

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
May 24-25, 2006
Room 7C13
441 G Street NW
Washington, DC 20548

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Wednesday, May 24, 2006

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Mosso, Messrs. Allen, Dacey, Farrell, Patton, Reid, Schumacher and Werfel, Ms. Cohen. Mr. Marron attended Thursday, May 25th. The executive director, Wendy Comes, and general counsel, Jeff Jacobson, were also present throughout the meeting.

- **Approval of Minutes**

Minutes of the prior meeting were approved electronically in advance of the meeting.

- **Other Administrative Matters**

Mr. Mosso introduced Mr. Werfel of the Office of Management and Budget. Mr. Werfel will represent OMB.

Agenda Topics

- **Objectives**

Staff presented the update on the Objectives project. At the March 2006 Board meeting, the Board agreed that the broad objectives of financial reporting should be maintained. Also, the Board agreed that there would be benefit to articulating FASAB's role in relation to those broad objectives, but noted that there were various approaches for accomplishing this goal. The different options required further Board assessment and, to assist in discussing the topic at today's meeting, the Board asked staff to prepare an analysis of the strategic plans prepared by the Governmental Accounting Standards Board (GASB) and Financial Accounting Standards Board (FASB) and to continue to develop the White Paper on the objectives.

Staff noted that the Board last reviewed the White Paper in August 2005. The White Paper presented events and issues related to the objectives project in a chronological manner. Staff believed that the document could be restructured depending on how the Board decides to use the White Paper, such as maintaining the document internally or publishing it as a report.

Staff discussed that since the August 2005 review, staff made some changes throughout the document; however, the most significant change was the addition of a section that discusses an assessment of FASAB's role in relation to the broad objectives of financial reporting. Staff believed that each of the objectives were equally important and did not attempt to rank the objectives. Instead, staff presented an assessment that included two levels of focus for FASAB in the near-term¹ as follows:

Primary Focus Objectives—Primary Focus Objectives are those objectives where there is the greatest opportunity for FASAB to play a direct role in developing standards to achieve the stated objectives, based on its comparative advantage and other factors. Therefore, the Operating Performance and Stewardship objectives would be considered the primary focus objectives.

Secondary Focus Objectives—Secondary Focus Objectives are those objectives where there is not the greatest opportunity for FASAB to play a direct role in

¹ Near-term is defined as approximately five years for the purposes of this document. In conjunction with strategic planning, FASAB may re-evaluate this assessment at earlier intervals in future years.

developing standards to achieve the stated objectives, based on its comparative advantage and other factors noted above. In contrast to primary focus objectives, FASAB believes that it will play an indirect role in developing standards that would meet these objectives in the near-term. The Budgetary Integrity and Systems and Control objectives would be considered the secondary focus objectives.

Board members discussed the staff's proposed assessment of FASAB's role. While they agreed with the overall assessment, some members believed that labels other than "primary" and "secondary" could be used for the focus categories. For instance, the focus could be categorized in relation to a time horizon, such as "near term," because the Board's focus could change over time. Also, it was noted that perhaps categories should not be used. The objectives are interrelated and an issue could arise that requires the Board to focus on multiple objectives. However, staff noted that the two categories (primary and secondary) were established because, throughout the project, the Board has expressed a need to address the fact that there are objectives that FASAB has not dealt with as much as others. The need will still exist if the categories are eliminated.

Members acknowledged that FASAB appears to have more of a comparative advantage in achieving the primary objectives (Operating Performance and Stewardship) and a supporting role in the secondary objectives (Budgetary Integrity and Systems and Control). Staff will revisit the terminology used to categorize FASAB's role in relation to the objectives.

The Board discussed that strategic planning has merits and that a strategic plan could be used to narrow-down where the Board will focus over the next 3-5 years. Also, a strategic plan could inform constituents about the Board's mission and current thinking on priorities. However, as noted by the staff analysis of other standard-setter's strategic planning efforts, the strategic planning process requires significant amounts of Board and staff time. These factors could overwhelm the Board's resources as it seeks to accomplish a challenging technical agenda.

It was noted that the objectives project incorporated steps and topics that are typically a part of strategic planning exercises. For example, the White Paper includes a scan of the environment. The document discusses the evolution of FASAB's role and the evolution of laws and regulations since the CFO Act. Also, the White Paper engaged the community and includes discussions with roundtable participants. The discussions provided feedback on significant financial reporting issues and where constituents believed FASAB should demonstrate leadership and provide education. In addition, the White Paper presents FASAB's mission and current thinking on priorities.

Given that the White Paper already addresses key aspects of strategic planning and the limited amount of FASAB resources, the Board agreed to publish the White Paper as the document that communicates its strategic plans and staff will revise the White Paper for public issuance. The Board may later consider enhancements to the White Paper if

it finds that the document does not serve well in this capacity. The Board next discussed the following due process options for the document:

1. Because the Board has been involved throughout its development, release the white paper without a comment period.
2. Invite comments on the white paper in a manner similar to FASAB's invitation for comments on technical agenda options.
3. Subject the white paper to a review by a team of constituents familiar with FASAB's work and federal financial reporting efforts.

Considering resource and time constraints, the Board agreed with option 3. The review team would consist of some of the roundtable participants and Board members.

Ms. Comes noted that it normally takes two rounds of comments before a document can be ready for the Board's final review and vote. Accordingly, staff plans to complete one round of comments by the July meeting.

CONCLUSIONS: The Board agreed that the White Paper will serve as FASAB's strategic plan and the Board may consider enhancements to the document if it later determines that the White Paper does not serve well in this capacity. Staff will revisit the terminology used to categorize FASAB's role in relation to the objectives and prepare the White Paper for public issuance. Also, staff will issue the White Paper to a review team for an initial round of comments. The review team will include Board members and selected roundtable participants.

- **Elements**

The objective of the session was to obtain the Board's approval for release of a ballot draft of a proposed concepts statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements*. Ms. Wardlow provided a ballot draft and a ballot for each member. The draft and transmittal memo indicated the changes proposed since the preballot draft that was circulated to Board members on April 28, 2006. The Board also received a staff summary, requested by the Board at the March meeting, of the differences in the GASB's proposals for a concepts statement on Elements compared with the FASAB's proposals. The summary had been reviewed by GASB staff. The Board had received separately a copy of the latest draft of the GASB's Elements statement.

Ms. Comes said that the Congressional Budget Office (CBO) had proposed a revision to Question 2 in the Questions for Respondents and an additional question relating to the Congress's ability to change laws. Mr. Torregrosa said that CBO is comfortable with the revised language in Question 2, which is intended to elicit comments on whether an additional element is needed to report social insurance obligations. Several Board members suggested further revisions or clarifications to Question 2. Ms. Cohen said

that the revised question is much narrower than the original one and would lead readers to focus attention on the specific resources and obligations mentioned, rather than providing more general comments. She suggested dividing the question into two questions—one general and one more specific. After discussing alternative revisions, the Board agreed to present Question 2 in two parts.

The Board then discussed the new proposed Question 8, which relates to paragraph 44 in the document and quotes part of that paragraph. Paragraph 44 indicates that the fact that the Congress may change a law in the future does not affect whether a liability exists under current conditions. The Board agreed with Mr. Patton's proposal that the entire paragraph 44 should be included rather than part of it. The Board also concurred with Mr. Farrell's suggestion that respondents should be asked whether they agree or disagree with the question, and not just whether they agree with it. Also, as proposed by Mr. Allen and other members, the Board agreed that it is important to ask respondents to explain the reasons for their agreement or disagreement. The Board indicated that the staff should ensure that the same approach is taken in each question. After discussion, the Board agreed with the inclusion of Question 8, with a change in the last sentence of the quotation, which also would be changed in paragraph 44 of the concepts statement.

Ms. Wardlow asked the Board whether they wished to discuss any of the changes proposed to the preballot draft or other issues related to the ballot draft. Mr. Mosso suggested starting with proposals from Mr. Dacey. Mr. Dacey began with the differences between the FASAB and GASB exposure drafts. He noted at least two fundamental differences and indicated that the Board should decide whether to proceed with the FASAB draft or explore with the GASB whether there are opportunities to narrow the differences and achieve convergence between the two documents. He noted that the GASB chairman, Mr. Attmore, was willing to work with the FASAB. His concern was with the two Boards issuing different exposure drafts without agreeing that such was acceptable. As differences, Mr. Dacey highlighted that the GASB document focuses on the flows statement—flows of resources—which is the reason the GASB is proposing to define resource inflows and outflows as having their own characteristics rather than being changes in assets and liabilities, and also is proposing elements for certain deferred items that would allow the GASB to determine what should be reported in the flows statement in the current period. Another difference is that the GASB document indicates that constructive obligations do not arise from nonexchange transactions. The FASAB document does not distinguish between exchange and nonexchange transactions in the concepts it proposes. Mr. Dacey said he wanted to be sure that the FASAB members are aware of these differences before casting their ballots.

Mr. Werfel said that one difference he noted was that the GASB's definition of a liability refers to "little or no discretion." He thought that language was relevant to the FASAB's discussion in paragraph 44 concerning the Congress's ability to change the law. Because of that discretion, it would appear that the FASAB is going in a different direction from the GASB in terms of defining a liability. He wondered whether GASB would find paragraph 44 of the FASAB ED consistent with their definition of a liability

and asked whether the FASAB members wished to discuss the issue. Mr. Mosso and Ms. Cohen said that the issue was discussed earlier in the project. Mr. Mosso said that the “little or no discretion” language was included at one time in the FASAB draft but was eliminated.

With regard to the purpose of the staff summary of the GASB draft, Mr. Werfel asked whether it was an objective of the FASAB to ensure consistency between the two elements statements and whether the FASAB believes that its draft is consistent with the GASB’s draft. Mr. Mosso responded that consistency is desirable but is not an objective of the FASAB, and it is not an objective of the GASB to be consistent with the FASAB or with the FASB. Mr. Allen said that he did not believe the GASB would reach a different conclusion from the FASAB on the FASAB’s paragraph 44, because of the example the GASB gives concerning social, moral, and political consequences of constructive obligations. As to the purpose of the comparison, he found it valuable in ascertaining whether there is something in the GASB’s thinking that the FASAB has not addressed. He noted that the GASB and FASAB staff considered differences but did not find them to be substantial. However, if FASAB members believe there are differences they should raise them. Mr. Mosso noted that each Board will expose its draft and will have the opportunity to comment on the other Board’s draft. In his view, those comments would be the place where any issues about differences should be raised.

Mr. Werfel said that he thought the GASB’s inclusion of “little or no discretion” in its liability definition was a potentially significant difference that should be highlighted and discussed. If it has already been discussed as a difference, that was fine, but he wondered whether the Board had concluded that FASAB and GASB are consistent on this issue and therefore can move forward. Ms. Wardlow explained the background to the FASAB’s decision not to include “little or no discretion” in the liability definition. She noted that the phrase came from the FASB’s discussion of its definition of a liability, although it was not in the actual definition. The FASAB concluded that to have “little or no discretion” was not an essential characteristic of a liability of the federal government. It was unclear what the term would mean in the federal environment given that the government always has some discretion to make changes. Moreover, as indicated in paragraph 44 of the ED, the Board decided that conclusions about whether a liability exists should be based on existing conditions and not on whether the Congress could make changes in the future. Thus, rather than whether there was “little or no discretion” to avoid settlement, the Board focused on the need for an agreement or meeting of the minds of the two parties to the present obligation concerning settlement and when it should occur. Ms. Wardlow added that she did not know why the GASB had decided to include “little or no discretion” in its definition. She had talked extensively with the GASB staff member leading their elements project and she and that member do not believe there is a major difference between the GASB and FASAB drafts other than differences due to different environments, different Boards, and language differences. It is Ms. Wardlow's understanding that the GASB staff member managing the project does not believe that there is a major difference in the way the two Boards view a liability.

Mr. Mosso noted that the GASB draft is not yet ready for exposure, so that what is currently in the draft is tentative. Ms. Wardlow agreed and said that at the upcoming GASB meeting the GASB would be reviewing its currently proposed definitions and the staff's proposal of different ways of phrasing the definitions. Ms. Comes noted that, in addition, the GASB plans to discuss further paragraph 19 of its draft, which addresses constructive obligations, and her understanding is that the GASB is evenly split on the content of that paragraph. Mr. Allen said he is unsure about the usefulness of that paragraph, which refers to the existence of "social, moral, or political consequences" that would leave the entity "little or no discretion" to avoid settlement. He thinks that everything a government does can have social, moral, or political consequences, so that he does not think the concept helps decide whether the government has an obligation or not.

Mr. Mosso invited Mr. Dacey to present other issues that he has. Mr. Dacey said that, in reviewing the Alternative View, he identified a question he has about some of the language in the Exposure Draft (ED) that refers to measurement. One concern is the repeated use of the term "measurement" when the ED states that it does not include measurement in its scope. In discussing it with Ms. Comes, she had explained that some of the references to measurement had been inserted to try to address the concerns of those who were presenting an Alternative View. He wondered whether the Board really wished to refer to measurement in several paragraphs that he had identified. He noted that measurement is defined in paragraph 5, but then in going forward he found some statements that may not be necessary, and he and other proponents of the Alternative View found other instances where the reference should be to "measurable" or "measurability," rather than "measurement." Mr. Dacey gave the Board proposed revisions to ED paragraphs 7, 57–59, and 61, which in some cases would delete the reference to measurement and in other cases would substitute the word "measurable" or "measurability" for the word "measurement." His question was whether the Board wished to retain the references to measurement and, if not, whether the proposed changes are appropriate. Mr. Patton added that "measurable" comes from the recognition criteria, which state that, to be recognized, an item must meet the definition of an element and must be measurable.

Mr. Mosso asked Ms. Wardlow to comment. She said that in the ED, as discussed and drafted to date, "measurability" and "measurement" are two different things. The Board agreed that the ED would not address measurement and would state that measurement would be addressed in a future document. In some of Mr. Dacey's proposed changes, the sentence would not mean the same thing if "measurement" was replaced by "measurability," given the way measurability is defined in the ED. She added that she does not think there is an uncertainty or probability issue with measurability, as that term is defined in the ED. Rather, uncertainty may come in when one chooses an attribute and a method of measuring; uncertainty may come into the result of measuring something. In contrast, as defined in the ED, the concept of measurability simply refers to whether something can be quantified in dollars, and the answer is "yes" or "no." There should be no uncertainty about that. Therefore, she suggested that the issue is whether the Board wishes to change the definition of "measurability" and, therefore, change the proposed recognition criteria.

Mr. Mosso asked for comments from other members. Mr. Allen asked Mr. Dacey for his reaction to Ms. Wardlow's comments. Mr. Dacey said that in applying a standard, certain items are not recognized because they are not measurable or not reasonably measurable. He thinks the same concept applies at the conceptual level. There is sufficient uncertainty about some items that they are not measurable and should not be recognized. Mr. Allen asked whether the uncertainty is based on measurability or whether uncertainty is based on the technique selected. He thinks that there is probability in whether an asset or liability exists, but with regard to measurability, the answer is "yes" or "no"—either there are techniques to do it or there are not.

Mr. Dacey said there are circumstances when because of uncertainty one does not believe that one can quantify an item in a way that meets the qualitative characteristics. He added that another issue that concerns the proponents of the Alternative View is that there is more to measurability than simply being able to assign a numeric value to something, which is what the ED may lead readers to believe. If the Board holds that view, then the Board should proceed accordingly. However, the proponents of the Alternative View believe that if measurability just means the ability to assign a number, then virtually everything is measurable, but the resulting number may not be very relevant or reliable. Those who hold the Alternative View believe that there are more concepts to measurability than simply whether an item can be quantified, and that criterion seems to be fairly hollow if all one has to do is to assign a number. It does not seem to screen anything because one can assign a number to virtually anything.

Ms. Wardlow responded that assessing measurability was not intended to be the last step. One still has to go through the measurement process. One has to decide what to measure and how to measure it, and then one makes an assessment of whether the result is a relevant, reliable number and one thinks about cost-benefit and materiality. There is a whole host of things that one would do. The intent in the ED is exactly how measurability is defined in both the document and the glossary—that "measurability" simply means quantifiable in monetary units, and some things that one looks at are not measurable and some things are. When one actually gets the result of measuring something and makes a decision as to whether that is too uncertain to be recognized, that is a step beyond what the current ED is addressing.

Mr. Patton responded that the ED states that one recognizes something if it meets the definition and is measurable. It doesn't say the other things. Ms. Wardlow said that the ED states there will be another document that will address the selection of measurement attributes and methods. Mr. Patton said that one cannot say something is measurable unless one has a basis of accounting in mind. Ms. Wardlow responded that one can say whether one can assign a dollar number to something, but one cannot say whether the measurement will be acceptable for recognition until one knows what attribute is being measured. The ED provides criteria that are necessary for recognition, but it does not say that those are the only things one must do. If that is not clear, then the point should be clarified in the ED. However, the document does say that one needs to select an attribute and a measurement method and that those steps will be addressed in a future document.

Mr. Mosso said that he found the difference being discussed between measurement and measurability was too subtle. In his view, measurability leads one to look at measurement processes and that is where one encounters uncertainty. He said he would like to hear other members' views, but in his view the ED language is fine as drafted. He probably could accept some of the changes Mr. Dacey is proposing, but he does not see a particular need for them and would prefer not to take more time with word-smithing. He suggested that the proponents of the Alternative View should include their proposed changes in the Alternative View.

Mr. Farrell said that he too missed the subtlety of the difference between measurability and measurement. He asked Mr. Dacey whether he could provide a real-world example of how the changes he is proposing would make a difference. For example, is there a concern that one would start capitalizing citizens? Mr. Dacey said there are two concerns. One is that if the ED includes recognition criteria, they should be complete. He does not believe it is a good idea to say that the requirements that an item should meet a definition and be measurable are only some of the recognition criteria. Measurability is relevant in applying any standard. One considers what the measurement basis is and decides whether an item is measurable on that basis, whether it is a best estimate or some other basis. One judges whether there is evidence, in the sense of qualitative characteristics, to support that a number should be recognized. In his view, one goes through a rational process of deciding whether an item is measurable given the measurement focus for that item. Routinely, one finds instances where items are not measurable and they are disclosed rather than recognized. Similarly, at a conceptual level in the ED, if an item meets the definition but is not measurable, then one would choose disclosure to tell the reader about an item that cannot be measured. If one accepts that in the ED "measurable" only means "quantifiable," then anything is quantifiable and the point of having an acceptable measurement that meets the qualitative characteristics is missed.

Mr. Mosso responded that, implicitly, "quantifiable" just pushes one into the measurement concepts and standards that the Board will be working on in the future. Mr. Dacey agreed but added that he sees a difference between the measurement basis that one has to apply and calculate and articulate as opposed to the concept that an item may or may not be measurable for whatever basis one has. He thinks that is a critical determination for whether an item is or is not measurable and it entails more than simply assigning a number to the item. However, he appreciates that other members may not agree.

Mr. Mosso asked whether Board members wished to consider further the distinction between measurability and measurement, or whether they are comfortable with the words in the ED. Mr. Allen said that he does not think one could include Mr. Dacey's proposals without affecting the future project on measurement. He thinks that if one discusses measurability and probability, one has entered the future project's domain of what is the best measurement method and related considerations. If one wishes to keep the new project separate, then he would accept the words in the current draft ED. Mr. Farrell agreed with Mr. Allen. Ms. Cohen and Messrs. Torregrosa, Reid, and Schumacher said they are comfortable with the ED. Mr. Werfel said he believes Mr.

Dacey's argument would enhance the document by broadening the concept of measurability to measurement so that there are other factors under consideration as the Board moves forward. There is a qualitative judgment as to whether the number that one assigns to a liability is not just a "shot in the dark." He thinks Mr. Dacey's proposal is an improvement because it avoids the conclusion that the validity and reliability of the measurements are not factors. Messrs. Dacey and Patton indicated they would prefer to make the proposed changes to the ED. Mr. Mosso indicated he is comfortable with the ED as drafted. Thus, seven Board members would retain the draft ED language with respect to measurability and measurement and three members would prefer to make changes. In response to a question from the Board, Ms. Comes indicated that the measurement project would be the last phase in the concepts projects and she expected it to be initiated within a year.

Mr. Dacey responded to Mr. Mosso's request for additional issues. He stated that the proponents of the Alternative View are making some changes based on the issues already discussed and the language may need to be modified based on the morning's discussion. He had a copy to distribute but did not know how the Board would wish to handle the changes. Ms. Comes said that the Alternative View stands on its own and there is no need for the Board to edit it. Mr. Dacey said he wanted to be clear about the Alternative View in case other members wished to discuss related changes. Mr. Patton pointed out that Question 7 in the Questions for Respondents might need to be changed. Mr. Mosso said he thought the Board has the gist of the Alternative View. Mr. Dacey invited members to provide any thoughts they may have to improve the expression of the points in the Alternative View.

Ms. Comes indicated that June 5, 2006 was the tentative issue date for the ED. In response to Mr. Farrell's question, Ms. Comes indicated that members should indicate on their ballots that their vote includes the changes agreed during the meeting to paragraph 44 of the ED and to Question 2 in the Questions for Respondents, as well as the addition of a new question, tentatively numbered Question 8. Ms. Comes also proposed a change in the comment period from October 5, as proposed in the preballot draft, to August 5. The change was based on comments from CBO and the potential that the Social Insurance ED would not be issued in July. Any late responses to the Elements ED would still be accepted. Mr. Reid asked whether such comments would influence the decisions with respect to Social Insurance. Ms. Comes indicated that CBO wished to see the comments. There are some advantages to accelerating the comment deadline and one could always extend the comment period. Also, an extensive outreach is planned on the document. Mr. Reid said that, with regard to social insurance, it would be extremely helpful to receive responses to the Elements ED. Mr. Mosso said that, as Ms. Comes had indicated, there is a deadline for comments but the Board traditionally has accepted later comments, until the public hearing. So, those who need it can take more than sixty days to comment.

Mr. Mosso then asked if the Board approved the change in the comment deadline. The Board members unanimously approved the change. Mr. Torregrosa said that Board member Mr. Marron (CBO) wished to emphasize the importance of a broad outreach effort and that the Board should try to obtain responses from the academic community,

FASB, and GASB in order to bring in fresh insights. Mr. Mosso said that Ms. Comes already has prepared a significant list of potential respondents, but it would be helpful if Board members that have any thoughts on potential contacts would provide them to Ms. Comes. Mr. Allen suggested a request to GASB to email their list of about 1,200 contacts, which includes those who have previously commented or have a particular interest. Mr. Farrell suggested including a list of independent public accountants from around the country.

Ms. Comes reiterated the call for ballots, which would recognize the changes agreed at the current session. Mr. Mosso reminded members that it was possible for members to sign an “approve” ballot even though they included issues in an Alternative View.

Conclusion

1. The Board accepted proposed revisions to the preballot draft circulated to the Board on April 28, 2006, as marked on the ballot draft and cover memo distributed for the May 24, 2006 FASAB meeting, except for the proposed comment deadline. (See point 6 below.)
2. A majority of the Board (seven members) preferred not to make the changes proposed by Mr. Dacey to the references to measurement in paragraphs 7, 57–59, and 61 of the ED. They preferred to retain the language in the ballot draft.
3. The Board agreed, by a vote of seven to three, to issue the ED with the changes in the ballot draft indicated in items 4 through 6 below. The issue date would be June 5, 2006.
4. Question 2 of the Questions for Respondents will be revised to read as follows:
 2. The proposed Concepts Statement defines five elements of accrual-basis financial statements: *assets, liabilities, net position, revenues* and *expenses*. (See paragraphs 2, 3, 35–37, and 56.)
 - a) Are there additional elements of accrual-basis financial statements that should be defined in the Concepts Statement? If so, what are they and what are their essential characteristics? Alternatively, how would you define these additional elements?

Some constituents believe that, because of the unique nature of the federal government, additional elements are needed for certain transactions and other events. For example, certain intangible resources, long-term social obligations, and other commitments are viewed by these constituents as requiring a different element or elements than those identified in this proposed Concepts Statement.

b) Do you agree or disagree that there are additional elements that need to be defined? If you agree, what are the essential characteristics of these elements? Please provide examples of the types of transactions that align with these additional elements.

5. The following question, tentatively Question 8, will be added to the Questions for Respondents. (The concluding sentence in par. 44 quoted in this question was modified from the ballot-draft version.)

8. The proposed Concepts Statement addresses the government's ability to change laws in the future as stated in paragraph 44 as follows:

To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on existing conditions, including current law, because an essential characteristic of a liability is that the government has a present obligation, even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability.

a) Do you agree or disagree with the concluding sentence in par. 44 above? Please explain your views.

6. The Board changed the deadline for comments from October 5, 2006 to August 5, 2006. The deadline will be extended if necessary to accept additional comments.

- **Application of the Liability Definition**

Staff presented a brief status report on the project, explaining that the task force that was formed to discuss the liability classifications had held two meetings, the first on April 12 and the second on May 11.

The materials presented at the May 24 board meeting included a summary of the April 12 meeting and a working draft of the task force objectives. The April 12 task force meeting focused on tasks one and two of the working task force objectives document – I. Provide Feedback on the Liability Classification Structure Established by SFFAS 5

and Overall Satisfaction with the Level of Liability Guidance Provided by SFFASs 1, 2, 5, 6, and 12; and II. Describe the Common Relationships and Key Events Among Federal Events and Transactions.

Staff conveyed to the board that there was unanimous agreement by the participants at the April 12 meeting that the classification structure from SFFAS 5 (exchange transactions, nonexchange transactions, government-related events and government-acknowledged events) was working fairly well.

Staff noted that participants did not have any general comments about the four classes from SFFAS 5, but the participants did communicate several specific issues or areas related to liabilities that they felt FASAB should address. The main areas of concern noted by participants related to problems with the intragovernmental reconciliation, proper treatment of leases, current deliberations on social insurance, recognition of asbestos-related and other cleanup costs, responsibility for judgment fund transactions, and the selective interpretation of standards. Staff highlighted those areas as well as several others in the board materials and characterized the issues raised as operational rather than conceptual or having to do with the characterization of liabilities.

Staff orally communicated that the May 11 task force meeting focused on tasks three and four of the working task force objectives document – III. Provide Feedback on Staff’s Proposed Enhancements to the Definitions of the Four Classes; and IV. Provide feedback on the Completeness of the Liability Sub-Classes within Each of the Liability Classes.

Staff noted that the participants had unanimously approved the four classes at the April 12 meeting. However, at the May 11 meeting, after the participants became more involved in trying to classify actual transactions and events, they saw more of the difficulty that the board and staff have faced in trying to fit certain things into categories.

Staff stated that a poll of participants around the table at the May 11 meeting resulted in twelve voting to maintain them, four stating that the classes should be revised, and one having no strong opinion.

Staff received some helpful feedback on the proposed revisions to the definitions of the classes and the completeness of the sub-classes. Staff communicated to the board that it proposes to take the input from the task force, update the class definitions and the subclasses, and then create a survey of five or six questions for wider distribution to the federal community for comment.

Staff proposed that the benefits of doing a survey would be two-fold: (1) reaching out to a wider representation of agencies to give them an opportunity to weigh in on the front-end before FASAB drafts new liability standards, and (2) encouraging the federal community to respond to the elements exposure draft because the agencies would actually be able to see that there is a standard currently being revisited as a result of the newly proposed liability definition.

There were no objections by the members to staff's recommendation to circulate a survey to the federal community as the next step.

CONCLUSIONS: Staff will circulate a survey to the federal community to solicit feedback on the enhancements to the class definitions drafted by staff and the completeness of the liability sub-classes based on the feedback from the task force.

- **Consolidated Financial Report of the U.S. Government Requirements**

Mr. Gary Ward of Treasury's Financial Management Service led the discussion. He explained that the briefing materials included a draft Statement of Federal Financial Accounting Standards based on the prior exposure draft. Three issues raised by respondents were identified for discussion. They were disclosures of (1) liabilities covered and not covered by budgetary resources; (2) loan and loan guarantee modifications; and (3) forfeited assets not available for sale due to legal restrictions (e.g., drugs).

The Board discussed each point and concluded that the proposal would not be modified. Mr. Ward was asked to prepare a ballot draft as soon as possible.

CONCLUSIONS: A ballot and ballot draft SFFAS will be circulated after the meeting.

- **Project Plan for Phase 3 of the Conceptual Framework**

Team Approach

Ms. Comes directed the Board to Section III of the proposed plan for the conceptual framework. The revised plan proposes a team approach, with individual staff members having assignments, with one staff member coordinating the project and covering areas not otherwise assigned.

Sustainability Reporting

Ms. Comes recommended that a task force be formed to address sustainability reporting. She recommended inviting very high-level individuals, such as former CBO Directors or Deputy Directors, as well as members of "think tanks" such as Brookings and American Enterprise Institute. Ms. Comes does not envision a large task force, and believes that less than twelve members would be ideal.

Mr. Werfel said that the OMB would support such a task force. Mr. Dacey agreed that a broad, government-wide perspective was desirable, perhaps including actuaries that might contribute ideas on how to present the information in a meaningful way. Mr. Allen

said that it might be helpful to include members of the user community, such as the media, bond-rating organizations, and/or taxpayer organizations.

Mr. Farrell and Mr. Dacey noted that such a project would include addressing certain programs such as Social Security and Medicare, although the overall perspective of such a statement would be government-wide.

Mr. Allen said that an additional item might be to explain how items such as RSI, the Notes to the Statement of Social Insurance, and a potential Statement of Sustainability, might articulate with or enhance the display of the information in the basic financial statements. For example, if there would be a Statement of Sustainability, how should it relate to the information in the other financial statements?

Ms. Comes mentioned that staff would be contacting the Federal Board members regarding task force participation and/or staff-level support.

CONCLUSIONS: The staff will begin forming the task force on sustainability as well as working on the plan as drafted.

- **Department of Defense Request for Assistance**

Ms. Parlow explained that the Department of Defense had requested guidance regarding inventory held for repair.

First, the department expressed concern that the category was not clearly defined and seemed to be referring to “broken” items. In practice, the department uses the category for remanufacturing of high value items. A significant portion of annual cost related to inventory is in this category.

Second, in terms of valuation, current standards require that items in this category be valued at the cost of a serviceable item less the estimated cost to repair. Then, as the repair work is done -- and generally this is contracted out -- that repair work is capitalized as the item becomes closer and closer to being serviceable and then, when it is repaired, it has the same value as a serviceable item. That sounds pretty simple, except that every time they buy a new one, when new ones are available, the cost of a new one will change. So, there is this constant moving average re-valuation going on, and a whole lot of cumbersome transactions. Staff indicated that this does not seem consistent with the intent of the standard. What was intended was that certainly an unserviceable item should be valued at less than a serviceable item and that, when it is repaired, it should be valued at the value of a serviceable item.

Board members expressed the following concerns with regard to the request and the staff proposal to amend SFFAS 3:

- The issues seem resolvable between the preparer and auditor.

- DoD may seek another amendment later on the grounds that they are unable to comply with the revised standards.
- The issue of multiple entries could be resolved by making adjustments to meet the goal of “value of a serviceable item” periodically rather than on an ongoing basis.
- The staff recommendation would add a third prescriptive approach to valuation.

The following benefits of providing an amendment were noted by staff and members:

- DoD is a large and complex organization; the cost of reaching agreement among the components and with the auditors is thus much higher.
- DoD has been unable to reach agreement on a workable implementation approach for more than a dozen years.
- The language in the standard itself is not well defined – the term “value” is not clear and DoD believes it means each item must be valued and subsequently revalued at the “current” value of a serviceable item while others believe it means the value of a serviceable item when the unserviceable item is returned with no revaluation (except for the addition of repair costs).

CONCLUSIONS: The staff will develop proposed guidance or an amendment. Staff will strive to recommend the most efficient means of providing authoritative guidance.

- **Proposed Technical Bulletin Regarding Asbestos Liabilities**

Staff presented a Proposed Draft Exposure Draft of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, to the board for review and discussion.

Staff explained that unlike standards and concepts, technical bulletins are staff documents that are released for public comment if a majority of members does not object.

The briefing materials contained a timeframe for issuing the technical bulletin, including the due process involved, and the text of Technical Bulletin 2000-1, *Purpose and Scope of FASAB Technical Bulletins and Procedures for Issuance*, which addresses the appropriate use of a technical bulletin.

Staff explained the background behind the need for the technical bulletin, explaining that representatives from two of the major CFO Act agencies informed FASAB staff that

its independent public accountant (IPA) indicated that the agencies needed to reconsider their accounting for nonfriable asbestos for fiscal year 2006. The agencies noted that they had recognized an estimated liability for removal of friable asbestos posing an immediate health threat, but had not prepared an estimate for the future removal of nonfriable asbestos that does not pose an immediate health threat. The issue arose as a result of the Financial Accounting Standards Board (FASB) issuance of FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47) in March 2005. Prior to FIN 47, organizations following FASB standards did not consistently recognize liabilities for nonfriable asbestos. The agencies cited this inconsistency as well as the inconsistency among all federal agencies as the basis for not recognizing liabilities for nonfriable asbestos.

Staff stated that the agencies and the IPA requested that the FASAB reconfirm existing guidance or issue new guidance on whether federal entities are required to recognize a liability for future cleanup of nonfriable asbestos.

Staff explained the technical difference between friable and nonfriable and the apparent inconsistency in federal reporting of asbestos-related cleanup costs over the years since SFFAS 6 was issued.

Staff presented the proposed technical bulletin, recommending that federal entities should (1) estimate both friable and nonfriable asbestos-related cleanup costs and (2) recognize a liability and related expense for those costs that are both probable and reasonably estimable, consistent with the current guidance in SFFAS 5, *Accounting for Liabilities of the Federal Government*; SFFAS 6, *Accounting for Property, Plant, and Equipment*, Chapter 4: Cleanup Costs; and Technical Release 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*. In addition, staff recommended that federal entities should disclose information related to friable and nonfriable asbestos-related cleanup costs that are probable but not reasonably estimable in a note to the financial statements, consistent with SFFAS 5 and SFFAS 6.

Staff noted that the technical bulletin would be effective for periods beginning after September 30, 2008 (fiscal year 2009). Staff explained that the extended implementation date should give agencies time to complete some type of feasibility study to determine if they can estimate the nonfriable cleanup costs or if it would result in a note disclosure.

Staff concluded by stating that, if no more than six board members objected by June 1, the exposure draft of the proposed technical bulletin would be issued on June 1 with comments requested by June 30.

Members asked a number of clarifying questions, which the staff answered. The session concluded with staff requesting that editorial comments be forwarded to staff and reiterating that the exposure draft would be issued on June 1 absent six board member objections.

CONCLUSIONS: Staff will incorporate any editorial comments received from board members and issue the exposure draft of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*, for comment on June 1, absent six board member objections.

- **Natural Resources**

Staff, Rick Wascak, noted that the objectives for the May 2006 Board meeting were to:

1. Review the issue paper on royalty free production of oil and gas.
2. Review the revised draft ED and obtain comments from Board members.
3. Gain Board approval for circulating a pre-ballot ED.
4. Gain Board approval to study coal in the next phase of the natural resources project.

Staff explained that royalty relief has two thresholds, quantities and prices. If operators or producers do not meet these thresholds, then they can produce oil and gas without having to pay royalty up to a certain quantity or price threshold. Staff added that when the binders for the meeting were sent out to Board members, it had information about how royalty revenue, sales volume and the sales value are received on a monthly basis. However, it did not have any information about calculating an estimated value of royalty relief (or foregone revenue). Staff's concern was a way to come up with an estimate of the value of royalty relief. Staff noted that since the binders were sent out to the Board members, it had received information from the Department of Interior explaining that they would be able to calculate an estimated value of royalty relief at the end of each reporting year. Therefore, instead of the general options presented in the issue paper on royalty free production of oil and gas, staff was proposing to disclose what that estimated value of royalty relief is each year. Staff referred the Board to paragraph 25C in the proposed standard, which already requires that information be disclosed in regard to the sales volume, the sales value, and the royalties earned for each region. Staff stated that in addition to this required information the disclosure would also require that an estimated value of royalty relief be provided.

Mr. Reid asked if there is a way that the estimated value of royalty relief could be translated into what that would mean in terms of the value of the asset (i.e., estimated petroleum royalties). That is, he was looking to see if there was a way to translate what the royalty relief actually did cost the Federal government.

Ms. Comes explained that the way the royalty value is calculated provides a net royalty percent. For example, if the royalty rate should have been 15 percent but because you didn't get any royalty revenue off of some of the sales volume and value, it brings the net royalty rate down to 13.5 percent. The 13.5 percent is applied to the total reported proved reserves in calculating the asset to book. As a result, the Federal portion of proved reserves may be under- or over-valued because you are assuming that the same mix and level of relief that you had during the reporting period is going to go forward. To put a cost on how much the asset value should really be reduced would be difficult because it would have to be based on production and cost and prices of oil over future periods.

Ms. Comes added that "foregone royalties" may also be misleading since the calculation is based on the misperception that you would have gotten all of the royalties based on the

reported estimated quantity of proved reserves absent the program. She noted you may not have some of these proved reserves if royalty relief was not provided. CBO has pointed out that the royalty relief program also affects the bonus bid amounts. So, to a certain extent, the bonus bid amounts ahead of production compensate for the future relief. She added that it was a very dynamic situation and to put a cost on the relief per se would be challenging.

Mr. Torregrosa added that there is a difference between what was expected at the time of the lease and the actual royalty revenue realization, and that is an argument for the disclosures.

Mr. Reid stated that he believes the royalty is foregone revenue. He added that if foregone revenue information is available or it is not onerous to calculate it, to require it. If after a few years the Board decides it is not meaningful or useful, the Board can always change the requirement. If there is information about foregone revenue, this is a piece of information that users of the financial statements would probably like to see.

Mr. Mosso asked staff to add the requirement of reporting foregone revenue in the disclosure.

Mr. Allen stated that he would like to ask a question in the Board's due process about this. He said if the Board learns that the bonus bid really does offset this royalty relief, then it is not right to say you are foregoing something that you are really gaining back another way. He added that it actually could be misleading to say this is the amount of foregone revenue if it is determined that you are not foregoing revenue. Basically you are getting a higher bonus bid because you granted royalty relief. Mr. Allen explained that the Board is requiring foregone revenue be disclosed to try to inform people that, if there were no royalty relief programs, there would be an expectation that the revenue would have been higher. The Board has got to make sure it is not misleading people.

Mr. Mosso asked staff to add a question to the ED regarding the nature of requiring that foregone revenue be disclosed and to add a reference to the basis for conclusions that explains the disclosure requirement.

Mr. Dacey commented that in paragraph 25C the requirements talk about one report for each region. The information to be reported is based on information that are reported from the people that are extracting the oil and gas. He said he was thinking in terms of audit issues with respect to what the disclosure requirement is, and whether that would present any problems or not. He added his concern was about how the disclosure requirements are worded.

Mr. Farrell suggested that the language in paragraph 25C of the proposed standards be more specific about the terms (sales value, sales volume, and royalties earned) used in the disclosure requirement. He said you could ease some audit issues by saying report the sales volume as has been provided by the oil producers. That way, you are not implying that the auditor must go out and audit it. Mr Dacey added that in theory the audit would go back to what was reported. Mr. Dacey suggested that, based upon prior experiences, there may be too literal of an interpretation drawn in the way the standards are currently phrased.

Mr. Mosso noted that he did not hear any objections. He asked Mr. Dacey to work with FASAB staff to make the standards more specific. Mr. Dacey said he would work with FASAB staff.

The next area addressed was the Request for Comments questions. Staff proposed to shorten question number three. That is, to summarize the background information provided for question number three, present the question, and to move the majority of the background information to

the basis for conclusion. The summarized background information preceding the question would refer readers to the basis for conclusions for additional background information.

Board members agreed to the staff proposal.

Regarding the Request for Comments questions, Mr. Torregrosa noted that since questions two and three address concerns raised by the Congressional Budget Office (CBO), the CBO is likely to have an alternative view for each question.

Staff referred Board members to paragraph 27A. Staff explained paragraph 27A proposed that information available for unproved oil and gas reserves and undiscovered resources be reported as RSI. Staff acknowledged, however, that there would not be complete information available for these two categories. This is because there is no unproved reserve information for on-shore oil and gas; and, for the off-shore unproved reserve information, there is only information available for two of the four regions. In addition, for the undiscovered resources, you could only get that information from national assessments. Staff noted for off-shore, the national assessment is done every five years. However, for on-shore, the last one was done in 1995, and they periodically go out and update that information by assessing certain basins. As a result, it is not as complete as the off shore.

Staff added that while discussing this requirement with people from the Energy Information Administration and Department of the Interior, they proposed reporting technically recoverable resources as required supplementary information (RSI). Technically recoverable resources are a total of all undiscovered resources, discovered resources and unproved reserves. They would not be delineated in any way. This information would be obtained from the Energy Information Administration from the same report in which estimated quantities of proved oil and gas are obtained. The technically recoverable information in RSI would be nine months old, similar to the estimated proved oil and gas quantities. Staff referred Board members to an example on page 13 of the draft ED for the type of information which could be presented.

Mr. Mosso acknowledged that reporting information about technically recoverable resources would be much more comprehensive.

Mr. Mosso asked if the Board members agreed with the proposal. There were no objections. Mr. Mosso asked staff to make the reporting change in the draft ED.

Staff explained it had received comments from some other board members in regard to paragraphs 20 and 21. Staff indicated that the Board members found the two paragraphs confusing and difficult to understand.

Regarding paragraph 20, Mr. Patton asked why the value of royalty rights identified for sale that are disclosed in the footnotes would be different from their value if they were just treated as estimated petroleum royalties. Ms. Comes responded there is a difference because the royalty rights identified for sale are based on a field specific royalty rate and field specific sales price, and not the average royalty rate and average price used to value estimated petroleum royalties. She added that because the specific fields are known, the field specific royalty rate and price is used to presumably get a more accurate value of rights identified for sale.

Mr. Patton noted that there is no gain or loss based on this disclosure. He asked if that could be explained in paragraph 20.

Regarding paragraph 21, Mr. Patton noted that at the time the rights identified for sale are sold, the value of future royalty rights sold should be calculated based on the quantity of crude reserves, royalty rate, and the price pertaining to the specific field at the time of the sale. He asked why isn't some book value of the asset based on the overall average royalty rate and average price used instead of a specific field royalty rate and specific field price. Ms. Comes explained that when you have a big bucket with many things in it, taking a more precise value out of the bucket when an item is sold provides you with a gain or loss more reflective of reality.

Mr. Mosso commented that the thrust of paragraphs 20 and 21 are good, however, they do need some clarification. Mr. Mosso asked staff to revise and clarify the paragraphs based on Mr. Patton's comments.

Mr. Dacey noted that the draft ED proposed that the term region be defined and determined by the component entities involved in Federal oil and gas activities. He said he wanted to ensure that there is consistency between the regions which are used to calculate estimated petroleum royalties and the regions used to disclose sales value, sales volume, and royalty information. (Staff will revise the disclosure to ensure consistency in the use of regions.)

Mr. Mosso asked what the time-frame was for circulating a pre-ballot draft ED for the proposed oil and gas resources standards. Ms. Comes responded that a pre-ballot ED would be circulated for comments before the July Board meeting, similar to how it was done with the elements pre-ballot ED. It would then be in the binder for the July meeting as a ballot.

Staff stated that there was one other topic to discuss. Staff explained that since the Board was close to issuing an ED for oil and gas, staff would begin working on the next phase of the natural resources project. Staff noted it had originally proposed working on coal next. However, it was suggested by one Board member that, instead of focusing strictly on coal, staff try to look at a group of mining minerals to see if it is possible to come up with a standard which has similar principles for a group of mining minerals.

Mr. Mosso stated that the suggestion was reasonable. There were no objections from any Board members.

Ms. Comes noted that since there is an indication that there would be alternative views included in this ED, she would like to set a target of having the alternative views by the 16th of June?

Mr. Farrell asked if the Board had any discussion around this table about the Cambridge Energy Research Associates (CERA) report on oil and gas reserves disclosures approach.

Ms. Comes indicated it was briefly discussed when the Board had some panel members come in more than a year ago to discuss the options. She added that staff could provide more information on the Cambridge approach. Mr. Farrell commented that he does remember the Board deciding not to go way out on a limb for what it was valuing, but didn't realize this is what it was called.

Mr. Torregrosa indicated he recalled the Board discussing the other categories, the probable and possible reserves and the possibility of broadening how you calculate reserves. He added that he believes staff has captured what the consensus of the board was.

Mr. Mosso asked staff to prepare a brief write-up on the CERA report for the next Board meeting.

CONCLUSIONS: Staff will revise the draft ED based on decisions made during the Board meeting and prepare a pre-ballot ED for circulation prior to the July Board meeting. In addition, staff will prepare a brief write-up on the CERA report for the next Board meeting.

- **Steering Committee Meeting**

The Steering Committee received a status report on the Appointments Panel interviews. A budget update is being deferred until travel related to interviews is firm.

Adjournment

The meeting adjourned at 4:00 PM.

Thursday, May 25, 2006

Agenda Topics

- **Social Insurance and Discussion with Comptroller General David Walker**

The Board reviewed the latest draft of the social insurance exposure draft (ED). The Board began with the questions for respondents that had been added since the March 2006 meeting. The first question asked respondents whether they agree that the obligating event for liability and expense recognition for social insurance programs is the attainment of fully insured status and, if not, what would be the obligating event.

Mr. Werfel observed that the ED's Executive Summary (ES) had the flavor of a defense rather than a summary. He questioned whether the ES was the appropriate vehicle for outlining these types of issues.

Chairman Mosso said he and Ms. Comes had been considering including in the ED the points made in the Office of Management and Budget's (OMB) letter of May 1, 2006. He said that including such counterpoints in an executive summary would be unusual but justified in this case due to the uniqueness of the subject matter.

Mr. Allen said that the ES sought to explain why the issue was being reconsidered.

The Board discussed balancing the current ES with counterarguments. Mr. Patton said the ES was not intended to present balanced arguments but rather to present the majority's proposal and why they are doing and how it improves financial reporting. He noted that traditionally an executive summary does not contain counterarguments; counterarguments would be presented in an "alternative view."

Mr. Allen said that he would normally agree with Mr. Patton but the magnitude and significance of this issue is such that support was needed and building it might require unusual procedures. He noted that GASB Statement 34 took five or six years and much iteration to complete. He said he thought the majority should acknowledge and fully present the significant minority's position and provide an opportunity for almost unbiased feedback. He suggested that the Board could then re-deliberate the issue considering all the feedback and hopefully develop a consensus. He said this might require a modified exposure draft.

Chairman Mosso noted that SFFAS 17 presented alternative views. He said the presentation was balanced because each side agreed that what was said about their position was fair.

Mr. Patton said that such argumentation was appropriate for the basis for conclusions but he said he did not think that that was the role of the executive summary. He asked whether, if that was the Board's attitude, what was more fundamental than the elements. He said if the social insurance exposure draft was going to be restructured he would like to revisit the structure of the elements exposure draft for the same courtesy. However, he said that that was not his preference. He said he preferred that both exposure drafts have the same structure. He said he strongly favored the structure in SFFAS 17 whereby alternatives were presented along with the Board's rationale for its conclusion.

Mr. Mosso directed staff to develop a balanced argument for the basis of conclusions using the SFFAS 17 structure.

Mr. Allen asked whether the Board would review the new material before voting on where to insert it in the exposure draft. Chairman Mosso answered affirmatively but said it might be worth doing something different for social insurance, perhaps in an overall release rather than the executive summary.

Staff continued with the review of the questions for respondents. Mr. Allen noted that the Board had agreed yesterday to ask respondents to give reasons for agreement as well as disagreement. Staff noted its intent to change the wording of the questions accordingly.

Regarding question for respondents #1, which asked respondents whether they agreed with the obligating event provided in the ED for expense and liability recognition, Mr. Allen said that when he joined the Board he agreed with what he characterized as the Board's compromise position whereby cost begins to be recognized or allocated at 40 quarters of work in covered employment, but he said a proper interpretation of accrual accounting as it applies to the allocation of cost to periods calls for accruing cost when someone is required to pay a tax and participate in a program because the participants have to qualify for each quarter. He said he did not subscribe to the notion that only deferred compensation costs, e.g., pensions, are allocated to periods, which he perceived as the argument in the draft ED. He said a legitimate reason for allocating costs to periods is that someone is required to pay a specific tax specifically earmarked

to fund a program. He suggested adding, for example, the following to question 1b: “or should the liability be recognized in some other period, such as due and payable or in an earlier period such as during the period a worker pays Social Security and Medicare tax.” He said he thought that would be a more balanced question.

The Chairman and Mr. Dacey expressed agreement. Mr. Dacey said he wondered whether a person reading this material for the first time would have enough background just from the wording in the question.

Mr. Allen suggested adding a paragraph or more to the basis for conclusions explaining that “others may believe” earlier recognition of cost is appropriate and cross-referencing the question to the paragraph(s). Some members concurred. The staff will develop question 1b further, add the paragraph(s) to the basis for conclusions, and cross-reference them.

The Board next discussed the term “fully insured.” Mr. Patton said the ED still needed clarification regarding when a participant is fully insured versus permanently fully insured. Mr. Farrell suggested and the Board agreed that an explanatory table should be added to the glossary definition of “fully insured” illustrating the points when participants become fully insured, including permanently fully insured.

The Board next considered question #2, which asked whether respondents agreed with the changes to the statement of social insurance. Mr. Allen noted that the question asked if the new line items were understandable and informative. He said he would ask whether the new SOSI information, linked to the principal financial statements, is necessary or essential for transparency of financial reporting. He said he would agree that the financial information is available. He said the question should ask whether financial statement users find the proposed information necessary. He suggested a part “c” to question #2 that would address this aspect and ask for alternatives. There were no objections.

The Board next considered questions #3 and #4. Mr. Werfel said he viewed these questions as the staff’s attempt to reflect some of the issues raised in the OMB letter to the Board dated May 1. He said he appreciated this and asked that he be allowed to re-draft these two questions because in OMB’s view some of it may have been lost in translation. Specifically, he said he wanted to be sure that the questions are worded such that the respondent would not feel that they need to rise to the level of concern that OMB has. He noted that OMB used some strong terms that reflect its concern, e.g., “misleading” and “undermine the credibility.” He said a respondent might not feel comfortable saying it is misleading etc. but they might agree that with some of the points on the merits that OMB raised about the appropriate classification of a liability. He said it was important to focus on the merits of the arguments and not on how strongly they were stated.

Also, Mr. Werfel said OMB would like to add a question for the Board’s consideration about the importance of harmonizing the United States treatment of future social insurance payments with international accounting. He noted that this issue was raised

in the OMB letter but was not in the summary list. He said the ED differed from OMB's understanding of international accounting standards and how other governments treat future social insurance payments.

The Board discussed the International Public Sector Accounting Standards Board (IPSASB) standards. Mr. Allen said that he was only aware of adoption of the IPSASB optional cash basis standards adopted by developing countries. He said he was not aware of any country with accrual-based accounting adopting the IPSASB accrual standards. He said that one could refer to international standards but one could not say "harmonizing of federal reporting" because that is not the case. He said IPSASB was created by the World Bank and generally issues standards for the countries with which the World Bank is involved, e.g., by providing grants.

Mr. Werfel disagreed and said he proposed to provide some additional cases and research to demonstrate that there are other countries applying standards. Mr. Allen acknowledged that his information was based on a review a year and a half ago and may be outdated.

Mr. Reid said OMB might be able to look at other countries that have a standard that is similar to FASAB's even though they are not using the IPSASB standards. They may have their own standard like Canada or Britain or others that is similar to or different from FASAB's.

Staff noted that IPSASB still lists the "social obligations" project as a developmental project. No final decisions have been made and thus any reference to the IPSASB would have to be to a work in process.

Mr. Werfel responded that the objective would be to set out a statement with respect to the state of affairs in the international community that the Board could agree with and then make a point about whether the respondent believes that the ED as drafted is aligned with that and, if not, is that a concern. He said OMB would work on the wording for the question for the Board's consideration.

Mr. Allen noted that the International Accounting Standards Board (IASB) has addressed the issue with respect to what private companies are doing in various countries around the world.

Mr. Farrell suggested that since it was going to include what some standard setting bodies were doing, the Board should include what other standard setters are doing, especially the FASB. He suggested looking at private sector accounting, e.g., with respect to pensions where people are beginning to look at liabilities differently than they used to. He said this would balance the presentation.

Mr. Patton asked about the timing of the elements and the social insurance EDs. Ms. Comes noted that the social insurance staff had to draft questions and develop a balanced basis for conclusions, and therefore would be presenting new material at the July FASAB meeting rather than a pre-ballot draft ED. She could not say whether for the September meeting staff would present more new material or a pre-ballot draft. She

noted that the Board would also have some comments from the elements project by September. Thus, the elements project would be substantially ahead of social insurance.

Mr. Werfel agreed with Mr. Patton's concern about timing. He said that finalizing the elements standard and the liability definition before considering social insurance made sense. He said finalizing elements would create a foundation for the social insurance work.

Chairman Mosso said he appreciated that logic but if it waited for final concept statements the Board would not have any standards at all. He noted that this is true for every standard setter.

Mr. Allen said that, from his experience at GASB and Chairman Mosso's at FASB, he would conclude that concept statements and definitions do not help much. The standard-setting process is such that seven or ten different people are looking at a set of circumstances and trying to understand the economic substance and determine if a liability exists. He said that rather than waiting for the elements project he would take an opposite view and argue to disconnect the social insurance project from the elements project, e.g., by taking out the wording in the executive summary that the social insurance standard conforms with the definition in the elements exposure draft. He said he might put this wording in the basis for conclusions. He said he did not think the Board should treat a concepts statement as binding because concepts statements are intended to provide guidance to the Board -- and to preparers and attestors where there are not standards. He referenced the FASAB's 30 standards, many of which involve liabilities and were developed under the common notion that the Board is trying to capture economic reality. He said all the Board is trying to do in the elements project is to put on paper the notion that people have used in arriving at those first 30 standards.

Mr. Marron noted that he was new to the Board but could imagine his position on the social insurance statement being influenced by how the element ends up being defined. He said his understanding from the prior day's discussion was that the Board would make a concerted effort to point out to people the potential implications of the liability definition and seek input about what this might imply for social insurance. He noted that in principle that feedback could influence the Board's conclusion about that element.

Mr. Allen viewed a concept statement as being neutral and theoretically "pure." He said he could provide examples of GASB and FASB having concept statements but developing a standard for particular circumstances. Mr. Allen agreed that yesterday the Board said it would make a concerted effort to point out to people the potential implications of the liability definition and seek input, but he was concerned that the Board would be perceived as approving the definition based on what outcome was desired for a particular project. He reiterated that a concepts statement provides guidance though the Board would not pledge allegiance to it and acknowledges for different reasons -- whether economic or political or otherwise -- the Board may vary.

Mr. Werfel said he agreed with what Mr. Allen said but had a different application. Purity of the concepts process can be preserved if it is completed before the public debate is started on a standard that is significantly impacted by that concept. He noted the earlier discussion with respect to the executive summary that this is an unusual situation with respect to the magnitude of this particular standard and the controversy surrounding it, and therefore if you are going to do a standard that is big and controversial and different you would want a strong foundation. He did not see the completion of the elements project as a major delay.

The members concluded the discussion of questions #3 and #4 by agreeing to allow OMB to re-draft questions 3 and 4 for the Board's consideration.

The Board temporarily suspended its discussion of the draft ED for Comptroller General David Walker's scheduled presentation to the Board.

Comptroller General (CG) Walker thanked the Board for being flexible about the time for his session. He noted the joint letter from the JFMIP principals delivered to the Board today, May 25, and hoped that the members had had a chance to read and reflect on it. He said that one of the first things he did as CG was to approach the FASAB to encourage it to make more progress on accounting and reporting for social insurance. He opined that more transparency is needed about both the current financial position of these programs and their long-term fiscal sustainability. As a public trustee of the Social Security and Medicare Trust Funds from 1990-1995 he had pushed for disclosure of the discounted present value numbers and for summary annual reports. He complimented the FASAB on his own behalf and on behalf of the JFMIP principals for promulgating a number of standards in its short life, including making a lot of progress on social insurance. He said more was needed with respect to social insurance. However the JFMIP principals are very concerned about where the Board is on social insurance liability recognition. He said the principals were concerned that FASAB's current discussions to recognize a liability would be (1) inappropriate, (2) incomplete, and (3) inconsistent.

The CG said that based on all the authoritative literature he had seen the proposed liability recognition would be inappropriate. He said unlike a typical employer health and pension arrangement there is no exchange transaction. He said that, speaking for himself, that if there is an exchange, it occurs when the federal government takes people's money in the form of payroll tax and spends it and gives a bond guaranteed by the government. These bonds are characterized by the government as hard assets of the "trust funds." On the other hand, there is no exchange transaction and related liability with respect to the rest of the commitment by the federal government. Importantly, unfunded social insurance commitments are not legal obligations. Participants are on notice that the government will not be able to fulfill the current commitments. The programs must be restructured.

The CG said, secondly, the JFMIP principals were concerned that the focus just on social insurance is incomplete. There are other things that need to be done, for example, reporting on fiscal sustainability of which social insurance is an important part.

Another problem is how to show the inter-generational implications of existing federal fiscal policies. He asked the Board to consider a new statement, one that would not necessarily exist in the private sector, one that would be a combination of liabilities, commitments and obligations and provide total fiscal sustainability and intergenerational equity picture, including per capita numbers, GDP, and other measures.

The CG said that the approach was inconsistent with what people are being told through the Trustees' reports and through the Social Security individual statements that the resources are insufficient to pay all the scheduled benefits. He said that he had made a personal special effort over the past several months to reach out to members of IFAC, FASB, GASB, INTOSAI, Intergovernmental Audit Forum, Congress, and the Executive Branch and he could not find any basis or any real support for treating] long-term Social Insurance responsibilities as a liability under these programs. He stated that one of the real concerns he has is outreach: what are the efforts to try to understand users' need and whether this is generally accepted and – rightly or wrongly – the FASAB does not get that many comments when things go out for exposure. He said the last thing he wanted was a veto but feelings on this issue are very strong.

The Comptroller General asked the Board to think about its position on social insurance liability recognition and about whether this was the time to expose this as an ED.

Chairman Mosso noted the FASAB extensive due process. He asked what was wrong with proceeding with the exposure process and getting back the comments. He said he expected plenty of comments, as was the case in regard to SFFAS 17, especially since the Comptroller General and others keep raising the issue.

The Comptroller General said he was concerned about proceeding to exposure based on a 6-4 vote on this very big issue.

Mr. Allen mentioned the value of due process. He cited GASB's process regarding Statement 34, which had required three separate comment periods over five years before seven members could agree. He noted the Board's discussion about re-writing and adding questions to ensure people understood the social insurance arguments. With respect to the argument that there is no present obligation and therefore the proposal is inappropriate, Mr. Allen said that what is unique about the social insurance proposal is not whether or not there is an obligation. He said softer obligations than this are required to be recognized by international standards, FASB standards, and GASB standards, e.g., employee retirement healthcare benefits. He said there is far greater likelihood that Social Security and Medicare benefits will be paid than employee healthcare benefits. He said the issue is a measurement issue and what financial reporting measures is the economic substance of the existing promise, acknowledging that it can be modified.

With respect to incompleteness, Mr. Allen noted that the standard proposes to link the liability and cost with the SOSI. He said he did support a "statement of sustainability" in addition to the social insurance proposal. The question for him is how to provide all of that information and still maintain the integrity of the display in the traditional

statements. He added that he did not think it is inconsistent because the liability and cost amounts articulate with the SOSI.

Comptroller General Walker agreed that a statement of fiscal sustainability is needed regardless of the outcome regarding the social insurance proposal and that it was more important even than social insurance proposal. He noted that reasonable people are disagreeing in this case. He mentioned that he had been Assistant Secretary of Labor for pensions and health; that he had been integrally involved with FAS 87, 88, and 106; and that he had run a worldwide consulting practice for pensions and healthcare, and for him there was a fundamental difference between social insurance and pensions and healthcare. He said every other country in the world believes there is a fundamental difference. He said he talked to the chairman of GASB yesterday and this does not meet their standard. He noted that GASB had a debate recently about whether there should be a liability for nonexchange transactions and the answer was no. He said the real issue is not whether there needs to be more transparency regarding social insurance amounts but whether there is an exchange. He said reasonable people can differ about whether there is an exchange but in his view and that of the other JFMIP principals there is no exchange. He said the current proposal creates something that does not exist. He added that there is no way the federal government is going to deliver on current Medicare promises over the long term; the government has been very clear about that. He stated that the proposal creates false expectations by telling somebody who could be as young as 29 years old, after completing 10 years of creditable service, that he or she has earned Medicare benefits. With respect to asking questions in the ED, he suggested that the Board consider whether there should be more than one option for respondents to comment on. He said that would be progress.

Chairman Mosso mentioned in the interests of balancing the discussion that many people in the private sector advocate publicly that a liability be recognized for social insurance. Although he understood the feeling of the JFMIP principals, there is another side to it; the Board is not alone in its views.

Comptroller General Walker responded by saying that this is not a private sector issue because the private sector does not have social insurance. He said the private sector may have an opinion but social insurance is not relevant to the private sector.

Mr. Patton asked Comptroller General Walker if he understood him correctly to say that nonexchange transactions would never result in a liability beyond the “due and payable” amount.

Comptroller General Walker responded by saying he was not trying to make general statements. He said he was trying to draw an analogy. When you are dealing with a pension or a health promise, which is an employer promise, there is clearly an exchange of services for current and deferred compensation. He said in that case the accounting is the same whether the entity is a governmental, private, or not-for-profit; but there is not an exchange in the context of social insurance – other than the payroll tax/Treasury bond exchange mentioned earlier, which the Board currently is not considering.

Mr. Patton continued by asking the CG if he would extend that principle to other transactions. Comptroller General Walker said he would have to give the question more thought. He said that it was a clear and compelling issue for Social Insurance. He said another issue is that there are dedicated revenue streams that are being ignored in Board's proposal for liability and cost recognition, although they appear on the SOSI.

Chairman Mosso noted that the liability measures only what has been accumulated as of the reporting date. He said if all future benefits and revenue were included the liability amount would be even larger. He said future revenues are not relevant to the accumulated obligation.

Comptroller General Walker mentioned that the Board had picked 40 quarters for liability recognition and reasonable people can and will differ on that. He said he did not know if there is a "right" answer.

Staff mentioned that the proposal focused on meeting conditions for liability recognition rather than an earnings process, and that there are various alternative points where one might argue conditions are met, e.g., 40 quarters, age 62 or 65, and "due and payable." Staff asked the CG to comment on that notion.

Comptroller General Walker responded that the 40 quarter point is too early for liability recognition. He reiterated the point made earlier that he thought accruing a liability for a 29-year old participant was misleading.

Mr. Allen responded that current law says the 29-year old will receive the benefits.

Comptroller General Walker said that the benefits were "subject to" available resources.

Mr. Allen said that one of the advantages of financial statement presentation is that any changes made in the programs will be reflected.

Comptroller General Walker said he was not concerned with whether the Board required additional transparency and measures and information, including the present value of people who already have 40 quarters. He said he was concerned with calling that measure a liability.

Comptroller General Walker departed and the staff resumed the consideration of the draft ED.

The staff noted that questions for respondents 1-4 had been considered before the break for Comptroller General Walker. Staff stated that questions 5-11 dealt with aspects of the standards and asked respondents to comment thereon. Question 8 focused on the treatment of Medicare and raised the issue of whether the Board agreed with the staff that future premiums for Medicare Parts B and D should be subtracted from the liability measure whereas payroll taxes for Medicare Part A should not. The staff reasoned that, first, the premiums are necessary only if the participants enroll in Parts B and D. Part A payroll taxes are paid well before the coverage is in effect but not afterwards and the payment of payroll taxes beyond 40 quarters has no relationship to

future benefits. Once fully insured, participants receive Part A coverage whether additional payroll tax is paid or not. The premiums are also more or less a voluntary, exchange-like transaction while payroll tax is compulsory. Lastly, the budget approach for tax revenue versus revenue “earned” by the program is similar: taxes are displayed apart from expenditures whereas revenue “earned” by the program is off-set against expenditures at the program or agency level.

Mr. Allen said the proposal was consistent with the decision made at the March meeting that Parts B and D would not be treated as an insurance program. He said deducting the 25% premium is a measurement issue.

Mr. Reid said the approach struck him as inconsistent with what is being done with Social Security. Mr. Reid noted that the proposal would include future premium revenue would ignore future general fund contributions.

No other member voiced an objection to the staff proposal.

The Board did not object to questions 5-11.

At the conclusion of the Board’s consideration of questions for respondents Mr. Allen said he was troubled by the Comptroller General’s references to what he considered a flawed part of GASB’s draft concept statement. He said that although it is still deliberating and currently has a 4-to-3 majority on the issue, GASB did make the statement in paragraph 19 that constructive obligations can arise only from exchange transactions, and yet also in paragraph 19 used as an example of a constructive obligation the additional obligation under a substantive postemployment healthcare plan that provides additional benefits from the written plan. Mr. Allen said such benefits are not like a pension where credits are earned for years of work. He said for postemployment healthcare benefits all that is required is to reach a certain age; the employee for example could have worked as little as three years; on the other hand, someone could work for 20 years and leave before retirement and get no healthcare benefits. Mr. Allen said that, although he understood that the FASAB had concluded that social insurance involves nonexchange transactions, he tended to agree with Comptroller General Walker about the significance of paying payroll taxes. Mr. Allen said he believed it was far more likely that requiring someone, no matter how much they make and how much net tax they paid, if any, to pay a dedicated tax for social insurance programs for a specific period of time is far more an earnings process than reaching age 65 with as little as three years of work at a company and end up postemployment healthcare benefits. He said he did not want to start re-deliberating the substance of the standard but did want the Board to think about asking respondents to consider whether social insurance involved exchange or nonexchange transactions. He concluded that Comptroller General Walker’s argument seemed to hinge on this question.

Mr. Mosso noted that FASB requires liability recognition for pledges, which are pure nonexchange transactions. Thus, there is precedent.

Mr. Werfel said he would not object to such a question for respondents, but he said he might ask to include in it a sub-question, for example, about the larger implications of a concept whereby the payment of taxes is an event triggering eligibility. He mentioned that typically benefits are paid or services provided at a certain level of eligibility and to date the payment of taxes has not been considered an eligibility point.

Linking back to the Board's earlier discussion of liability in the concept statement, Mr. Werfel commented that Mr. Allen was seeing a point earlier in the process for recognizing the social insurance liability. He said there is a distance in time, e.g., using social insurance, 40 quarters to age 62, in which much uncertainty exists. He said it hinges on how one thinks about the definition of liability, and if there is a probability or likeliness component that drives you to a different conclusion about whether it is appropriate to book a liability at age 29, as Comptroller General Walker said.

Mr. Allen acknowledged the uncertainty and opined that it could be factored into the value of the liability.

Chairman Mosso said the exchange argument was a kind of red herring. He said the fundamental idea is to account for the promises made.

Mr. Allen agreed but stated that, if it is going to be used as a major argument and FASAB has a difference from GASB, then it would be worthwhile countering it. He reiterated that social insurance is closer to an earnings process than postemployment healthcare.

Mr. Dacey made a point regarding Mr. Allen's healthcare analogy. He said the employee has a bargained-for exchange with the employer whether it is ultimately enforceable or not; it is deferred compensation. He said in response to a question from Mr. Allen that there is no bargain-for exchange with respect to social insurance; it is compulsory.

The Board concluded its consideration of the questions for respondents and its review of the ED. Mr. Dacey mentioned that the Board had made key decisions along the way, e.g., how to treat the cap on resources, which he would like to see reflected in the questions for respondents. Staff will develop questions in areas that Mr. Dacey identifies, e.g., the resources cap and the treatment of Medicare premiums.

Mr. Patton asked whether the social insurance ED would go forward. The Chairman answered affirmatively. For the July meeting the staff will develop new material reflecting the Board's direction at this meeting, e.g., questions for respondents and the balanced argument in the basis for conclusions. A pre-ballot draft will not be prepared for July.

Ms. Comes provided an overview of the July schedule. The first and second distributions of materials are due on July 7 and 14, respectively. She mentioned that one or two members mentioned alternative views and she suggested June 30 as a tentative date for members to share alternative views with staff and with other members in order for the material to go out July 7.

The Board discussed adding material to the basis for conclusions to address the three points made in the letter from the JFMIP principals. Mr. Allen noted that the social insurance standard is not an “either/or” choice. The members agreed that the liability and cost amounts are a piece of a much larger picture and not necessarily the most important piece. Chairman Mosso mentioned the cash flow information as a percent of GDP and taxable payroll and the dependency ratio that continues to be required as RSI. Mr. Allen suggested addressing the JFMIP points in the basis for conclusions.

In order to clarify Comptroller General Walker’s (CG) position, Mr. Dacey said that, although he could not speak for all the JFMIP principals, the CG is concerned that there has not been sufficient input from the user community in developing the ED. His intention is to gather more public input into the concepts at this time. Also, Mr. Dacey said that CG’s vision is of equal alternatives rather than an ED and an alternative view.

Mr. Allen asked Mr. Dacey if expanding the questions and added more neutral, balanced discussion as discussed earlier would be helpful. Mr. Dacey answered affirmatively.

Mr. Werfel added that he agreed with the CG’s point about getting more pro-active buy-in from relevant stakeholders, but he said he would argue that that would be a step taken before the ED was issued. He said he did not know the type of vehicle to communicate to stakeholders the kinds of debates the Board was having and the issues with which it was grappling, but he did not favor an ED that had only two options because when you go into final you did not really give a good sense in the ED about exactly what direction you were going in. Also, OMB has a general concern about signing off on something where the content of the current ED is not deemed a viable alternative.

Mr. Allen said that the vehicles available included invitations to comment, preliminary views, and exposure drafts. His experience at GASB was that when an ED with an alternative view was used the members felt they could adopt either view at the end of the process, even if the initial alternative view represented only one member. He said he was troubled to hear Mr. Werfel say he did not think the proposal was viable. Mr. Allen said he hoped that all the members would acknowledge that they all have differences of opinion and see things differently but they will always be open to feedback from due process. He said that if users say strongly that the minority view is more valuable and it is confusing to have a liability displayed etc., he could support that; but he hoped that the minority would also acknowledge that if the broad feedback overwhelmingly supported the majority that the minority would also consider supporting that. He said that is an obligation the members have.

Mr. Werfel said he completely agreed that there was reasonable disagreement here and he respect the other position. He said the point he was making is that you have an ED that has two options that the FASAB is grappling with, and if OMB votes in favor of that, he wanted to be sure it was not construed that, by OMB voting in favor of that, OMB believed both options are acceptable.

Mr. Allen said the ED would make that clear.

Mr. Werfel said that, since the CG brought it up, he would like to brief his principal on an equal treatment ED before he presents it to him as a fait accompli. He said it was going to be GAO's position that this is something worth exploring and before he responds negatively he wanted to be sure his sentiments are shared by his principal.

Mr. Dacey said the CG would prefer something other than an ED to expose the alternative views and get broad feedback. A preliminary views (PV) document was discussed. Mr. Dacey said that a PV or other an alternative to an ED can be used where there is major disagreement as well as where the Board has not expressed a preference among alternatives.

Mr. Werfel said a PV seemed to him more intuitive than an ED with two equal treatments. A PV would allow the alternatives to be presented without a final standard looming on the horizon.

The Chairman polled the members regarding whether they were willing to proceed with the ED as it is but including more articulation of the opposing view and the additions to the questions discussed this morning. The Board voted 6 to 4 to proceed.

CONCLUSIONS:

1. Staff will change the wording of the questions to ask respondent to explain both agreement and disagreement with the ED positions.
2. Staff will develop a balanced argument for the basis of conclusions using the SFFAS 17 structure.
3. Staff will develop question 1b further, add a paragraph(s) to the basis for conclusions regarding alternative cost recognition points, and cross-reference the question to the basis for conclusions.
4. Staff will add an explanatory table to the glossary definition of "fully insured" to illustrate the points when participants become "fully insured," include permanently fully insured.
5. Staff will add a part "c" to question #2 that will ask respondents whether they think the new SOSI information is essential for transparency and ask for alternatives.
6. OMB will re-draft questions 3 and 4 for the Board's consideration and draft a question on the state of the international community.
7. GAO will identify the key decisions the Board made in the project, e.g., the resources cap and the treatment of Medicare premiums, which are to be reflected in the questions for respondents. Staff will develop the questions.
8. Staff will proceed with the ED in its current form and include more articulation of the opposing view and the additional to the questions.

Adjournment

The meeting adjourned at noon.