]The Office of Management and Budget's (OMB) *Capital Programming Guide*, Supplement to OMB Circular A-11, Part 3 (July 1997), integrates the various executive branch and statutory asset management initiatives, including the Government Performance and Results Act, the Clinger-Cohen Act, and the Federal Acquisition Streamlining Act, into a single, integrated capital-programming guide.

[16]"Capital assets are land, structures, equipment, and intellectual property (including software) that ... have an estimated life of two years or more... The cost of a capital asset is its full life-cycle cost, including all direct and indirect cost for planning, procurement ... operations and maintenance, including service contracts and disposal." Capital Programming Guide, version 1.0, definition of capital asset, p. i (July 1997).

[17]Published March 4, 1998 as SOP No. 98-1.

[18]"Technological feasibility" is the criteria that the Financial Accounting Standards Board (FASB) used in Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed.*

64. One respondent asked for clarification regarding management's commitment to the software project. This is critical, since it is the starting point for the capitalization of software cost. The Board believes that management's authorization and commitment are a recognizable point for major software projects. A "go/no go" decision should be a visible milestone. Management should use its best judgment to identify when its commitment to a major software project takes place.

65. The Board decided that the "technological feasibility" test in SFFAS No. 6, which follows the Financial Accounting Standard Board's Statement of Financial Accounting Standards No. 86, should be changed. The Board believes that that test is appropriate for software developed for sale or lease or otherwise marketed but is not applicable to internal use software. Federal software should be capitalized because it is a long-lived operating asset rather than inventory to be sold. However, federal entities normally do not develop software for sale. If, in a rare instance, an entity should engage to develop software for another federal entity, SFAS No. 86 would be applicable.

Software Licenses

66. One respondent asked for guidance on accounting for licenses for COTS software. The Board had not discussed software licenses during its deliberations leading up to the publication of the ED. Software licenses can cover periods ranging from the entire estimated service life of the software (a "perpetual" license) to annual or more frequent periods and are similar to leases of general PP&E.

67. The Board believes that it would be appropriate for the federal entity to apply lease accounting concepts[19] 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.

Capitalization Thresholds

68. In SFFAS No. 6, the Board carefully considered whether to take a prescriptive approach regarding capitalization thresholds or to permit each entity to set its threshold in light of its own particular operating environment. The Board decided that federal entities were too diverse to require one threshold for all entities; hence, the Board adopted a materiality approach whereby each entity establishes its own threshold as well as the guidance for bulk

[19]See SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, "Capital Leases," pars. 43-46, and SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, par. 20, for federal accounting standards for leases.

purchases. The Board continues to believe that permitting management discretion in establishing capitalization policies will lead to a more cost-effective application of the accounting standards.

Data Conversion Cost

69. The issue of whether to capitalize all, some, or no data conversion cost is a difficult one. Some argue that the cost of converting existing data to a new software system is analogous to the types of cost that the Accounting Principles Board Opinion (APB) No. 17, *Intangible Assets*, requires to be expensed as incurred because they are not specifically identifiable, have indeterminate lives, or are inherent in a continuing business and related to an enterprise as a whole—such as goodwill (APB 17, par. 24). The Board is persuaded that data conversion costs are operating costs and should be expensed.

Amortization Period

70. Most respondents said that no maximum period for amortization should be set in the standard. One respondent asked for clarification regarding the meaning of the general requirement that the amortization period be “consistent with management’s plan for use.” Another respondent asked whether the amortization period should begin when capitalization stops or when the system is put into use, saying that, often, there can be a significant time lag between these two events. One respondent asked for clarification regarding incremental implementation.

71. The Board has added additional guidance regarding the cessation of capitalization and commencement of amortization. The standard now focuses on the point when testing is complete. The term “operational,” which some respondents found vague, is no longer used as a definitive point for cessation of capitalization. Also, provision has been made to treat each location and/or module separately.

Enhancements

72. Several respondents requested additional guidance for distinguishing maintenance from enhancements. The exposure draft proposed capitalizing the cost of changes to the existing system as an enhancement if it is more likely than not that the changes add capabilities or useful life. One respondent asked whether the cost of changes that make the software or system easier to use and users more efficient, but do not significantly change the capability/functionality (i.e., the system does not do any additional tasks), should be expensed or capitalized. Also, the ED proposed that year 2000 (Y2K) cost be expensed as incurred, even though they extend useful life. Several respondents asked whether Y2K cost were “enhancements.”

73. The Board believes that an "enhancement" should be limited to instances where significant new capabilities are being added to the software. Merely making the software more efficient and/or extending its service life should not constitute a capitalizable cost. Software is more fluid and malleable than other PP&E and the Board concludes that a higher threshold for additional capitalization is reasonable.

Impairment

74. Two-thirds of the respondents said that the guidance on impairment was sufficient. Several respondents had questions about how the impairment provisions would apply to particular situations.

75. A respondent asked whether the availability of a new, updated version of COTS software with significantly improved functionality, efficiency, or effectiveness means that the older version is impaired even if the older version is still performing the functions for which it was designed. He asked whether the availability of new technology, whether adapted or not, render existing software "impaired." He asked about the affect of modernizing existing software to take advantage of the new technology. This respondent was concerned that if modernization is included in the definition of "impairment," there will be constant write-downs.

76. The Board believes that none of the situations cited by the respondent would meet the criteria of this standard in paragraphs 28-31. According to the criteria, in order for software to be considered impaired, it would have to have lost its service potential such that the federal entity would plan to remove it from service or the software would have had its capabilities reduced.

77. One respondent asked about the ED's proposal for expensing Y2K cost. Since the implementation date for this standard has been moved back to FY 2001, the issue is largely moot. However, the Board's rationale for recommending that the Y2K cost be expensed is that such cost is incurred to repair a design flaw rather than to add to the software's capabilities or useful life, although the latter would be affected.

Working Capital Funds

78. At least one respondent was concerned about the impact of capitalizing non-COTS internal use software on the cash flows, billing rates, and performance measurement of working capital funds (WCFs). This respondent said that developing software internally and through contractors could require long lead times during which WCFs would have to finance the project because WCFs could not start to recover the cost from customers until the software project was complete and amortization commences. Also, this respondent said that write-downs or write-offs due to impairment by rapidly changing technology would be difficult to

recapture from customers who expect and budget for consistent billing rates. This respondent believes that the capitalization of internally developed or contractor-developed software could result in fluctuating rates depending on when new projects come “on line” and on write-downs or write-offs due to impairment.

79. This respondent said that if write-downs or write-offs cannot be recovered from customers, then capital funds would be unavailable for investment, the WCFs’ equity could be seriously impaired, and the WCFs would rapidly become unable to effectively provide the services for which they were established. The respondent said that WCFs are vulnerable to capital shortages because they operate on a break-even basis rather than generate retained earnings, and because they do not have access to private capital markets. This respondent’s WCF currently capitalizes COTS software because it is a proven commodity; it becomes operational immediately and the WCF can begin chargingback the cost to customers.

80. Fixed assets usually provide important future benefits but require large amounts of resources up-front and extended periods for planning and acquisition. Making capital planning decisions is often difficult for agencies because full budget authority is required before the acquisition can commence and the entire acquisition has an immediate budgetary impact. This makes capital assets look expensive relative to, for example, annual lease payments even though the latter may be more expensive in the longrun.[20]

81. Notwithstanding these very real concerns, the Board concludes that the WCFs problem is one of budgetary control and program finance rather than of accounting. Congress has instituted various alternatives for WCFs to acquire capital. The Board’s responsibility is to recommend what it considers the best accounting treatment considering all the circumstances and the Board’s objectives.

Implementation Date

82. The 23 respondents who addressed the question of the implementation date were almost evenly divided as to the feasibility of an FY 1999 implementation date. Most respondents opposing the FY 1999 date said that federal agencies do not have the cost accounting systems as yet to account for capitalized cost but are developing such capabilities. Some respondents said that most federal agencies have a great deal “on their plate” now, when one considers the many recent initiatives. They said that an FY 2000 or FY 2001 implementation date would be better.

[20]See GAO, *Budget Issues: Budgeting for Federal Capital* (GAO/AIMD-97-5 Nov. 1996), for (1) an analysis of capital budgeting problems experienced by WCFs and federal agencies generally and (2) possible solutions.

83. One respondent said that the AICPA's SOP is effective for periods beginning after December 15, 1998, and that there is no reason for the federal government to adapt such a standard before the private sector does. The respondent said that federal implementation after the private sector implements its standard would allow the federal government to learn from the private sector's experience.

84. The Board believes that federal entities are striving to meet deadlines for audited financial statements, performance reports, cost accounting, technology management, and other initiatives. Entities resources are under stress to meet these deadlines. Thus, the Board believes that moving the implementation to FY 2001 is reasonable.

Appendix B: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

Statement of Federal Financial Accounting Standards 6: Accounting for Property, Plant, and Equipment

Status

Issued	November 30, 1995
Effective Date	For periods beginning after September 30, 1997.
Interpretations and Technical Releases	TR 2, *Determining Probable and Reasonable Estimate for Environmental Liabilities in the Federal Government* TR 13, *Implementation Guide for Estimating the Historical Cost of General Property, Plant, and Equipment*
Affects	None.
Affected by	• SFFAS 10, paragraph 7, rescinds SFFAS 6, paragraphs 27 and 28, and SFFAS 10, paragraphs 8-36 provide a comprehensive standard for accounting for internal use software. • SFFAS 14, paragraphs 5-9, affect SFFAS 6, paragraphs 79-80, and 83-84 by changing certain section headings, deleting paragraph 79, and adding phrases to paragraphs 83-84. • SFFAS 16, paragraphs 6 and 8-12 replace SFFAS 6 paragraphs 59 and 60-62, respectively; SFFAS 16, paragraph 14, replaces SFFAS 6, paragraph 63; SFFAS 16, paragraph 15, provides additional implementation guidance. • SFFAS 23, affects SFFAS 6, paragraph 23, by rescinding the category name “Federal mission property, plant, and equipment”; SFFAS 23 rescinds SFFAS 6, paragraphs 46 through 56 and the accompanying heading “Federal mission property, plant, and equipment”, which precedes these paragraphs, SFFAS 23 affects SFFAS 6, paragraph 35, by adding the following sentence as a separate bulleted line item: “A composite or group depreciation methodology, whereby the costs of PP&E are allocated using the same allocation rate, is permissible.” • SFFAS 29, par. 10-11 and 30 affect SFFAS 6 by rescinding par. 57-76 and amending text in par. 21. • SIG 23.1. • SFFAS 32 amends paragraphs 45, 83, 84, and 107 through 111. • SFFAS 35 amends paragraphs 40 and 45. • SFFAS 40 amends paragraphs 77, 78, 80, 82, 83, and 84. • SFFAS 42 rescinds paragraphs 77 through 84 and Appendix C.

Summary

This statement contains accounting standards for Federally owned property, plant, and equipment (PP&E); and cleanup costs.

Property, Plant, And Equipment

The Federal Government's investment in PP&E exceeds $1 trillion[1] and includes many types of PP&E used for many different purposes. "PP&E" is defined as follows:

> Tangible assets that (1) have an estimated useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity.

The diversity among Federal PP&E creates a need for meaningful categories of PP&E with different accounting standards for each category. The categories of PP&E are:

- general PP&E are PP&E used to provide general government services or goods;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land[2] (i.e., land other than that included in general PP&E).

Complete accounting standards for *general PP&E* are included in this document.

[1]Department of the Treasury, Financial Management Service, *Consolidated Financial Statements of the United States Government*, prototype 1993, p. 23. The prototype statements provide gross historical cost investment amounts for all PP&E recorded by government entities. These amounts have not been audited.

[2]Land acquired for or in connection with *general PP&E* would be included in that category. Land not associated with general PP&E would be considered stewardship land.

General PP&E

The general PP&E category consists of items that:

- could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but are used by the Federal entity to produce goods or services, or to support the mission of the entity; or
- are used in business-type activities;[3] or
- are used by entities in activities whose costs can be compared to other entities (e.g., Federal hospitals compared with other hospitals).

General PP&E includes land acquired for or in connection with other general PP&E.[4]

General PP&E shall be reported in the basic financial statements: the balance sheet,[5] and the statement of net cost.[6] The acquisition cost of general PP&E shall be recognized[7] as an asset. Subsequently, except for land which is a nondepreciable asset, that acquisition cost shall be charged to expense through depreciation.[8] The depreciation expense shall be accumulated in a contra asset account—accumulated depreciation.

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

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

[5]"Balance sheet" refers to the statement that reports on assets, liabilities, and net position of the entity at the end of the reporting period. This statement is referred to in OMB Bulletin 94-01, Form and Content of Agency Financial Statements, as the Statement of Financial Position.

[6]"Statement of Net Cost" refers to the statement providing information on the entity's flows of exchange revenues, expenses, gains, and losses. The Board presented this new statement in its Statement of Federal Financial Accounting Concepts 2, *Entity and Display.* In addition, the Board has exposed for comment a standard for reporting net costs and has provided an illustrative statement which might give effect to this standard in the ED on *Revenue and Other Financing Sources*, July, 1995.

[7]"Recognize" means to record an amount in entity accounts and to report a dollar amount on the face of the Statement of Net Costs or the Balance Sheet either individually or so that the amounts are aggregated with related amounts.

[8]"Depreciation" is the systematic and rational allocation of the acquisition cost of an asset, less its estimated salvage or residual value, over its estimated useful life.

In addition, the standard addresses donations, transfers, and retirements of general PP&E as well as disclosure[9] requirements.

Deferred Maintenance

The Deferred Maintenance requirement contained herein have been rescinded and replaced by SFFAS 42, *Deferred Maintenance and Repairs*, Amending SFFAS 6, 14, 29, and 32. Information related to the condition and the estimated cost to remedy deferred maintenance of PP&E is to be reported as required supplementary information.

Cleanup Costs

Cleanup costs are the costs associated with hazardous waste removal, containment, or disposal. In some instances, the Federal Government incurs liabilities[10] for cleaning up hazardous waste at sites or facilities it operates or has operated. Generally, cleanup cannot be, or is not, done until permanent or temporary closure or shutdown of sites or facilities. The Board has completed accounting standards for liabilities which address liabilities for environmental cleanup resulting from an accident, natural disaster, or other one-time occurrence. Those liability standards do not address inter-period cost allocation when cleanup relates to operations that span many periods.

Therefore, the Board chose to provide additional guidance relative to cleanup costs in this standard. The additional standards in this statement provide for the timing of recognition of the liability and related operating expense.

[9]"Disclosure" refers to reporting information in notes regarded as an integral part of the basic financial statements.

[10]FASAB's Statement of Federal Financial Accounting Standards 5, *Accounting for Liabilities of the Federal Government*, recommends the following definition for liability: a probable future outflow or other sacrifice of resources as a result of past transactions or events. The standards require recognition, in general purpose Federal financial reports, of probable and measurable liabilities arising from past exchange transactions; government-related injuries or damage; or non-exchange amounts that, according to current law and applicable policy, are due and payable to the ultimate recipient. The standards also provide guidance for disclosures related to liabilities that are not both probable and measurable at the balance sheet date.

For cleanup costs associated with general PP&E, probable[11] and measurable cleanup costs shall be allocated to operating periods benefiting from operations of the general PP&E. This allocation shall be based on a systematic and rational method. For example, the estimated cost could be allocated to operating periods based on the expected physical capacity of the PP&E and the amount of capacity used each period. In addition, disclosure of the total estimated cost is required.

For cleanup costs associated with stewardship PP&E, probable and measurable liabilities shall be recognized when the stewardship PP&E is placed in service. Simultaneous to recognizing the liability, the related expense for cleanup cost shall be recognized.

[11]The term "probable" means that which can reasonably be expected or believed to be more likely than not on the basis of available evidence or logic but which is neither certain nor proven. For example, cleanup costs would be probable if (1) laws and regulations that have been approved as of the balance sheet date, regardless of the effective date of those laws and regulations, require cleanup or (2) compliance agreements (e.g., agreements with state or local authorities relating to the extent and the timing of remedial action) had been entered into by a Federal entity.

Table of Contents

Chapter 1: Introduction

Purpose

1. The purpose of this statement is to provide accounting standards for Federally owned property, plant, and equipment (PP&E); deferred maintenance; and cleanup costs. This introduction provides information on:

   - the scope of the standards,
   - consideration of reporting objectives,
   - applicability of the standards,
   - capitalization threshold,
   - materiality, and
   - effective date.

2. Chapters 2, 3, and 4 present the accounting standards for PP&E, deferred maintenance, and cleanup costs, respectively.

3. Appendix A presents the Basis for Conclusions. This appendix provides the Board's rationale for the decisions made and responds to the major issues raised in comment letters.

4. Appendix B presents illustrations to aid in categorizing PP&E.

5. Appendix C provides an example of a deferred maintenance disclosure.

6. Appendix D illustrates cleanup cost accounting.

7. Appendix E is a glossary of terms used in this statement [Omitted. See Consolidated Glossary in "Appendix E: Consolidated Glossary" on page 1.]

Scope

8. This statement identifies and defines categories of PP&E and addresses recognition and measurement of, and disclosure requirements associated with property, plant, and equipment (as well as land), including accounting for deferred maintenance and cleanup costs. This statement does not address natural resources. However, the Board is undertaking a project to address accounting for natural resources.

Reporting Objectives

9. In drafting accounting standards for PP&E, the Board relied on the Statement of Federal Financial Accounting Concepts Number 1, Objectives of Federal Financial Reporting. Ultimately, all accounting standards taken as a whole will help meet the four reporting objectives expressed in the Objectives statement: budgetary integrity, operating performance, stewardship, and systems and controls. The focus of these standards is on the two reporting objectives most relevant to PP&E—operating performance and stewardship. These objectives and how they could be met through PP&E accounting are discussed under the headings (1) operating performance, and (2) stewardship.

Operating Performance

10. The Board believes that it can contribute to meeting the operating performance objective[1] by measuring the cost associated with using property, plant, and equipment and including that cost in entity operating results. The Board first sought to identify PP&E costs that would be appropriate to include in operating expense. Then, from consideration of cost information required, the Board determined what balance sheet information would have to be reported.

11. To meet the operating performance objective, the Board seeks to provide accounting standards that will result in:

- relevant and reliable cost information for decision-making by internal users (e.g., program managers, budget examiners and officials),
- comprehensive, comparable cost information for decision-making and program evaluation by Congress and the public, and
- information to help assess the efficiency and effectiveness of asset management (e.g., condition of assets including deferred maintenance).

[1]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 composition 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.
c. the efficiency and effectiveness of the government's management of its assets and liabilities.

Stewardship

12. The Board believes that Federal financial reporting can fulfill the stewardship objective[2] if the Board provides standards that will result in reporting information on:

- asset condition;
- changes in the amount and service potential of property, plant, and equipment;
- cost of property, plant, and equipment where applicable; and
- spending for acquisition of property, plant, and equipment versus non-capital spending.

Capitalization Thresholds

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

Applicability

14. For guidance on the general applicability of this standard and all other Federal financial accounting standards please refer to Statement of Federal Financial Accounting Concepts No. 2, *Entity and Display.*

Materiality

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

[2]Federal financial reporting should assist users in 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 nations's financial condition have changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:

a. whether the government's financial position improved or deteriorated over the period.
b. whether the future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.
c. whether government operations have contributed to the nation's current and future well-being.

Effective Date

16. The Board recommends that the accounting standards presented in this proposed statement become effective for periods beginning after September 30, 1997. Earlier implementation is encouraged. In addition, under early implementation individual provisions of the accounting standards may be implemented before other provisions. For example, provisions for stewardship PP&E may be implemented before provisions for general PP&E.

Chapter 2: Property, Plant, And Equipment

Definitions

17. Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria:

- they have estimated useful lives[3] of 2 years or more;
- they are not intended for sale in the ordinary course of operations; and
- they have been acquired or constructed with the intention of being used, or being available for use by the entity.

18. Property, plant, and equipment also includes:

- assets acquired through capital leases (See paragraph 20), including leasehold improvements;
- property owned by the reporting entity in the hands of others (e.g., state and local governments, colleges and universities, or Federal contractors); and
- land rights.[4]

[3] Useful life is the normal operating life in terms of utility to the owner. (adapted from Kohler's Dictionary for Accountants)

[4] "Land rights" are interests and privileges held by the entity in land owned by others, such as leaseholds, easements, water and water power rights, diversion rights, submersion rights, rights-of-way, and other like interests in land.

19. Property, plant, and equipment excludes items (1) held in anticipation of physical consumption such as operating materials and supplies[5] and (2) the Federal entity has a reversionary interest in.[6]

20. Capital leases are leases that transfer substantially all the benefits and risks of ownership to the lessee. If, at its inception, a lease meets one or more of the following four criteria,[7] the lease should be classified as a capital lease by the lessee. Otherwise, it should be classified as an operating lease.[8]

- The lease transfers ownership of the property to the lessee by the end of the lease term.
- The lease contains an option to purchase the leased property at a bargain price.
- The lease term is equal to or greater than 75 percent of the estimated economic life[9] of the leased property.
- The present value of rental and other minimum lease payments, excluding that portion of the payments representing executory cost, equals or exceeds 90 percent of the fair value[10] of the leased property.

The last two criteria are not applicable when the beginning of the lease term falls within the last 25 percent of the total estimated economic life of the leased property.

[5]Accounting for operating materials and supplies is addressed in Statement of Federal Financial Accounting Standards No. 3 *Accounting for Inventory and Related Property.*

[6]The Federal Government sometimes retains an interest in PP&E acquired with grant money. In the event that the grant recipient no longer uses the PP&E in the activity for which the grant was originally provided the PP&E reverts to the Federal Government.

[7]Note that the criteria for identifying capital leases for financial reporting purposes differ from OMB criteria for budget scoring of leases. OMB Circular No. A-11, *Preparation and Submission of Budget Estimates*, includes criteria for identifying operating leases in Appendix B. OMB provides four additional criteria which relate to the level of private sector risk involved in a lease-purchase agreement. This is necessary because, for budget purposes, there is a distinction between lease-purchases with more or less risk. This distinction is not made in the financial reports and, therefore, FASAB does not include the four criteria related to risk levels.

[8]"Operating leases" of PP&E are leases in which the Federal entity does not assume the risks of ownership of the PP&E. Multi-year service contracts and multi-year purchase contracts for expendable commodities are not capital leases.

[9]"Estimated economic life of leased property" is the estimated remaining period during which the property is expected to be economically usable by one or more users, with normal repairs and maintenance, for the purpose for which it was intended at the inception of the lease, without limitation by the lease term.

[10]"Fair value" is the price for which an asset could be bought or sold in an arm's-length transaction between unrelated parties (e.g., between a willing buyer and a willing seller). (adapted from Kohler's Dictionary for Accountants)

Standards And Categories

21. The following paragraphs provide recognition and measurement principles, and disclosure requirements for general PP&E. For standards relating to heritage assets, multi-use heritage assets and stewardship land, see SFFAS 29, Heritage Assets and Stewardship Land.

22. In determining which category PP&E should be placed in, it will be necessary to identify the "base unit"[11] of PP&E against which the category definitions will be applied. For example, units as large as entire facilities or as small as computers could be categorized. In determining the level at which categorization takes place, an entity should consider the cost of maintaining different accounting methods for property and the usefulness of the information, the diversity in the PP&E to be categorized (e.g., useful lives, value, alternative uses), the programs being served by the PP&E, and future disposition of the PP&E (e.g., transferred to other entities or scrapped).[12]

General Property, Plant, and Equipment

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

- it could be used for alternative purposes (e.g., by other Federal programs, state or local governments, or non-governmental entities) but is used to produce goods or services, or to support the mission of the entity, or
- it is used in business-type activities,[13] or

[11]"Base unit" refers to the level of detail considered in categorizing PP&E. Generally, the base unit is the smallest or least expensive item of property to be categorized. The term "base unit" may be used by others to have a different meaning—the meaning intended in this standard is limited to that specified above.

[12]The concept described here is intended for PP&E categorization purposes only. However, for the purpose of record keeping, greater detail may be necessary to maintain accountability for PP&E so that assets can be safeguarded against loss, theft, misappropriation, etc. Categorizing PP&E with less detail considered does not necessarily mean that (1) accounting systems or (2) property records must follow the same level of detail.

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

- it is used by entities in activities whose costs can be compared[14] to those of other entities performing similar activities (e.g., Federal hospital services in comparison to other hospitals).

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

25. Land and land rights acquired for or in connection with other general PP&E[15] shall be included in general PP&E. In some instance, general PP&E may be built on existing Federal lands. In this case, the land cost would often not be identifiable. In these instances, general PP&E shall include only land and land rights with an identifiable cost that was specifically acquired for or in connection with construction of general PP&E.

Asset Recognition

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

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

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

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

- fair value of facilities and equipment donated to the government; and
- material amounts of interest costs paid.[16]

27. ... [See SFFAS 10 for revised standards regarding internally-developed software][17, 18, 19]

28. ... [See SFFAS 10 for revised standards regarding internally-developed software][20]

29. The cost of general PP&E acquired under a **capital lease** shall be equal to the amount recognized as a liability for the capital lease at its inception (i.e., the net present value of the lease payments calculated as specified in the liability standard[21] unless the net present value exceeds the fair value of the asset).

30. The cost of general PP&E acquired through donation, devise,[22] or **judicial process** excluding forfeiture (See paragraph 33) shall be estimated fair value at the time acquired by the government.

31. The cost of general PP&E **transferred from other Federal entities** shall be the cost recorded by the transferring entity for the PP&E net of accumulated depreciation or amortization. If the receiving entity cannot reasonably ascertain those amounts, the cost of the PP&E shall be its fair value at the time transferred.

32. The cost of general PP&E acquired through **exchange**[23] shall be the fair value of the PP&E surrendered at the time of exchange.[24] If the fair value of the PP&E acquired is more readily

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

[17][See SFFAS 10 for revised standards regarding internally developed software]

[18][See SFFAS 10 for revised standards regarding internally developed software]

[19][See SFFAS 10 for revised standards regarding internally developed software]

[20][See SFFAS 10 for revised standards regarding internally developed software]

[21]See Statement of Recommended Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government.*

[22]A will or clause of a will disposing of property.

[23]This paragraph applies only to exchanges between a Federal entity and a non-Federal entity. Exchanges between Federal entities shall be accounted for as transfers (See paragraph 31).

[24]If entity enters into an exchange in which the fair value of the PP&E acquired is less than that of the PP&E surrendered, the PP&E acquired shall be recognized at its cost as described in paragraph 32 and subsequently reduced to its fair value. A loss shall be recognized in an amount equal to the difference between the cost of the PP&E acquired and its fair value.

determinable than that of the PP&E surrendered, the cost shall be the fair value of PP&E acquired. If neither fair value is determinable the cost of the PP&E acquired shall be the cost recorded for the PP&E surrendered net of any accumulated depreciation or amortization. Any difference between the net recorded amount of the PP&E surrendered and the cost of the PP&E acquired shall be recognized as a gain or loss. In the event that cash consideration is included in the exchange, the cost of general PP&E acquired shall be increased by the amount of cash consideration surrendered or decreased by the amount of cash consideration received.

33. The cost of general PP&E acquired through **forfeiture** shall be determined in accordance with Statement of Federal Financial Accounting Standards No. 3, **Accounting for Inventory and Related Property** (SFFAS 3).[25] Amounts recorded for forfeited assets based on SFFAS 3 shall be recognized as the cost of general PP&E when placed into official use.

34. PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity.[26] In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E.

Expense Recognition

35. Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E,[27] except land and land rights of unlimited duration.[28]

    - Estimates of useful life of general PP&E must consider factors such as physical wear and tear and technological change (e.g., obsolescence).

[25]SFFAS 3 requires that forfeited real and personal property be valued at market value less an allowance for any liens or claims from a third party.

[26]Delivery or constructive delivery shall be based on the terms of the contract regarding shipping and/or delivery. For PP&E acquired by a contractor on behalf of the entity (e.g., the entity will ultimately hold title to the PP&E), PP&E shall also be recognized upon delivery or constructive delivery whether to the contractor for use in performing contract services or to the entity.

[27]Software and land [See SFFAS 10 for standard regarding internally developed software] rights, while associated with tangible assets, may be classified as intangible assets by some entities. In this event, they would be subject to amortization rather than depreciation. “Amortization” is applied to intangible assets in the same manner that depreciation is applied to general PP&E—tangible assets.

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

- Various methods can be used to compute periodic depreciation expense so long as the method is systematic, rational, and best reflects the use of the PP&E.
- Any changes in estimated useful life or salvage/residual value shall be treated prospectively. The change shall be accounted for in the period of the change and future periods. No adjustments shall be made to previously recorded depreciation or amortization.
- A composite or group depreciation methodology,[42a] whereby the costs of PP&E are allocated using the same allocation rate, is permissable.

36. Depreciation expense shall be accumulated in a contra asset[29] account—accumulated depreciation. Amortization expense shall be accumulated in a contra asset account—accumulated amortization.

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

38. In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized[30] shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service.

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

[42a] The composite methodology is a method of calculating depreciation that applies a single average rate to a number of heterogeneous assets that have dissimilar characteristics and service lives. The group methodology is a method of calculating depreciation that applies a single, average rate to a number of homogeneous assets having similar characteristics and service lives.

[29] A contra asset account is an account which partially or wholly offsets an asset account. On financial statements they may be either merged or appear together.

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

Implementation Guidance

40. Although the measurement basis for valuing G-PP&E remains historical cost, reasonable estimates may be used to establish the historical cost of G-PP&E, in accordance with the asset recognition and measurement provisions herein. Estimates may be based on:

- cost of similar assets at the time of acquisition,
- current cost of similar assets discounted for inflation since the time of acquisition (i.e., deflating current costs to costs at the time of acquisition by general price index), or
- other reasonable methods, including those estimation methods specified in SFFAS 23 paragraph 12.

41. Accumulated depreciation/amortization shall be recorded based on the estimated cost and the number of years the PP&E has been in use relative to its estimated useful life. Alternatively, the PP&E may be recorded at its estimated net remaining cost[31] and depreciation/amortization charged over the remaining life based on that net remaining cost.

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

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

43. In recording existing general PP&E, the difference in amounts added to asset and contra asset accounts shall be credited (or charged) to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in the statement of changes in net position. For published financial statements presenting prior year information, no prior year amounts shall be restated.

[31] *Net remaining cost* is the original cost of the asset less any accumulated depreciation/amortization to date.

44. In the period that these standards are implemented, disclosure of the adjustments, by major class[32] of PP&E, made to general PP&E and accumulated depreciation/amortization is required.

Disclosure Requirements

45. The following are minimum G-PP&E disclosure requirements:

- the cost, associated accumulated depreciation, and book value by major class;
- the use and general basis of any estimates used;
- the estimated useful lives for each major class;
- the method(s) of depreciation for each major class;
- capitalization threshold(s) including any changes in threshold(s) during the period; and
- restrictions on the use or convertability of G-PP&E.

... [paragraphs 46-56 and accompanying heading were rescinded by SFFAS 23, par. 9]

Heritage Assets

... [paragraphs 57-65 were rescinded by SFFAS 29, par. 11]

[32]"Major classes" of general PP&E shall be determined by the entity. Examples of major classes include buildings and structures, furniture and fixtures, equipment, vehicles, and land.

[Footnotes 47 through 51 were rescinded by SFFAS 23, par. 9; footnotes 52 through 54 were rescinded by SFFAS 29, par. 11; and footnotes 55-57 were rescinded by SFFAS 29, par. 30.]

Stewardship Land

... [paragraphs 66-76 were rescinded by SFFAS 29, par. 30]

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

Chapter 3: Deferred Maintenance

Paragraphs 77 through 84 were rescinded by SFFAS 42.

Chapter 4: Cleanup Costs

Definition

85. Cleanup costs are the costs of removing, containing, and/or disposing of (1) hazardous waste (see paragraph 86) from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E.

86. Hazardous waste is a solid, liquid, or gaseous waste, or combination of these wastes, which because of its quantity, concentration, or physical, chemical, or infectious characteristics may cause or significantly contribute to an increase in mortality or an increase in serious irreversible, or incapacitating reversible, illness or pose a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, disposed of, or otherwise managed.

87. Cleanup may include, but is not limited to, decontamination, decommissioning, site restoration, site monitoring, closure, and postclosure costs.

Scope

88. This standard applies only to cleanup costs from Federal operations known to result in hazardous waste which the Federal Government is required by Federal, state and/or local statutes and/or regulations that have been approved as of the balance sheet date, regardless

of the effective date, to cleanup (i.e., remove, contain or dispose of).[33] These cleanup costs meet the definition of liability provided in Statement of Recommended Accounting Standards no. 5, *Accounting for Liabilities of the Federal Government* (SRAS no. 5).

89. However, due to the nature of the liability and the timing associated with cleanup costs, additional guidance is provided in this standard on the recognition of cleanup costs over the life of the related PP&E. Guidance is required since cleanup can not occur until the end of the useful life of the PP&E or at regular intervals during that life.

90. This standard is intended to supplement the accounting requirements for liabilities in SRAS no. 5. SRAS no. 5 defines liabilities as a "probable future outflow or other sacrifice of resources as a result of past transactions or events." Further, SRAS no. 5 requires recognition of liabilities that are probable and measurable. Measurable means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable.

91. The recognition and measurement standards provided in this standard are subject to the criteria for recognition of liabilities included in SRAS no. 5. That is, liabilities shall be recognized when three conditions are met:

- a past transaction or event has occurred,
- a future outflow or other sacrifice of resources is probable,[34] and
- the future outflow or sacrifice of resources is measurable.[35]

92. SRAS no. 5 also provides for disclosure of liabilities that do not meet all of the above criteria; these standards apply to cleanup costs as well.

93. Other cleanup costs, such as those resulting from accidents or where cleanup is an ongoing part of operations, are to be accounted for in accordance with liability standards and are not subject to the recognition guidance provided in this standard. This guidance does not apply to these other types of cleanup since the cleanup effort is not deferred until operation of associated PP&E ceases either permanently or temporarily.[36]

[33]Accounting for environmental liabilities such as cleanup costs is currently undergoing change—due to both improved measurement techniques and increased attention from the accounting community. The Board will monitor these changes and revisit these standards as needed.

[34]Probable means that the future confirming event or events is more likely than not to occur.

[35]The unit of analysis for estimating liabilities can vary based on the reporting entity and the nature of the transaction or event. The liability recognized may be the estimation of an individual transaction or event; or a group of transactions and events. For example, an estimate of the cleanup costs could be made on a facility by facility basis, or an entity by entity basis.

[36]Cleanup may be deferred for other reasons, such as availability of resources. However, this type of deferral does not affect the recognition of the liability.

Recognition And Measurement

Estimation Methods

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

95. The estimate shall contemplate:

- the cleanup plan, including
  - level of restoration to be performed,
  - current legal or regulatory requirements,[37] and
  - current technology; and
- current cost which is the amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current period.

96. Estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

Cleanup Cost for General PP&E

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

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

[37] Laws and regulations approved as of the balance sheet date, regardless of the effective date of those laws and regulations, shall be considered.

99. As reestimates (see paragraph 96) are made, the cumulative effect of changes in total estimated cleanup costs related to current and past operations shall be recognized as expense and the liability adjusted in the period of the change in estimate.

100. As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

Cleanup Cost for Stewardship PP&E

101. Consistent with the treatment of the acquisition cost of stewardship PP&E (i.e., expensing in the period placed in service), the total estimated cleanup cost shall be recognized as expense in the period that the stewardship asset is placed in service and a liability established.

102. The liability shall be adjusted when the estimated total cleanup costs are reestimated as described in paragraph 96. Adjustments to the liability shall be recognized in expense as "changes in estimated cleanup costs from prior periods."

103. As cleanup costs are paid, payments shall be recognized as a reduction in the liability for cleanup costs. These include the cost of PP&E or other assets acquired for use in cleanup activities.

Implementation Guidance

104. Two implementation approaches have been provided for liabilities related to general PP&E in service at the effective date of this standard:

- A liability shall be recognized for the portion of the estimated total cleanup cost that is attributable to that portion of the physical capacity used or that portion of the estimated useful life that has passed since the PP&E was placed in service. The remaining cost shall be allocated as provided in paragraphs 97 through 99.
- If costs are not intended to be recovered primarily through user charges, management may elect to recognize the estimated total cleanup cost as a liability upon implementation. In addition, in periods following the implementation period, any changes in the estimated total cleanup cost shall be expensed when reestimates occur and the liability balance adjusted. The provisions for cost allocation provided in paragraphs 97 through 99 shall not apply under this implementation method.

105. The offsetting charge for any liability recognized upon implementation shall be made to Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in any statement of changes in net position that may be required. No amounts

shall be recognized as expense in the period of implementation. The amounts involved shall be disclosed and to the extent possible the amount associated with current and prior periods should be noted.

106. For stewardship PP&E that are in service at the effective date of this standard, the liability for cleanup costs shall be recognized and an adjustment made to the Net Position of the entity. The amount of the adjustment shall be shown as a "prior period adjustment" in any statement of changes in net position that may be required. The amounts involved shall be disclosed.

Disclosure Requirements

107. The sources (applicable laws and regulations) of cleanup requirements. The U.S. government-wide financial statements need not disclose the sources of cleanup requirements

108. The method for assigning estimated total cleanup costs to current operating periods (e.g., physical capacity versus passage of time). The U.S. government financial statements need not disclose the method for assigning estimated cleanup costs to current operating periods.

109. For cleanup cost associated with general PP&E, the unrecognized portion of estimated total cleanup costs (e.g., the estimated total cleanup costs less the cumulative amounts charged to expense at the balance sheet date). SFFAS 32 provides for disclosure requirements for the U.S. government-wide financial statements regarding the unrecognized portion of estimated total cleanup cost associated with general PP&E.

110. Material changes in total estimated cleanup costs due to changes in laws, technology, or plans shall be disclosed. In addition, the portion of the change in estimate that relates to prior period operations shall be disclosed. The U.S. government-wide financial statements need not disclose material changes in total estimated cleanup costs due to changes in laws, technology, plans, or the portion of the change in estimate that relates to prior period operations.

111. The nature of estimates and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations. The U.S. government-wide financial statements need not disclose the nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations

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

Appendix A: Basis For Conclusions

112. This appendix summarizes significant considerations by the Board in reaching the conclusions in this statement. In the following paragraphs, the Board's considerations in developing these standards as well as positions on specific issues raised in alternative views, comment letters, and during public hearings are explained. The Board relied extensively on input from a task force on Capital Expenditures as well as a small working subgroup on Physical Property. These paragraphs include reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

113. This appendix addresses each of the three standards in sequence.

Property, Plant, And Equipment

Background

114. Before addressing specific issues resolved following issuance of the exposure draft, this section provides a broad basis for the main provisions of the standard on investments in PP&E. The Federal Government makes many expenditures that can be characterized as investments or investment-type expenditures. These include expenditures for Federally owned PP&E.

115. Accounting for expenditures for PP&E as well as for the existing stock of PP&E is a significant undertaking because the Federal Government owns substantial amounts of diverse PP&E. Federal PP&E includes approximately 650 million acres of land, buildings containing over 1.5 billion square feet of floor space, many different forms of equipment, and military hardware.

116. These are used for a wide range of purposes; including, among others, operating, defense, conservation, and heritage purposes. Some of these purposes relate to the Federal Government's responsibility to provide for the Nation's common defense and general welfare. Specific types of PP&E are used by the Federal Government to meet this responsibility. Other types of PP&E are held and used for operating purposes that are not unlike those of non-federal entities.

117. Some Federal operations are similar to profit-seeking enterprises and can be described as business-type activities. However, these business-type activities account for a small portion of the investment in PP&E. The majority of the investment in PP&E is used to provide government services and goods where user charges are not the primary source of revenues.

118. The Board found that a single accounting method for such diverse Federal PP&E would not meet the objectives established in its *Objectives of Federal Financial Reporting*. Therefore, the Board identified categories of PP&E and set different accounting methods for each category.

Categories Required

119. The PP&E standards incorporate the following categories:

- general PP&E are PP&E used to provide general government services;
- Federal mission PP&E are PP&E that are an integral part of the output of certain unique Federal Government missions;
- heritage assets are those assets possessing significant educational, cultural, or natural characteristics; and
- stewardship land[38] is land other than that included in general PP&E.

120. The latter three categories of assets are referred to as stewardship PP&E. The term "stewardship PP&E" is used simply to refer to those categories of PP&E to be reported on a stewardship report.

General PP&E

121. General PP&E are items used to provide general government services; including PP&E that:

- 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
- is used in business-type activities, or
- is used by entities whose costs can be compared to other entities (e.g., Federal hospital services in comparison to other hospitals).

122. Allocation of the cost of general PP&E, excluding land, among accounting periods is essential to assessing operating performance. The Board's concepts statement, *Objectives of Federal Financial Reporting*, focuses on relating cost to accomplishments in reporting an entity's operating performance. Cost information is of fundamental importance both to program managers in operating their activities efficiently and effectively and to executive and congressional decision makers in deciding on resource allocation. General PP&E will be capitalized and depreciated to provide this information.

[38]Note that land acquired for or in connection with general PP&E would be included in that category. All other land would be subject to stewardship reporting and is referred to throughout this document as stewardship land.

Stewardship PP&E

123. For stewardship PP&E,[39] the predominant reporting objective is stewardship. This is in contrast to general PP&E, for which the Board is concerned with providing information to assess operating performance and, therefore, provided for depreciation accounting. The most relevant information is about the existence of stewardship PP&E and that information can be provided through a new type of reporting—supplementary stewardship reporting.

124. For stewardship PP&E, the Board believes that allocation of historical cost to operating expense for each period would not contribute to the measurement of entity operating performance. Prior to issuing its *Objectives* statement, the Board conducted a user needs study and met with representatives of a wide variety of user groups. Most users specifically indicated that depreciating stewardship PP&E such as weapons systems would not provide meaningful information for assessing the entity's operating performance. The Board believes that its standards should address the needs of users and the Board has found that users do not need information which includes depreciation expense on this category of PP&E.

125. The Board noted in its *Objectives* statement that the government's responsibility for the nation's common defense and general welfare is unique and that, in some cases, the most relevant measures of performance are nonfinancial.[40] Despite the preference for nonfinancial performance measures for stewardship PP&E, the government must demonstrate that it is being an appropriate "steward" for these assets. To meet the stewardship objective, the government must be able to answer basic questions such as:

- What and where are the important assets?
- Is the government effectively managing and safeguarding its assets?

126. Answers to these questions can be provided through supplementary stewardship reporting. The stewardship information provided would not necessarily have the same measurement basis as information shown on the balance sheet. Information could include value, quantity, and capacity depending on the category being reported on. These types of information are not typically found in balance sheet reporting. (Also, see discussion of deferred maintenance in paragraph 171 through 181 regarding other information that users consider relevant.)

[39] The term "stewardship PP&E" is used to refer collectively to federal mission PP&E, heritage assets, and stewardship land.

[40] *Objectives*, paragraph 54.

127. The Board is addressing supplementary stewardship reporting in another standard. The information to be provided for stewardship PP&E is proposed in detail in that standard. Each of the stewardship PP&E categories are discussed further in the following paragraphs.

Federal Mission PP&E

128. Federal mission PP&E are specific PP&E acquired to provide a unique good or service for which there is not necessarily a periodic output against which to match costs. For example, the existence of and readiness of weapons systems supports national defense regardless of their actual combat use on a period by period basis. Also, space exploration equipment is used in long-term research efforts which may or may not produce an output each period but which nevertheless benefits the nation in the long run.

129. The standard specifically identifies weapons systems and space exploration equipment as Federal mission PP&E as well as providing a list of characteristics of Federal mission PP&E. The Board articulated characteristics of Federal mission PP&E because it recognizes that there are other types of PP&E, or PP&E may be developed in the future, that are similar to these two items. To be categorized as Federal mission PP&E an item shall meet at least one characteristic from each of the following two types of characteristics.

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

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

131. Characteristics related to the useful life are that it:

- has an indeterminate or unpredictable useful life[41] due to the manner in which it is used, improved, retired, modified, or maintained; or
- is at a very high risk of being destroyed during use or of premature obsolescence.

132. The cost of Federal mission PP&E acquired during the period be shown on the operating statement.

[41]This may be evidenced by the ability (1) to retire the PP&E and later return it to service, or (2) to continually upgrade the PP&E to maintain its usefulness. In addition, PP&E that is held for "one-time" use, such as a warhead, has an indeterminate life.

Heritage assets

133. Heritage assets are held for their cultural, architectural, or aesthetic characteristics. Users have identified nonfinancial information as being relevant for these assets. For assessing operating performance, the Board believes that relevant cost information is provided through reporting of periodic maintenance cost since heritage assets are intended to be preserved as national treasures. It is anticipated that they will be maintained in reasonable repair and that there will be no diminution in their usefulness over time.

134. In addition to assets held purely for heritage purposes (e.g., the Washington Monument), the Federal Government uses heritage assets in its day-to-day operations. For example, many Federal office buildings, such as the Old Executive Office Building, have monumental characteristics. The Board considered whether these multi-use heritage assets would be more appropriately categorized as general PP&E.

135. Despite their heritage characteristics, these assets serve a function that could otherwise be served by assets that do not possess heritage characteristics. Therefore, the standards provide that costs of reconstruction, renovation, or improvements that are directly associated with supporting operations be treated in a manner consistent with general PP&E. The Board based this decision on the need to measure cost for operations and to compare cost between entities.

Stewardship Land

136. The Federal Government owns vast amounts of land and its use of land is diverse. In some instances Federal land is integral to the ownership of general PP&E. For example, the cost of land upon which an office building is sited is integral to the cost of that building. Land acquired for or in connection with general PP&E will be recognized on the balance sheet to provide a more comprehensive measure of the assets devoted to general government operations. However, since land is not a depreciating asset, depreciation expense will not be recognized on land included in general PP&E.

137. Most Federal land is not directly related to general PP&E. For example, the national parks and forests are not used to support general PP&E. The Board concluded that land other than that acquired for or in connection with other general PP&E should not be reported on the balance sheet. This is consistent with the Board's treatment of heritage assets in that much of the government's land is held for the general welfare of the nation and is intended to be preserved and protected.

Issues

138. Following issuance of the ED, the Board specifically considered several issues related to the PP&E standard. These issues are addressed in the sequence that they appear in the standard.

Definitions

139. The Board asked respondents to comment on the appropriateness of the definitions of PP&E, general PP&E, Federal mission PP&E, heritage assets, and stewardship land. Respondents raised issues on the overall definition of PP&E including (1) internally-developed software, (2) land rights, (3) capitalization threshold, and (4) reversionary interests in property. These four issues are discussed below. An issue raised regarding the Federal mission PP&E definition is also addressed below.

Internally-developed Software

140. The ED proposed that internally-developed software be excluded from PP&E—in effect, that it be expensed when incurred. In making this proposal, the Board pointed to concerns affecting the objectivity/accuracy of any capitalized cost for internally-developed software in general PP&E.[42] The Board was concerned that costs could be overcapitalized thus understating expense for the period and that it would be difficult to provide for the removal or write-off of costs related to unsuccessful projects and/or cost overruns. Given these practical concerns and the expectation that costs for software development efforts would not fluctuate dramatically since they related to continuous agency efforts, the Board proposed that these costs be expensed.[43]

141. Many respondents supported the Board's view. They noted that, among other problems, it would be difficult to distinguish new development efforts from ongoing system maintenance. In fact, some respondents commented that software undergoes continuous improvement and updating.

142. On the other hand, the majority of respondents objected to the exclusion of these costs from PP&E. Many argued that internally-developed software met the overall definition of PP&E and that accounting could accommodate the problems of cost overruns and unsuccessful efforts. Many suggested that costs be held in a work-in-process account and any

[42]Internally-developed software may be a component of general PP&E or stewardship PP&E.

[43]In fact, the majority of private-sector entities do not capitalize the cost of internally-developed software. The Financial Accounting Standards Board has not developed guidance on this issue.

unsuccessful efforts subsequently written off in the period deemed unsuccessful. In addition, many believed that cost overruns were appropriate to include in the cost of the asset.

143. Ultimately, the Board made two changes to the PP&E definitions— they removed the statement excluding internally-developed software from PP&E and they added a provision for recognition of internally-developed software as a component of general PP&E under certain circumstances. Since the Board's concern was with the potential for overcapitalization of these costs, they found that it was not necessary to exclude the costs from the PP&E categories for which costs would not be capitalized. Therefore, any internally-developed software costs appropriately classified as an item of stewardship PP&E may be included in those categories.

144. For internally-developed software costs that would be categorized as general PP&E, the Board placed several restrictions on the capitalization of costs. To be capitalized, it must be intended that the costs be recovered through charges to users. In addition, only certain costs may be capitalized after it has been established that the software project is likely to be successful. Once capitalized, the costs can not be amortized over a period longer than five years.

145. In addition to internally-developed software, the Board discussed accounting for contractor-developed software. In principle, the Board's consensus was that the same accounting should be provided for contractor-developed software as for internally-developed software. However, the Board believed that this proposal should be exposed for comment prior to establishing a standard to that effect. Therefore, the standards do not provide specific provisions restricting the capitalization of contractor-developed software.

Land Rights

146. The Board received a request to address restrictive easements acquired by a Federal agency. This agency acquires restrictive easements limiting the use of land adjoining the agency's own property. The Board considers these easements a "land right." Land rights are interests and privileges held by an entity in land owned by others.

147. The Board provided for the recognition of land rights as part of PP&E since they are generally associated with other items of PP&E actually owned by the entity. In addition, where land rights are for a limited period of time and are includable in the general PP&E category, the Board provided for depreciation of the cost.

Capitalization Threshold

148. Many respondents requested that the Board provide a capitalization threshold as an element of the PP&E definition. The Board addressed this issue in developing the ED. At that time,

the Board carefully considered whether to take a prescriptive approach by setting a threshold or to permit entities the latitude to establish a threshold suited to their particular operating environment. The Board believes that Federal entities are sufficiently diverse that one threshold would not be suitable for all entities. For example, Title 2's $5,000 threshold would be immaterial for defense department operations but perhaps not for a smaller entity such as the Small Business Administration.

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

Reversionary Interests in PP&E

150. The Board also received a request to address reversionary interests in PP&E. In some instances, the Federal Government provides grants to state and local governments for the acquisition of PP&E. If the state or local government eventually decides that it no longer needs to use the PP&E for the purpose specified in the original grant there is often a provision that the PP&E must revert to Federal ownership. In these cases, the Federal Government maintains a reversionary interest in PP&E. In essence, these are contingent assets and should not be recognized on the balance sheet. The Board elected to specifically exclude these items from PP&E.

Federal Mission PP&E

151. Some respondents indicated that the term "Federal mission PP&E" had broader implications than intended by its definition. It was suggested that some may assume any PP&E used to meet an agency's mission would fit this category (e.g., essentially all Federally owned PP&E).

152. The Board agreed that it was possible that a mere reading of the term "Federal mission PP&E" could lead to broader application of the category than permitted under the standard. However, the Board found that there was no brief term that would effectively communicate the nature of the PP&E properly includable in this category. The Board believes that the characteristics provided as well as the illustrations included in Appendix B of this document will clearly establish the appropriate use of this category. In addition, the Board has incorporated in the standard a cautionary footnote regarding loose interpretations drawn from the term "Federal mission PP&E."

Depreciation

153. The exposure draft posed several questions related to depreciation accounting for general PP&E. Briefly, the questions addressed:

- usefulness of depreciation expense for the assessment of operating performance,
- an alternative view suggesting that depreciation accounting be limited to business-type activities,
- usefulness of the allocation of depreciation expense to responsibility segments, and
- cost/benefit of allocating depreciation expense to programs

154. Overall, the respondents supported the Board's proposal to require depreciation accounting on all general PP&E. Many indicated that depreciation accounting would improve performance measurement by producing comprehensive, comparable cost information. In addition, operating expenses would not be overstated in periods that assets were purchased and understated in other periods.

155. A few respondents supported the alternative view that would limit depreciation accounting to business-type activities. They argued that depreciation was only necessary where expenses were to be matched to revenues. This view is contrary to the operating performance objective and would not support development of cost information to associate with performance measures.

156. The Board did not make any changes to its requirements to apply depreciation accounting to general PP&E.

Multi-use Heritage Assets

157. The ED addressed renovation, reconstruction, improvement, and rebuilding costs for multi-use heritage assets (e.g., monumental style office buildings). Under the ED's proposal, any costs not directly associated with the heritage nature of the asset would be capitalized and depreciated as general PP&E. The ED also provided that abnormally high costs due to the heritage features of the assets (e.g., replacement of a specialized roofing material versus a modern day equivalent) be treated as heritage asset costs.

158. Respondents indicated that it would be very difficult to apply the proposed standards. Difficulties would include segregating the cost associated with preserving the heritage assets and supporting operations as well as identifying abnormal costs. In response to these concerns, the Board modified the treatment of multi-use heritage assets. The standard now provides that only renovation, reconstruction, and improvement costs directly attributable to operations be capitalized as general PP&E.

Current Value

159. The ED included an alternative view espousing the use of current value accounting for Federal Government PP&E. This view was not supported by the respondents. The majority of respondents believed that current values would be difficult and costly to obtain, and subject to manipulation. Many indicated that current values were often useful to decision makers and should be provided on an as needed basis rather than incorporated in the basic financial statements.

Federal Mission PP&E

160. Overall, the reaction to the Federal mission PP&E category was favorable. Respondents indicated that they would not have difficulty applying the category descriptions. However, the Board received the following specific requests for major revisions in the Federal mission PP&E category:

- to retain the definition but include Federal mission PP&E on the balance sheet and apply depreciation accounting to these assets, and
- to make use of the category optional (e.g., managers would be free to use the general PP&E category for PP&E that would otherwise qualify as Federal mission PP&E).

Depreciate Federal Mission PP&E

161. The Board did not adopt the first proposal—to apply depreciation accounting to Federal mission PP&E. While there may be management uses of this information, no persuasive examples of management uses have been identified. The Board remains convinced that depreciation accounting for these unusual items of PP&E would not provide meaningful information—a view that is supported by the Board's 1992 user needs study. Further, the Board wishes to note that nothing precludes management from developing depreciation information through cost finding means if it desires to do so for particular management purposes.

Make the Federal Mission PP&E Category Permissive

162. It was proposed that classification of PP&E as Federal mission be permissive rather than mandatory. Two reasons were given for this proposal:

- some PP&E is used as both Federal mission and general PP&E (for example, office facilities located at nuclear weapons production plants), and
- entity management should be free to decide that depreciation information on Federal mission PP&E is useful.

163. It was suggested that adopting this proposal would allow agencies to classify property as best suits their needs. The Board discussed this proposal at length. Some Board members were favorably inclined to permit entity managers to exercise judgment regarding the accounting treatment of Federal mission PP&E. However, the majority of the Board members believed that making the category optional would be inappropriate.

164. These members argued that (1) the user needs study supported their belief that historical cost depreciation on these types of items was not useful, (2) it would not be appropriate to give entities the latitude to use different accounting methods for similar assets, and (3) it would not be cost-beneficial to permit entities to make item by item judgments on appropriate accounting treatment. The members noted that, in connection with the proposal to require depreciation accounting for Federal mission PP&E (See paragraph 161), they had not been able to identify any management uses of depreciation information on Federal mission PP&E. The Board was concerned that entities may make unsupported, and costly, decisions regarding the election to categorize items as general or Federal mission PP&E. While entities can use cost finding to determine depreciation expense for internal purposes if they so desire, the Board does not believe that depreciation of Federal mission PP&E would be useful for general purpose financial reports.

165. The Board decided that use of the Federal mission PP&E category would remain mandatory for PP&E exhibiting the designated characteristics. The Board did add guidance in the standard regarding the selection of the base unit to be used in categorizing PP&E (See paragraph). One respondent had proposed that this guidance be added and stated that it would aid entities in establishing the level of detail necessary to properly categorize PP&E. For example, should PP&E be categorized on a site by site basis or by a smaller unit such as building by building. As with the capitalization threshold, the Board has indicated the factors that should enter into the selection of a base unit but has ultimately left the actual selection up to management.

Other PP&E Meeting the Characteristics

166. The Board posed a question in the ED regarding the classification of **nuclear weapons production facilities** and **military base facilities** as Federal mission PP&E.[44] This question was posed because of a discussion among the Board members as to whether these items would or would not meet the Federal mission PP&E definition.

167. The majority of the respondents indicated that nuclear weapons production facilities meet the current characteristics of Federal mission PP&E—confirming the initial reaction of the

[44]FASAB Exposure Draft, *Accounting for Property, Plant, and Equipment*, February 28, 1995, page 19, paragraph 71, Item IC.

Board members. One respondent did indicate that these facilities could be converted to other uses—as had munitions plants following World War II—however, the Board believes that the cost of such a conversion would be so great as to make it improbable in the near term. The Board has not elected to add this as another specifically identified item that qualifies as Federal mission PP&E because it is a good illustration of the purpose and application of the characteristics developed. In addition, the Board prefers not to engage in an exercise of listing all items that qualify since the absence of certain items may lead practitioners to assume that an item was specifically excluded.

168. The majority of respondents indicated that military base facilities would not as a group meet the definition of Federal mission PP&E and that the category should not be expanded to accommodate these assets. Many respondents pointed out that military base facilities have alternative uses and are currently being reviewed for just that purpose. The Board agrees with these views and has not modified the definition to permit inclusion of military base facilities in the category.

Audit of Federal Mission PP&E

169. Several respondents expressed concern regarding the level of audit coverage applicable to Federal mission PP&E. Although the ED did not specifically address supplementary stewardship reporting for those categories of PP&E removed from the balance sheet, there was concern that removing these categories would lessen the audit coverage. Respondents noted that military weapons systems and space exploration equipment represented a substantial investment. They were concerned that the changes could lead to poor tracking systems for these items as well as weak internal controls over them. Other respondents pointed out that the key information is the existence and condition of these assets rather than the historical cost of the items. In addition, they suggested that devoting audit resources to verifying historical cost dollar amounts would detract from auditing more important existence and condition information.

170. The Board responded with the following points:

- auditing standards are beyond the scope of the Board's responsibilities,
- Board members representing the Government Accountability Office (GAO) and the Office of Management and Budget (OMB) indicated that the audit coverage would be appropriately addressed in their work on Federal audit requirements,
- accounting standards should be established based on information needs not audit concerns, and
- the ED on supplementary stewardship reporting will include a statement to the effect that the Board expects that the responsible parties will produce audit requirements to satisfy concerns of the respondents.

Deferred Maintenance

171. The deferred maintenance standard was well received by the majority of respondents. The Board addressed the issue in part due to the many state and local governments as well as national groups that concerned over the deteriorating condition of government owned PP&E. A report of the U.S. Advisory Commission on Intergovernmental Relations (ACIR), High Performance Public Works,[45] notes that maintenance competes for funding with other government programs and is often underfunded. Contributing to this underfunding is the fact that the consequences of underfunding maintenance are often not immediately reported. The consequences include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations.

172. The ACIR recommended that entities disclose information on:

- the condition of assets,
- the cost of unfunded maintenance,
- the consequences of unfunded maintenance, and
- the uncertainty in estimates of unfunded maintenance.

173. The Capital Expenditures task force also recognized that deferred maintenance was an issue for Federal PP&E and requested that the Board address it. The policies and initiatives related to deferred maintenance at three Federal agencies[46] were reviewed and it was found that Federal agencies are developing systems to report on deferred maintenance. Although the systems are different, the goals of the systems are consistent—to provide reliable information on the condition of PP&E and to estimate the cost of correcting deficiencies.

174. Under these accounting standards, deferred maintenance information will be incorporated in the financial reports despite the differences in measurement among the agencies. The Board believes that deferred maintenance is a cost—a cost that management, at whatever level, has elected not to fund. However, the Board found that deferred maintenance is not sufficiently measurable to be recognized in the accounting systems.

175. However, to highlight the reality that the cost remains despite being unfunded, the standards provide that deferred maintenance be disclosed by placing a line item on the statement of net cost with a note reference in lieu of a dollar amount on the financial statements. This

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[45]U.S. Advisory Commission on Intergovernmental Relations, High Performance Public Works: A New Federal Infrastructure Investment Strategy for America, November 1993.

[46]These agencies are the Department of Energy, the Department of the Navy, and the National Aeronautics and Space Administration.

recommendation is consistent with the findings of the Board's user needs study; that information on the cost of deferred maintenance is important to users. In addition, due to the measurement differences between entities, the disclosure requirements are flexible.

176. The standards provide two alternatives for estimating amounts to be disclosed—condition assessment surveys and life cycle cost analyses. Condition assessment surveys would provide disclosure of the estimated cost to return the PP&E to its desired condition. Life cycle cost analyses would highlight differences between planned maintenance and actual maintenance.

177. Both of these methods will be under the control of entity program managers since deferred maintenance is dependent on the purpose for which PP&E is held and on judgment regarding what condition PP&E should be in to meet that purpose. Entities are permitted flexibility in (1) setting standards for maintenance requirements and (2) establishing cost beneficial methods to estimate the cost of deferred maintenance.

178. The proposed standards require disclosure of information on the condition of PP&E, estimates of the cost of deferred maintenance, and methods used to assess deferred maintenance. The standards apply to both PP&E reported on the balance sheet and the stewardship report.

179. In response to the ED, two opposing suggestions were raised—(1) recognize the amounts as a liability, and (2) remove the information from the notes.

Recognition

180. A few respondents, including two appearing at the public hearing, suggested that the Board provide for recognition of the liability associated with deferred maintenance. The Board does not believe that deferred maintenance can or should be recognized as a liability because it is not sufficiently measurable to be recognized. Deferred maintenance reporting is in an evolutionary phase with Federal agencies currently developing a variety of systems to assess deferred maintenance. Measurement can not be described at this time as consistent or comparable. The deferred maintenance standard will remain as drafted. However, if and when government maintenance standards (e.g., minimum acceptable condition and standard repair costs) are set, the Board will revisit the accounting and consider requiring recognition of the liability and the cost.

Remove From Notes

181. A few respondents requested that the Board provide for deferred maintenance information through required supplemental information to lessen the audit burden associated with the information. The Board—as was the case with Federal mission PP&E—does not believe that

audit coverage should govern the placement of information in the annual reports. Deferred maintenance information is considered important because it ensures that readers are informed of the condition of Federally owned PP&E. If there is a need to reduce the audit coverage, the Board believes that GAO and OMB can best address this need.

Cleanup Cost

182. The Board elected to address cleanup costs from long-term Federal operations as one of the costs associated with PP&E. For example, the Federal Government operates nuclear facilities and is required by law to cleanup any hazardous materials upon closing the facilities. This obligation meets the Board's definition of liability.[47] However, because the cleanup of these types of facilities would not occur until operations cease, additional guidance is needed to determine when and how to recognize these costs and liabilities.

183. The guidance in this standard builds on the accounting standards developed for liabilities. These standards were published in the Board's statement entitled *Accounting for Liabilities of the Federal Government* (liabilities standard). The liabilities standard includes:

- the liability definition,
- recognition criteria, and
- disclosure requirements.

184. The liabilities standard is applicable to cleanup costs. For example, if cleanup costs are not both probable and measurable the disclosure requirements in the liabilities standard would apply. The standards in this statement address cleanup cost accounting including:

- allocating cleanup costs to operating periods,
- estimating cleanup costs to be paid far in the future (e.g., using a current cost approach), and
- recognizing changes in estimates prior to actual cleanup.

185. Because of the differences in accounting for the costs of general PP&E and stewardship PP&E, the Board developed different methods for allocating cleanup costs to operating periods depending on the category of the related PP&E.

[47]FASAB, Recommended Accounting Standard No. 5, *Accounting for Liabilities*, September 1995.

Cleanup of General PP&E

186. The Board concluded that the liability for cleanup costs related to the operation of general PP&E would be recognized in a systematic and rational manner over the periods that the associated general PP&E is in use. This approach is consistent with the requirement to depreciate general PP&E. In addition, the Board requires disclosure of the estimate of total cleanup costs.

Cleanup Of Stewardship PP&E

187. For cleanup costs related to stewardship PP&E, the Board concluded that the total estimated liability for cleanup cost would be recognized at the time that the stewardship PP&E is placed in service. This is consistent with the treatment of the acquisition cost of the stewardship PP&E which is recognized as a cost of operations in the period that the PP&E is placed in service.

Estimating Cleanup Costs

188. With regard to estimating cleanup cost, the Board concluded that the estimate would be based on the current cost to perform the cleanup. Current cost should be based on existing laws, technology and management plans. An alternative to current cost would have been to estimate costs in the future, factoring in expected inflation, and discounting this amount to current dollars. The Board did not believe that this approach offered any greater degree of accuracy in return for the additional effort involved in making the estimate.

189. As with all estimates, the estimates of cleanup costs will change over time. These changes will be due to inflation as well as to changes in laws and technology.

190. For cleanup costs associated with general PP&E, changes in estimates related to current and prior period operations be recognized as an expense in the period of the change. For example, if a facility with a capacity to produce 100 tons of material has produced 60 tons of material, then 60% of the change in estimate should be recognized as expense in the year that the estimate changes.

191. For cleanup costs associated with stewardship PP&E, the total change in estimate be recognized in the period of the change.

Cleanup Cost Issues

192. Respondents to the ED were supportive of the Board's efforts to address cleanup costs. However, several suggested that the Board's treatment of the liability associated with general

PP&E—recognizing it incrementally over the life of the PP&E—was inconsistent with its definition of a liability. In some cases, respondents argued, the cleanup liability is incurred at the time the PP&E is placed in service. These respondents suggested that the Board provide for full recognition of the liability if an amount is reasonably measurable at that time.

193. The Board did not adopt this suggestion. While the Board recognizes that in fact the liability may be incurred at the date that general PP&E is put in service, the actual recognition of the liability is problematic in a double entry accounting system. Generally, the recognition of a liability, a credit account, generates a concurrent recognition of either an expense (e.g., accounts payable for fuel bills is offset by fuel expense) or an asset (e.g., a capital lease liability is offset by an asset—PP&E), both typically debit accounts. In this case, the cleanup cost is not appropriately includable in operating expense of the period that the PP&E is placed in service. This would create a need for a balance sheet debit to offset the liability.

194. The Board does not believe that it would be appropriate to recognize an asset to offset the cleanup liability. Although some argue cleanup cost is a deferred cost of associated PP&E, the Board does not believe that these costs meet the asset definition and finds that recognition of cleanup cost as a component of PP&E would significantly overstate assets.

195. Other respondents expressed the opposite position, suggesting that it is not appropriate to recognize cleanup costs until they are budgeted for. This approach is not only inconsistent with the definition of a liability but would keep users of the financial statements in the dark as to the magnitude of Federal commitments for environmental cleanup.

196. The Board believes that the standards it has developed will contribute to meeting the operating performance and stewardship reporting objectives of Federal financial reporting. The cleanup cost standards have not been modified for either of these recommendations.

197. One modification that was made relates to implementation of the standard. Implementation is a significant issue given the magnitude of the Government's existing facilities and its obligations for cleanup of those facilities. One Board member requested that the implementation guidance related to cleanup of general PP&E provide an alternative method. It was suggested that provision of a second method would lower the cost of implementing the standard in situations where the related PP&E had been in service for a substantial portion of its estimated useful life.

198. The second method would be to recognize the entire estimated total cleanup cost as a liability upon implementation. In periods following implementation, entities electing this method would recognize any changes in the estimated total cleanup cost as expense for that period in lieu of the pro-rata amount of the estimated total cleanup cost. This method could be applied only by entities not seeking to recover their costs through user charges.

199. The Board adopted this recommendation in light of the large number of Federal facilities that will be affected by this standard and the cost of implementing the standard.

Appendix B: Illustrations Of Categories

200. In developing categories for Federal mission PP&E, Heritage Assets and Stewardship Land (See paragraphs 46, 57, and 66), the Board sought input from Federal agencies, the Standard General Ledger Issues Resolution Committee (SGLIRC), and other subgroup members. The Board found that there were many cases where similar assets could fit more than one category.

201. For example, aircraft and ships are used by law enforcement agencies as well as by the Department of Defense. Under the proposed categories, only those used by the Department of Defense would meet the criteria for Federal mission PP&E. The illustrations provided are intended to clarify the application of the categories to actual assets.

Illustration 1: Federal Mission Property, Plant, And Equipment

202-213 ... [The category Federal Mission, property, plant, and equipment was rescinded by SFFAS 23, par. 9][48]

Illustration 2: Heritage Assets

214. Many assets are clearly heritage assets. For example, the National Park Service manages the Washington Monument, the Lincoln Memorial and the Mall. However, other assets, particularly Federal office buildings, have historical, cultural or architectural significance as well as being used for general operations.

215. The Board has found that these multi-use heritage assets should still be categorized as heritage assets. Any costs to maintain the assets themselves should be treated as heritage assets. However, any costs that are operational in nature (e.g., reconfiguring of office space or modernized communications wiring) should be classified as general PP&E. Costs of these types of improvements or renovations would then be capitalized and depreciated—providing useful information for performance measurement.

216. For assets that are used solely for heritage purposes (e.g., the Washington Monument), the Board believes that the cost of operation, maintenance, and other periodic expenses

[48]... [The category Federal Mission, property, plant, and equipment was rescinded by SFFAS 23, par. 9]

combined with deferred maintenance disclosures, are sufficient to assess operating performance. Allocating the cost of heritage assets to accounting periods through depreciation would not enhance the information available for performance assessment.

217. Following are examples of general PP&E that exhibit characteristics of heritage assets.

Illustration 2A: Major Office Building

218. A Federal agency constructed a central office building in 1950 to house its headquarters personnel. The building was subsequently placed on the historical registry but continued to serve as headquarters' office space.

219. Public tours are available and educational exhibits are provided in the hallways. However, public access is restricted to guided tours. The majority of floor space is devoted to offices, meeting rooms, cafeterias, and storage.

220. The building is currently undergoing major renovations. The cost of these renovations should be capitalized and depreciated over their expected useful lives only to the extent that the work is tied to operations rather than to preserving the building. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

Illustration 2B: New Office Building

221. A Federal facility previously used for industrial purposes (e.g., production of equipment parts) is being renovated and remodeled to serve as office space. The brick facade is being preserved because of its historic significance. Office space is being constructed inside of the brick facade.

222. The building can be viewed by visitors to the Federal facility, however, access to the office space will be restricted.

223. The original cost of the brick facade should not be included in the cost of the new office building. The cost of new construction should be capitalized and depreciated as part of general PP&E and none should be treated as a heritage asset. Additional information on the heritage nature of the existing brick facade, if material, would be provided through stewardship reporting.

Illustration 2C: Library Of Congress

224. The Library of Congress is undergoing restoration and renovation. This includes:

- restoring artwork and architectural features,
- installing wiring for workstations, and
- building office space.

225. Expenditures for restoration of heritage aspects of the buildings should be treated as a period cost for heritage assets. However, expenditures for operational aspects of the renovation should be categorized as general PP&E. Additional information on the heritage nature of the asset would be provided through stewardship reporting.

Illustration 3: Land

226. The proposed standard provides that land acquired for or in connection with other general PP&E be included in that category. For example, the cost of land on which facilities are located would be included in general PP&E. Other land would be subject to stewardship reporting.

227. The following illustrations cover two potential issues associated with land. First, identifying land associated with general PP&E. Second, identifying land improvements as general PP&E or PP&E subject to stewardship reporting.

Illustration 3A: Military Uses Of Land

228. In general, land used for military bases would be considered general PP&E. However, in some cases, land is used by the military as a site for missile silos, testing grounds or firing ranges. Land used for these purposes meets the definition of stewardship land. The Board believes that period-by-period cost information related to holding land for defense purposes is not relevant to assessing operating performance.

Illustration 3B: Roads On Public Lands

229. Public lands have various types of roads to provide access. These types include:

- rough dirt roads created from years of use,
- dirt roads created by non-Federal land users (e.g., oil & gas exploration crews) and then abandoned, and
- roads created by Federal entities to provide access (e.g., gravel & paved roads).

230. Some of these roads are maintained while others merely exist until natural conditions overtake them.

231. Under private sector accounting, permanent improvements to land are included in the cost of land on the balance sheet. Typically, the cost of clearing and establishing the road bed is considered a permanent improvement because, with routine maintenance, it will remain indefinitely. Any pavement or gravel that must be replaced periodically would be considered depreciable PP&E. For a Federal entity, if the road could be categorized as general PP&E this practice would be appropriate since the period-by-period cost of assets is relevant for assessing operating performance.

232. For land subject to stewardship reporting, the cost of establishing the roadbed would be expensed in the year incurred since the land improved by the roadbed is not capitalized on the balance sheet. On the other hand, the paved and gravel roads are general PP&E because they are operational and the period-by-period cost is essential for assessing operating performance. The cost of pavement or gravel would be capitalized and depreciated. Decisions about the quality of the road conditions (e.g., how often roads are repaved) are an element of operating performance and of the cost of providing government services.

Appendix C: Deferred Maintenance Illustration

Par. 233 and the related illustrations were rescinded by SFFAS 42.

Appendix D: Illustration Of Cleanup Cost

234. This appendix illustrates one method of complying with the standards proposed for cleanup costs. The examples shown in this appendix are for illustrative purposes only. There are many types of cleanup that may be accounted for under this proposed standard (e.g., nuclear facilities, landfills, or laboratories). Applying this proposed standard may require consideration of estimated cost components other than those shown here.

235. The computations are based on a formula allocating the estimated total cleanup costs (i.e., the total amount to be spent in the future to accomplish cleanup) to accounting periods. In identifying the amount to be expensed for the period, the formula considers the cumulative amounts:

- of capacity used at the end of the accounting period; and
- recognized as expense in prior accounting periods.

236. The components of the formula are defined below:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[49]
c = total estimated capacity[50]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

237. To calculate the appropriate expense amount, the following formula is used:

$$(a \times b/c) - d = e$$

238. Simply put, the end of period estimated total cleanup cost (a) is multiplied by the percentage of capacity used up at the end of that period (b/c) to arrive at the portion of cleanup cost that has been generated by operations through the end of the period. Theoretically, that amount of expense has been incurred and should be recognized. Amounts recognized as expense in prior periods (d) should be deducted to arrive at the current period expense amount (e). If this is the first period, the deduction for expense recognized in prior periods (d) is zero.

[49]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[50]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

Illustration 1: Hazardous Waste Disposal Site

Operating Assumptions

239. The hazardous waste disposal site will begin accepting waste in 1995. The following assumptions apply:

- the site capacity is 100,000 cubic yards of waste
- it is estimated that the site will accept waste for ten years at an average rate of 10,000 cubic yards per year
- after the site is closed the following cleanup efforts are required by state, local and Federal laws:
  - site closure & sealing
  - thirty year monitoring
  - remediation
- 1995 cost estimates are based on current cost for 1995
- 1996 cost estimates are based on 1996 costs adjusted for inflation at a rate of 1.0%
- 1997 cost estimates are based on current costs for 1997 and include new technology and changes in monitoring requirements

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1995 (Dollars in thousands)

Estimated Total Cleanup Cost[51] based on Current Cost in 1995

1.	Site Closure and Sealing Cost:	
	Facilities for monitoring operations	$100
	Sealing site	750
	Erosion and control facilities	500
2.	Monitoring Cost (for a period of 30 years):	
	Inspection	3,000
	Sampling & Testing	2,250
	Maintenance of facilities	300
3.	Remediation Cost:	
	Projected remediation based on statistical studies	500
	TOTAL ESTIMATED CLEANUP COST	$7,400

[51]This estimate includes any costs of any cleanup efforts required during the thirty year cleanup period. While these activities will not occur until the associated PP&E is closed, the costs are estimated at the current cost to conduct similar efforts.

Calculation of Annual Expense and Accrued Liability Amounts

This proposed standard would require that a portion of the estimated total cleanup costs be recognized as an expense and as a liability each period that the site operates. During 1995, the site accepts 15,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,400 x 15,000/100,000) - 0 = e
$7,400 x .15 = e
$1,110 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[52]
c = total estimated capacity[53]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense	$1,110	
Cr. Cleanup liability		$1,110

To recognize estimated cleanup costs.

[52]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[53]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1996 (Dollars in thousands)

Estimated Total Cleanup Cost based on Current Cost in 1996

1.	Site Closure and Sealing Cost:	
	Facilities for monitoring operations	$ 101
	Sealing site	758
	Erosion and control facilities	505
2.	Monitoring Cost (for a period of 30 years):	
	Inspection	3,030
	Sampling & Testing	2,273
	Maintenance of facilities	303
3.	Remediation Cost:	
	Projected remediation based on statistical studies	505
	TOTAL ESTIMATED CLEANUP COST	$7,475

Calculation of Annual Expense and Accrued Liability Amounts

During 1996, the estimated total cleanup costs were adjusted for inflation of 1.0% and site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d = e
($7,475 x 25,000/100,000) - $1,110 = e
$7,475 x .25 - $1,110 = e
$759 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[54]
c = total estimated capacity[55]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense $759

Cr. Cleanup liability $759

To recognize estimated cleanup costs.

In addition, the proposed standard would require that any material changes in the estimate due to changes in laws, technology, or cleanup plans be disclosed. However, there is no indication that material changes occurred.

[54]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[55]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

RECOGNITION OF EXPENSE AND LIABILITY AMOUNTS FOR 1997 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1997

1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$ 115
Sealing site	740
Erosion and control facilities	500
2. Monitoring Cost (for 30 years):	
Inspection	2,250
Sampling & Testing	1,300
Maintenance of facilities	300
3. Remediation Cost:	
Projected remediation based on statistical studies	400
TOTAL ESTIMATED CLEANUP COST	$5,605

Calculation of Annual Expense and Accrued Liability Amounts

During 1997, a new estimate of total cleanup costs was prepared and the site accepted 10,000 cubic yards of waste. The following calculations show the amounts required to be recognized:

(a x b/c) - d =e
($5,605 x 35,000/100,000) - ($1,110 + 759)= e
$5,605 x .35 - $1,869 = e
$1,962 - $1,869 = e
$ 93 = e

where:

a = total cleanup cost estimated as of end of period
b = cumulative capacity used at end of period[56]
c = total estimated capacity[57]
d = amount previously recognized as expense-beginning of period
e = cleanup expense recognized in the current period

The following journal entry would be required:

Dr. Cleanup expense	$93	
Cr. Cleanup liability		$93

To recognize estimated cleanup costs.

In addition, the proposed standard would require that material changes in estimated cleanup costs be disclosed and that amounts attributable to prior period operations be disclosed. One means of calculating this amount is to segregate the amount recognized as cleanup expense for the current period between “changes in estimated cleanup cost from prior periods” and “current period cleanup cost.” These two amounts would be disclosed.

Changes in estimated cleanup costs from prior periods are:

f = (a x b1/c) - d
f = ($5,605 x 25,000/100,000) - ($1,110 + 759)
f = $5,605 x .25 - $1,869
f = $1,401 - $1,869
f = $(468)

[56]If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[57]If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

where:

a = total cleanup cost estimated as of end of period
b1 = cumulative capacity used at beginning of period[58]
c = total estimated capacity[59]
d = amount previously recognized as expense at beginning of period
f = changes in estimated cleanup cost from prior periods

Current period cleanup costs are:

g = e - f
g = $ 93 - $(468)
g = $ 561

where:

e = cleanup cost recognized in the current period
f = changes in estimated cleanup cost from prior periods
g = current period cleanup costs

SUMMARY:

FINANCIAL STMT.	1995	1996	1997
Operating expense	$1,110	$ 759	$ 93
Liability	$1,110	$1,869	$1,962

Illustration 2: Nuclear Facility Qualifying As General PP&E

Operating Assumptions

240. A nuclear facility was placed in operation in 1981. No recognition of cleanup cost was made under past accounting policy. At the end of 1995, the entity adopts the accounting policies presented in this proposed standard.

[58] If recognition of the costs is based on the passage of time rather than physical capacity, the cumulative amount of time passed since the associated PP&E began operating shall be substituted.

[59] If recognition is based on the passage of time, the estimated useful life of the associated asset shall be substituted.

The following assumptions apply:

- the entity has an expected useful life of thirty years
- after the site is closed the following cleanup efforts are required by state, local and Federal laws:
  - site closure & sealing
  - thirty year monitoring
  - remediation
- 1995 cost estimates are based on current cost for 1995

RECOGNITION OF LIABILITY AMOUNTS FOR 1995 (Dollars in thousands)

Estimated Total Cleanup Cost Based on Current Cost in 1995

1. Site Closure and Sealing Cost:	
Facilities for monitoring operations	$1,000
Sealing site	3,000
2. Monitoring Cost (for 30 years):	
Inspection	6,000
Sampling & Testing	3,000
Maintenance of facilities	600
3. Remediation Cost:	
Projected remediation based on statistical studies	2,000
TOTAL ESTIMATED CLEANUP COST	$15,600

Calculation of Liability Amount To be Recognized Upon Implementation

At the end of 1995, the estimated total cleanup costs was $15,600,000. The following calculations show the amounts that should have been recognized as of the end of 1995 if the proposed standard had been in effect since the facility began operating on October 1, 1980:

(a x b/c) - d = l
($15,600 x 15/30) - $0 = l
$15,600 x .5 - $0 = l
$7,800 = l

where:

a = total cleanup cost estimated as of end of period
b = number of years of operation
c = estimated useful life
d = amount previously recognized as expense-beginning of period
l = liability to be recognized at the end of 1995

Dr. Net Position	$7,800	
Cr. Cleanup liability		$7,800

To recognize estimated cleanup liability.

No expense is recognized in the year of implementation.

SUMMARY:

FINANCIAL STMT.	1995
Prior Period Adjustment	$7,800
Liability	$7,800

Appendix E: Glossary

See Consolidated Glossary in “Appendix E: Consolidated Glossary”.

APPENDIX 9: PURCHASE CARD ACCRUAL PROCEDURES AND RESPONSIBILITIES

A9-1. **Purpose:** The purpose of this appendix is to identify the procedures and responsibilities referenced in *Chapter 4. Purchase Card Accrual Policy* of the *Accounting Policies Handbook.*

A9-2. **Effective Date of These Procedures:** September 2015. These procedures will be reviewed annually and updated as needed.

A9-3. **Procedures and Responsibilities:**

A. The Assistant Chief Financial Officer for Accounting (ACFOA) will maintain an employee as a GPC user of the servicing bank's electronic access system with capability limited to generating and downloading reports from the electronic access system. The ACFOA's designated user will have no authorization or capability to make purchases within the GPC system.

B. ARC will determine the billing cycle covered by the GPC invoice, which generally is a 30 day period ending on the 3rd calendar day of the month of the accounting period for which financial statements are being prepared.

C. Assuming the preceding billing cycle example, ARC will generate a GPC report to determine the GPC expenses that have been incurred from the 4th calendar day of the accounting period through the end of the accounting period (end of month).

D. ARC will provide the report to be used for accruals to the Office of the Chief Financial Officer's Accounting Center (CFOAC) for quarterly review and approval. Upon approval by CFOAC, ARC will work to generate a Journal Entry (JE) template for the accruals using the data from the report and request approval from CFOAC to process. This will ensure recognition of the GPC expenses which have been incurred, but not included in the latest GPC invoice previous to the expense.

E. Upon receiving the GPC report from ARC to be used for accrual purposes, the CFOAC staff will review the report for accuracy and provide an approval to proceed with the JE template. Upon receiving the JE template, CFOAC staff will review the JE and provide approval to ARC for quarterly entry in Oracle and ultimately the general ledger.

F. The JE for the accruals will be broken down by the accounting string used to incur the charge.

G. ARC will execute the JE document for the accruals quarterly under the following posting model.

ARC USSGL	Description
Dr 61000001	Operating Expenses/Program Costs
Dr 31070001	Unexpended Appropriations - Used
Dr 46100004	Allotments - Spending
Cr 21100002	Accounts Payable - Receipt Accruals
Cr 57000001	Expended Appropriations - Expensed
Cr 49010001	Delivered Orders - Obligations; Unpaid

H. ARC is responsible for maintaining adequate documentation to support the purchase card accrual and the CFOAC staff is responsible for reviewing the information to ensure accuracy.

APPENDIX 10: GOODS AND SERVICES RECEIVED BUT NOT INVOICED PROCEDURES AND RESPONSIBILITIES

A10-1. Purpose: The purpose of this appendix is to identify the procedures and responsibilities referenced in *Chapter 5. Goods and Services Received but Not Invoiced* of the *Accounting Policies Handbook*.

A10-2. Effective Date of These Procedures: August 2016. The policy will be reviewed annually and updated as needed.

A10-3. Responsibilities:

A. On a quarterly basis, the Office of the Chief Financial Officer's (OCFO) Accounting Center (CFOAC) will compute accruals and submit them to HUD's shared service provider, Treasury's Administrative Resource Center (ARC) for processing and recording in the accounting system.

B. CFOAC will use the Discover report entitled SAR Accrual Review – Open Obligations.

C. The file will be sorted to isolate contractual obligations and a threshold of $100,000.00 will be used to capture material contract expenses. A formula will be used to compute the Life To Date (LTD) expense of the contract. The formula will compute the expense incurred to date based on the performance start date of the contract. The number of months that should be expensed by the end of the quarter will be computed and then multiplied by $\frac{1}{12}$ of the original obligation amount.

D. On the week prior to quarter end, the CFOAC will run the SAR Accrual Review – Open Obligations report and provide the LTD expense.

E. The file will then be sent to ARC for processing. ARC will use the LTD amount provided by CFOAC and reduce it by any paid invoices to compute the actual accrual amount.

F. ARC will upload the file and process to record an accrual against each obligation in the accounting system using the following posting model.

ARC USSGL	Description
Dr 61000001	Operating Expenses/Program Costs
Dr 48010001	Undelivered Orders - Obligations, Unpaid
Dr 31070001	Unexpended Appropriations - Used
Cr 21100002	Accounts Payable - Receipt Accruals
Cr 49010001	Delivered Orders - Obligations; Unpaid
Cr 57000001	Expended Appropriations - Expensed

G. CFOAC will receive confirmation of posting and review the General Ledger to ensure accruals were posted.

H. CFOAC is will maintain the spreadsheets used to compute the accruals for goods and services received but not invoiced.