

Final Minutes on June 22-23, 2005

**FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD**  
**June 22 - 23, 2005**  
**Room 7C13**  
**441 G Street NW**  
**Washington, DC 20548**

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***Wednesday, June 22, 2005***

**Administrative Matters**

- **Attendance**

The following members were present: Chairman Mosso, Messrs. Dacey, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen and Ms. Robinson.

The executive director, Wendy Comes, was also present.

- **Approval of Minutes**

The minutes were approved electronically before the meeting.

- **Other Administrative Matters**

Two new staff members - Mr. Ross Simms, Assistant Director, and Mr. Nicholas Dorsey, a summer intern - were introduced to the members.

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Ms. Comes announced that efforts to reschedule the October 2005 meeting were unsuccessful and the meeting will be held on the 5<sup>th</sup> and 6<sup>th</sup> as originally planned.

## **Agenda Topics**

- **Objectives**

Staff member Melissa Loughan introduced the Objectives agenda item and noted that new staff member, Ross Simms was joining her on the project team. She provided an overview of the Objectives project. She noted that staff began drafting a white paper on financial reporting objectives. The white paper builds upon the work completed by former staff member Bob Bramlett and is following the outline that the board approved during the March 2005 meeting.

Also, Ms. Loughan noted that the white paper is an "in-process" document and, as sections are completed, staff will ask for board member input. Currently, the following outline sections have been completed.

A - Statement of Federal Financial Accounting Concepts (SFFAC) 1

B - Evolution in FASAB's Role

Staff has started work on section C, Nature and Limits of Federal Financial Reporting.

### Are Concepts for the Board or for the Board and the Profession?

Before entering discussions regarding the current version of the draft white paper, Ms. Loughan introduced an issue regarding whether concepts are for the board or for the board and the profession. She asked for the board members' views on whether the board would like to elaborate more on this topic in the white paper. She pointed out the current language in SFFAC 1<sup>1</sup> and referred the board members to the staff paper that presented excerpts of the conceptual framework language used by other standard setters. Ms. Loughan noted that other standard setters generally elaborated more on how the concepts assist others.

Mr. Patton stated that he liked the language that the FASB uses. Although the essence of the FASB language is already included in SFFAC 1, some additional language may be helpful. To emphasize the difference between the FASB and IASB concepts language, Ms. Loughan noted that the IASB language includes the statement that users can apply the concepts on topics that have not been addressed.

Chairman Mosso asked the board members to consider making the concept statements "semi-authoritative." For example, upon their completion, the assets and liabilities definition project could result in concepts that are designated as authoritative requirements and are applied in new areas. He noted that professionals are almost

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<sup>1</sup>SFFAC 1, paragraph 2 states, "Instead, statements on concepts, after approval by the Board's sponsors, provide general guidance to the Board itself as it deliberates on specific issues. They also help others to understand federal accounting and financial reports."

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invited not to use the concepts when we include the statement that concepts are not authoritative requirements.<sup>2</sup>

Mr. Farrell presented a concern that if the concept statements are promoted to "semi-GAAP," entities may need to review those accounting policies that were designed for transactions not specifically set forth in the standards and make sure that they comply with the newly promoted concepts statements. Chairman Mosso stated that implementation may need to be gradual and certain instances may need to be grandfathered.

Mr. Reid agreed that valid concepts should be used to fill "gaps" in the standards. However, he discussed a concern that the concept "idea" may not apply as well or have the rigor to be used as the board believes concepts should be used. He pointed out that although the concept statements and the first 8 standards were issued about the same time, the concepts and standards do not "mesh" very well. Mr. Reid noted that he would be concerned about requiring agencies to use the present concepts when the board did not use them in developing those early standards.

Chairman Mosso noted that currently, FASAB staff members have been applying the existing concepts in developing standards, but the existing concepts are too broad to help the board members focus their efforts. He believed that the asset and liability definitions project and possibly other concepts projects could result in rigorous concepts to be used when new issues are encountered. Also, he suggested that the white paper include a discussion on this topic to provide board members with additional background information. Regarding a question on whether the asset and liability definitions and other concepts would be issued as concepts statements or standards, Chairman Mosso stated that he envisioned that concepts statements would become a standard where a standard does not exist otherwise.

Mr. Reid suggested that, due to the level of effort that has been applied to the asset and liability definitions, those concepts could be issued as something other than a concepts statement, rather than elevating the authoritative nature of all the existing concept statements.

Regarding the elevation of the concepts statements, Ms. Loughan asked whether Chairman Mosso envisioned language similar to the following IASB language.

The Framework may also assist preparers of financial statements in applying International Accounting Standards and in dealing with topics that have yet to form the subject of an International Accounting Standard.

Chairman Mosso responded that the language did not appear to raise the concepts to the level where an entity would have to comply in certain cases. For instance, if an entity did not comply, it would not cause them to receive a qualified opinion on their financial statements.

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For example, SFFAC 1, paragraph 1 states, "Statements on concepts are more general than statements of standards and do not contain specific recommendations that would, when issued by the Board's sponsors, become authoritative requirements for federal agencies and auditors."

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Chairman Mosso noted that Mr. Patton previously expressed a preference for the FASB concept statement language, found on page 4 of the staff paper, and asked board members whether they had a preference for either the FASB or IASB language presented in the staff paper.

Board members preferred the FASB language and some board members suggested that one approach to elevating the authoritative nature of concepts is to issue certain concepts as standards. Ms. Robinson noted that the IASB states that the concepts framework assists auditors in forming an opinion. However, some members believed that auditors would not know how to apply this statement, and they would need further explanations from the board. Because specific authoritative concepts may be less difficult to apply, some board members suggested that the asset and liability definitions be issued as a standard rather than a concept statement.

Mr. Dacey cautioned board members that the IASB and FASB are rethinking their position and they may not continue in the current direction. Chairman Mosso noted that the board will follow the two standards setter's progress and, given that the white paper is an in-process document, the board will have time to consider new thinking that may apply to FASAB.

#### Draft White Paper - Key Changes in the Role of the Board

Regarding the draft white paper, Ms. Loughan asked whether the board members believe that the document prepared to date discusses all the key changes in the role of the board, primarily the status change resulting from AICPA Rule 203.

Mr. Farrell noted that the mission statement presented in paragraph 4 of the white paper may be obsolete. Ms. Loughan emphasized that the first section of the white paper, including paragraph 4, presents the mission statement at the time of FASAB's creation and that a goal of the white paper is to identify the areas that will need to be revised and updated. Chairman Mosso pointed out that the white paper does indicate areas for revision. He noted that a bulleted item on page 8 of the white paper asks the following question.

Is it appropriate to include FASAB's mission in the SFFAC 1 document if the ultimate goal is to produce a strategic plan?

Chairman Mosso noted that implicit in this question is the need for revisions.

Ms. Loughan agreed and stated that in earlier board discussions, the board considered the idea of preparing a strategic plan separate from the update to the concept statement. If the board plans to prepare a strategic plan, a revised mission statement may be best suited for that document. She asked whether the board believed that the mission statement should be in a concept statement or a strategic plan. Mr. Dacey responded that the mission statement should be the broader mission of FASAB and the strategic plan may not go as broad as the mission in the short term. The mission should be stated at a high level and the strategic plan may be narrower or focus on certain areas.

Ms. Loughan asked whether there are key changes that should be included in the white paper. Mr. Farrell suggested that the white paper explain the exposure period process.

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Ms. Loughan stated that the white paper can provide background information on FASAB's due process.

Mr. Reid noted that the term "supermajority" used in paragraph 14 may not be accurate. This term was not used at the time the board was focusing on the matter of independence.

#### Draft White Paper - Whether GAAP Status Requires Greater Emphasis on Public Interests

Ms. Loughan asked whether board members agree that GAAP status requires a greater emphasis on the public interest and directed board members to paragraph 17 of the white paper. Board members agreed that emphasis on the public interest existed prior to the Rule 203 designation. Rule 203 confirmed that the board was emphasizing the public interest and the perception of independence. Chairman Mosso noted that Rule 203 was an important historical point in the evolution of the board, but it is not necessary to provide an assessment of whether it was more important than others.

#### Draft White Paper - Whether GAAP Status Limits the Board's Role

Ms. Loughan asked whether the board believed that the GAAP status limits the board's role and referred the board members to paragraph 18 of the white paper. She noted that there have been discussions regarding cost information and performance measures and whether that type of information is appropriate information for the board to review, given the board's GAAP status. Board members agreed that GAAP status does not limit the board's role and paragraphs 17 and 18 of the white paper should be deleted. Ms. Loughan stated that staff will revise the white paper to emphasize that Rule 203 confirmed certain actions taken by the Board, such as a greater emphasis on public interests.

#### Draft White Paper - Preference for Inclusion of both External and Internal Users

Based on the discussion regarding emphasis on public interests, Ms. Loughan stated that it appeared that board members prefer inclusion of both external and internal users in SFFAC 1; however, she wanted to confirm that this was the board's preference. Chairman Mosso stated that from an agency point of view, external users include people "up the chain" so that what is internal to the federal government as a whole may be external to the individual agencies, because of the oversight process and their placement in the management hierarchy. Ms. Robinson agreed and raised the question whether, that at the highest level, Congress is an internal or external user. Ms. Cohen and Mr. Reid noted that they were probably both.

#### Draft White Paper - Next Steps

Regarding the next steps for the white paper, Ms. Loughan stated that the beginning sections of the white paper will be revised based on today's discussion and staff will continue "filling in" the remaining sections of the white paper outline.

Mr. Patton asked about the staff plans for completing the section of the white paper concerning the objectives for financial reporting. Ms. Loughan explained that staff plans to conduct roundtable discussions on each of the four objectives of financial reporting and following those discussions articulate the board's position on the objectives.

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Ms. Comes noted that staff will conduct the roundtables after the August 2005 board meeting, but before the end of December 2005. Staff plans to provide board members with preliminary results from the roundtables at the January 2006 board meeting. Ms. Comes noted that the roundtables will provide board members with insights from experts involved in performance reporting and those experts external to the accounting community whom the board has lost touch over the years. Also, it provides an outreach opportunity that can reengage the community.

Ms. Comes pointed out that the board could move on and go through due process if the board decided to issue an amendment to SFFAC 1 or a replacement for SFFAC 1. Accordingly, the outreach effort would be deferred. Mr. Patton stated that he would like to get to a sensible, stable outcome and stated that the outreach effort sounds reasonable. The objectives of financial reporting will be the core of what the board will ultimately decide.

Mr. Dacey stated that the Accountability of Tax Dollars Act of 2002 seemed to relate to a specific issue while the purpose of the white paper was to discuss broader matters. He suggested that the section be removed and Chairman Mosso agreed.

**CONCLUSION:** Staff will continue drafting the white paper and incorporate the board's recommended changes.

### • Elements

Ms. Wardlow gave a brief overview of two papers that she prepared for the Board. The first discussed the recognition criteria adopted, respectively, by the FASB and six other standard-setting authorities for elements of financial statements. The FASAB had requested the paper at the March 2005 Board meeting. The second paper explained amendments made to the March draft of the liabilities section of a possible FASAB document on elements of financial statements. Most of the amendments had been requested by the Board in March. An amended draft was attached to the June paper.

With regard to recognition criteria (paper 1), Ms. Wardlow explained that a key feature of the approach adopted by the FASB and other authorities was the distinction they made between meeting the definition of an element and meeting recognition criteria. For example, an item might meet the definition of an asset but not meet the criteria for recognition. If so, the asset should not be reported in the body of a balance sheet or statement of position, but it could be disclosed in the notes or as supplementary information. She recommended that the Board adopt that approach. That recommendation was the first of six staff recommendations included at the end of the paper. Mr. Mosso suggested that the Board move directly to the recommendations, which may be summarized as follows:

1. The FASAB should acknowledge the distinction between an item meeting the definition of an element and recognizing the item in the financial statements. Items that meet the definition but not the recognition criteria that the FASAB establishes would be candidates for disclosure in the notes or as supplementary information.

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2. Two criteria should be met in order for an item to be recognized in the financial statements of the federal government: the item should meet the definition of an element and it should be reliably measurable.
3. In contrast to the FASB, the FASAB should not establish relevance or reliability as a specific recognition criterion (although a reference to reliability in the measurement criterion may be appropriate).
4. The FASAB should *exclude* a notion of probability from the definitions of elements and *include* a notion of probability or expectation in the recognition criteria. The Board may wish to discuss at a later date whether and, if so how, it should stipulate a level of probability or expectation.
5. If the Board agrees with these recommendations, the recognition criteria for federal government financial statements would be as follows (wording not intended to be final):

An item should be recognized in the financial statements when all of the following criteria are met:

- a. It meets the definition of an element of financial statements.
- b. The element is measurable with sufficient reliability.
- c. The inflow or outflow of benefits or services inherent in the definition of the element is reasonably expected to occur in the future.

An asset or liability should be removed from the financial statements if it ceases to meet either the definition of an asset or liability or other recognition criteria.

It may be useful to mention in a discussion of recognition criteria in a concepts document that, when applying recognition criteria, consideration should be given to all of the qualitative characteristics including the pervasive constraint of materiality and cost-benefit considerations.

6. If the Board basically agrees with these proposed recognition criteria, further discussion of them, refining of wording, etc. should be deferred until the Board is ready to adopt a definition for each of the elements. Postponing further discussion might avoid the need for redeliberations if the definitions that the Board adopts suggest a need for changes in the essence of the recognition criteria or the desirability of specific wording.

Mr. Farrell said that he agreed with all six recommendations, although he had a question about the fifth one. Mr. Patton stated that he agreed with the first recommendation. Mr. Zavada asked how that recommendation would work: Would one be able to quantify the disclosure? Ms. Wardlow responded that one might be able to quantify the disclosure to some extent, but less than would be appropriate for reporting in the balance sheet. Mr. Mosso offered oil and gas as an example; there could be dollar values for some amounts but others might be quantifiable in acres or barrels but not in dollars. The Board generally agreed with the first recommendation.

Concerning Recommendations 2 and 3, Ms. Robinson questioned how relevance would relate to reporting elements such as liabilities. Mr. Zavada asked whether it would

relate to materiality. Ms. Wardlow thought that all of the qualitative characteristics are part of a recognition decision, but it is difficult to establish hard and fast rules. Relevance, for example, relates to what the standard setter or preparer thinks users ought to know. Concepts of relevance and usefulness underlie financial reporting. Something might meet the definition of an element and yet not be material or very relevant to users, so that it might not meet any kind of recognition criteria for those reasons, or might not even merit note disclosure. Mr. Zavada said that at first sight he did not see how an item could meet the definition and recognition criteria and yet not be relevant, but then he thought there might be some applicability to social insurance liabilities. For example, the Board has discussed whether a liability on the balance sheet beyond the due and payable amount is relevant, given that there is a statement of social insurance. But he could not think of other liabilities that would not be relevant. Mr. Mosso thought that members would vary in what they thought was relevant. Mr. Reid thought the issue related to the notion of fair presentation in terms of considering what one needs to report to fairly present the situation. A particular item might not meet a specific definition, but it still might be relevant to discuss it. He thought relevance might be a consideration for items that do not meet the first two criteria—definition and measurability—but one believes something should be said about them. Mr. Mosso agreed and said his response to Ms. Robinson's question would be similar. Meeting a definition leads to recognition or disclosure, but that does not preclude disclosure of other items that may not meet the definition. They may not be measurable but they may be very relevant to fair presentation. Mr. Mosso indicated that he thought that all members agreed with Recommendations 2 and 3.

Mr. Dacey wondered whether there was a way to make the applicability of qualitative characteristics, as an overriding concept, operational when considering the definition of elements. He mentioned the FASB's recent deliberations and noted that there was considerable discussion currently in this area. Mr. Mosso asked in which of the concepts projects the Board would address the qualitative characteristics? Ms. Comes said she needed to revisit the project plan for the conceptual framework. The qualitative characteristics currently are in the white paper before the discussion of reporting objectives, because they are part of the FASAB's Concepts Statement No. 1. The FASAB has not said as much about the qualitative characteristics as the FASB has, but the language is very similar to the FASB's language. The FASB characteristic that the FASAB did not adopt is neutrality. Personally, she did not believe there were a lot of issues that the FASAB should address. There has always been a tradeoff between relevance and reliability, but she views that as a judgment issue which cannot be tightened unless one abandons the notion of the tradeoff. However, given the FASB's current review of qualitative characteristics, she believes the FASAB may need to give more time to discussing them than anticipated in the original project plan. She would suggest removing qualitative characteristics from the white paper on objectives and finding an appropriate place for them in the other phases of the conceptual framework project. Her view of the qualitative characteristics is that there is no real difference in government except that one would apply different judgments about weighing the qualitative characteristics and what is relevant. Therefore, she does not believe that the FASAB should say anything very different about qualitative characteristics from anyone else in the accounting profession. She would like to see how the FASB and IASB's

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discussions proceed and schedule the FASAB's discussion for after those two boards have made some progress.

Mr. Mosso asked Ms. Wardlow to elaborate on her Recommendation 4. She gave a brief overview of previous Board discussions about uncertainty in financial reporting and whether a notion of probability should be explicitly included in the definition of assets and liabilities or in the recognition criteria, particularly in measurement. She reminded the Board that the FASB's inclusion of the word *probable* in their definitions of assets and liabilities was one of the issues that the FASB planned to discuss with the IASB, which did not include the word in their definitions, whether the word should be included or not. The current view of the FASB appears to be that the issue of probability should be addressed in measurement. One possibility for the FASAB would be to add the notion of probability or expectation to the recognition criteria, as suggested in Recommendation 5. Another possibility would be to include in the concepts statement a section covering the importance of uncertainty. The FASAB had reviewed the section on uncertainty from FASB Concepts Statement No. 6 at previous meetings. If the FASAB took that approach, the Board might wish to make some changes from the FASB's section to make the discussion more appropriate to the federal environment. A separate discussion of uncertainty might be preferable to including a notion of probability in either the definition or the recognition criteria.

Mr. Patton thought it might be risky to attempt a generic discussion of uncertainty that would apply to both definition and recognition, given that the Board had just decided to distinguish between definition and recognition. Ms. Wardlow said she thought the FASB's paragraphs on uncertainty did not refer specifically to definition or recognition, but rather were a general discussion of the fact that there is uncertainty in financial reporting. Mr. Patton said that, if the Board accepts that an item could meet the definition of an element but not the recognition criteria, one of the ways that could occur would be through measurement, in that the probability of an inflow or outflow of future assets or services is not high enough for recognition, but it is high enough to meet the definition. In that case, the discussion of uncertainty would not apply symmetrically to both definition and recognition.

Mr. Mosso said his preference would be to include a discussion of probability as an inherent part of measurability. Even historical cost carries with it the obligation to record amounts that are recoverable, and whether they are recoverable is a probability assessment. Also, when one considers notions of present value and expected value, the notions are based on an estimated cash flow, which is a probability assessment. Market values by their nature incorporate an expectation of future events that embodies a probability notion. At the moment, the Board is discussing measurability as a criterion for recognition. However, when the Board discusses at some future date how items should be measured, he believes the discussion should include a notion of probability. He asked Mr. Patton if that would meet his concerns.

Mr. Patton responded that his understanding is that measurability is at the recognition stage, not at the definition stage. The Board's interest in "casting a wide net" with the definitions suggests that the same parameters would need to apply for recognition also. He asked what it means to "cast a wide net" at the definition stage and then have a "narrowing" at the recognition stage? Mr. Reid said one might have disclosure of an

item because the item was within the wide net of the definition stage but did not meet the recognition criteria. Mr. Patton agreed that could be the outcome, but he inquired what would be excluded from the wider net? Mr. Farrell responded that items that did not meet the definition would be excluded. He added that he did not understand Mr. Patton's concern. Mr. Zavada said Mr. Patton's concern was: What would not be in the net, given the breadth of the definition as it currently stands? Mr. Mosso responded that anything that was not a present obligation or did not meet the three essential characteristics underlying the definition would not be in the net. He thought those requirements would exclude a lot of items, and it is the measurability that constitutes a tighter net. Mr. Reid said he did not see the harm in casting a broader net at the definition stage, if in fact the Board then focuses at the measurement stage on the things it believes are important. Mr. Patton commented that the references to a "net" were confusing to him. Also, one needed to consider the asset side as well as the liability side. What the Board appears to be saying is that no matter how improbable a future inflow or outflow associated with a resource or an obligation might be, we could still say that we have either an asset or a liability. He thinks that is the implication of ignoring probability at the definition stage. If that is the Board's intent, would it not be better to say that, rather than stay silent?

Ms. Robinson said she also had an issue with the concept of probability in an evolving government context. One of the issues she has is legal enforceability, which she believes belongs at the definition stage. Under what set of circumstances is it probable? The GSEs are the classic example. Referring to PBGC, she said there are probably \$100 billion of unfunded liabilities that the government is not liable for at this point. But, who believes that Congress will allow millions of pensioners not to receive their pensions starting in 2018 or whenever the money runs out? In that context, she finds the notion of probability strange. Is it probability under current law? Under current law, there is no probability. The government is not liable. PBGC effectively will close. So, what is meant by probability? Is it a political probability, a legal probability or something else? In her view, in a government there is a lot more than financial probability.

Mr. Reid thought that one has to start down the road somewhere. When one gets to measurement, probability is inherent in that and one has to deal with it. Mr. Patton agreed. Mr. Reid continued that Mr. Patton is saying there are two cuts at probability. One is that—using the GSE example—it is highly improbable that the government will do anything in that arena (assuming that is your conclusion) and therefore the unfunded liability is not a liability. That is among a number of other reasons why it would not qualify under our definition, but let us say that one would cut off consideration of whether the item is a liability because government action is not very probable. But then, when you get to measurement, some definition of probability must factor in. For example, when you look at things like bad debt reserves you must consider probability. Mr. Reid asked whether it would cost the Board anything not to have excluded the item at the definition stage and then exclude it at the measurement stage along with the other things that are excluded at that stage? Ms. Robinson thought it does cost the Board something. It happens a lot with the budget, where people want to add to the budget estimated liabilities for PBGC and other GSEs. But the budget should only include what the government actually is liable for. One cannot let people believe that the government is budgeting for those amounts or even considering them, because the

government is not liable. So, putting the amounts on the books might actually mislead people into thinking the government has accepted an obligation to support these future amounts.

Mr. Zavada said he liked the way Ms. Wardlow had addressed the issue because the notion of probability is so difficult. But, in the essential characteristics of liabilities there is a notion of probability in the third characteristic. (See page 5 of the attachment to paper 2.) In paragraph L7c it indicates that "the obligated entity has very little possibility of avoiding settlement at a determinable date." There is a notion of probability in that—in meeting the definition of a liability — because it has to meet all three characteristics. Ms. Wardlow agreed. Mr. Patton thought that the definition must include the characteristics. So, if the Board likes probability in the characteristics, it ought to like probability in the definition because they need to match.

Mr. Dacey asked Mr. Patton whether his concern is that by casting a wide net initially the Board would be including too many things. Mr. Patton said no; to him it was just a matter of logic. If it does not matter how low the probability is for either the asset or the liability element definition, then the Board ought to say that explicitly. Mr. Zavada said that then one should not include any probability. Mr. Patton recalled that the Board had discussed including the word *could* in the asset definition. He was not sure how to say it in the liability definition, but it should be included so that a reader would not reach the opposite conclusion—that you need 100 percent probability to meet the definition. In response to Mr. Mosso's request, Mr. Patton elaborated that the FASB had the word *probable* in their definitions, with a footnote explaining that the word was not used in the same sense as it is used in FASB Statement No. 5. It is just to ensure that readers do not assume that 100 percent certainty that future inflows or outflows will occur is required for an item to meet the definitions. Mr. Patton views that as a vague standard of probability at the definition stage, which is supplemented later in measurement.

Mr. Mosso asked why probability would be needed in the definition if it will be included in measurement? Mr. Patton responded that under the Board's concept of "wider net, narrower net," more things would meet the definition than would meet the recognition criteria. That appears to be the Board's goal. He would like to ensure that readers do not think that any probability notion that is in the recognition criteria would apply to definition. There is a lower hurdle for definition, and if the Board stays silent, the problem will not go away. Mr. Mosso agreed with the last point. He does not favor putting the word *probable* in the definition, but he thinks a discussion of the notion in the document would be very useful. Mr. Patton said that a generic discussion of probability that would apply to both definition and recognition would not work if the Board has different cut offs, at least implicitly, in definition versus recognition. He could imagine two discussions of uncertainty—one with respect to definition and a separate one for recognition. However, if the notion of probability will be included in the essential characteristics, then he believes there must be a match between the characteristics and the definition.

Mr. Reid said that he believes the purpose of the characteristics is to expand the definition and make it clearer. One could say a lot of things in characteristics that were not explicitly in the definition. One would not need perfect symmetry there or one would not need the characteristics. Mr. Patton thought one could expand the discussion of the

characteristics, but each characteristic should be in the definition. Otherwise, it would not be a necessary part of the definition. Ms. Wardlow pointed out that no standard-setting body had done that. Most have tried to get a fairly succinct definition. Then the purpose of going beyond that was to expand a bit and state what the characteristics underlying the definition are. They do not have to be repeated in the definition because otherwise there would be no need to state the characteristics. Then, the standard setters go one step further and explain the characteristics. So, there is an expanding notion of explanation. The FASAB has previously discussed the importance of trying to make it clear in the document that the Board expects readers to read everything and not just to pull out the one-sentence definition and jump to conclusions that it means something other than the Board intended. One needs the whole discussion to understand the meaning and intent of the definition. With regard to the FASB's discussion of uncertainty, it does not apply to recognition because Concepts Statement No. 6 does not cover recognition criteria; it only covers the definitions. The FASAB still has before it a decision as to whether recognition criteria will be in the same document as definitions or in another document, and that decision may affect what the Board wishes to say about uncertainty, if it is discussed.

Mr. Patton said that in the current draft of a definition and characteristics of liabilities (attachment to paper 2), there was a correspondence between the definition in paragraph L4 and the list of characteristics in L7. However, upon reviewing them, he agreed that the reference to "very little possibility of avoiding settlement" in the third characteristic was not in the definition. Mr. Patton said that he believed the Board was reluctant to put probability into the definition. He suggested that Ms. Wardlow exclude probability at the definition stage and provide separate discussions of the role of uncertainty at the definition and recognition stages so that there would be a clear understanding that probability plays a role in both, but the hurdle is different at the two stages.

Mr. Farrell said that maybe the notion of "cast a wider net" is causing confusion because it is not in the draft. He thinks that the succinct definition of a liability is supported further by the essential characteristics. It is all part and parcel of the same thing. So, to meet the definition, you also need to meet the criteria (essential characteristics). There are no "two tests" here. There is no wider net. Mr. Patton inquired whether Mr. Farrell meant there is no wider net between definition and recognition, so that anything that met the definition would be recognized? Mr. Farrell said no. He said one has a definition that is further explained by the essential characteristics. That enhances the definition. The definition and characteristics are tied together. There is not one probability for the definition and a different probability for the characteristics. The characteristics are a further embellishment of the definition because we are trying to keep the definition succinct. But, to fully understand the definition, you have to understand the characteristics. Ms. Robinson said she thought Mr. Patton was saying that the difference in probability levels would only be between definition and recognition. Mr. Farrell agreed and said that one is really not casting a wider net. It is just a phrase in the cover memo that is actually in quotes.

Mr. Reid thought that one might be casting a wider net for the definition and characteristics taken together versus the recognition criteria. Mr. Farrell and Ms.

Robinson agreed. Mr. Reid continued that there might be a lot of reasons for the wider net at the definition stage. One might have one group where the information is relatively easy to get and pursuing it is cost-beneficial. For another group, one might conclude that though the information meets the definition, it should not be recognized because it does not meet the cost-benefit test. So, among many items that meet the definition, some would be recognized on the balance sheet and some would be disclosed. That is what the "wider net" means. Therefore, in his view, one looks at whether an item meets the definition. If it does, one looks at whether it meets all the characteristics. If it does not, one decides whether to stop or continue to the recognition stage and apply those criteria. So, the initial definition may capture a lot of items that in fact are not recognized. That is why he believes capturing more items at the definition stage is not harmful, because there is a thought process that one goes through logically. There are a few things that initially you may have a question about and then later you read something that indicates that the item should not be recognized. Mr. Farrell added that he thought that the definition is not in search of items that might meet it. Transactions and events occur that you apply against the definition. You do not take the definition and say "let's go search for things." Transactions and events occur in the federal government and you assess them against the set of rules the Board is setting up in order to conclude whether they meet the definition.

Mr. Patton agreed that there are a lot reasons for not recognizing items that meet the definition. One of those might be probability. Considering the asset side, if there is a resource and there is a 0.01 chance of the resource providing benefits to the government, do we want to recognize that resource as an asset? Do we want to say that, first of all, the resource meets the definition of an asset? In the spirit of "wide net," you might say "yes" to definition and "no" to recognition. In his view, if the Board wants people to behave in that way, the Board needs to be explicit somehow at the definition stage. Maybe the word "probable" is not needed in the definition itself, but it needs to be said somewhere very close to the definition and applied to that definition so that people can distinguish between "probability criterion for definition: low" and "probability criterion for recognition: higher."

Mr. Mosso thought that a discussion in the draft of the whole notion of probability and where it fits was a good idea, and he asked Ms. Wardlow whether she thought that could be done. Ms. Wardlow said that the original discussion of uncertainty that she had included in the draft did not address recognition, so the conflict the Board has discussed would only occur if one rewrote the current discussion of uncertainty to cover both definition and recognition. Mr. Reid asked Mr. Patton whether the issue could be addressed either as a footnote or in a basis for conclusions, or would it need to be in the standard? Mr. Patton responded that the proposed statement is a concepts statement. He thought the issue was important enough to be close to the definition. A footnote would be close enough, but a basis for conclusions would be too distant.

Mr. Dacey said he was not sure he fully understood Mr. Patton's position, but he thought he agreed on a couple of points. Whatever the definition of a liability is and whatever the Board's criteria for recognition are, they need to be clearly spelled out in some detail so the reader knows what the Board means, especially as the Board may be changing from the current definitions. He also thinks there is a different concept in

what meets the definition versus recognition when you talk about probability, for the reasons Mr. Patton stated. The Board had talked about the word *could* in the asset definition. What *could* means ought to be defined and discussed at the definitional level. That is different from the probability one likely would discuss on the recognition side. Secondly, Mr. Dacey believes that the characteristics should be the same as the definition. The discussion of the points, whether those in the definition or in the characteristics, needs to be supportive, and he did not know why "very little possibility" was in the characteristics but not in the definition. The following paragraphs can then describe what the concepts mean. Ms. Wardlow said she could try to do what had been suggested. When she looked at other standard setters' work, she noted that they had made an effort to keep the definition very succinct and then expand in the characteristics. If one does not do that, one tends to get a two- or three-sentence definition, and then you go to the next paragraph on characteristics and question why the definition is being repeated. Mr. Dacey said he referred only to the phrase "very little possibility." He was not sure it would add anything to the definition, but it is included in the characteristics. So, he wondered why it was in the characteristics but not the definition. Ms. Wardlow said it was simply to keep the definition short, which is the same reason that the FASB referred, as the FASAB may recall, to "little or no discretion" in the characteristics, but they did not include the phrase in the definition. She had been following a similar model to try to keep the definition succinct, but include a paragraph in the draft to try to encourage readers to read the whole section. If the definition is taken out of context, one can interpret it different ways.

Ms. Wardlow continued that, with regard to talking about probability or uncertainty, one can do so in many different ways. She asked the Board whether they wished to include recognition criteria in the same document with the definitions of elements. If so, the approach to talking about uncertainty would be different than if recognition criteria were not included. She thought it fair to say that most people would understand that, when considering whether an item meets the definition, one is considering something that may happen in the future. There is inherent uncertainty and some notion of probability is present, but in terms of explaining what probability is and how you assess it one would get into measurement, which is a recognition issue not a definitional one. That should come across in the document, if that would help. She saw some difficulty with including an explicit reference to probability in the definition without saying what that means—how you measure it, for example. If you say how you measure it at the definitional stage, what do you do at the recognition stage? Do you say it again, or are the measurement criteria different?

Mr. Patton thought one could simply have some notion of uncertainty in the definition to assist when, for example, two accountants are trying to decide whether an item is an asset or not and one thinks the probability of future benefits has to be 0.7 and the other says it does not have to be more than 0.2 probability. Recognition can be debated later. It seems that, because the item has to meet the definition before recognition is considered, the different views allow such a wide range of apparently acceptable interpretations of a notion of uncertainty that it is dysfunctional.

Mr. Mosso said there are different notions of probability. In the definition it concerns the possibility of getting out of the obligation. It deals with whether the present obligation is

binding, whereas the probability that is inherent in measurement has to do with the extent of the resource flow. Mr. Patton asked whether, in that view, the present obligation is really binding at a very high level of probability and the dollar amount might be uncertain, but as one of those events occurs, some resource flow will occur. Mr. Mosso agreed. He thinks the first notion is like an on-and-off switch. There has to be a binding agreement or understanding. He sees that as a different notion. If one uses the word *possible*, there is no doubt that has a probability connotation. Mr. Patton asked if the same would apply to assets. Mr. Mosso said yes. You have a resource, but you must have a pretty good notion that you have control over it.

Mr. Farrell asked Mr. Patton what kind of word he would insert in paragraph L4<sup>3</sup> of the draft to convey a level of uncertainty or probability? Would it be that the entity "could" have incurred . . .? "May" have incurred? Mr. Patton suggested ". . . a present obligation that an entity has incurred that could lead to providing assets or services to another entity at a determinable date . . ." etc. The Board had included "could" in the draft asset definition to say something like "a resource that could produce economic benefits or services . . ." Ms. Wardlow said that one of the problems she has with that language for liabilities is that she believes the Board should make it clear what the obligation is for. When one says that "a liability is a present obligation that *could* result in providing assets or services," the implication is that it might not, in which case, what kind of obligation are we talking about?

Mr. Dacey said that he was somewhat familiar with treaties and believed there are agreements with other countries to do certain things that the government may not have to do because many of them are contingent upon other events. So, conceptually we may have a liability to these other countries, even though at this point and for the foreseeable future, we do not think it will be exercised. In the context of definition versus recognition, there is a question as to what one would do in that situation. Mr. Reid said that in the context of the wording "when a specified event occurs," for a NATO treaty the government has a liability "when a specified event occurs." It has not occurred yet, so the question is how one would measure that because that specific event could occur in twenty-three different countries and it might be one of several kinds of liabilities, and you have a measurement problem. So you probably say nothing. But you do acknowledge the fact that you have an obligation. The word *could* in the definition would not affect that discussion at all. Once you have signed the treaty, you have an obligation. You do not necessarily have a recorded liability until something else happens. But you have created an obligation, which is the first step of the analysis. Even though there is a clear probabilistic exercise one would need to go through in that discussion, the fact of whether probability is in the definition would not affect any of it. That is a specific example, but it is the reason that he is not convinced that it makes much difference whether you have the word *could* or not in the definition when you get to the recognition stage. Although he has not yet fully considered the issue of recognition, his sense is that the Board may be better advised to put the recognition

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<sup>3</sup> Paragraph L4 of the June draft contains a proposed definition of a liability. It reads: "A liability is a present obligation that an entity has incurred to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand." [footnote omitted]

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criteria in individual standards, because the Board may reach different conclusions based on the nature of the information, the records, and the obligation. The Board would want to be able to make those distinctions and would not want a "one size fits all" situation. He said Ms. Wardlow raises a good question: Should recognition criteria be in the same document with definitions? He thinks the Board needs to talk about that.

Mr. Mosso asked Ms. Wardlow whether she would be able to sort out in drafting the difference between a probability notion in definitions and probability in measurement? Ms. Wardlow said she would try and see how it works out. One of her first questions would be whether the Board would like to see a notion of probability specifically stated in the recognition criteria, which is one of the questions she raised for the Board in the first paper (on recognition criteria) for the current meeting. An alternative would be a general discussion of the notion of uncertainty, even though the discussion might distinguish between uncertainty at the definition stage and uncertainty at the recognition stage. Ms. Robinson observed that the current staff papers include a notion of uncertainty in both places—"very little possibility" in the essential characteristics of a liability and "reasonably expected" in the recognition criteria. They give some indication of the levels Mr. Patton was talking about and they could be elaborated as a separate issue.

Mr. Patton said that Mr. Mosso's point about what the probability applies to was resonating with him, although he had not yet quite sorted it out. Referring to paragraph L7 (essential characteristics of a liability) of the attachment, he thinks that the "very little possibility of avoiding settlement. . . when a specified event occurs . . ." is a contingent probability, and indicates that if the event occurs there is a very high probability of settlement. That is different from the probability standing today, which involves contingencies with respect to both the occurrence of the specified event as well as the amount of the flow subsequent to the event. He therefore believes it is important to decide which of those probabilities is being invoked at the definition and the recognition stages. He thought they might be the same, but they might be different.

Mr. Farrell said that he liked Mr. Reid's example, where the government signs a contract, such as a NATO agreement, and it is clear that one has to look at these definitions to decide on how to report it. In his view, there is no implication of probability in the fact that the government has signed something. It is there; you have a document, or a transaction or an event which makes you look at a definition and decide what to do. It is pretty clear it fits the definition, with or without any probability concerns in this definition, and then what you do with it for financial reporting purposes goes further into these characteristics, and then maybe even into another standard or statement.

Ms. Robinson said she drew a different conclusion from Mr. Reid's example, especially when he referred to a treaty. The government signs many things which it does not intend to carry out. An example is U.N. documents. There is a historical pattern and diplomats know that what they have just signed is not going to occur. That is an example of probability. Mr. Farrell commented that somehow one needs to put historical-based accounting back into the equation. Ms. Robinson said that this is where legal enforceability is important, which is a topic in paper 2.

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Mr. Mosso made two suggestions on how to proceed. One was along the lines of his discussion earlier with Mr. Patton, concerning trying to differentiate the kinds of probability that apply at the definition versus the recognition stage. An alternative suggestion was just to drop the third characteristic of a liability [(c) the obligated entity has very little possibility of avoiding settlement at a determinable date, when a specified event occurs, or on demand.] He did not think that characteristic was needed. If an obligation is the issue and you have a present obligation to transfer assets or do other things, the fact that you may not do it—and the possibility that one party will not perform is inherent in every financial instrument—does not mean it was not a binding arrangement. It was binding, but somebody defaulted. On the asset side, when you move to measurement you may decide the chances of default are so great that you have nothing to recognize. With respect to treaties, Mr. Reid said the government might sign a treaty in good faith and circumstances might change later so that a decision is made that the treaty is no longer in the national interest. Mr. Farrell pointed out that someone would need to make that decision in order for an accountant to be able to reverse the obligation. Mr. Reid agreed and added that in fact it argues against a notion of probability in the definition. The obligation exists and even though someone says that the government is not going to honor it so no liability will be recorded or disclosed, in the interests of full disclosure one would have to disclose that the amount is not recorded because the probability of settlement is so low. Maybe the fact that the obligation was included in the liability definition initially might get you to that answer rather than excluding it at that point because you thought the probability was close to zero.

Mr. Mosso asked Ms. Wardlow what she thought about dropping characteristic (c) from paragraph L7. She said it would make the liability characteristics simpler. Then the Board would need to decide whether it wants to retain part (c) of the recognition criteria (first paper), which refers to probability in measurement, or whether the reference to probability should be deleted in both places (liability definition and measurement in the recognition criteria) and discussed instead in separate paragraphs of the draft. She added that, in consulting the definition one is asking "Do I have an obligation or not?" Whether or not there will be settlement in the future is something that has to be assessed when deciding whether to recognize or disclose a liability.

Mr. Mosso asked the Board members what they thought about trying that approach—that is, dropping characteristic (c) from the liability characteristics but having a discussion of probability that tries to put it in the context of whatever characteristics the Board adopts. Those characteristics would be the first two, if the third one is dropped. Mr. Patton asked for clarification whether the proposal was to drop only the phrase "very little possibility" from characteristic (c) or also the mention of determinable date, specified event, and so forth. Mr. Mosso thought those timing factors should be retained. Mr. Reid wondered, in that case, whether paragraph L7 was needed because all it would do would be to repeat the definition. Mr. Patton thought it set up the structure for the discussion in the following paragraphs. Mr. Zavada asked Mr. Mosso whether he proposed that the discussion of probability should follow the characteristics. Mr. Mosso said staff should select the best location. Mr. Farrell agreed with Mr. Reid that, with the proposed change, one would not need to specify the characteristics any more. Characteristics (a) and (b) would be extended to include the timing factors, which

would make them the same as the definition. So, you would be further explaining the definition, as opposed to explaining the characteristics. Ms. Wardlow agreed that it would be repetitive, but she thought that if one says that the definition is built on essential characteristics, then one would have to state what the characteristics are, before proceeding to explain them.

Mr. Mosso elaborated that his proposal could tie accomplished in paragraph L7 by striking the phrase "and the obligated entity has very little possibility of avoiding settlement." Then, the remaining wording would read ". . . provide assets or services to the other entity at a determinable date, when a specified event occurs, or on demand." Mr. Zavada asked whether the next paragraph would address the notion of probability or uncertainty. Ms. Wardlow said she thought that one would first need to explain the meaning of "present obligation" and "settlement of the obligation." Then there would be a separate section on the role of uncertainty. Mr. Dacey asked whether the notion "very little possibility of avoiding settlement" would move to the recognition criteria. Mr. Mosso said he would leave staff to select an appropriate place, but it would need to be prominent. Ms. Wardlow said she thought the removal of "very little possibility" from the definition criteria would lead one to place it with the recognition criteria, in measurement. She recommended that the Board retain part (c) on page 13 of the first paper ["c. The inflow or outflow of benefits or services inherent in the definition of the element is reasonably expected to occur in the future."] and include a discussion of it.

Mr. Mosso observed that the Board's discussion thus far had bridged the two staff papers. He asked Ms. Wardlow what else she needed from the Board. She responded that there was a lot in the second paper that the Board had not yet addressed. Mr. Farrell thought the second paper was where the problems were on which the Board's discussions had gone back and forth at several meetings. Mr. Mosso agreed and said that if the Board could solve the issues in the second paper, those in the first also would be resolved. Mr. Farrell agreed. He thought that if the Board could settle the items on page 8 of the second paper ["Issues for Possible Vote of the Board" in the Board memo], it would be helpful to the staff and would help move the project forward.

Ms. Wardlow said there was an issue she would ask the Board to address before moving to the second paper, because it would help guide the focus and drafting of the section on probability. Should the recognition criteria be explicitly included in the same document with the definitions or should there simply be a reference to the fact that definition is not the only consideration and the Board would address recognition criteria in another document? Ms. Robinson and Mr. Mosso said definition and recognition . criteria should be in the same document. Otherwise, it would be difficult for constituents to understand the distinction between definition and recognition. The other Board members generally agreed. However, Mr. Reid had some reservations because he thought it would be difficult to consider all the relevant factors surrounding recognition, including the circumstances in which recognition might or might not be cost effective, in a document of the nature the Board was contemplating. He did not think the Board wished to allow users to determine what is and what is not cost effective. Ms. Wardlow thought that in a concepts statement the issues could be maintained at a high level, and the Board could address particulars of how to apply recognition criteria in individual standards. Mr. Mosso said there should be a mention of measurability. He thought that

the various aspects of how to measure items would need to be addressed in a separate document, but the recognition criteria—measurability—could and should be included in the same document as the definitions of elements.

The Board then turned to the second staff paper and the "Issues for Possible Vote of the Board" on page 8. The first issue was: "1. Can federal entities have assets and liabilities that are not recognized in the financial statements—that is, they meet the definition of an asset or liability but they do not meet the other recognition criteria? (In that case they might be disclosed in the notes or as supplementary information.)" The Board had already responded affirmatively to this question in their discussion of the first paper (recognition criteria) and did not discuss it further.

Ms. Robinson referred to Issues 2. and 3. on page 8: "2. Is legal enforceability an essential characteristic of a federal government liability? (An obligation that is not legally enforceable would not meet the definition of a liability.)" and "3. Should the ability of Congress to change existing laws affect the definition of a liability? Or, should it potentially affect only recognition and/or measurement of the liability?" She said she liked the fact that the document stressed current law and the legal framework. She agreed that clearly legal obligations were liabilities and sometimes there might be other liabilities. But, even though the document does not ignore the legal foundation of government actions, legal enforceability should be a primary characteristic of most liabilities of government. Ms. Wardlow asked if most liabilities of government are technically legally enforceable. She said she thought that many liabilities would be omitted if legal enforceability was an essential characteristic. Her understanding was that the government currently reports liabilities where the potential recipient of settlement has no standing to sue for settlement. Should those items not be considered liabilities? Ms. Robinson thought that related to Issue 3 which deals with current law. Under current law there are many more things that are legally enforceable than if one thinks that Congress will change the law. If you think that current law is going forward, then you could sue for your retirement benefits, health care, and so forth. The Supreme Court has said that if Congress changes its mind, then one cannot sue. But, current law increases enforceability greatly, if you assume that will be the law when the suit happens.

Ms. Robinson said that she viewed environmental liabilities a little differently because of sovereign immunity. She had some concerns about whether they should be recorded, because she questions whether the government will in fact comply with them. That is a probability issue that may be considered part of measurement and recognition. However, in a fundamental sense the government is not liable. It could stop clean-up activities now. The contracts are legally enforceable when they go forward, but there is doubt about some future clean-up activities. With respect to Issue 3, Ms. Robinson said it was a matter of whether Congress is considered part of the reporting entity or not. If Congress is external to the entity, then one can assume that current law will continue, but that is not the case if Congress is part of the entity, and that would affect both definition and recognition and measurement. She also believes that legal enforceability is related to whether Congress is considered external or internal. In response to Mr. Mosso's question, Ms. Robinson agreed that the issue of whether Congress is internal or external should be addressed directly. If Congress is internal, then they can change

things and the financial statements should not give the impression that there will be no change. Alternatively, the Board could state that Congress is external. It can do whatever it wants, but right now, under current law, the agencies are operating in this fashion with these obligations.

Ms. Cohen asked whether, with respect to legal enforceability, an appropriation would not ultimately be required. For example, in Pennsylvania several years ago the highest court handed down a final judgment that the state was responsible for judicial expenditures, but the legislature refused to fund them and there was no recourse. So, she had a problem with legal enforceability as a required characteristic, because ultimately either the government made an appropriation or it did not and, if it did not, what would be the recourse? Ms. Robinson asked whether that was not part of the difference between meeting the definition of an element and recognizing the element? The courts have determined that the state is liable. The fact the state does not pay it would be something that would factor into what value should be recorded. Ms. Cohen disagreed. She said that if the Board only looks at legal liabilities it would be very limiting and it would miss some important liabilities. Ms. Robinson and Ms. Cohen continued to discuss their different views, including the situation with callable capital. Ms. Cohen thought there would be no point in having standards if the important consideration is that Congress can change the law. Everyone knows that laws can change. However, one has to base accounting on current law because that is what is in force. Ms. Robinson said that she saw danger in recording liabilities that the government might not settle. Ms. Cohen said that possibility or probability would be taken into account in measurement.

Mr. Mosso indicated that the Board needed to conclude the discussion and break for lunch. He thought that all Board members, except Ms. Robinson, viewed the Congress as part of the federal government, and all of the FASAB's concepts statements had taken that view. The consolidated report includes the Congress. He said he did not fully understand the implications of the inclusion of Congress for Ms. Robinson's views and he asked whether she could explain further. He said he thought the Board should address the issue somewhere in the elements document because the issue of the Congress being able to change the law keeps coming up in many contexts.

Mr. Dacey thought that legal enforceability needed to be addressed. He did not know that it was an essential element, but he thought it was a valid consideration in looking at a liability, and there may be other things that one should consider if it is not legally enforceable. He thinks that most liabilities are legally enforceable but there are some that are not. He said that the whole concept needed to be discussed. Mr. Farrell said to Mr. Dacey that, based on what he had just said, the answer to Issue 2 would be no; legal enforceability is not an essential characteristic of a liability. Mr. Oacey responded that it was not an essential characteristic but it was a critical one. Mr. Farrell indicated that, based on the discussion, the answer to Issue 3 also would be no. Mr. Dacey agreed.

Mr. Zavada said that he agreed with Ms. Robinson that it was difficult to separate the notion of Congress's ability to change the law between definition and recognition. The Board should go one way or the other. Ms. Wardlow said that we are trying to look at the situation as it is at a particular time. The fact that the Congress can change the law

in the future would be the same for the private sector. A board of directors can change its mind in the future or the law might change, but the board is looking at the situation right now, when a decision must be made about whether there is a liability now. If Congress has been doing something that indicates that a change in the law is imminent, that might come into one's assessment of probability at the recognition stage, but she did not think it would change one's assessment of whether there is an obligation now or not. Mr. Zavada asked whether that would not lead, as Mr. Dacey was saying, to predicting what Congress is going to do, in terms of recognizing the liability. Ms. Wardlow did not think so. She said that in all accounting and financial reporting one is basing what one does on events that have occurred and what the situation is now. Mr. Reid said it might lead one to conclude that something should be disclosed about what is happening in Congress and about whether it might impair or change the values one has already recorded, if Congress actually takes a specific action. He thought one might disclose that information, but one was compelled to record information based on the current law. Mr. Farrell noted that, if Congress is contemplating a particular action, private corporations disclose the potential impact, even though the law has not been signed. Mr. Zavada asked at what stage the disclosure would be made—for example, when the bill is introduced? Mr. Farrell said one would look at SEC regulations on disclosures. He thought that if a bill had been introduced it would be disclosed. Ms. Cohen pointed out that disclosure may actually lead to changes in the law because they may raise issues that have not been considered. She thought that was part of the reason for financial disclosure.

Mr. Mosso asked Ms. Wardlow whether she had sufficient information or whether the discussion should continue after lunch. Ms. Wardlow requested a vote on the issues listed on page 8 of paper 2 because they had been discussed many times and she was uncertain what other information she could give to the Board to bring them to closure. She thought that Issue 5 (whether probability should be addressed at the definition or recognition stage) had been discussed sufficiently in the context of paper 1, but she would like a response to Issues 2, 3, and 4 (whether an appropriation or other form of funding was an essential characteristic of a liability). Mr. Mosso agreed.

The Board adjourned for lunch at 12:00 PM.

Following lunch, the Board addressed the "Issues for Possible Vote of the Board." Mr. Patton voted "yes" to Issues 1 and 5 and "no" to Issues 2, 3, and 4. Ms. Robinson asked Mr. Dacey whether he thought there should be a major hurdle to overcome for an obligation that is not legally enforceable to be considered a liability. Mr. Dacey agreed. He said he did not know how one would define that. His answer to Issue 2 was "no," but if the obligation was not legally enforceable there would need to be other criteria that should be met. Mr. Schumacher observed that, on page 3, the staff paper (paper 2) says that "activities of federal entities are 'legally based' in the sense that they operate within a framework of laws." He asked whether that statement was not strong enough. Mr. Reid and Mr. Dacey thought that meant only that the government cannot do anything illegal, Ms. Wardlow reminded the Board that the language in the draft on liabilities (attachment to paper 2) had been developed at previous meetings, with the assistance of legal counsel Mr. Jacobson. Also, there is another paragraph, L3, which

reads: "Settlement of a federal liability may be legally enforceable, as is the case, for example, with contracts. However, laws that create or support federal liabilities do not always confer legally enforceable rights on recipient entities. Legal enforceability may provide additional evidence that a liability exists, but it is not a prerequisite." That paragraph was intended to make the Board's view of legal enforceability clear, but the language could be changed if the Board wished. At previous meetings, the Board had struggled with the issue and the language, and a majority of Board members had indicated that liabilities should not be limited to those that are legally enforceable.

Having called the question, Mr. Mosso concluded that a majority of the Board did not believe that legal enforceability is an essential characteristic of a liability. However, he thought it might be possible to strengthen the language in the current draft. Mr. Dacey suggested that staff develop the criteria that it might be important to consider when an obligation is not legally enforceable. Mr. Farrell questioned whether the language referred to was not simply a precursor of the definition. He observed that paragraph L3 makes the point that legal enforceability is not an essential characteristic and then "liability" is defined in the next sentence (paragraph.L4).

Using PBGC as an example, Ms. Robinson again expressed the view that obligations should not be recognized as liabilities if the government is not obliged to settle them, and PBGC is reporting liabilities beyond the amount they are required to pay by law. Ms. Cohen said that, in the private sector, if a company does not have the money to settle its liabilities it is insolvent, and that is the same for the PBGC. Ms. Robinson pointed out that PBGC is consolidated with the rest of the government and the liability is not eliminated. Mr. Dacy read an excerpt from an audit report on PBGC, which indicated that the agency did not have the resources to cover long-term obligations to plan participants. He said that the liabilities are recorded to the extent that they are probable and meet the FASB Statement 5 requirements. Then, there are other liabilities that are reasonably possible and are not recorded.

Ms. Robinson repeated her question about how these items can be called liabilities when there is no obligation to pay them at a future date. Ms. Comes said that topic had been discussed before in the context of social security, where the same situation exists. That is, the benefits exceed the resources that the Social Security Administration is authorized to use to pay for them. So, absent a change in the law, under current law, you cannot pay the whole amount going forward to the 75-year point. In the Social Insurance project, the Board had talked about discussing that as a measurement issue. Ms. Robinson pointed out that all the figures from the SSA that the SI staff has presented so far included the cut that would occur. The SSA assumes a 22 percent cut in 2041. Ms. Comes responded that she thought the staff was presenting data from the Trustees' report that included scheduled benefits.

Mr. Mosso said that the Board should move on. He did not believe the Board was sympathetic to making legal enforceability an essential characteristic of a liability. Mr. Patton endorsed Mr. Dacey's suggestion of an elaboration of what facts and circumstances might be considered when an obligation is not legally enforceable. He suggested that issue be addressed somewhere in or around paragraph L2. For example, he thought that the example beginning in line 6 needed expansion because it did not indicate when a natural disaster might result in a federal liability and when it

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would not. Mr. Farrell said he had a similar problem with the language beginning in line 10, which did not indicate what facts and circumstances might lead to a conclusion that there is a liability. Ms. Wardlow said that this language had been debated extensively with the help of Mr. Jacobson, and that in the examples given judgment was required. There were no existing requirements that led to one conclusion versus another. The intent was that the facts and circumstances would need to be compared with the definition of a liability and the underlying essential characteristics to conclude whether there was a liability or not. Ms. Comes said that paragraphs L2 and L3 are a preamble. After them, the document presents the liability definition and the essential characteristics of a liability. Then the document discusses "Present Obligation" and the requirements for "Settlement of the Obligation." She said that if one is looking for the "meat," it is under the heading of "Present Obligation" and what it takes to discern that a present obligation exists.

Mr. Farrell suggested retaining the first sentence of L2, as Mr. Patton had previously suggested, and then eliminating the material including examples until the sentence beginning at the end of line 15: "In the circumstances described in this paragraph . . ." He thought that would be less confusing. Ms. Wardlow agreed to try that and see if the result provided enough information.

Mr. Mosso turned to Issue 3, which referred to the ability of Congress to change laws, and asked for members' reaction. Several Board members agreed that the answer to both parts of the question is "no." No members disagreed.

With regard to Issue 4, Mr. Mosso said he believed the Board had established that neither an appropriation nor any other form of funding is an essential characteristic of a liability. He asked whether any member disagreed with that. Mr. Dacey asked whether a "cap" would have an effect—for example, when the law establishes a maximum payout. Several members indicated they thought that is a measurement issue. Ms. Comes said she thought it was similar to insurance where there may be a cap, and it was a measurement issue not an issue of definition.

Mr. Farrell said that the answer to the two parts of Issue 4 were, respectively: "No, the existence of an appropriation or other form of funding is not an essential characteristic of a liability" and "Yes, an entity can have a liability, even though currently there are no funds available to settle it." Mr. Mosso asked if any member disagreed with those responses and none did.

**Conclusions:** Ms. Wardlow indicated that she would prepare a section for the draft concepts statement that would discuss the issues of uncertainty and probability, including references to, respectively, definition and recognition. She also would make some changes to the current draft on liabilities along the lines discussed at the meeting. She suggested adding the assets draft that the Board has previously reviewed to the amended liabilities draft, so that the Board could view them together at the next meeting. Mr. Mosso, Mr. Farrell, and other members agreed. Mr. Farrell suggested also including a discussion of the recognition criteria and other members agreed. Following a suggestion from Mr. Patton, Ms. Wardlow agreed to reconsider the need for and language in

paragraph L13, concerning an entity's ability to unilaterally specify or change the settlement date of a liability.

- **Social Insurance**

The staff presented four items for the Board's consideration. Regarding the first item Ms. Comes explained that the staff was presenting a synopsis of the social insurance eligibility characteristic intended as a basis for the Board's assertion that there is a present obligation before payments are due and payable. She noted that the staff has related a notion of eligibility to the notion of conditions being met instead of what had previously been a performance notion. Ms. Comes said she thought the draft paragraphs would resonate better when they become part of a complete basis for conclusions.

Chairman Mosso commented that "eligibility" is probably not the right word to emphasize. He said he did not want to change the substance of what the staff had presented but noted that on page 2, the second line of the first paragraph states that eligibility requires conditions to be met and the last line of the second paragraph says that conditions determining eligibility are met over time. He said it seemed to him that the conditions are the subject and "eligibility" means different things to different people. For some it is practically a "due and payable" notion while for others one's first day in covered employment.

Mr. Farrell said he thought these would be conditions for recognition, not eligibility criteria. He said the liability definition would have been met before conditions are considered. He said the liability definition had been satisfied when a program was established and people began contributing. Next is how that liability is measured, and that then we get into defining certain conditions that have to be met.

Ms. Comes noted that FAS 116 language regarding accounting for contributions speaks in terms of conditional promises and satisfaction of conditions leading to the requirement of a fulfilled promise. She said she thought the draft paragraphs could be readily converted from eligibility to meeting conditions. Mr. Patton added that FAS 116 says that the criterion is when the conditions are substantially met. He suggested using that phrase in the draft basis for conclusions. He said that that phrase would allow Board members to reach different conclusions regarding when conditions are substantially met but agree on the criterion for deciding whether recognition was appropriate. Ms. Comes responded that staff would move in that direction.

Ms. Comes asked about the second item presented by staff, the question of why 40 quarters is preferred over 62 years of age. Ms. Robinson asked if the issue really was whether there is a present obligation to do something in the future. Ms. Comes said that that was the core of the liability question. She agreed with Ms. Robinson that in different programs different operational terms may be used to assess what obligations exist. A program may necessitate analyzing whether specified conditions have been met; or whether an arrangement exists between two parties - and sometimes there aren't two clear parties that can reach an arrangement; or whether some external, third-party triggering event has created a present obligation between two other parties.

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She said the analysis would require talking about this in different words operationally but it all comes back to deciding whether there is a present obligation of the sort that results in outflows of assets. Mr. Patton said he agreed with Ms. Comes' statement.

Chairman Mosso asked whether the members who requested the item #2 write-up were satisfied with the wording. Mr. Farrell said he was satisfied. Mr. Patton said that he was concerned that the statement on page 3 of the memorandum about additional considerations supporting the conclusion that a present obligation exists at 40 quarters, [i.e., any remaining unmet conditions are beyond the Government's control and the likelihood of unmet conditions remaining unmet is remote] is not consistent with the conclusion that the obligating event arises at 40 quarters. He said it would be true also for the beginning-work-in-covered-employment event. He indicated that the likelihood of laws being changed and measurability were not reasons to support age 62 over 40 quarters.

Ms. Comes asked Mr. Patton what he thought the critical condition was for creating a present obligation at age 62 rather than 40 quarters if it is not the likelihood of laws being changed and not measurability. She said perhaps it is aging, which appears to be the only thing left between 40 quarters and age 62. She said she was not sure, in terms of present obligation to pay in the future, why aging is relevant. Mr. Patton said it was relevant because is it a condition for receiving payments. Leaving another 20 years before one is eligible to receive any payment means that the conditions are not substantially met at 40 quarters. Ms. Comes asked what differentiated age 62 from the due and payable approach with respect to meeting conditions? Mr. Patton said he thought there was a difference between being eligible to receive any payment versus the next payment. Ms. Comes said she was having a hard time explaining the difference other than a preference regarding the quantity of years.

Mr. Reid said one of the ways he would distinguish the two is that under accrual accounting it is important to recognize cost and match it with whatever is happening. He said 40 quarters does that much better than age 62. While both events are significant to the program, the 40 quarter event addresses the problem of having the payroll tax revenue received well before the associated cost is recognized.

Mr. Patton said the cost argument makes social insurance sound like a pension plan, which he did not think it is. In his view social insurance is a social program where costs are not incurred as participants work in covered employment. They occur when conditions are substantially met. Mr. Reid noted that the revenue is recognized as participants work in covered employment.

Regarding the question of 40 quarters versus attaining 62 years of age, Mr. Schumacher said one factor contributing to his own decision to favor the 40-quarter obligating event was what he, as a potential beneficiary, had control. For example, he had control over his entry into the workforce, at least to some extent, and whether he satisfied the 40 quarter requirement. He does not have control over attaining 62 years of age, nor does the Government.

Ms. Comes summarized the Board's discussion as follows: the draft language for the basis for conclusions would be revised to include an explanation of the superiority of 40 quarters over beginning-work-in-covered-employment. And, for the argument regarding

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the superiority of 40 quarters over attaining age 62, there are three key pieces missing: (1) control over conditions being met not resting with the potential beneficiary; (2) conditions can relate either to being eligible for a payment or the timing of it; and (3) the notion of matching of cost.

Ms. Comes introduced staff item #3, the project schedule for the rest of the year. She noted that the schedule proposed to present a draft of an exposure document in January that is formatted and structured as a proposal. She said the staff has found that working in the context of a proposal is beneficial. It introduces a level of discipline. The issues can be worked incrementally, a complete and clear basis for conclusions can be developed, and all the bases can be covered.

She said that a decision would have to be made eventually regarding the type of exposure document to release. Two alternatives - a "preliminary view" document and an exposure draft of a proposed standard - would require majority support for the position taken. An invitation to comment is a third alternative. She said that item #3 gives the Board a preview of when we expect to start doing that.

Mr. Reid asked if there had been discussion of the advantage of doing a preliminary view document versus just an exposure draft, or a conclusion that a preliminary view document was necessary. Ms. Comes said that no conclusions have been reached.

Mr. Reid expressed concern that there are large pieces of the social insurance project that had not been addressed yet. Ms. Comes said the project plan stopped at the initial draft of the exposure document but she anticipated at least three and probably more meetings to get the exposure document right.

Mr. Zavada said that a preliminary view document probably would be beneficial for something this controversial. Also, he asked about the similar stages for the elements project.

Ms. Comes said that the Board had decided today that recognition criteria should be bundled with the asset and liability definitions. She said that in August and October the Board would see the scope of the papers presented broaden to include asset and liability recognition criteria. After several more iterations, the Board can decide whether to spend another couple of cycles doing revenue and expense and whether to include loss or gain, and then expose that for comment. Thus, in 2006 the Board could be considering similar exposure documents for Ms. Wardlow's phase of the conceptual framework project and Mr. Fontenrose's social insurance. The exposure documents could be issued concurrently; or, if one is sufficiently far along, separately.

Mr. Reid asked whether staff had done any work on the measurement criteria. For example, was staff working under the assumption that the numbers that the Trustees' compute could be used or would different computations be possible. He said the main thrust of the trustees' work is sustainability, which does not strike him as appropriate for a liability. Chairman Mosso said that staff has done some preliminary work on measurement and would discuss options in August, including what is done now and what other options are available.

Mr. Zavada questioned whether an exposure document could be issued dealing with the application of the definition before the definition itself.

Mr. Patton said he favored a preliminary view document and linking the elements with the application in Social Security. A preliminary view document on Social Security would slow the Board down and let the elements project catch up, and a final liability definition would not be needed for a preliminary view document. He said that, on the other hand, presumably, if the Board were proposing a specific solution, it would want to have a final liability definition in place to support that.

Chairman Mosso said he would not want to slow things down. He said the Board's pace was already slow, although that was typical of standard-setters. He favored moving things as quickly as possible, even if everything was not perfect. He noted that a lot is learned in the exposure process. He favors the exposure draft route regardless of the subject simply because a second exposure draft or a third is possible if needed. He said a preliminary view document does nothing except guarantee that time will be lost.

Mr. Patton responded that the Board was fairly evenly split and a preliminary view document could present the multiple views in an even-handed manner, as opposed to a standard and an alternative view. Chairman Mosso responded that the basis for conclusions can do that just as well. He noted that it was not necessary to decide this question today but that it would be possible to do part of the concepts and the first exposure document concurrently, which he said he thought would be helpful to the constituents.

**CONCLUSION:** Staff will continue drafting language for a basis for conclusions, including language regarding conditions being substantially met. The draft language for the basis for conclusions will explain the superiority of the 40 quarters obligating event over beginning-work-in-covered-employment. And, for the argument regarding the superiority of 40 quarters over attaining age 62, three key pieces would be added: (1) control over conditions being met does not rest with the potential beneficiary; (2) conditions can relate either to being eligible for a payment or the timing of it; and (3) the notion of the matching of cost.

Staff will present measurement concepts and alternatives with emphasis on what is currently available from the SSA versus other possible approaches. Staff also will present a comprehensive illustration of the basic financial statements (including the Statement of Social Insurance) with some alternatives for presenting an accrued liability, actuarial gains and losses, and expenses for Social Security and Medicare. Alternatives presentations will be provided including ways to relate the articulated statements to the Statement of Social Insurance.

- **Research into the Application of the Liability Definition**

Ms. Ranagan referred the members to the three papers located at tab D - the staff discussion memorandum regarding the Corporation for National and Community Service's Service Award Liability; the staff analysis of minutes from the May session; and the highlights from the GASB Preliminary Views on Pollution Remediation Obligations, the FASB Financial Interpretation Number (FIN) 45 on Guarantees, and the

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FASB FIN 47 on Conditional Asset Retirement Obligations. She explained that, as discussed in the last staff meeting, staff was providing copies of documents from other standard-setters that were deemed by FASAB staff to be helpful and/or relevant in formulating its position papers. She noted that the documents from GASB and FASB were recommending earlier recognition of liabilities and justified such a position by stating that such earlier recognition would lead to earlier and more complete reporting, representational depiction of assets and liabilities, transparency about obligations, and information about expected future cash flows. There were no comments on either the analysis of the May minutes or the highlights of relevant issues so Ms. Ranagan launched into a discussion of the staff memorandum.

Ms. Ranagan summarized that at the May 2005 meeting she recommended that the submission of the contract and documentation of supporting evidence be selected as the obligating event for the Farm Service Agency's Milk Income Loss Contract (MILC) and Feed Grains Direct and Counter-Cyclical Payment programs. She noted that several members agreed with staff's recommendation of the obligating event but there was not a formal vote on the matter. In addition, at the March 2005 meeting, staff had recommended that the government's verification of eligibility be selected as the obligating event for the Supplemental Security Income program, but several members felt that the government's determination need not be inserted as an essential step in creating an obligating event.

Ms. Ranagan stated that the subject of this meeting's discussion memorandum is the Corporation for National and Community Service's Service Award Liability (SAL) and her objective is to present an analysis of a government program that currently recognizes a liability before the due and payable point even though it is a nonexchange transaction and not all conditions have been met for the member to have a legal claim to the award. She noted that Appendix 1 (pages 13 - 27 of the staff discussion memorandum) contains a fact sheet on the Corporation's SAL, which gives detailed background information on the program.

Ms. Ranagan explained the SAL life cycle events via a chart on page 2 of the staff discussion memorandum. She noted that the point when the Corporation currently books its SAL is when a member has completed 15 percent of his term of service. However, at that point, there are still substantial conditions that must be met before the member can receive payment. The member still must leave for compelling circumstances or complete his full term of service and submit a request for payment of eligible education expenses.

Mr. Reid asked if 100 percent of the liability is booked at 15 percent or if it is booked based on percentage of completion to date. Ms. Ranagan responded that the full amount of awards earned plus expected to be earned minus certain discount factors based on historical earning and usage rates are booked at that time. Recognition does not occur as service is performed; the full (albeit discounted) liability is recognized at 15 percent of service.

Mr. Zavada asked if there is a contract or agreement between the Corporation and the member. Ms. Ranagan responded that in a majority of cases, the application and approval process is conducted through the Web-Based Reporting System and she is

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not aware of anything that would constitute a "contract" between the Corporation and the member.

Ms. Robinson asked who actually pays the member's expenses - the Corporation or the sponsoring program. Ms. Ranagan responded that the individuals request payment directly from the Corporation and upon approval, payment is then sent to the eligible institution or loan holder.

Mr. Reid said that the accounting treatment for this does not appear to be based on Generally Accepted Accounting Principles (GAAP). He said he could understand recognizing 15 percent of the expected award amount once the member has completed 15 percent of service, but he does not see 100 percent of the anticipated liability (albeit adjusted for earning and usage factors) being booked once the member has completed only 15 percent of service as being equivalent to GAAP.

Mr. Farrell said he could understand recognizing a liability for the member after he has completed his full year term of service and possibly adding a factor for the number that will leave for compelling circumstances after completing 15 percent of service.

Mr. Reid said he could also see recognizing a liability along the way as the member uses it, e.g., after completing 50 percent of service, a liability could be recognized for 50 percent of the expected award amount, adjusted for further earning and usage factors of who will actually complete service within 12 months and claim an award at some point down the road.

Ms. Ranagan explained that the Corporation records the full amount of the appropriation received by the trust as a financing source ("revenue") in the year that it is received and invested by the trust. The appropriation received each year is intended to cover all outlays for that program year throughout the seven to nine years that the members of that program year are engaged in earning and using their awards. As a result, the full expense for each program year (the full amount that is expected to be outlaid for that program year) is also recorded so on the top of the income statement you have the dollars that went in to fund that program year and on the bottom, subtracted from that, is the dollars that will go out to pay for that program year.

Mr. Reid again questioned how the difference between 15 percent and 100 percent could be considered GAAP. He asked what the justification is for recognizing the difference between what has actually been earned as of the reporting date and what is expected to be earned when the member has completed one year of service.

Ms. Ranagan responded that she applied the FAS 5 criteria on page 5 of the staff discussion memorandum to justify recognition of the liability:

FAS5, Par. 8

8. An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if both of the following conditions are met:
  - a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
  - b. The amount of loss can be reasonably estimated.

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FAS 5, par. 1 states "For purpose of this Statement, a contingency is defined as an existing condition, situation or set of circumstances involving uncertainty as to possible gain (hereinafter a "gain contingency") or loss<sup>1</sup> (hereinafter a "loss contingency") to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability." <sup>1</sup> FAS 5, Footnote 1 states "The term *loss* is used for convenience to include many charges against income that are commonly referred to as *expenses* and to others that are commonly referred to as *losses*."

Ms. Ranagan stated that when you apply those criteria to the Corporation, approximately 80 percent of members that enroll will use their award, which definitely fits the criteria for probable. In addition, the liability can be reasonably estimated. The Corporation has developed a model to estimate the liability that has been proven to result in historically accurate estimates based on a recent independent verification of the model's accuracy.<sup>4</sup>

Mr. Reid questioned whether the expense is being recorded in the correct year. He said he believes GAAP dictates that the Corporation recognize a liability that would mirror the member's service. He provided the example of Social Security, stating that if the Board uses 40 QCs as the recognition point for Social Security, the cutoff point would be 40 QCs and the balance sheet would reflect future benefits based solely on the work performed from entry into the workforce through 40 QCs. There would be no estimate for future work to be performed and no recognition of that amount until it is performed.

Mr. Zavada said he feels there is an exchange involved, an exchange of services for this benefit. Mr. Reid said he does think it looks a lot like an exchange transaction. Mr. Dacey said it looks like an exchange transaction and he can agree with Mr. Reid about the accrual notion but it is also possible that the Corporation may have determined that their model is materially consistent with that notion.

Mr. Mosso said FAS 5 may not be the right standard but it seems like what the Corporation is doing is pretty close to complying with FAS 5.

Ms. Ranagan responded that she does not view the members' service to the sponsoring programs as an exchange transaction in any way. She referred the members to the poll question on page 8 of the staff discussion memorandum and asked if the members agree that the Board should abandon the distinction between exchange and nonexchange as a defining characteristic in determining when to recognize a liability.

Mr. Zavada says he feels that there is an exchange between the person that is performing this service and the benefit that he is getting on behalf of the services that he is rendering. He believes that the distinction between exchange and nonexchange makes liability recognition much, much clearer.

Ms. Ranagan asked Mr. Zavada how the SAL program would differ from Social Security where the participant is providing services to another organization in return for the benefit. Mr. Zavada said Social Security is totally different - the same benefit goes to everyone, there is no difference in the weighting of the formula based on earnings or income, etc. He said with SAL, it seems very clear to him. The member enters the

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<sup>4</sup> Report by Econometrica, Inc., "Assessment of the CNCS Service Award Liability", June 17, 2005

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program, performs these services, and gets this benefit. He said it is the difference between an exchange program and a social program.

Ms. Ranagan responded that the standards define an exchange transaction as the government receiving something similar in value to what they are providing. She stated that she does not see where there is anything of value being returned to the government other than the goal of furthering the program, which could apply to every government benefit program. Mr. Zavada responded that there is service to the program or organization that the members are assigned to. He said there might not be a direct benefit to the government but the service is helping to further the mission of the Corporation and it does not matter whether the service is to the nonprofit organization or to the Corporation itself.

Ms. Ranagan replied that one could say the same thing about Social Security - the individuals are performing service for a public or private corporation or enterprise in anticipation of receiving a benefit in return. The work in covered employment and payment of social security taxes serves to achieve SSA's mission.<sup>5</sup> Mr. Dacey said that it seems to be a whole different situation for the SAL because individuals opt into this program; they are agreeing that they will work a year in exchange for the education benefit. Mr. Dacey said you do not have much choice in Social Security or Medicare; you will be taxed if you work.

Mr. Mosso asked Mr. Dacey if he sees the program as an exchange. Mr. Dacey stated that it seems to him to be more like an exchange than not. Mr. Dacey said whether the service is done directly for the government or a third party does not make much difference to him.

Ms. Comes asked the members if they think the classification between an exchange and nonexchange transaction is important in deciding when an obligating event has occurred or is it inherent in evaluating each circumstance as it comes along?

- Mr. Dacey said it might be a recognition issue because when one has an exchange or the agreement to have an exchange, it clearly sets up the obligation at that point in time. He said he thinks that is different from other types of nonexchange programs.
- Mr. Zavada said he agrees; the classification adds clarity to when the present obligation has occurred.
- Mr. Mosso said he agrees with that but said he thinks that means it is easier to account for exchange transactions but he does not believe they are substantively different. One can still have obligations arising in nonexchange; it is just more difficult to sort them out and put a value on it.

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Per the SSA FY 2004 Performance and Accountability Report, SSA's Mission is "To advance the economic security of the nation's people through compassionate and vigilant leadership in shaping and managing America's Social Security programs." (see <http://www.ssa.gov/finance/2004/Overview.pdf>)

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- Mr. Patton said, "If the economic relationship in the transaction is different, you could have the goal of saying, 'Is there an obligating event?' but the operationalization of that existence of an obligating event could differ if it is exchange or nonexchange."

Mr. Reid said to say that the distinction is not useful goes too far; he thinks there is some use for the distinction but he does not think it is determinative.

Mr. Mosso said, in this case, we seem to be saying that there is an obligation, we are not sure the Corporation is measuring it right, but there should be something recognized. There were several nods in agreement.

Ms. Robinson said she believes the obligating event for the SAL occurs when the slots are awarded to the programs but recognition may occur later when it becomes more reliably measurable.

Ms. Ranagan clarified that her position for recommending the point of application of the member as the obligating event is based on an application of FAS 5 (the loss is probable and reasonably estimable); the draft FASAB liability definition (present obligation to provide assets or services at a determinable date, when a specified event occurs, or on demand); Ms. Wardlow's discussion of a present obligation (two parties leading to a mutual understanding); and FASB FIN 45 (point of guarantee is the noncontingent aspect of the transaction agreeing to stand ready to perform in the future should a specified event occur and the contingent aspect of the guarantee is when the specified event actually occurs). At the time a member enrolls (agreement/mutual understanding that creates a present obligation), the member has 12 months in which to earn the award (determinable date) and seven years after that in which to use the award (upon demand).

Mr. Farrell asked Ms. Ranagan how she would apply this logic to the MILC program. Ms. Ranagan stated that the point the milk producer signs up for the program would meet the definition (that would be the obligating event); however, FSA would need to be able to reliably measure if, when, and how often the milk price would fall below \$16.94 per hundredweight during the contract period for that obligation to be recognized in the financial statements.

Ms. Robinson said she would consider the obligating event to be when the government awards the member slots to the grantee because that is the point at which the government loses control over the process.

Mr. Reid said he agrees with the obligating event and the liability notion but he does not agree with the fact that the measurement at that point would be 100 percent of what will ultimately be paid out. He said that ends up putting a portion of the expense in the wrong year.

Ms. Comes stated that Mr. Reid would probably prefer a deferred compensation model to the loss contingency model. Mr. Reid responded that he just wants to match the costs to the correct period.

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Ms. Robinson said she would like to go on record as saying she does not like the grant model at all. She said once the government tells a university it has \$150,000 to do research, it is out of the government's control what happens from there. When the university submits a bill for \$150,000, the government has to pay. Ms. Robinson said she would book the liability earlier than IBNR (incurred but not reported).

Mr. Farrell said he thought the purpose of studying this program was to determine how the liability definition would be operationalized and not to debate how they are accounting for it. He questioned whether auditors could use the draft definition and reach a conclusion on each program. He said he thinks they could but it might not be the same one that staff has reached or whether it would be parallel to other programs.

Mr. Mosso noted that staff had recommended when the person signs up which is when there is a "meeting of the minds" of two parties, which is one of the conditions of the draft liability definition. He stated that mutual understanding occurs when the individual signs up for the program and that application works for him.

Mr. Farrell summarized that under that logic, the liability definition is met when the milk producer submits the contract for MILC and when the participant enters work in covered employment for Social Security. He said he thinks the Board is moving in the right direction on the liability definition - the SAL program proves it, the MILC program proves it, and the Social Security program proves it.

Ms. Robinson noted that not all of the board members have come up with the same obligating events. Mr. Farrell responded that he thought the Board was in agreement on obligating events but not on measurement. Mr. Schumacher noted that the opposite appears to be true. Mr. Farrell said if that is true, it appears that the Board needs to go back and define obligating event.

Ms. Comes responded that it is not shocking for members of standard-setting bodies to have varying views and judgments based on concepts statements. She said it is not surprising that a concepts statement is not a flowchart where every single person answers the same questions and comes to the same conclusions. The concepts statement forces you to ask if there is an obligation and if it is measurable; it puts you into a framework of discussion where judgments differ.

Mr. Mosso asked if the members agree that, in this case of the SAL, something should be measured before due and payable? None of the Board members were opposed to recognition of a liability for the SAL earlier than due and payable.

Mr. Mosso said it comes down to a debate of whether this is an accrual (matching) situation or whether it is a contingency (guarantee) situation, but we are not here to debate the Corporation's accounting so much as to test the liability definition. He said it could become in issue since the Board is currently considering initiating a project on accounting by Government Corporations that could ultimately require government corporations to follow FASAB standards. Thus, the issue of how to change FASAB standards to allow for recognition earlier than due and payable in this instance would need to be addressed.

Mr. Mosso asked what staff proposes to do next. Ms. Ranagan mentioned the proposed FASB Staff Position (FIN 45-b, Application of FASB Interpretation No. 45 to

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Minimum Revenue Guarantees Granted to a Business or its Owners), which specifically applies FIN 45 to situations where an entity is guaranteeing the minimum revenue of a business. She proposed revisiting the analysis of the MILC program, which did not result in any decisions by Board members, updating the analysis and applying guarantee accounting to the MILC program.

Mr. Zavada asked if staff had thought about looking at larger programs since the ones staff had looked at were rather "obscure" programs. Staff responded that she did not have any to recommend. Mr. Mosso said staff would look at the range of government programs and determine if it could find one that would be a good representative, if possible. He said it would be helpful to differentiate between earning/performance type programs and guarantee type programs.

Mr. Patton asked the Board to confirm that they have not abandoned the distinction between exchange and nonexchange.

Ms. Comes summarized that she heard Messrs. Zavada and Dacey supporting the notion that whether a transaction is exchange or nonexchange influences how you assess the obligation but that you should not specify that due and payable is the obligating event for all nonexchange transactions. In other words, you would not build recognition criteria around the exchange/nonexchange split, as was done in SFFAS 5, and put nonexchange on a purely due and payable basis.

Mr. Patton said that is right but he believes the obligating event is the key and your interpretation of obligating event could depend on whether the transaction is exchange or nonexchange. Ms. Comes said that might be a factor that affects your decision but she has not heard anyone say that being classified as nonexchange was critical in resolving a specific obligating event; you still need to evaluate the circumstances and being nonexchange is a factor in evaluating the circumstances. Mr. Patton said maybe they are close but explained that, in the SAL example, if the transaction is classified as exchange, you would see the person earning the right to certain benefits and that would lead someone to record the obligation in one way, but if the transaction was classified as nonexchange the obligation might occur at a point in time when conditions are substantially met, which could lead to the obligation being recorded in a different way. Mr. Patton said the distinction between exchange and nonexchange is critical to his assessment. Ms. Comes said she believes that is similar to what she said.

Ms. Comes indicated that staff would listen to the tapes and try to get the sense of the Board on this issue.

**CONCLUSION:** The Board members did not vote or make any formal decisions. However, based on listening to the tapes of the meeting and preparing the notes, staff believes that the members appeared to agree<sup>6</sup> on the following two points:

- (a) The obligating event for this particular program (SAL) should result in the recognition of some amount earlier than due and payable; and,

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<sup>6</sup>As used by staff in this conclusion, "agree" means the sum of those members that verbally agreed or remained silent on the issue was larger than the sum of those members that verbally disagreed.

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- (b) The classification between exchange and nonexchange transactions should not be a determinative characteristic for recognition.

- **Fiduciary Activities**

The Board approved the exposure draft, *Accounting for Fiduciary Activities*. The exposure draft was issued on June 27, 2005. Comments are requested by August 30, 2005. A public hearing has been scheduled for August 17, 2005. If adopted, the proposed standard would be effective for periods beginning after September 30, 2006.

In addition to the proposed standards, the exposure draft seeks comments on two alternative views. One member does not believe that the proposed disclosures for the consolidated financial report of the United States Government are sufficient. Another member believes that a basic financial statement is the appropriate mechanism to use in reporting on fiduciary activity.

Copies of the exposure draft are available on the FASAB website (<http://www.fasab.gov/exposure.htm>).

- **Steering Committee Meeting**

The Steering Committee discussed a revised draft letter responding to the American Institute of CPAs' recommendations. The members agreed that any further editing would be accomplished via e-mail to facilitate approval within the respective members' organizations.

## **Adjournment**

The meeting adjourned at 4:00 PM

## ***Thursday, June 23, 2005***

### **Agenda Topics**

- **CFR Requirements Relief Project**

Allan Lund of the Financial Management Service (FMS) led the discussion accompanied by Gary Ward also an FMS employee. Mr. Lund opened the discussion by indicating that this project is intended to implement SFFAC 4. Mr. Lund noted that the Board has been following SFFAC 4 since it was issued in January 2003 with respect to new standards. This project revisits standards issued prior to January 2003 to determine disclosures appropriate for the CFR. As requested by the Board, Treasury has identified items for elimination or modification and has drafted proposals for the Board to consider.

Mr. Lund continued by noting that at the May FASAB meeting, the Board decided that all of the items identified by Treasury should be presented at this meeting. Accordingly, a draft exposure draft has been prepared that presents all of the items.

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Mr. Lund suggested that before beginning a review of the draft exposure draft, the Board address issues described in the transmittal memo and in Executive Director Comes' memo. Chairman Mosso agreed with this approach.

The transmittal memo posed three alternative approaches for directing readers to component entity reports. The standards could require:

1. A "general reference" to component entity reports
2. Examples of component entity reports
3. Examples of component entity reports based on quantitative and qualitative criteria

After some discussion the Board decided on alternative 3 in the transmittal memo that requires the use of criteria for determining examples. Mr. Dacey indicated that his staff will suggest alternative wording for the wording suggested in the transmittal memo.

Regarding the items addressed in Ms. Comes' memo, the Board agreed not to require separate reporting of costs associated with earning revenue. Regarding the pricing disclosure, Ms. Comes indicated that the disclosure requirements called for narrative explanations of pricing policies that result in less than market prices. The illustrations presented from Interior and Energy demonstrate that the disclosures serve as a red flag but do not reveal the magnitude of any lower than market pricing policies. She indicated that she was uncertain of the value of the narrative disclosures at a government-wide level.

Mr. Dacey observed that nothing significant has occurred in this area but if something significant happens, it should be disclosed. Addressing items based on materiality would be useful. Mr. Dacey indicated a need to draw a line between program specific disclosures (not suitable for the CFR) and other big events that should be disclosed in the CFR.

Ms. Robinson asked how useful is the data at the CFR level? For example, some requirements result in the government providing free goods to the public such as copies of records or census results. Mr. Dacey responded that his concerns are narrow - that a global reporting of pricing policies is not his goal. He indicated a need to work out some language that would cover anomalous situations.

Mr. Farrell indicated that there should be no disclosures unless the item is material at the CFR level. Mr. Lund responded that board members should be open to the idea that the content of the CFR should be different from the content of agency reports for material items since this is what SFFAC 4 contemplates. If this project is limited to immaterial items that need not be reported or disclosed per the pervasive notion that applies to all FASAB standards, the effect will be to nullify SFFAC 4. Mr. Lund continued by observing that the proposals in the draft exposure draft must be reasonable for material items - if they're not, they should be rejected.

Mr. Dacey indicated that his intent was to make the proposals reasonable by ensuring that unusual transactions are disclosed. Mr. Farrell noted that it is always appropriate to disclose unusual transactions and perhaps some preliminary language could say this. Reid responded that this can't really be done realistically. Ms. Comes suggested that

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such items would be addressed in MD&A under the current requirements and this functions as a safety net of sorts. Mr. Reid agreed that the preparer would want to report significant items. Mr. Mosso asked if using MD&A would be sufficient? Mr. Dacey responded that MD&A is not the place to introduce a lot of information - some language could be crafted to address significant and rare items in the notes. This could be top level language.

Mr. Mosso and Ms. Comes suggested moving to a pre-ballot exposure draft that could be e-mailed to board members before the August meeting. Mr. Lund indicated that he would work to make this happen. Mr. Lund also noted that requirements for footnote 1 were included in the draft exposure draft.

Mr. Dacey indicated that he wanted to change some of the proposed disclosures and would suggest language. Mr. Farrell indicated that the changes have to be meaningful. Mr. Reid observed that there is tremendous variability in agency level disclosures and trying to accommodate such variability could result in disclosures at the CFR level that are not meaningful. Mr. Patton indicated that the burden of proof is on those who want to include more disclosures since SFFAC 4 needs to be considered. He noted that unusual items would be appropriate to disclose.

Mr. Mosso emphasized the need to avoid clutter and disclosures about useful lives tend to add clutter. Mr. Dacey proposed bringing back some language for the Board to consider. Mr. Mosso suggested that Bob Reid, Bob Dacey, and FMS get together on the disclosures but clutter should be avoided. Mr. Lund indicated that it does not appear that a pre-ballot draft will be prepared before the next meeting. Mr. Mosso agreed. Mr. Farrell indicated that it was important to move quickly and a pre-ballot draft should be prepared if possible.

**CONCLUSION:** Mr. Dacey will work with the Treasury team to develop revised language for the ED. A revised ED - perhaps in pre-ballot form - will be available for review at the August meeting.

- **Agenda Setting**

The Board reviewed a revised invitation to comment on proposed new projects. The project description relating to the appropriate source for GAAP was revised to exclude mention of government sponsored enterprises. Ms. Comes indicated that she would circulate a ballot and revised draft after the meeting.

## **Adjournment**

The meeting adjourned at 11:30 AM