OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION
TECHNOLOGY
AND LOGISTICS

OCT 7 2005

MEMORANDUM FOR DEPUTY ASSISTANT SECRETARY OF THE ARMY
(FINANCIAL OPERATIONS)
DIRECTOR, OFFICE OF FINANCIAL MANAGEMENT
OPERATIONS, DON
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL OPERATIONS)
USSCOM, DIRECTOR OF SORR – J-8

SUBJECT: Military Equipment Valuation Program Policy Implementation Guidance – Composite or Group Methodology and Baseline Valuation Methodology for Modifications

The Deputy Chief Financial Officer and Director, Acquisition Resources and Analysis established a set of principle-based business rules to be followed in order to value military equipment. These rules have been issued in a jointly signed memorandum, subject: Military Equipment Valuation Project Business Rules, dated June 8, 2005. Because the business rules are principle-based, they do not provide guidance for every specific question regarding valuation. Accordingly, the Property and Equipment (P&E) Policy Office, from time-to-time, will issue implementation guidance that is arrived at by consensus with the Military Departments and reviewed by the Director, Accounting and Finance Policy and Analysis and the office of the DoD Inspector General.

The P&E Policy Office has prepared just such guidance for "Accounting for Military Equipment Acquisitions Under A Composite or Group Methodology" and "Baseline Valuation Methodology Position Paper: Modifications, Modernizations, Upgrades, and Improvements". This guidance is attached for your information and use. It is also posted on the military equipment valuation website at www.acq.osd.mil/me.

If you have any questions or need additional information, please contact Mr. Harry Chelpon at 703-604-6350 ext 125 or by e-mail at harry.chelpon@osd.mil.

Richard K. Sylvester

Richard K. Sylvester
Deputy Director, ARA
(Property & Equipment Policy)

Attachments:
As stated

Baseline Valuation Methodology Position Paper:
Modifications, Modernizations, Upgrades,
and Improvements

Background

This paper describes the baseline methodology for accounting for the costs of modifications, modernizations, upgrades, and improvements (hereinafter referred to as modifications).[1]

Proposed Policy [2]

The proposed policy for baseline valuations addresses the following three scenarios: (1) Modifications can be linked to specific end items; (2) Modifications can be linked to a specific program or programs but not specific end items; and (3) Modifications relate to a type of assets (such as ships), but the information is not available to link the cost of the modifications to affected programs or specific end items.

Scenario (1) – Modifications can be linked to specific end items.

- Capitalize the cost of modifications that extend the useful life of an end item, notwithstanding the cost of the modification or the net book value of the end item, as part of the cost of the end item and depreciate over the end item's new useful life.
- Capitalize the cost of modifications that enlarge or improve the capacity of an end item, but do not extend its useful life, notwithstanding the cost of the modification or the net book value of the end item, as part of the cost of the end item and depreciate over the end item's remaining useful life.
- Write off (recognize as a loss) the net book value of the end at the time of end item disposition.

Scenario (2) – Modifications can be linked to a specific program or programs but not specific end items.

- Capitalize the modification costs incurred during a given fiscal year as a separate item and depreciate over the estimated useful life of the modification, notwithstanding the value of the modification or the net book value of the end items referred to below.
- Develop an estimate of the portion of these modification costs allocable to end items in service at the end of the fiscal year in which the modification costs were incurred. For example, if modification costs of $100,000,000 were incurred in FY 1998 and the number

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[1] Statements of Federal Financial Accounting Standards provide that they need not be applied to immaterial items. Accordingly, this Policy Position Paper does not apply to immaterial modification costs.

[2] This Policy Position Paper addresses modifications to Military Equipment end items. It does not address modifications to items classified as Inventory and Related Property.

of in end items in service at the end of the 1998 was 1000, the estimate modification cost per end item would be $100,000.

- Associate the capitalized modification costs with the end items in service at the end of the year in which the modification costs were incurred through a parent-child relationship.
- Write off (recognize as a loss) the net book value of the end item and associated estimated modification cost at the time of end item disposition.[3]

Scenario (3) – Modifications relate to a type of assets, but the information is not available to link the cost of the modifications to affected programs or specific end items.

- Capitalize the modification costs incurred during a given fiscal year as a separate item and depreciate over the estimated useful life of the modification.
- For baseline valuation, because under this scenario modification costs cannot be associated with a program or programs or specific end items, no provision is made for the write off of a portion of this account balance upon disposal of the related but unknown end item.

[3] To illustrate, assume the following: (1) the entity incurred modifications costs of $100,000,000 in 1998; (2) modifications had a useful life of 10 years; (3) the entity uses straight line depreciation; (4) the modifications affected 1000 end items in service; and (5) the destruction of 100 end items in 2001. At the end of 2001 the net book value of the modifications related to end destroyed end items was $7,000,000 ($100,000,000 book value less $30,000,000 accumulated depreciation equals $70,000,000 net book value. Destroyed end items equal 10% of total end items or 10% of net book value - $7,000,000)