FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
July 26-27, 2006
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, July 26, 2006

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Mosso, Messrs. Allen, Dacey, Farrell, Patton, Reid, Schumacher and Werfel, and Ms. Cohen. Mr. Marron attended Wednesday afternoon, July 26th and Thursday, July 27th. During his absence, David Torregrosa represented Mr. Marron. The executive director, Wendy Comes, and general counsel, Jeff Jacobson, were also present throughout the meeting.

- **Approval of Minutes**

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

- **Original Pronouncements Update**

Ms. Comes announced that the 2006 update of original pronouncements should be completed during August. In addition, she explained that the presentation of amendments would be changed. With this edition, all pronouncements will be presented as amended. The update of the current text, a topical arrangement of standards and other guidance, will follow completion of the original pronouncements. However, Ms. Comes expressed her concern that the current text was not widely used and the benefits of maintaining it may not justify the cost of doing so. This is an issue she will explore before making a recommendation to the Board on the continuation of the current text volume.

- **Remarks by Mr. Patton**

Mr. Patton requested that his prepared remarks on the independence of the Board and the stability of its concepts and standards be incorporated in the minutes. Ms. Cohen indicated that she shared his concerns. Mr. Torregrosa expressed his own concern that a valuable perspective would be lost if the federal government did not include non-federal participants in its standard setting activities. Mr. Allen acknowledged the concerns and suggested that the Board move ahead for now. Following the meeting, Mr. Schumacher asked that the minutes reflect that he also shares Mr. Patton's concerns.

Mr. Patton's prepared remarks are presented as Attachment 1.

Agenda Topics

- **Objectives**

Staff presented the update on the Objectives project. At the May 2006 Board meeting, the Board decided to revise the white paper to serve as the document to communicate FASAB's strategic directions by clarifying its role in achieving the broad objectives. Staff revised the white paper and prepared a draft report. In June 2006, staff circulated the draft report to Board members and a review team that included participants from the Roundtable Meetings. The feedback from the Board members and review team was positive with minimal comments received. Staff incorporated the comments in the revised report entitled, *FASAB's Strategic Directions—Clarifying FASAB's Near-Term Role in Achieving the Objectives of Federal Financial Reporting*, which was included in members' July 2006 meeting materials.

Board members expressed that they were pleased with the revised report overall and they provided suggestions to help improve its clarity. Board members also discussed whether the document should present FASAB's plans regarding international public sector accounting standards. It was noted that the purpose of the document was to express FASAB's strategic thinking in relation to the objectives of financial reporting, rather than presenting a formal strategic plan. Including a discussion on this topic may cause some to misinterpret that FASAB is committing to more actively engage in international public sector accounting standards. Also, it was noted that the Board currently shares draft standards with the International Public Sector Accounting Standards Board (IPSASB) and monitors their work. However, limited resources preclude the Board from having a more active role. The Board directed staff to explore whether FASAB's present activities regarding international public sector accounting standards could be included considering the scope of the document.

Staff noted that because the document is a report, rather than a standard, staff can issue the report upon approval from the Chairman. Accordingly, staff will incorporate the Board member comments received and provide members with a revised document for their review. Absent further comments, staff will seek the Chairman's approval to release the report.

> **CONCLUSIONS:** Staff will incorporate the comments received from Board members and provide them with a revised report for their review. Absent further comments, staff will submit the report to the Chairman for his approval to release the report.

- **Elements**

Ms. Wardlow provided the members with a report on her outreach activities and an update on related International Accounting Standards Board and IPSASB activities.

- **Inventory Issues Raised by the Department of Defense**

After a brief discussion, the Board approved the Exposure Draft (ED), *Interpretation: Items Held for Remanufacture,* for issuance on August 1, 2006, with a comment period ending on October 15, 2006.

- **Update on Phase 3 of the Conceptual Framework**

Staff presented a proposed list of task force members for Sustainability Reporting, and a draft outline briefing package for task force members. The Board approved the outline briefing package and discussed the draft list of task force members. Mr. Werfel indicated that he had additional non-federal candidates to recommend and that this would diversify the membership with respect to perspectives. Staff also noted that the Congressional Budget Office had identified its planned representatives on the task force, but that the representatives from the Office of Management and Budget, the Treasury Department and the Government Accountability Office had not yet been identified.

CONCLUSIONS: Staff will draft a briefing package as described in the outline and revise the list of task force members.

- **Social Insurance**

The Board reviewed the latest draft of the social insurance exposure draft (ED). The staff began by asking for comments on the changes to the chairman's cover letter, which attempted a balanced explanation of the controversy and the two perspectives.

Mr. Patton favored a shorter letter that would state, for example, that there are two points of view and would refer the reader to specific parts of the ED. He said it was difficult to summarize the contending viewpoints concisely and fairly. Messrs. Farrell, Schumacher, and Allen agreed. Mr. Allen suggested the same approach for the questions for respondents.

Mr. Allen was concerned in general with the complexity of both the ED – i.e., the cover letter, the summaries, the questions, the standard, etc. – and the issues involved. He said that most respondents would be overwhelmed.

Mr. Dacey said one of his concerns had been that the executive summary did not provide a sense of balance. He noted that the changes to the cover letter as an attempt to address this. He said a better discussion was needed but he preferred the executive summary as the vehicle rather than the cover letter.

Mr. Patton opined that Mr. Dacey was suggesting an alternative view. He did not think the ED format should be changed since it afforded ample opportunity for an alternative view.

At this point the Chairman asked the members to address the question of whether to issue an ED or a preliminary views document (PV).

The Chairman asked Ms. Comes to explain the rationale for a PV. She explained that among other things a PV document would avoid the perception that the Board is acting precipitously, and afford an opportunity to consider the response to the elements ED. She added that the effective date for the eventual standard – FY 2010 – would not be affected by the PV.

Mr. Allen noted that the unchanged effective date was important because it meant the PV would not delay the standard. Also, he said he shared the concern expressed by members about due process and with the perception of undue influence by the federal members. He said he could agree with a PV if the members could agree to be educated by due process.

Mr. Werfel argued that an executive summary in a PV document should present an integrated discussion of the various viewpoints. Mr. Allen agreed.

The Board discussed the timing of due process. Ms. Comes thought a PV would add a minimum of 120 days simply considering process time. Mr. Allen said, from his experience, the Board should plan on an additional year. He added that the timing of the document was less important to him than re-structuring it to be as user and response friendly as possible. He did not believe the document could be re-structured in time to ballot in September.

The Chairman said he did not anticipate changing the basic document when converting it to a PV. He favored the September balloting and envisioned only changing the cover letter, the executive summary, and the questions.

Mr. Allen said a PV could present both positions in a very neutral fashion and then ask very simple questions such as: which of these views do you agree with, or do you have another view; and which of these methods of display will be more informative and helpful.

Ms. Comes said that typically the alternative view would be inserted as the last few paragraphs of the basis for conclusions and the majority would have an opportunity to alter its basis for conclusions in response. She said these changes could be done for the September meeting, provided a strict timeline could be established and adhered to.

Mr. Werfel said one advantage of a PV is that it presents an opportunity for the Board to add in some upfront discussion about the things on which all ten members agreed unanimously. He said the current ED structure might not be conducive to a presentation that highlighted what the members agreed upon. For example, the members agreed on the importance of the social insurance issue, on the need for transparency, on the need to display information in the financial statements, on the need to audit basic information, and on the need to highlight the fiscal imbalance. He said the Board was having disagreements regarding how to achieve these agreed upon objectives and such a statement would help focus the problem for the respondents.

The Chairman polled the members about the preference for an ED or a PV. Messrs. Patton and Farrell and Ms. Cohen favored an ED. Messrs. Schumacher, Dacey, Werfel, Reid, Marron, Allen, and Mosso favored a PV. The Chairman said the Board would proceed with a PV that would have minimal changes from the ED but would stress the points made, for example, regarding balance in the executive summary.

Mr. Dacey asked whether there was unanimity regarding the objective of the eventual standard but disagreement about how to achieve it. He said that, if so, that would be helpful to know, for example, when amending the ED/PV. Mr. Werfel agreed.

Ms. Cohen said that the alternative view would explain areas of disagreement and everything else would be areas where the Board agreed. She did not see the value of stating points that all the members agreed upon. Mr. Allen agreed. He said the simplest approach would be for the alternative view to explain areas of agreement and disagreement.

Mr. Werfel said that, if it is only in the alternative view section, then the discussion of agreement and disagreement would be taken merely as the minority's view, rather than the whole Board coming together to note areas of agreement before proceeding to discuss areas of disagreement. He said he would work on changes with the FASAB staff for the Board's consideration in September.

Mr. Patton did not think the Board could agree on the structure or content of what it agreed on. He noted that the framing of it would be like the questions for respondents, which resulted in argumentative questions leading in a given direction. He said agreement by September depended on using a simple structure.

Ms. Cohen said the people who will be looking at the PV will be familiar with the subject and the points of contention; it is not an obscure subject. She added that a statement of the points of agreement and disagreement would not be relevant.

The Board discussed the staff's changes to the basis for conclusions that were intended to explain the entire spectrum of potential obligating events and the choices of the majority and minority. Mr. Dacey said he appreciated that the staff had used the JFMIP principals' letter and other such sources for the minority position. He said he would have some refinements and additions for it and would work with FASAB staff for that purpose.

The Board discussed an alternative view section. Mr. Farrell asked if there will be new illustrations. Messrs. Dacey and Werfel answered affirmatively. Mr. Dacey said there will be a free standing discussion of the alternative view and an illustration of the alternative presentation to help the respondents visualize it.

Mr. Werfel envisioned an illustrative financial statement with two parts. One part would be audited and would present the state of social insurance payments. The other part would display the $40-50 trillion that the majority would put on the balance sheet, and would be part of the audit. Also, there would be supplementary information similar to what the sustainability task force will be looking at. He thought the PV approach along with the sustainability task force would allow the Board to get some very rich feedback in validation. He anticipated that draft would be distributed early enough for feedback from the members on the write-up and the alternative tables. He said the Board might find some of the alternative tables helpful to include.

Mr. Patton said that the majority had talked about recording the social insurance liability as not the end but rather the start of the process. He could imagine ultimately agreeing with the minorities' alternative statement at some point in the not-too-distant future. He said the minority's argument is that the majority is acting too precipitously because it has not considered other possible disclosures; but he was not necessarily against their proposal, except for the liability on the balance sheet. He said the argument was over timing more than anything else.

Mr. Werfel responded that his instincts told him that the Board will find the presentation agreeable but incomplete because of the liability issue. This supported his belief that there are things the members agree on and the Board may want to highlight that. He thought the work could be done by September and the Board could make a judgment about whether additional improvements should be undertaken at that time.

Mr. Dacey added that one of his concerns is that it is not simply a matter of a liability or not. There is also the matter of whether the total disclosure package provided sufficient and appropriate information to aid users in assessing the condition and sustainability of social insurance programs. He has felt that without the bigger picture the disclosure is incomplete.

Mr. Patton said that the other side of the coin, from the majority's point of view, would be that the proposed standard is an incomplete but important step. The majority is saying "let's get this done and then consider the sustainability project in the future." He said the alternative view is not very "alternative" in the long run.

Chairman Mosso noted that the standard procedure is to circulate the alternative view to all the Board members for comments, both in terms of improving the alternative view and for developing a paragraph for the basis for conclusions in response – not to debate it but to further explain the majority position.

Ms. Comes noted that the alternative view would have to be circulated no later than late August in order to allow the members to comment.

The session in the afternoon of July 26th ended at approximately 3:00. In the morning of July 27th the Chairman offered the following plan for the social insurance project to which no objections were raised.

1. The timeline for social insurances is as follows:
    a. September 13 – pre-ballot draft to members
    b. September 27 – ballot draft

2. The preliminary view document will have the following features:
    a. The transmittal will point up controversy and highlight points of agreement.
    b. The executive summary will be balanced with the alternative view getting full coverage.
    c. The questions for respondents will be scaled back. There will be at least one question. It will state that some members would accrue a liability starting with the first day of work in covered employment and some would

accrue at the “due and payable” date, but that the majority supports accrual at 40 quarters and ask what the respondent agree with and why.

d. There will be an alternative view following the standards section and before the basis for conclusions.
e. The comment period will be at least 120 days.

3. A hearing will be scheduled for March.

CONCLUSIONS: The staff will follow the plan immediately above. Also, the Board set a target of the end of August for the minority to circulate the alternative view to the others members and staff for comment.

- **Natural Resources**

Staff, Rick Wascak, explained that that the objective of the meeting was to review a revised draft of the exposure draft (ED) entitled *Accounting for Federal Oil and Gas Resources* and to obtain comments from Board members. Staff noted that a revised draft was circulated to the Board in late June based on comments that were received at the May meeting. Staff added that significant changes were made to that document, which included:

1. the addition of an alternative view from the CBO regarding fair value;

2. the addition of disclosure requirements showing the factors that produce the asset value for each reported period;

3. the movement of the sales volume and sales value information to RSI from disclosure; and,

4. revisions to the requests for comment.

Staff informed the Board members that the current ED was revised based on comments received from Board members for the ED circulated in June. Staff stated that, with the exception of adding two questions in the Request for Comments section of the document pertaining to fiduciary activities and disclosures for the consolidated financial report (CFR), the majority of revisions made were editorial in nature. Staff noted, however, that it had prepared two issue papers for discussion by the Board members based on two issues raised by the Congressional Budget Office (CBO) in its comments on the June draft ED. Staff provided the two issue papers to the Board members.

The two CBO issues were discussed first followed by other issues raised by Board members.

<u>Valuation of Natural Gas Liquid (NGL) Proved Reserves</u>

Staff stated that the first issue raised by the CBO related to the valuation of natural gas liquid (NGL) proved reserves. Staff noted that natural gas liquids, as reported by the Energy Information Administration (EIA), include natural gas plant liquids[1] (NGPLs) and lease condensate[2]. Staff explained that in the proposed standards, the value of estimated petroleum royalties for oil would be the total value of oil, lease condensate, and natural gas plant liquids based on a weighted[3] average price per barrel for the three commodities. Staff noted, however, that representatives from the CBO maintain that the market value for NGPLs is generally much lower than that for crude oil. For example, for fiscal year 2005, the average price per barrel of oil was $47 and the average price per barrel of NGPLs was $30 – a variance of $17. Therefore, representatives from the CBO believe it would be inaccurate to value NGPL proved reserves at the crude oil price.

Mr. Allen noted that valuing NGPLs individually would require an additional calculation to be made; and, since estimates are already being used in the calculation of estimated petroleum royalties, he questioned its added value. Mr. Farmer, from the CBO, stated that the average price per barrel of NGPLs already has to be calculated in the proposed standards to get the weighted average price per barrel of oil, which is the weighted average price of the combined per barrel price of oil, lease condensate, and NGPLs.

Staff explained how the value of estimated petroleum royalties reported as oil would be calculated based on the proposed standards. Staff indicated that sales values and sales volumes of all types would be included in the calculations so that an average including NGPLs with crude oil would result.

Next, staff explained the CBO's proposal. In the CBO's proposal, the sales value of NGPLs would be divided by the sales volume of NGPLs to arrive at an average price per barrel of NGPLs. The average price per barrel of NGPLs would then be multiplied by the quantity of barrels of NGPLs and the effective average royalty rate to determine the value of NGPLs. In addition, the combined value of oil and lease condensate would be determined by multiplying the weighted average price per barrel of oil and lease condensate by the total quantity of barrels of oil and lease condensate and the effective average royalty rate. The combined value of oil and lease condensate and the value of NGPLs would be added together to arrive at the value of estimated petroleum royalties for oil. Mr. Farmer noted that the CBO makes use of this level of information (i.e.,

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[1] Natural gas plant liquids: Those hydrocarbons in natural gas that are separated as liquids at natural gas processing plants, fractionating and cycling plants, and, in some instances, field facilities. Lease condensate is excluded. Products obtained include ethane; liquefied petroleum gases (propane, butanes, propane-butane mixtures, ethane-propane mixtures); isopentane; and other small quantities of finished products, such as motor gasoline, special naphthas, jet fuel, kerosene, and distillate fuel oil. (Source: EIA glossary of terms)

[2] Lease condensate: A mixture consisting primarily of pentanes and heavier hydrocarbons which is recovered as a liquid from natural gas in lease separation facilities. This category excludes natural gas plant liquids, such as butane and propane, which are recovered at downstream natural gas processing plants or facilities. (Source: EIA glossary of terms)

[3] Weighting would be based on the production mix during the 12-months preceding the valuation date.

NGPLs separate from oil and lease condensate) for budget projections and legislative purposes.

Staff provided the Board members an illustration presenting the two proposals.

Mr. Allen suggested that because the average price per barrel of NGPLs would be available regardless of which proposal is used and because the number on the balance sheet would give credibility to the numbers at the level of information used by decision makers, he believes the value of NGPLs should be calculated separately from oil and lease condensate. Board members agreed.

Selection of the Correct Price Series for Natural Gas

Staff described the second CBO issue. Staff explained that the representatives from the CBO believe that, because the proposed standards already have specified that proved reserves of natural gas will be measured as pipeline quality, the total natural gas reserves should be valued at a “dry” gas price. (Gas can be priced either of two different ways. One is the value of unprocessed (wet) gas, which still has the valuable NGLs mixed with it. The other is the value of processed (dry) gas---that is the pipeline-quality gas that has had the liquids removed.) Staff agreed with the CBO’s proposal because the estimated quantities of proved gas reserves to be provided by the Energy Information Administration (EIA) for calculating the estimated petroleum royalties for gas will be dry gas quantities and, therefore, a dry gas price should be used. Staff added it would clarify in the standards that the dry gas price should be used in calculating the value of estimated petroleum royalties for gas.

CBO’s Alternative View

(From CBO Alternative View: The exposure draft posits that information needed to estimate fair value is not available. However, several methods are available for estimating the fair value of federal oil and gas reserves, including the value of comparable private market transactions and discounted cash flow valuations of the government’s projected receipts from leases on federal lands. Some methods, such as discounted cash flows, appear to be more suitable for arriving at the fair value of proved reserves, while the value of comparable private market transactions may be more suitable for determining the fair value of other holdings.) Mr. Allen asked if the CBO had tested their proposed methodology, which they presented in their alternative view, and if information is available for them to make the calculation using the proposed methodology. Mr. Allen noted that, if people respond positively to the proposed methodology in the alternative view, the Board has to have some assurance that the methodology is achievable.

Mr. Torregrosa said for rents and bonuses the discounted cash flow methodology can be used and there are databases that exist for the sale of proved reserves. Mr. Allen asked if the databases give sufficient information so that sales can be aggregated and applied on a regional basis to ensure that the sales information is robust and representative of prices on a regional basis.

Mr. Torregrosa responded that he has not looked at the databases but the fair value methodology does give the accountant some discretion to use a hierarchy of fair value measurement methodologies. He cannot say that the databases can serve as the fair value for all oil and gas fields. Mr. Torregrosa noted if there hadn't been a lease issued yet, the value of undiscovered resources could be roughly similar to a comparable private estimate of undiscovered resources. For unproven reserves he suggested that probably the way to go would be using comparable sales prices.

Mr. Dacey asked if Mr. Torregrosa was also proposing that the value of proved reserves be discounted. Mr. Torregrosa responded that was correct and using future prices. He added multiplying the effective average royalty rate by the current average price and quantities would give a biased estimate. Mr. Dacey indicated there appears to be a factual issue as to the reliability of the timing of cash flows for using the discount cash flow method.

Mr. Allen said the Board didn't have to answer it now but, based on responses, he was concerned as to whether or not the Board could adequately and accurately respond to the alternative view. He added that before the ED goes forward, the Board should be sure that it can make the alternative view work if enough respondents say that they support it.

Mr. Torregrosa commented that if the CBO did not believe its proposed methodology was a practical approach they would not have presented it. He added that the CBO deals with a lot of uncertainty and puts it into perspective. He said the CBO is not saying its proposal is how the Board has to do it, but fair value allows choice based on what is practical. He said the CBO was just laying the methodology out as an alternative to the majority view of the Board.

Mr. Mosso asked Mr. Torregrosa if the Cambridge Energy Research Associates (CERA) approach is along the same lines the CBO is proposing to estimate reserves.
(The Board's proposal uses a single best estimate method for the measurement and reporting of recovering reserves. The CERA report suggests using a probabilistic method of measuring proved reserves. The probabilistic method for measuring and reporting reserves generates a range of estimates and their associated probabilities of recovering reserves are as follows:

a. There should be at least a 90% probability that the quantities of proved reserves actually recovered will equal or exceed the estimate.

b. There should be at least a 50% probability that the quantities actually recovered will equal or exceed the sum of estimated proved plus probable reserves.

c. There should be at least a 10% probability that the quantities actually recovered will equal or exceed the sum of estimated proved plus probable plus possible reserves.)

Mr. Torregrosa responded that it was. He added that one point the CERA is looking at is that the 90% confidence interval that is widely but not consistently used for proved reserves is not how the industry makes its investment decisions. He said they look at a much broader notion. He added that he believes looking at this approach and laying it out in the alternative view for use by the Federal government is worth getting feedback on.

Mr. Allen commented that what he was hearing said was that the CBO doesn't know for sure if the proposed methodology in the alternative view would work but that the CBO believes it can be done. So, if the Board believes it can be done, the Board can go forward with the ED. There were no objections from Board members to include the CBO alternative view in the ED.

Use of the Term "Deterministic"

Mr. Patton asked what the term "deterministic" meant. Staff responded it meant a specific value, and added that probabilistic meant a range of values. Mr. Allen noted that in the ED, it is explained the deterministic method is used to measure proved reserves, while the probabilistic method is used to measure unproved reserves. Mr. Patton commented that it seems inappropriate to him to say the scope of reserves is different from the measurement of reserves. He said the deterministic method could be used to measure either proved or unproved reserves and the probabilistic method could also be used to measure either one. Mr. Patton added that while deterministic is used in the oil and gas industry, to most other readers, deterministic means there is no uncertainty involved in whatever is being measured. That is, it is a point estimate. Mr. Patton said he believes a more accurate term should be used to describe the deterministic method. Mr. Patton suggested that either point estimate or best estimate be used instead of the term deterministic. He added that he believes the term deterministic is misleading to a non-oil and gas industry reader.

Mr. Patton also explained that, to him, proved reserves versus unproved reserves is different from deterministic versus probabilistic. Even though, as in this case, the Board may wind up applying the deterministic method to only proved reserves and the probabilistic method to unproved reserves. In addition, he said deterministic sounds like other kinds of probabilities are being ignored and the Board is just using a mechanical calculation. When in fact, the best estimate is what the Board really means. Mr. Patton said he would not use the term deterministic. Instead, he would use best estimate.

Mr. Farrell suggested the following revision to paragraph A61 in the ED:

> A61. The Board's proposal uses a method in which a single best estimate of recovering reserves is used based on known geological, engineering, and economic data, which is known in the oil and gas industry as the deterministic method. In contrast, the probabilistic method of estimation uses the known geological, ……………………..

There were no objections by Board members to Mr. Farrell's suggestion. Staff stated that it would make this revision to appropriate paragraphs in the ED.

Ms. Comes asked Mr. Torregrosa if he would clarify the proposed CBO valuation method. Mr. Torregrosa explained the approach the CBO was proposing would present two separate lines items being calculated. One line item would be a calculated value for proved reserves based on the use of the deterministic method. The second line item would be a calculated value for unproved reserves based on the best estimate after using the probabilistic method to calculate a range. The two best estimate values would be added together for presentation on the balance sheet. Based on this clarification, Ms. Comes noted that question 1d. in the Request for Comments section could be deleted.

Mr. Patton indicated he was worried about the attitude that the ED only needs to communicate with experts in the oil and gas field. He said he believes this is a narrow attitude and that the Board should be able to communicate with a broader field.

Transfer of Revenue to States

Mr. Torregrosa noted that, in the proposed standards, bonus, rent, and royalty revenues are distributed to other federal entities as a transfer-out. However, he didn't see anywhere in the proposed standards that bonus, rent, and royalty revenues are being transferred out or distributed to the states. He asked if the proposed standards should reflect those mandatory distributions to states. Staff responded that the revenue distributed to the states is not recorded as a transfer-out. Staff explained that the portion of the revenues to be distributed to the states is first transferred (out) to another Federal entity, which, in turn, makes payments to the states. Staff added that the MMS records the payments as an operating expense on its Statement of Net Cost.

Mr. Mosso asked if Board members had other questions or comments. There were no other questions or comments. Mr. Mosso asked what the next steps were for the draft ED. Staff responded that it would make revisions to the draft ED based on comments during the meeting and circulate a pre-ballot before the September Board meeting. Staff added that the tentative plan is to ballot the ED at the September meeting.

> **CONCLUSIONS:** Staff will revise the draft ED based on decisions made during the Board meeting and prepare a pre-ballot ED for circulation prior to the September Board meeting.

Adjournment

Immediately before adjourning, the Board discussed the nature of the fiduciary activities session scheduled for Thursday morning.

The meeting adjourned at 5:35 PM.

Thursday, July 27, 2006

Agenda Topics

- **Fiduciary Activity**

Prepared statements were presented by James E. Cason, Associate Deputy Secretary of the Department of the Interior and Ross O. Swimmer, Special Trustee for American Indians at the Department of the Interior, Office of the Secretary. Following the prepared statements was a question and answer session and a Board discussion of the issues presented.

James E. Cason presented the following prepared statement:

Statement of James E. Cason
Associate Deputy Secretary — United States Department of the Interior
Before the Federal Accounting Standards Advisory Board
Regarding the Revised Exposure Draft Entitled Accounting for Fiduciary Activities"

Thank you for the opportunity to comment on the Statement on Federal Financial Accounting Standards No. 31, "Accounting for Fiduciary Activities." I am Jim Cason, Associate Deputy Secretary and I have with me Ross Swimmer, Special Trustee, and Daniel Fletcher, Deputy Chief Financial Officer.

The Department of the Interior respectfully disagrees with FASAB' s requirement of Generally Accepted Accounting Principles (GAAP) accrual basis of accounting for Indian Trust Fund activities. We firmly believe that using a comprehensive basis of accounting other than full accrual, such as a cash/modified cash basis, provides comparability and consistency to private sector Trust activities. Moreover, we believe that the note disclosure of the Trust Funds in our consolidated Department of the Interior financial report meets the requirements of existing accounting standards. Our reading of the current standard is affirmed by our independent auditor reports (KPMG and OIG) which have not identified an exception to our note disclosures on the Trust Funds.

I want to emphasize that the Department of the Interior is committed to fulfilling its trust responsibilities and works to ensure that an environment of accountability is in place. To fulfill its trust responsibilities DOI through the Special Trustee, has established a Comprehensive Trust Management Plan (CTM). The CTM has resulted in improved Trust management control activities (cash reconciliations with Treasury, etc.), and enhanced beneficiary reporting. These results are part of a work in process to improve Trust financial management that also includes the Historical Trust Accounting. The historical accounting work has involved collecting over a quarter of a billion pages of Indian Records and reconciling the actual and expected account. These efforts have provided a basis for DOT to have a high degree of certainty that there is no evidence that historical records are in error, and that there is ample evidence to support that monies collected for Indians were distributed to the correct recipients.

We have invested over $150 million in these activities to improve the accounting and reporting for Trust activities. Our approach has involved highly respected accountants and statistical experts to establish independence and reliability.

Given our experience in managing the program and the progress we have made in improving financial management, it is our position that:

> The current cash/modified cash basis of accounting is in accordance with current standards and provides optimal benefit to beneficiaries;

> There is a significant cost to obtain limited benefit to the readers, including the beneficiaries, of the financial statements implementing accrual basis accounting;

> There is no inherently governmental reason to create a standard that is inconsistent and not comparable with Private sector Trust activities; and,

> Unique characteristics of the Indian Trust Funds including fractionation and "at will" participation make the proposed change problematic.

Statement for the Record:

Benefits of Current Accounting

The current cash/modified cash basis accounting supports over 670,000 beneficiary statements and allows beneficiaries to compare their accounts to other holdings. The current model provides a complete accounting of receipts and disbursements that allows beneficiaries to determine their amounts available for withdrawal. Since the Trust is for the benefit of the beneficiaries, providing the amounts available is the key requirement/objective for beneficiary decision making.

Our position is based on a review of Statement on Federal Financial Accounting Concepts No. 1, Chapter 5, "Balancing Costs and Benefits in Recommending Standards," and Chapter 6, "Qualitative Characteristics of Information in Financial Reports." These chapters and the paragraphs contained therein discuss the unique characteristics of Federal financial reporting and the users of those reports. They guide the standard-setter to consider the cost and benefit of any standard as well as caution against an attempt at satisfying financial accountability issues without first addressing other more cost beneficial means.

Significant Cost to Implement

The estimates of complying with this requirement are almost $38 million initially and up to $4 million annually with no identifiable benefit. Additional costs could be expected for annual operation and maintenance of the systems necessary to provide this information within the 45 days currently permitted by 0MB to provide financial statements. These amounts will be borne solely by the American taxpayer as the Department of the Interior does not charge for this service nor have any way to recoup expenses other than through their appropriations. In addition, an accrual basis of accounting could be misleading to beneficiaries because it portrays amounts that are not available for disbursement, frequently require adjustment based upon actual collections, and could adversely impact a beneficiary's economic status if amounts are pledged as collateral.

Unique Characteristics of Trust Fund

The two Trusts have several unique characteristics that create significant challenges to determine reliable accrual activity, including fractionation and voluntary participation in the Indian Trust Fund. Fractionation happens when a beneficiary's account is distributed to heirs and causes a never ending expansion of account holders, and often results in account balances less than $1. The ability of account holders to jump in and out of the Trust at will causes additional complications in developing accruals. It is costly to implement an accrual methodology that accounts for these issues and that can be audited in 45 days. Our auditors generally require that actual activity be compared to the accrual estimate and the time period of subsequent activity for these accounts would exceed 45 days.

Accrual amounts concern the Department for many reasons including the difficulty of developing a verifiable estimate, the effects of seasonal and yield variables on those estimates, and the possibility of litigation resulting from the perceived distribution to beneficiaries of these estimates.

Verifiable estimates would require additional audit requirements and costs, as well as administrative support to track and adjust these estimates and provide education to the beneficiaries. Our auditors have indicated that accrual will require a high level of accuracy that can only be obtained based upon a transaction level methodology. In addition, the public sensitivities and visibility of this program will only increase the need for that accuracy.

For example, surface lease terms are not consistent within commodities and would require very detailed analyses to even attempt estimation. Another example involves timber yields that are affected by snowstorms, insect infestations or fire but can be estimated based upon the type of timber and the width/diameter of the stump. Obtaining this information timely is difficult due to the land area that must be covered to perform these counts. Although other crops are affected by much of the same environmental and yield variables their estimation becomes even more difficult because averages may or may not be available for that commodity. Sub-surface estimation would be impacted by many of the same variables and by a greater degree by emerging technologies and would include additional coordination through many other agencies.

The fiduciary manages trust assets (land and associated resources) to protect and enhance for future generations as well as collect receipts for the beneficiary/owner. This does not include any unconditional guarantee related to the collection and potential distribution; these accruals may be interpreted as some type of distribution guarantee that could be misinterpreted.

In summary, we believe that an auditable accrual will be difficult and expensive to develop.

<u>Consistency and Comparability with the Private Sector</u>

The cash/modified cash basis, as currently used by the Office of Special Trustee, provides consistency and comparability with private sector Depository and Lending institutions. Maintaining consistency and comparability improves accountability and provides a framework to assess Trust management. The FASAB Concepts Statement Number 1, Chapter 6 defines effective communication with the essential characteristics of Understandability, Reliability, Relevance, Timeliness, Consistency and Comparability." The OST financial statements as prepared on a cash/modified cash basis are reliable, relevant and provide the most consistent and comparable data to beneficiaries and private sector financial institution reporting.

In summary, the current accounting and reporting is compliant with all authoritative guidance and the statutes governing these trust activities. The reporting performed today fulfills all of our fiduciary duties and mirrors existing industry accepted practices. There is a significant effort and cost associated with reporting any accrual activity related to these Trusts. The cash/modified cash basis of accounting provides the most comprehensive and economical solution for fiduciaries to perform and report their fiducial responsibilities.

***** End of prepared statement by James E. Cason *****

Ross O. Swimmer presented the following prepared statement:

Statement of Ross O. Swimmer
Special Trustee — United States Department of the Interior
Before the Federal Accounting Standards Advisory Board Regarding the Revised Exposure Draft Entitled "Accounting for Fiduciary Activities"

Thank you for this opportunity to appear today to comment on Federal Financial Accounting Standards No. 31, "Accounting for Fiduciary Activities."/8 This is my third appearance before the board regarding the accounting and reporting for the Indian Trust Funds as it is very important to me as the Special Trustee for American Indians that the Indian Trust Funds be accounted and reported in a manner that is concise, consistent with private sector practices and informative to the user in order that the information presented is understood by the readers of the financial statements, which in this case are the beneficiaries of the trust.

This trust is also referred to as a statutory trust, in that Congress created the trust with the enactment of the General Allotment Act of 1887, and subsequent statutory directives. The latest significant action on the trust occurred in 1994 with the passage of the "American Indian Trust Fund Management Reform Act" (Reform Act).

In addition to other provisions, the Reform Act sets forth the type of accounting required for the beneficiaries. Section 4011(a) requires that the trustee account for the daily and annual balance of all funds held in trust. Section 4011(b) goes on to require the Trustee to report the source, type, status of funds; the beginning balance; gains and losses; receipts and disbursements and ending balance in their account. Consequently, the proposed standard would require Interior to maintain its existing accounting and to perform an alternative accounting. It is important to note that we receive appropriated funds to perform our current accounting function. Our appropriation covers the costs of the current accounting system and processes to perform the accounting required by the Reform Act. Additional appropriations will be needed in order to add another accounting system to provide accrual accounting, which, as described later, could cost nearly $38 million to install plus annual operating expenses.

It is also important to note that the Indian Trust Funds are not public/Federal funds. They are fiduciary trust funds that neither the public-at-large nor the Federal Government or any agency thereof commands a beneficial interest in the funds. The Trust Funds belong solely to the individual Indians or Indian tribes. This premise has been recognized and established via Federal Accounting Standards Advisory Board Interpretation No. 1. Because Interpretation No. 1. is silent on the accounting and reporting requirements for the Indian Trust Funds, the present reporting is done in accordance with the pertinent provisions of Statement of Federal Financial Accounting Standard 7 (SFFAS 7) par. 85a — 85d. SSFAS 7 recognizes that certain trust funds are not held for public benefit and accordingly only requires disclosure of several key items including the basis of accounting used to account for the trust funds. This disclosure requirement is in line with private sector disclosure requirements in that a bank is only required to disclose certain key items in the footnotes to the financial statements regarding its trust department. This private sector disclosure requirement does not require the bank to maintain a separate set of accounting records for the sole purpose of the footnote disclosure.

Should the exposure draft become effective, it could cost Interior, and ultimately the U.S. taxpayers, as much as $38 million to implement and maintain an accrual accounting system in addition to the current accounting system. Interior now performs the financial trust accounting using a commercial-off-the-shelf trust system that seven out of the ten largest trust departments in the United States utilize. This proposed requirement for an accrual trust accounting system is not a private sector requirement; as a result, the initial as well as the on-going maintenance cost for such a unique system would be borne entirely by Interior, whereas now, the cost of changes to the COTS are shared by the user group.

Additionally, this initiative could very well distract from the historical trust accounting efforts and on-going reforms that are in full implementation by diverting financial resources at a critical time in Indian Trust Judicial history. In accordance with private sector practices, Interior is implementing an invoicing and billing system that will interface with the already implemented lockbox and title plant operations so that beneficiaries will know what they received in detail as well as an asset statement that shows land holdings and leases on the land holdings. Interior will also have the ability to know how much is due, from whom and when as well as the ability to charge standard late penalties. This added expense would result from the fact that Interior will have to continue to report to beneficiaries on the cash basis of accounting in order to mitigate confusion. Therefore, two sets of accounting records, systems, additional internal controls, additional audits costs, etc. need to be considered in order to comply with the proposed standard.

As I have stated, there would be a need for congressional authorization and appropriations to add an accrual accounting system for footnote reporting purposes and maintain a separate cash accounting system for beneficiary reporting purposes. However, what is possible does not necessarily make something meaningful. A question as to why accrual accounting should be initiated needs to be answered.

Accrual accounting is the matching of revenues and expenses to the time period the revenue/expense is earned/realized. This basically takes timing out of the reading of the financial statements and allows for the ability to run trend analysis and compare to other financial statements in the industry. It also can have a smoothing effect on the revenues and expenses. The focus of accounting under the trust, is to accurately report receipts and disbursements, not to match receipts and expenses. This is the case under either cash or accrual basis accounting.

The expenses of the trust are not reflected on the Indian Trust Funds Financial Statements. Instead, the expenses of the trust are reflected on the appropriated funds financial statements of the Department. The major objectives of accrual accounting are achieved with the current accounting methods cash(tribal)/modified cash(IIM) because the underlying management operations of Indian Trust assets is spread over numerous government (BIA, MMS, BLM, OST) and tribal offices across the nation and are cyclical in nature.

One other complicating factor in adding an accrual accounting system or providing estimates of revenue, is the difficulty of knowing with any certainty that an individual account holder will remain in the trust from year-to-year. The trust is a voluntary trust and people move out of the trust in several ways: voluntarily, as a result of a probate action, through sale of their trust assets or by electing to receive payments on trust assets directly rather than through the trust. As a result, revenues that might be projected will often be incorrect and can cause confusion among the account holders. Although Minerals Management Service has a process of accruing federal royalties, the accrued Indian activity is accounted for as one lump sum amount. OST would then need procedures to allocate these amounts between the IIM and Tribal financial statements.

In closing, it should be noted that approximately 20 million of 28 million transactions from 1985 to 2000 were for less than $1 .00. The trust currently has approximately 10% (24,000) account holders with balances from $.01 -$1.00. The proposed standard would require OST to keep two sets of accounting records; one on the accrual basis and one on the cash basis. The accrual basis information would be very costly and used only to provide footnote disclosure in the Department of the Interior's financial statements. The expense associated with complying with this exposure draft, should it become effective, does not appear to consider the cost and limited, if any, added value to the interested parties of the financial statements, the American Indian Beneficiary.

***** End of prepared statement by Ross O. Swimmer *****

At the beginning of the session, Chairman Mosso stated that the primary question was why the Department of the Interior (DOI) objected to the issuance of Statement of Federal Financial Accounting Standard (SFFAS) 31. Mr. Mosso said that the Board believes that SFFAS 7 already requires accrual accounting for the disclosure of fiduciary funds, and SFFAS 31 simply carries that requirement forward.

During the presentation of his prepared statement, Mr. Cason of the DOI showed a list of 100 owners of a piece of Indian land that is valued at $1.41. He said that there were about 4 million owners, and that accrual accounting would require a large number of individual transactions to be posted and adjusted in the accounting system.

Mr. Mosso thanked Mr. Cason, and said that Mr. Cason had not yet addressed the opening question, as to why the DOI objected to the issuance of SFFAS 31, because accrual accounting is not a new requirement.

Mr. Fletcher of the DOI said that the intent of Mr. Cason's statement was to provide background information, and that the statement of Mr. Swimmer would address Mr. Mosso's question.

Mr. Swimmer said that it was the opinion of the DOI that SFFAS 7 does not require the presentation of the Indian Trust Funds on an accrual basis. Mr. Swimmer said that it was not appropriate in SFFAS 7 and it would not be appropriate in SFFAS 31.

Mr. Swimmer said that the Indian Trust Funds are a statutory trust, created by the Allotment Act of 1887, and distinct from other private sector trusts, where the trust expenses are paid from the assets of the trust. When the Indian trust was created, it was not originally intended that income would be coming into the trust; it was a land trust to prevent land from being stolen from the Indians. Only about 15 years later was it decided to allow the Indians to lease out their land instead of generating income from the Indians' own activities, such as farming. At that point, revenues began to come into the trust. In most instances, the Indians handled their own lease agreements. At any point in time, the Indians are free to remove their land from the trust or manage their own lease agreements. The Bureau of Indian Affairs acts simply as a caretaker, in that sense. The fractionation over the years of land holdings has resulted in a situation where it is virtually impossible, in most instances, to get consent from the land owners, and it is now done for them. For example, when you have a thousand owners of an 80-acre tract, the tract is leased, revenue comes in, it is divided among the thousand owners, and that's not an unusual case.

Mr. Swimmer said that the statute dictates how the DOI manages the trust. He said that there are about four thousand statutes and regulations that govern how the DOI manages the trust. Over the years, there were complaints about the management of the trust. The major change that came about was in 1994 with the American Indian Trust Fund Management Reform Act. That act sets out how the accounting is to be done from the Indian Trust Fund to the beneficiaries. It says that the DOI must report to the beneficiaries on the source, type and status of funds, as well as receipts and disbursements, any gains or losses on investments, and the ending balance for their individual account. Mr. Swimmer said that the DOI believes that SFFAS 31 (but not SFFAS 7) would require a costly additional item, for which Congress has not provided an appropriation to implement. Mr. Swimmer claimed that SFFAS 31 would require the DOI to ask Congress for an additional appropriation of upwards of $38 million to implement this requirement. He said that the DOI has a cash accounting system to comply with legislation, and the additional accrual system would constitute having two sets of books. He said that the DOI does not believe that accrual accounting is currently required. Mr. Swimmer said that accrual accounting "is often used for the purpose of trying to view revenues and expenses in a timeframe that gives you an appropriate look at how the business is operated, so that you can smooth out that timing, so that you don't book all of your expenses upfront, and then all your income comes in the following year." Mr. Swimmer said that the DOI does not do that, because the Trust Fund has no expenses. He said "All we do is report receipts and disbursements. We have income into the individual; we have payments back out to the individual. We're a bank; we simply take the money in and give the money out." Mr. Swimmer said that there would be no purpose in attempting to present the Trust on an accrual basis.

Mr. Swimmer said that the Trust is not static; individual can go in or out of the trust, or receive money directly from the payer. Mr. Swimmer said that from 1985 to 2000, there were 28 million transactions in the various accounts- about 260,000 account holders. 20 million of those transactions were for less than one dollar. There are currently about 24,000 account owners with account balances of under one dollar.

Mr. Swimmer explained that to obtain a cost estimate ($20-38 million), they asked SEI (the contractor that the DOI uses to do accounting for the Indian Trust Funds). Mr. Swimmer said that the DOI uses an off-the-shelf system that is also used by banks for accounting for private trusts. SEI replied that it would cost between $15 and $25 million, depending upon the requirements package, statement of work, etc. The DOI asked its auditors what it would cost- extra- to audit an accrual accounting system. The auditors replied that additional audit costs would be between $1.5 million to $3.5 million/year. Mr. Swimmer mentioned that additional initial cost to manage an additional accounting system- such a policies and personnel- would cost $5 to $7 million dollars. He estimated that costs going forward would be $4 to $5 million/year. However, he said that the Congress would want to know the benefit of the additional costs. Mr. Swimmer said that he was not aware of any benefit that accrual accounting would have to the beneficiaries.

Mr. Swimmer said that although he would defer to Dan Fletcher of DOI for any further discussion of SFFAS 7, but that:

> “In our discussions with our auditors, they have never believed that Standard 7 requires us to report on an accrual basis. We don’t read Standard 7 as requiring that. We have not done so in the past. We think the new proposed standard would bring us under the accrual system. We are so unique in the Federal government that we’re the only ones who are affected by it. We see no value- no basis – for this extra expense that would be required to meet this proposed standard.”

Mr. Mosso said that SFFAS 7, paragraph 86 specifically says that trust funds should report in accordance with legal requirements, but in addition were required to report accrual information. Mr. Mosso said that in order to remove the requirement for accrual accounting, the Board would have to go through due process- an exposure draft, etc.

Mr. Allen quoted from SFFAS 7 and explained that although the accounting within the trust itself should be in accordance with legal requirements, additional accrual information was required to be disclosed by the reporting entity – the Federal entity that administers the trust. Mr. Allen said that he did not believe that the provisions of SFFAS 31 would require accrual accounting within the trust itself in the way that the DOI representatives had described. Mr. Allen said that his reading of SFFAS 31 was based upon extensive experience in auditing, and that the DOI’s interpretation was so different from his own. Mr. Allen said that most entities only make accrual adjustments at the end of an accounting period, and its not done on a transaction basis because it would be impractical. Mr. Allen said that on a materiality basis, the question is “Do we have accruals that we, as preparers and/or auditors, believe would materially change the financial outcome if we were to book those accruals, or not book those accruals at the end of the year. I had always assumed that’s why your auditor’s didn’t qualify. To me, there’s no question that SFFAS 7 calls for accrual accounting. I assumed that, having read this, your auditors would say, ‘well, because we deal primarily with cash and we don’t have significant or material accrual adjustments to make, we’re not going to qualify because we don’t think it’s material in effect to this particular entity’- and that may well be the case. Every standard that we have says, ‘This does not have to be applied to immaterial matters or amounts.’ That’s how I assumed your auditors got where they got, not because Standard 7 doesn’t call for accrual accounting; I think that’s pretty clear.”

Mr. Allen: Speaking for myself, I saw that what the standard was trying to do was to give the reader an accurate view of the magnitude of responsibility that an entity has. In other words, we don’t want people to get the wrong impression about whose money this is. So, in essence, all of these trust funds have to come out of the financial statements and revert to a note, so that there isn't any question about ownership. All we're really talking about is that within that note, people get a sense of the magnitude of the trust activity and the changes from period to period- so that we can analyze, on a material, overall basis, the magnitude of those resources that you're managing. That is, very simply stated, how I saw the standard. I never envisioned any thought or discussion of transaction accrual or individual account accrual. What you report in the financial statements only has meaning or logic to someone outside of the government or outside your department looking at that overall and seeing- does this give me a sense of the magnitude of what you're managing, and is that changing- consistent from year to year, not based on the timing of a payment or a receipt, but based on the underlying substance of the transactions, which is why you go to accrual accounting, as you very well outlined. So that's why, as a Board member who voted for the Standard 31- the primary focus was on giving clarity to confusion over what is "trust" money and what is not "trust" money. As for accrual, I didn't see Standard 31 as making any change for Statement 7. But even if you do think it makes a change, I still can't imagine that you'd go back to paragraph 86 of Standard 7 and think that, if that was the intent of paragraph 86, that anything more than a higher level- for the reporting entity- is required."

Mr. Farrell asked the DOI to clarify a point about trust expenses. Mr. Farrell said that the DOI had noted that the trust itself has no expenses- so the only accruals would be related to revenues that are due but not yet received. Mr. Farrell said, "Wouldn't you, as a trustee, just managing the assets on behalf of someone else, have some knowledge of what lessees are out there that haven't paid you money? Does someone follow up and say, 'Exxon owes us money, because they're leasing this particular land and we didn't get that payment this month'?

Mr. Swimmer, DOI: We do have that. We are currently converting our system to allow them to allow us to do that, in total. We invoice for payments that are coming in, and we follow up if the payment doesn't come in. At the transaction level, we can track that. We don't think that that is in the same sense of accrual accounting, however, that would be required, and I think that our concern is that there is some kind of a desire to have modified accrual accounting. I agree with what you're suggesting, in the sense that there may be some value at some point, but not in this trust, not the way this trust is operated- because again, you would expect to look at both sides of the ledger- the expense side- to see if there was something you had booked or projected that turned out to be an anomaly and had to make an adjustment. This is simply receipts and disbursements; it's nothing more or less than that. In the private sector, that is trust accounting. They do not do trust accounting on an accrual basis.

Executive Director Ms. Comes: I would like to ask a clarifying question based on Minerals Management Service (MMS) practice: I just want to make sure that we're all clear about what information exists at Interior. You said that there's no accrual related to the trust activities, but MMS has a role as the first collector of oil and gas revenues and perhaps other kinds of revenue as well. MMS' role is to collect the receipts and pass them to the Office of Special Trustee to be distributed. In the MMS financial statements it says, “The royalty accrual for custodial receivables and distributions payable represents the current period activity anticipated to be received in the subsequent period. The balances are estimated based on an analysis of the last twelve months of royalty activity and recent events such as significant settlements due in September.” The amount is approximately $23 million, based on these audited financial statements- to me, that is an accrual of a trust activity. To me, that is a receivable that is currently on Interior’s balance sheet that is a fiduciary asset, which under Statement 31 would come off. What is your view of that accrual, and how does it differ from what you believe Statement 31 is asking you to report in a note?

Mr. Allen: Wouldn’t that be one of the most significant accruals that would have to be made?”

Mr. Swimmer: Well, yes, it would have to be made, and it is not being made now.

Ms. Comes: But it’s in the audited financial statements of MMS.

Mr. Swimmer: There are some significant differences. First of all, the accrual that MMS is doing primarily relates to oil and gas revenues owned by the Federal government. And they are bringing those incomes in against expenses. They provide to the Special Trustee the cash that belongs to the Indian Trust account holders, the third parties. We then take that money and break it down to the ownership level. They do not- they give it to us sort of in bulk; they do not accrue to us; they are simply collecting the money on a global level. They do have an accrual method for their own funds, but when they turn the funds over to us, it is not segregated between the tribal trust or the IIM trust; it is given to us on a lease-level basis. It is not accrued for our purposes.

Mr. Cason, DOI: Typically within the MMS revenue, the Indian trust revenues are about 1 to 2 percent of that; the Federal government gets the other 98 to 99 percent.

Mr. Dacey: In terms of what is currently reported in the Indian Trust Fund financial statements, the nature of the assets and liabilities- could you just cover that? Essentially, what is currently reported?

Mr. Fletcher, DOI: The line items for cash basis are cash and equivalents, investments, due from other Federal agencies, which is nothing in 05, held for Indian tribes, held for the Department of Interior to be considered U.S. Government funds- that comes from that reconciliation process that Ross talked about: after they get the funds, they do some analysis, and say, all of this really wasn’t for us, some of it is due to go back to the Department of the Interior. So, in essence, there are four line items reported with activity.

Mr. Dacey: Related to that- I know that we've been talking about revenues that are received in arrears, but are some of the revenues received in advance, for some of the types of revenues?

Mr. Swimmer: Not to any significant degree. You could have some prepayments on leases, but it's unusual; it's not the norm.

Mr. Dacey: I didn't know, if the land was different from the oil-

Mr. Fletcher: I think for easements, Ross, there are funds that come in advance; for utilities, those funds would come in advance, and there are others that do- a lump sum comes in advance for whatever the term of the lease is, whether it be 20 or 30 years.

Mr. Dacey: But in essence, this money is received and deposited and in many cases withdrawn from those accounts when it's received, is that correct.

Mr. Swimmer: Yes.

Mr. Dacey: So, we'd also incur- you'd have to figure out what all the revenue flows were, and create a liability, as well, for deferred revenue, and account for all that, as well.

Mr. Allen: Again, if that is a material-

Mr. Dacey: Right- I know, I understand, I just wanted to understand the nature and character of some of the transactions. I know that we've been thinking about the revenue side, but I think there is another side there, and I don't know the cost. I'm not saying it would be material; I don't know. Only to the extent that that would entail some effort, to go about doing and trying to create what would basically be an allocation of earnings for funds that have already been received and withdrawn from the account.

Mr. Allen: Again, in my opinion, that's why you have accrual accounting. Let's say that for whatever reason, Exxon or whoever makes a significant payment that's really big- it's 40 percent of whatever the income you get for that year, and is actually a prepayment. Wouldn't you want to know that? If that comes in as cash, and it's disbursed, and people say, "Golly, I got more money this year,"- well, we're going to get less next year. That's what accrual accounting is: if there really is significant variance as a result of some unusual transaction like that, it would help one understand that this bump-up of cash is really a prepayment for the next ten years, so we're not going to recognize revenue in the financial statements. To me, somebody looking at the financial statements could understand that it was not really revenue related to that year- that is the advantage of accrual accounting. Now, I frankly envision few accruals, other than the one dealing with oil and gas revenue- that's probably the only thing-

Mr. Dacey: That would be the biggest.

Mr. Allen: -And I'm not even sure that that would be big enough to say that's material and you have to accrue. But the concept of accrual accounting, as you well know, is that if there is something phenomenal, that it would be reported.

Mr. Cason: I guess I'm just curious about what you're thinking of in terms of materiality, because our trust is basically composed of hundreds of thousands of small transactions, and we don't have a lot of really big ones. If you take a look at where we've been with historical accounting, for example- over a 15-year period that we looked at- 1985 to 2000- there were about 2,000 transactions that exceeded $100,000, over a 15-year period. Virtually all the rest of our transactions are very small transactions. So, 60 percent of the money came in just with those, and even a $100,000 transaction doesn't materially change what we do.

Mr. Allen: And again, when you look at an auditor's opinion, it is addressed to the entity-- that our opinion relates to the entity as a whole, and any transactions that cumulatively—if they find an error in a single $100,000 transaction, it's not going to affect the opinion. But if they find a systemic- if there a lot of $100,000 errors that they believe accumulate to an amount that would be material-- The easiest way in the world to do an accrual cutoff for a test for revenue is just to look at the period after. I mean, if you come in three months after the year, and you look at what came in during that first three months, and you can quickly go through and see how much of these- were a material amount of these really earned in the prior fiscal year. You can usually fairly quickly make a determination as to whether or not there was a significant amount that ought to be accrued. I'm over-simplifying, I know, but I was an auditor; I did serve on the Auditing Standards Board of the AICPA and on the Ethics Executive Committee, so I do know a little bit about it.

Mr. Swimmer: From the trust point of view, though, the purpose of the audited financial is to provide the trustee and the public that you've reported fairly. What you say and described- if you received a prepayment or bonus, you've got to spread it over a period of time, so that we can appear to pay it out, but yet the beneficiary has already received it. So it would just be confusing to the beneficiary, so you wouldn't want to do that. The only thing we would gain by this is to create some kind of an accrual accounting system- maybe not on the transaction level, but still something that has to be audited separately from the cash accounting system that we use. You'd still have to do those tests. The auditors would have to do the tests to determine if the accrual is properly accrued based on what's coming in for future purposes, as we talked about earlier, a payment up front, so to speak, would be spread over a period of time. But I don't understand where the benefit is.

Mr. Allen: As I understand what you're saying is that most likely there would be few, if any, accruals- as a preparer of financial statements, you also have a professional obligation to assess materiality. If you did, you, as trustees would want to know; and Congress, or whoever the user is of the agency-wide financial statements. I understand what you're saying. If I had a private-sector trust relationship, and it was ongoing, and there were significant differences in flows from year to year, I would want my trustee to let me know why. Why did I get twice as much cash last year as this year? What happened? I understand that that can't happen for millions of individual accounts, and why you report to individuals on a cash basis, but it seems to me that if there you were ever sued by a trust account holder, saying "You paid me twice as much last year as this year, and the price of oil has gone up, so your accounting must be terrible." One could simply say, "No, here are the financial statements. Our financial statements show that we had an anomaly last year of a huge prepayment. We booked that as deferred revenue, because we recognized that it wasn't revenue from that period." What we have here is a broad concept. As a standard setter, if we started saying, well, OK, I'll take this little component, and argue that I don't think anybody really reads that component, and I don't care whether it's Interior or some other agency- therefore I'll say, for that agency, you don't have to do accrual accounting- you choose whatever... One assumes that when one looks at the Federal government, there is a sense of accountability, and that accountability ought to reflect accurately as possible what resources you're managing. And if year to year happens to change, that is reflected in your financial statements, because there are anomalies. If we're dealing with it at a high level, and there is a significant cost, then I think it is worth the benefit. If you're looking at $38 million and it's got to get down to every individual account, then I don't think you have—

Mr. Swimmer: But from a Department point of view, it is reported that way. This is a trust, separate and apart from anything that belongs to the Federal government. This isn't trying to adjust the Department's books, or to show anyone—if you were to read DOI's audited statement, it would not be incorporated in there.

Mr. Allen: It's interesting-- all we're really debating about is a note to the financial statements.

Mr. Swimmer: In the private sector, your trusts aren't done that way. Trusts do not accrue in the private sector.

Mr. Allen: I don't claim to have audited significant trust accounts. I would have to go back and research—

Mr. Swimmer: Our company, SEI, represents-

Mr. Allen: Accounting, maybe. But if one were to look at the financial statements of a trustee, I suspect that they would be on an accrual basis of accounting.

Mr. Swimmer: I would disagree.

Mr. Fletcher: It's not on the filings that we provided- the SEC filings that we provided as evidence indicate that they use the cash basis. But we could come back to that, because I do think you come back from our perspective that we have to have some cost/benefit. Some of the points you made, about if you had a sufficient subsequent period to do this--- you said three months; it would probably take longer than that, but we only get 45 days; so hence, some of this system requirement to get that level of accuracy in a time frame. We get 45 days to report, but our auditors have to audit and be able to opine in that time frame, which means that we have to get some of that information in advance, and we don't have a significant subsequent period to refine the accuracy of this. I think another point is that in discussions with our auditors, when we talked about the nature and extent of testing, one of the issues that we constantly view is that management very often can make representations about materiality. Auditors have to audit within materiality, and so we have to do something that is going to sustain an audit. Our concern is that when you talk about the miniscule dollar values and the fractionation and the continuing multiplicity of accounts, that we will have an error or two—a penny error on two cents is a significant error in the event of extrapolation—maybe it does become an audit issue. So again, having been "down in the weeds" on some of these types of issues, it is our concern that we can't disregard the audit impact that will drive our degree of accuracy, the extent of processing that we will have to do, the controls that will have to be implemented, and I think a third part is that our concern about reporting any expected amounts, our reporting them could be construed as our guarantee of collection- and so if we put on the statements- and Wendy [Comes] did pick what I would call the "low-hanging fruit"- it's the easiest one that we could identify, certainly, but even as Ross [Swimmer] indicated, there's complexity, and even in our statements, it's reported that some of it is erroneous. If we report those amounts, the trustees could expect that we guarantee collection. If we put any amount on those statements, or disclose or report somewhere, that there's a hundred million dollars that is due to beneficiaries, and the beneficiaries later got ninety-nine million, it opens up some risk for us. So, we're not trying to parse this into a thousand different arguments. We'd like to say that when you look at cost/benefits, you have to look at: what will it cost for management to do it; what is the benefit to the trustee?

Mr. Allen: But don't your auditors now have the same obligation? When they look at your accounting systems, they are looking at the controls that you have in place. A big part of any audit starts with analyzing and testing the internal controls. Those internal controls are not different based on whether at the end of the year you report on accrual accounting basis or not. They are exactly the same. The accrual comes at the end of a period. I can't imagine having an accounting system that would actually accrue individual transactions during the year. You book a transaction based on a payment or invoice. You look at the end of a period for the accrual impact.

Mr. Mosso: Let me clarify the question about the matter of fractionation. When you figured your $30 million cost, is that based on accrual accounting for individual accounts? All we are looking for- all accrual accounting is looking for- is an accrual for the total assets in the fund- the fund itself, and not individual accounts. Is the figure based on accrual for individual accounts?

Mr. Swimmer: I think the challenge is getting to that number you're talking about, without-- disregarding the transaction. We don't think that you can simply do that. If we project that next year, we're going to get $500 million, the auditors are going to say, "Oh, that's a nice number. Where did it come from?" Well, it came from ten million transactions that occurred at this level, from a penny up to a hundred thousand dollars. "Well, how many of those are we going to test, to see if you are correct in your assumptions?"

Mr. Mosso: I don't think that you're expecting pennies coming in on your leases, are you?

Mr. Swimmer: Oh, sure.

Mr. Mosso: Individual leases?

Mr. Swimmer: At the lease level, you may receive a hundred dollars. It may be distributed to a hundred people.

Mr. Mosso: Yes, well, we're only interested in the hundred dollars.

Mr. Allen: How you answer the auditor is, "We analyzed the prior period, and this is how the flows came in- during the first month, 50 percent of those related to the prior year; in the second month it was down to 15 percent, by the third month it was down to 2 percent, and so there's only a very small percentage after that. So our system is consistent and our collection has been consistent, and we make a calculation based on trends that we looked at in prior years." Companies know that; companies know if I give you a payroll check, they can tell you, if they manage their cash, exactly how many people are going to cash the check the next day, versus the day after that versus time after that. They have to make those projections to manage their cash. That's all you're doing, in reverse, when you're looking at the beginning of the year, and saying, how much of this, really, is prior period revenue that, if we were going to book it from an overall agency-level accrual basis, that is what we would have to do. Now, the stream within a year wouldn't be different at all, because we would have a beginning accrual you would reverse out. So the income statement probably is going to be the same on a cash or accrual basis. The only difference for your agency, probably, as I understand your agency, is that you would have an accrual amount on the balance sheet at the end of the year.

Mr. Dacey: Just a question about that: are these flows predictable? Is there a predictability to the flows on a given property, or even collectively? I'll clarify that. I don't know if you might get a check for five months, or are they monthly checks coming in?

Mr. Allen: You would have to satisfy Bob [Dacey] that you have a systematic way to make your estimate. But again, my only point was that I don't think you'd have to get down to an individual transaction level in order to convince him. But you would have to have some reasonable and rational way to estimate.

Mr. Dacey: I don't know the pattern- if they're predictable or not. And I hate to use that word; very broadly; "predictable"—but I can envision a situation where there are monthly checks coming in, and the extraction of oil is generally consistent, at least across all the properties, versus a situation where it was up and down and all around, and where you've got payments sometimes for a months, and sometimes for five months, and there was a wide level of variability, because that would affect the level audit effort. But I don't know the answer to that, and it's not critical, probably, to this discussion.

Mr. Allen: I can only speak for myself, but I suspect that if you went around the table and asked the Board members who voted for Statement 31, did you believe that you were voting for something that would require accrual on an individual transaction basis, they'd probably all say, "Heck, no." I don't want to pick on Alan [Schumacher]— but he's been involved in huge companies himself. Alan, did you manage accruals on an individual transaction basis?

Mr. Schumacher: No, we didn't. We did it exactly as you described.

Mr. Allen: You do it on a cash basis, making accrual adjustments at the end of the period.

Mr. Fletcher: I think that at some point, in some process maturity stage, you got to that. At an early stage, at what we're talking about, is implementing something, you would, and your auditors probably did, get down to some transaction levels. That's our point—we have to start somewhere. And to address some of Bob [Dacey]'s questions, and Ross [Swimmer]'s points, about variability and uncertainty, there is uncertainty, and so we have been in discussions with our auditors, and we do believe that they are certain that they will have to go down to the transaction level, at least initially. Could I tell you that in the future, they won't? I don't know. We provided some instances of uncertainty. We talked about natural disasters—fires, floods and rains—that impact significant revenue streams related to timber and grazing and so on. You talked about oil and gas. Well, last year, with hurricanes Katrina and Rita there were significant changes in production, and they happened at year-end. It was very difficult for the Minerals Management Service to come up with the accrual, and we had a lot of difficulty getting auditors' comfort with the unavailability of records, and so on. Now, that was an anomaly, we would hope. But we do know that forest fires and other types of natural disasters, flooding and raining, do happen with some regularity, but not enough regularity to be predictable. As so, again, I think at some point, at an audit maturity process, and I can't speak for my auditors, but I don't think in year one that we would have that certainty. I think that they'd have to go down to that depth that we've talked about, and then at some point out, when they have some comfort, and they've drawn a pattern of consistency, and they have comfort with it, then yes. But that still is at some point out, and so you'd have to make an initial investment, and you'd have to invest in controls and processes to get reliability and comfort for the auditors ongoing.

Mr. Werfel: From OMB's perspective, we get approached a lot across government, by agencies requesting help or assistance because the auditor is taking this approach or that, it's more challenging, and we often sometimes joke that a lot of agencies come to us and say, "We have a very tough auditor," Well, every auditor is tough, but what we've learned is that it's not a one-size-fits-all. We've seen situations where one auditor will approach a very similar issue in an agency in a very different way, and pull a different size sample and require a different type of testing, to an identical issue at another agency. There are various factors that can sometimes affect that, and I'm not saying that it's wrong. In this situation, while I don't know this for sure, I'm looking at the context of these assets—the limelight that is sometimes shown on Indian lands, and a lot of the political exigencies that exist, and it doesn't surprise me that the auditor would be taking what we would perceive as — a spectrum of the activity that one could undertake, at one end is going to be more limited, at the other end is a very detailed-- Just based on looking at how we see different auditors taking different approaches across government, it doesn't surprise me that the auditor is on this end of the spectrum; they're taking a very detailed look because of the unique nature of the situation and the unique nature of these assets, and some of the political realities that exist.

Mr. Allen: I definitely can appreciate that, and where they're coming from. I guess, as I read the opinion on the [Indian] trust itself, which basically says, "We don't have"—it isn't that it's on another—an OCBOA[4] basis of accounting, modified cash or cash- that caught my attention, but that the auditor basically is saying, "We don't have the ability to test the system right now. We basically are qualifying our opinion; that we really don't know…" It seems to me as I analyze that, I would say that if we had a pie [chart] of a dollar, it's going to use 90 percent of that dollar to get your current system to the point that the auditor can give a clean opinion on the basis of accounting that you've used, even if it's a cash basis of accounting. That's really the systems, and everything else. It's only the last ten cents of that dollar that's really going to get it from an adequate cash basis or modified cash basis of accounting to an accrual basis. So I see the underlying costs and problems of systems as not being primarily for the accrual basis; they are the current underlying challenges that you have, because of the complex and perhaps in some cases very antiquated systems and everything that goes with that.

Mr. Swimmer: The current system that we operate under now is auditable and is audited and but for historical issues, in our opinion, would be a clean opinion. We don't consider the current financial statements to be problematic at all to the auditors. But there were historic issues that involved previous kinds of accounting statements that were issued and performed over the years, and imbalances that when what we call the "cleanup period" after 1994, there were concerns expressed about issues where you couldn't identify certain transactions, and you

[4] "OCBOA: "Other Comprehensive Basis of Accounting"

got to the point where the research on it was going to be much more expensive that is was to simply put it aside and say we're not going to deal with it now, and then we can get some Congressional relief on it. Those things were in the mill, and we can take care of that.

Mr. Allen: You think you really do have—

Mr. Swimmer: Oh, yes. The current accounting system that we operate now is really second to none.

Mr. Allen: Again, on the auditor side, I've never seen two accounting systems- I've really only seen one accounting system, with accruals made, so I haven't seen an "accrual accounting system."

Mr. Swimmer: When we changed our accounting, when we brought it into the modern age, if you will, from—it was an antiquated system, we chose to go with a private sector trust accounting system. We follow a private sector trust accounting system. This is a system that is used- the type of accounting that is used- in every single trust company in the United States. Every single trust company reports cash basis for their accounting. SEI is our firm that does our accounting for us. They perform the accounting work, and they do this for all of their customers. For us to change, even if we don't adopt a full accrual system, but some kind of a modified system we talked about, is going to require significant software changes, just for us, in the accounting system that they have, that we are part of. It doesn't become part of the user group, because none of the users would ever do this. So, if we would go in and ask them, on a stand-alone, to make these software changes so we could do this type of accrual accounting you're requesting. And we're doing it just for this one purpose, of presenting a different financial statement on a footnote. The cost of that will be several million dollars that you can't get around, for them to make a change. The way it is now, the user group- which are all the large trust companies in the United States- when we get together and say, "You know, we need to fix this one thing; we'd like a change" it's then a shared cost by the user group, when you go in and ask tem to change your software. But this isn't shared by anyone, because this would be an anomaly. Nobody in the trust world would do this. It's strictly a cash accounting; we're not looking at expenses—keep in mind, it's strictly receipts and disbursements. We do not account for expenses. There are none.

Mr. Schumacher: I just have really one question. If the Board believes that paragraph 86 of Standard 7 requires accrual accounting, what are you asking us to do? To amend Standard 7? Or to change [Standard] 31 - because 31 really doesn't require, in my mind, anything different from what was required under Standard 7?

Mr. Swimmer: Our auditors are satisfied with the way that we have been reporting. We believe that the new standard proposed does change that. If the new standard is not adopted, and Standard 7 is left as it is, we're happy. We'll live with that, because our auditors are satisfied that the way we're reporting and the way that they're able to audit the statements is satisfactory. Whether that means we're in accrual or not accrual at this point is not relevant, but we do think that the new standard that is being adopted puts us in a different position- and us alone. There is no one else in the Federal government that would be affected.

Mr. Mosso: Is that just because it says, "generally accepted accounting principles (GAAP)"?

Mr. Swimmer: Yes.

Mr. Mosso: The old [FASAB] Board hadn't been designated to set those principles, so in Statement 7 they just talked about applicable accounting standards, and such words as that. Subsequently, the Board was designated to set GAAP, and that's why those words got in. It wasn't a substantive change; it was just bringing the terms up to date. Alan [Schumacher]'s question is on the central point: whether the auditors will continue to support non-accrual. That's for them to decide, but I think the Board will probably agree that accrual accounting is required by Statement 7.

Mr. Allen: I would agree with David [Mosso]. As a Board member, if I was going to provide you with relief, I would look to Statement 7-- to going back and modifying that. As I indicated, I always assumed as I read [Statement] 7 that your auditors had concluded that there just wasn't a material difference, and therefore they hadn't raised the issue. But I can't read paragraph 86 [of Standard 7] and not get to accrual accounting. So I think that you may well run into problems if you change auditors, or you change audit teams, or whatever.

Mr. Swimmer: We may have to come back to the Board and ask you to do more.

Mr. Allen: Yes, so we're not going to provide you with any long-term relief if we don't modify [Statement] 7.

Mr. Fletcher: And if we look at [Statement] 31, if it just said "comprehensive basis of accounting," because that's what we would plan to do for our fiduciary activities, then that probably takes away our argument with 31. We have dealt with [Statement] 7 for some time; we've made an interpretation, which as management we are required to do, and our auditors audited against that, and that's where we are.

Mr. Reid: Suppose we were willing to modify 31 to add a section in there that made it very clear that you weren't expected to go to the transaction level- that you weren't expected to modify beneficiary accounting systems, that you were expected to do some sort of historical review and come up with some top-level estimates- if we made it very clear that that's what we were looking for-- would that be acceptable, is that going in a direction that might be sort of a middle ground?

Mr. Swimmer: Again, it's just a cost issue- a cost/benefit issue. I guess I'm still troubled by where the benefit is. If we do that, there is a cost associated with it. We would have to look at the accounting system that we're using and do some modification to it, and I'm sure the auditors—that there would be some additional cost to having to establish credibility there.

Mr. Reid: I was struck by the fact that you had so few transactions over $100,000. What went through my mind when I heard that was, if you drew a line at like $20,000 or $50,000 or $80,000, whatever the right number is- that there might not be that many that you'd have to go back to on a historical basis to look at, and that would probably be most of the money. Assuming that it was clear, and Board could help you make it clear to the auditors, that we did not expect beneficiary accounting to change, or beneficiary accounting systems to change, that we just were looking for a high-level thing. I'm just wondering if there's somewhere in the middle that we perhaps might—

Mr. Swimmer: It obviously could be done- you're going to go down from $38 million down to something- there's still a cost issue.

Mr. Cason: As I mentioned on the $100,000 issue: we had about 2,000 of those over 15 years. We actually did, as part of our historical accounting process, go back and look at every single one of those, and we only found three that required any kind of an adjustment. So we just aren't in a situation to have these big material adjustments, based on the experience we've had. When you take a look at the structure of our trust, tribal land that's broken down into thousands of individual parcels, and individual land that's 130, 000 allotments that are broken down into 4 million ownership interests. When you have a structure like that, there isn't much room for big changes to occur. Essentially, we're leasing natural resources, and even if you have a timber sale or you find new oil or gas, it doesn't make a material difference in what's produced by the trust. The only way we would get to some kind of materiality would be if we discovered a new Saudi Arabia on an Indian parcel, and if that were the case everybody in the whole country would know about it.

Mr. Allen: That has led some of us to think, maybe naively, that there probably would be little if any difference or work to do, anyway. We wouldn't be asking you to do anything, if that's the nature of it, and there are not significant changes or prepayments or whatever-- other than If there were [significant changes], that those would be reflected in the financial statements.

Mr. Cason: I think the issue for us is the idea of setting up an accrual system to find those rare anomalies and report on them. There's a different way to do that. You know, you don't have to have an accrual system to get there if you have an anomaly- you can make that an informational footnote.

Mr. Allen: And I suspect that -- it sounds like you guys are on top enough that you already have the systems in place, as you manage these resources. You know significant uncollected at the end of the period. You would know and track significant prepayments that were an anomaly, so I'm not sure you would have to do any systems work. I think you have the management controls probably in place that you could sit down at the end of the year and decide if there is a need for anything at that point.

Mr. Swimmer: Which is why we think that the cash basis of accounting that we're doing right now is—

Mr. Allen: There is nothing wrong with the cash basis of accounting—over time, there are no differences between cash and accrual basis, if you take a 50-year period of time. All accrual accounting does is give you some integrity within the entity for the year.

Mr. Fletcher: You did mention the auditor's qualification. They did qualify based on certain parties do not agree with the balances, so that is another consideration that we would like to present.

Mr. Cason: That might be something just to share-- on the statutory matter of this trust, if you go back over the 115 years from the beginning of this trust, Congress had not given us any direction at all to provide any kind of accounting statements periodically to beneficiaries, all the way until 1994 In the 1994 Act, they said, "OK, I guess we do need to give statements to beneficiaries, and here's what we want you to have in the statements. Ross [Swimmer] went through that in his testimony, and it basically it's what did you receive—not what are you about to receive, but what did you receive—we want that in the statements." And so the lawsuit that Dan talked about is, some plaintiffs came forward and said, "We want an accounting for that historical period, where the Department wasn't providing statements- what happened there?" They raised a question about it. And we're going through the process, to look at that hundred-year history and see what was involved there. What we're finding is, surprisingly, the system worked pretty well, and that it was relatively accurate. We found a few errors, but not many. We've done a study of all the audits and reconciliations over time- almost 1,000 of those over the last 100 years. We didn't find any systemic error, or any systemic accounting problems. So, we're starting to get to a position that we're pretty well-prepared to deal with the historical reporting period.

Mr. Allen: Hopefully, over time, this qualification of the audit opinion will come off.

Mr. Cason: Yes.

Mr. Farrell: I just have to think, listening to this conversation, that we're talking about a very high-level type of accrual for receivables that would be disclosed in a footnote. That's all that Statement 31 is asking for. And it could be as simple a sentence that says, the Department estimates that the amount of uncollected receipts relative to the period being presented, at the end of the year, are – and it seems like you already have that number, within some broad estimates, using information from Minerals Management Service, using information from the prior year. I can't believe that someone could spend more than a day collecting this information, with all the information that's around.

Mr. Swimmer: I don't disagree; it sounds like that would be very simple to do. You just heard that at the transactions at the lease level, we don't have very many transactions of large income. Most of these leases bring in very little income. They're in the Great Plains, grazing leases, pasture leases. It takes 5 acres for one cow. So, when you talk about materiality, where do we go with that? If we say that at the end of the year, we have uncollected leases on the books for X dollars, and let's say it's a million dollars. Then KPMG doesn't necessarily accept our word for that. They have to go back into that million-dollar number and say, "OK, that's made up of ten thousand leases, or let's say a thousand leases. So we're going to pull fifty of them and do a test, and see if they in fact have not been collected, if they are due and payable, or whatever. That is additional work that they're not doing today, and that's an additional cost.

Mr. Allen: Two days, then, with testing of transactions.

Mr. Swimmer: And we have to provide them with assistance- to let someone go in and pull those out, those individual transactions, and do the test, and determine whether or not the million dollars is the correct amount.

Mr. Jacobson, FASAB General Counsel: The audit opinion says that they tested for compliance as part of the audit. Wouldn't they have to do some of what you're saying, anyway, because even if it's only on a cash basis, don't they have to do some testing to see that the people who owe money to the trust in fact, under the contracts, paid the money that they were supposed to have paid?

Mr. Swimmer: I'll defer to the auditor on that, because I don't know.

Mr. Jacobson: They've got to consider that, anyway. What I'm suggesting is, whatever work they did, assuming they did what they said they did, whatever work they did to test that companies A, B and C paid the cash they were supposed to have paid for the year that you're reporting on, and they test those contracts, for those same contracts they could test whether there were amounts due that had accrued but were due to be paid in a subsequent period.

Mr. Swimmer: I would defer to the auditors, but I really think they test the system, these tests, rather than at the individual transactions.

Mr. Dacey: Let me interject. The answer is no, and the reason is- and this is my interpretation, I won't project this to KPMG or any other auditors here- but the issue is, do you test compliance with laws that would have a direct and material effect on the financial statements, which are cash based, and so to some extent I'm not sure that you would get into that level of detail on the compliance side, because it's modified cash based statements. I'm not saying you wouldn't, but I'm just saying that you wouldn't necessarily do.

Mr. Reid: Even if you had a contract with payments over different fiscal years, it would be difficult to relate the payment to the accrual. If you did the accrual at a 20,000-foot level, which is probably what we're suggesting here, it would be difficult to determine whether or not that particular transaction was or was not part of—

Mr. Jacobson: That's essentially what I'm asking is, if they say they tested compliance with contracts, and they didn't have to do that for cash, then why would they have to do it because you're adding a high-level accrual, which is going to be a much smaller number than the cash amount.

Mr. Reid: There has to be some testing of the accrual, and those procedures, tests, that you're referring to, on a contractual basis, compliance with laws and regs, wouldn't extend to a point where you could get any comfort from it to the accrual, because you've got a completely different methodology: one, you're down at a transaction level, another one you're trying to do some overall estimates.

Mr. Farrell: I was thinking that auditors are looking at accruals every day. They're looking at IBNRs (Incurred But Not Reported) claims against, they're accruing payrolls- say, there's three days in the pay period that extends over- and I'll guarantee you, auditors are not going back looking at individual transactions- of who showed up at work for those three days- to come up with the estimate of whether that's an accurate accrual. And they're not looking at the individual claims submissions to come up with IBNRs. These are, as Bob [Reid] called them, 20,000-foot level accruals that are supported by reasonable estimates made by reasonable people, based on historical information that is available broadly. I don't think that transaction level takes it in.

Mr. Fletcher: I think you're very wrong in all of that.

Mr. Dacey: I hear you, but I at the same time I agree with Dan [Fletcher] to the extent that in the initial year, it's going to be a bump, not necessarily- I'm not telling the auditors-- at least we, looking at the audited Statement of Social Insurance for the first time, we're going to do a much more intense review of that process and audit than we would probably do five years from now. So I do think that over time, I would agree with you, but I think initially there is a significant issue there, to ensure that what's being produced is materially correct, and then move forward. So there's a balance. I think that over time I think you get there, and of course I've audited many large accruals as well, and you get comfortable with the model. Once you're comfortable with the model, and it may take awhile initially, you typically then look more at the model and the data going into the model, and seeing if it's continuing to produce reliable information. But those first few years can be an intensive process from an audit standpoint, because you've got significant risks of potential errors that might occur. But over time, I think it comes down. I can't suggest what the initial hit would be here, even at a high level, and to what level both management and the auditor would feel necessary to dig down to gain comfort with the model. But I do think that over time, yes, it does tend to lessen, once there is a comfort by management and the auditor that the number and the model are reasonable. And I say "model" because typically that's how these are derived. There's some kind of model that calculates an IBNR, might be one and a half months' worth of claims, or whatever.

Mr. Mosso: Would you be comfortable with anything we agree to do that involves re-exposure. We exposed Statement 31, and if we made a significant change it would have to be re-exposed. If we omitted it from Statement 31, then we'd be left with Statement 7, and if we tried to do something with Statement 7, it would have to be re-exposed. Are you comfortable with focusing on this one issue? It would attract a lot of attention. It seems to me that your choice is between having us go through the exposure process or taking one of these short-cut notions.

Mr. Fletcher: I certainly think that if we could see what the proposal is, we could vet it back through and say, "What would it mean?" I think you've heard our reaction to Bob [Reid]'s proposal of some higher level accrual. I see that FASB is going to consider that for leases, some high-level bright line above which we would focus on- that may make our lives easier. What we want to see is how would our auditors react; what do we think that would mean from our process standpoint, and certainly if we could do that and have time to vet that, that probably is a reasonable alternative.

Mr. Allen: It might be helpful for us to be able to talk with your auditors, to get someone to come in. Your auditors identify significant control weaknesses within your system, and that's part of their opinion on internal control. That was why I asked the question, but if that's historic and not now, maybe we were beyond that. But to get beyond that, your auditors have to be comfortable with your current systems before we can start talking about these high-level accrual adjustments.

Mr. Mosso: I think we would be willing to sit down with you and with your auditors and see if there is some simplified way- and I don't think what you hear around the table from everybody here is thinking about a lot of detail- I know you described your cash accounting system to Wendy and I a couple of months ago, and it sounded to us at the time that you're just one step away from accrual once you get that system in place. It might be advantageous to work something like that out. So, why don't we talk to you further and talk to your auditor. We've got some auditors around the table here with systems capabilities; we could at least explore that avenue.

Mr. Patton: I'd just like to ask a "due process" question. This standard was passed and is in a review period now. Have we ever—so, is this being kicked back to us because of the review period, or we're kind of now saying, "We didn't really mean that one and we want to take it back?" And do we start additional clocks? I just don't know.

Ms. Comes: My understanding of the Memorandum of Understanding (MOU) amendment and the direction I received from OMB was that for Statement 31, which was submitted in April, I believe, with July 25th as the end of the first 90-day period. Statement 31 has been submitted. The clock simply adds 90 more days, so from July 25th, 90 days additional, it will be issued by FASAB absent an objection from the OMB Director or the Comptroller General. So, unless the Board directs, by majority vote, that we retract Statement 31, as far as I'm concerned it is still in a 90 day review period. After that 90-day it will either be issued or we will issue a press release explaining why it was not issued.

Mr. Patton: If somehow we vote to bring it back and make some change…

Ms. Comes: As I understand this discussion, we are being asked to do routine maintenance on a standard. Whenever we issue a standard, we're available to give interpretations, technical guidance in the form of a technical bulletin or staff implementation guidance, or even a lesser-level letter guidance, if that is what we are asked to do, is explain the meaning of Standard 31- which can happen now, and give the preparers some comfort, or can happen in the routine process. We've given guidance on a number of things, as you know, with Standard 25. We came back and we gave a deferral on it after it was issued; we came back and gave it an amendment to put significant assumptions in the note. It is normal for us to stand ready to support implementation of a standard. We can start that in the 90-day period, or we can start it after the 90-day period. As I understand this discussion, we are being asked to provide guidance.

Mr. Patton: I see.

Mr. Werfel: I'd like to react to that. First of all, in response to some of the concerns of Jim [Patton]'s, that you raised yesterday morning, I just want to make sure that I share with the group our thought process, and maybe it's obvious now, based on this discussion, but I think that the concerns that you raised were significant enough to just address. When we were reviewing the standard, as we've reviewed standards under the MOU for the last seven years, we basically asked some basic questions, because what we are charged to do at the staff level, me in particular, is to make a recommendation to the Director of OMB on whether he should sign out the standard. We asked some very basic questions, in terms of, "Is there clarity in terms of what is being required by the standard- clarity in terms of the population that would have to comply with the standard? Do they know what's required, and is there clarity in terms of how they would comply with it? Are the costs understood? And is there a clearly identified benefit?" And we can talk about costs and benefits, and I know that benefits are difficult to quantify; we don't throw everything out the door if we don't have a very quantifiable benefit to compare with a quantifiable cost. But we want to understand the nature of the cost, and at a minimum, we want to understand if there's a clear, articulated and well-understood benefit that we can discuss and is commonly understood. We had questions on all of these elements. Because of information that came to our attention when the standard came to OMB for review, that the Department of Interior reached out to us. They indicated to us that later in the game than was understood by most people, this requirement for accrual- at the beginning of this debate, going back a couple of years, the debate surrounded more on whether to put these in the statements or not, and now the Department of Interior come to the realization later in the process, that, "Now, wait a minute- OK, now Standard 31 is requiring an accrual, and keeping in mind that they did not ever interpret Standard 7 to require this, this was something new- and so they brought to us information, and this information showed us a major disconnect was at play here, in terms of what they understood the authors of the standard to be required, and the level of effort that the Interior Department was indicating, and this disconnect was so significant. It had significant impact on taxpayer resources, it had significant impact on the audit of the Department of Interior, and just created a lot of risk. We thought that this was-- I personally felt that I owed it to the Board to bring it back and make sure that the Board understood that we have an opportunity- we have knowledge of a lack of clarity, of an ambiguity- and a potentially expensive ambiguity- in a binding standard that we're about to issue. So, I thought that- I didn't want to go forward with that, without making sure that the Board understood that ambiguity, and I just wasn't sure that that was well-understood. So prudence dictated, I thought, to try to see what we can do within given processes, without violating any process, to make sure that the Board had an opportunity to hear what we were hearing, and what we were hearing was this significant lack of clarity and ambiguity in terms of what was required, and that had significant cost impact. So that's why we're here today, and that's why we took the steps that we did. I just wanted to make sure you understood that, because the nature of your concerns that were raised, I don't think you had the benefit of understanding that type of analysis that we were doing. It was what we felt would be prudent, to make sure everyone understood. But in reaction to what Wendy [Comes] said, I would put forward that as a standard setter, I do believe that it is very important as a standard setter that, when standards are issued, to immediately take efforts to do technical assistance and guidance and issue any kind of bulletin- as we discussed yesterday, that is lower on the hierarchy than the standard itself, but it can help mitigate the risk that agencies or whoever is complying with the standard, take actions that are unnecessary or that are misguided. But, as a standard setter, where we know about a specific risk of misinterpretation, and we know about a specific level of ambiguity, I believe that we would want to fix that in the standard itself, rather than fix it in something that is at a lower level on the hierarchy than the standard, because knowing the Department of the Interior, knowing Federal agencies and how they react to accounting standards—once this standard goes out, with a threat of the loss of a clean audit, and the auditors standing there, saying "The way we read this standard, this is what we are going to require. We know technical guidance is coming, but this is what the standard- and the standard has the highest hierarchy…" that the Department of Interior would be, in my anticipation would start mobilizing resources the moment that standard is issued, and start to prepare for what their auditors are telling them they need to do. And so, they are going to start spending taxpayer resources and moving things up on their priorities to try to comply with this, not knowing exactly what the technical guidance is going to say, and not knowing exactly what effect that technical guidance will have on the auditor. In that environment, unless there's some pressing need that I don't know about, that we absolutely have to get this standard out now, I think we should take time and fix the standard if we can, or at least spend time debating how we can fix the standard, so that we're issuing something that does have more clarity than we have now, in terms of what's required, and how they would comply with it.

Ms. Comes: I want to explain something about the Standard 25 example that I used. The first amendment, the deferral, came because we were faced with a situation of people saying, "Don't require the Statement of Social Insurance to be audited until there is audit guidance." Well, the conundrum is, people won't write audit guidance until the standard is available for them to write audit guidance against. We issued with an effective date; the audit community began writing audit standards, and then came back and said, "We can't finish audit standards soon enough," so we deferred. I think in many cases the preparer and audit communities are similar; until the standard is there, they don't think in detail about the detailed work that needs to be done. I think there is benefit to getting a broad standard out there with a reasonable effective date, and then come back, with a recognition that we'll need to provide guidance-- but I think that we'll come to a meeting of the minds.

Mr. Werfel: To me, due process seems to be working here, from the standpoint that we sent out an exposure draft of a standard, and the respondent community, or the community that has to comply, both the preparer and the auditor, have looked very closely at that, in its proposed form, and are raising some very significant questions about it, and some very significant questions that revolve around ambiguity of what is being required. And so, instead of saying, "OK, well, we're so far in the process that we might as well just issue it, and then we can maybe issue amendments later and fix it, or technical guidance-- the process was to put this out for exposure so we could get these type of concerns, so we can consider them before we issued a binding standard. I want to make sure that there are options here, and clearly, one option is that we can go down to October 23rd, which is when the next 90-day process ends, try to work on some technical guidance in the meantime, have the standard come out, and continue to work on the technical guidance. That's one option. I'm just offering that there's another option here, that's worth consideration, and that is that we attempt to fix the language in the standard itself, before we issue it, so that the highest level of hierarchy, the standard, is clear, and we're not relying on the standard, plus technical guidance—that we're actually fixing the standard itself, if we can.

Mr. Mosso: I don't know what you mean by "ambiguity." I thought the problem was that the standard is clear.

Ms. Cohen: What is the ambiguity?

Mr. Werfel: Let's start with this first point. The Board indicates that Standard 7 requires accrual-based reporting. The respondent population- and we have a duty to the respondent population to issue clear guidance- doesn't read it that way. They read it- and it's not just one individual, it's in a group of individuals at the agency, within the Inspector General, and with the auditor- that are reading the standard- Standard 7- differently than we're reading that. I would indicate that that raises a certain level of ambiguity surrounding this particular standard and what's required.

Ms. Cohen: But shouldn't that, perhaps, have been brought to the attention of the Board earlier? I mean, is this the first—I have not been on the Board forever, but-

Mr. Werfel: That's a different question- that's a good question. But you asked me about ambiguity.

Ms. Cohen: You've got two different standards here. If [Standard] 31 is ambiguous, then an earlier standard—

Mr. Allen: And that's what Dave [Mosso] is asking in the first place: is there anything we could do in [Standard] 31 that would address your concerns, or are you really asking us to go back and modify, or clarify [Standard] 7.

Mr. Dacey: Doesn't [Standard] 31 supersede [Standard] 7? That part of [Standard] 7- if it's issued?

FASAB Staff: Yes, it would rescind that part of [Standard] 7.

Mr. Werfel: But I think it's important to point out that what is unambiguous to you, when you read something, can sometimes have the effect of not being as clear and unambiguous to the community, and that's what we're seeing here today.

Mr. Allen: What Claire [Cohen] is saying is that we wish we had known that much earlier on in the process.

Mr. Werfel: I think there's another key point of ambiguity here, and that is in terms of what would be required to meet the standard. We are trying to issue a requirement, and in issuing that requirement, we are issuing it in an environment of where we believe, as we go around the table, that we can take steps A, B and C, and I'll paraphrase John [Farrell], with 3 hours of work, or 30 hours of work, and get this done, but the realities out in the field, of those that are looking at it, is that it won't work that way. So the Board—you may think you're issuing a standard that's going to take 30 hours of work, but the way it's going to happen in practice, it's going to take 3,000 hours of work. I'm calling that an ambiguity; I'm calling that a disconnect. I'm saying that why would we issue a standard, unless there was some compelling reason to do it, where we have an opportunity to try to bridge that ambiguity, so that all parties come to the table- the Department of Interior, their Inspector General, and their auditor- we can all agree that it's going to take X hours to do, and these levels of activity make sense. That's the ambiguity that I'm pointing out.

Mr. Allen: And that's what we're—that's the intent of this meeting. They've agreed that we can talk with them, and their auditors, and see if we can, as Bob [Reid] and others suggested, get this down to a reasonable level.

Mr. Werfel: Right.

Mr. Allen: And it seems like, to me, that we need to do that before we can talk about whether we need to amend the standard or whether we don't.

Mr. Werfel: Agreed.

Mr. Patton: Is the nature of the "fix-up" here a change in auditing directions? Is that what we're going to do?

Ms. Comes: We cannot alter the auditing. What we can do is clarify—for example, what I hear is Interior believing that they need beneficiary accruals, whereas staff, at least, is saying you need lease accruals, and you have a system at MMS that treats the leases for Indians exactly as it treats the leases for Federal. So, staff is still puzzled as to what is not happening for the Indian leases, for oil and gas, in the MMS reports. So, the clarity is- is it sufficient, in the note disclosure in Interior's financial statements, to show an accrual from leases, as opposed to an accrual that exemplifies each beneficiary's accrued amount? So, we can work together to clarify that. Once that is clarified, the auditors will know what does the standard expect?

Mr. Patton: This reminds me of the discussion we've have over time about rules-based accounting versus principles, and how we have to teach Accounting 101 every time we issue a standard. It just seems like we're going to face this problem over and over as an affected agency finds a powerful ally that shares their concerns- and we'll be going through this dance repeatedly, which I think is not a good thing.

Mr. Allen: But it is actually a part of the charge of FASAB that goes beyond the charge- to help with implementation-- FASB and GASB don't have that specific charge within their bylaws that FASAB does.

Mr. Mosso: I think that we should wrap this up. We will do some further consulting.

Mr. Patton: Can I just ask a timing question? Are we likely by, when is it—October 23?

Mr. Werfel: October 23^{rd}.

Mr. Patton: So, we meet- in September. Are we likely to be able to fix this in September?

Mr. Werfel: It's possible.

Mr. Patton: Let's say we don't, and it expires. So we would need to pull it back and do some other things, that I think starts a new clock, and maybe a need for exposure. I mean, if this is a significant change-

Ms. Comes: I think the fastest guidance we can give is staff implementation guidance, and that can be done in about 45 days. However, I would be in a very odd position-- to argue that I could effectively do due process when no one can see the standard, because the standard has not been issued, and I'm asking people to comment on implementation guidance. So you've got a bit of a conundrum. I think that we will have to reach some sort of an agreement. I think that we could get 100 percent consensus on the Board on the implementation guidance, because I don't hear anyone saying that beneficiary-level accruals are required. So, I have to let you leave the table with the understanding that we won't have a piece of GAAP that could go out concurrent with the issuance of Standard 31. It's highly suspect if I ask people to comment on implementation guidance when they can't see the standard.

Mr. Reid: I'm very sympathetic to Danny [Werfel]'s point, and having worked through some of these problems where you have a difference in interpretation with the auditors, it's very difficult for the agencies to deal with that. They're usually relatively powerless if they have a difference of opinion with the auditor, and I'm sympathetic to the notion that it ought to be fixed in the standard. We should be clear in the standard, the level of effort that we expect the agency to undertake, and I think we need to be clear about what we don't expect to happen, as well. I'm not sure what our reach is to beneficiary accounting. I think that beneficiary accounting is controlled by the statute, and that goes on in a beneficiary accounting system which is outside of the agency accounting system. What we're saying here is that in agency records, we want disclosures made. I think that we're affecting that note in the agency's financial statements, and that's where we want to go. We don't want to do things that disrupt not only the existing systems but whatever plans they have to improve those systems as they move forward; something like this could seriously, as Danny [Werfel] pointed out, disrupt that process. That's certainly not our intent, and I think that putting something in the standard that clarifies all of that, particularly in this kind of environment, is maybe helpful.

Mr. Allen: Ironically, what that is, the fix to that, is just continue paragraph 86 in Statement 7, because that clearly is the point in Statement 7, where it says you may be required by statute or whatever else to do separate accounting. You're just saying that is governed by law, to the fiduciary, and if that's the case, that's fine, and that's how you should do it. All we're really asking in Statement 7 is that for that higher entity, that the report should have some accruals. So the fix, ironically, might be drawing in paragraph 86 of Statement 7.

Mr. Patton: I'm still confused about what we're likely to do here. Let's say we all agreed to the change- and I can imagine being against it, but let's say we all agreed. Is it such a big change that we'd have to re-expose, or is this a minor change that we wouldn't (if we want to do it in the standard)?

Ms. Comes: If it's simply a clarifying change, for example, "This doesn't do X, Y and Z," and it's consistent with what was exposed and what is embodied in Standard 31, you could add a "this doesn't mean," I think, because it doesn't change the standard. So, if you wanted to vote, on majority, to pull back the Statement 31 that was submitted, add something that says, "This doesn't mean," then you could probably pull it back, add the language, and re-submit it, and start the 90-day clock again. Anything more detailed than that, any technical guidance that would expand on that, and say, "Here are three ways to do it; ways one and two are not acceptable and way 3 is acceptable," I think that would require exposure at some level.

Mr. Reid: The standard is effective when, 2009?

Mr. Mosso: 2009.

Mr. Reid: It seems to me that you have a little time. I mean, it's not time-sensitive, particularly.

Mr. Patton: Well, we have an October 23 time to worry about.

Mr. Reid: I mean, as far as how we do the fix.

Mr. Werfel: We could fix this by 2009, is the point.

Mr. Reid: But Jim [Patton] is right; we have to stop the clock at some point.

Mr. Werfel: And that's a good point. That's another point that came into our determination at OMB to do some non-traditional action, to make sure that these issues were surfaced to the Board, because we realized that we have an opportunity to address this and still meet the 2009 reporting timeline, and not disrupt it.

Mr. Mosso: The fix we're talking about is, "how do you do accrual accounting" and I hope that we don't have to do that in every standard.

Staff: There's one piece of information, in order to do cost/benefit analysis: In November, we wrote a letter to Interior asking for estimated cost, as distinct from the cost that would be for them to address a current material weakness. Now, I am looking at KPMG's audit report—and this is not in the section on the past—it's not in the section on "past historical"—this is the section called "Reliance on the processing of trust transactions of the Bureau of Indian Affairs (BIA)"- part C, Accounts Receivable:

> "BIA had not fully developed and communicated standardized policies and procedures for establishing, tracking, and pursuing accounts receivable for

> the Indian trust funds. This results in inconsistent processes and increases the risk that amounts due to Indian trust funds are not identified and ultimately collected. Several agency offices prepared bills after receiving payments rather than sending bills in advance of the payment due date. In addition, certain agency offices did not identify or pursue past-due receivables and instead relied on landowners/lessors to inquire of overdue payments before pursuing the receivable. Furthermore, several agencies offices did not maintain a listing of leases and permits against which receivables could be established."

That's a material weakness. We've asked for that information. We have not received it—including today.

Mr. Swimmer: We do not expect to see that material weakness again. We have taken- with the accounting that we're doing now, we have removed the collection of funds from the Bureau of Indian Affairs. The collection of funds is now done through a lockbox operation. Invoices are sent out for the leases to acknowledge when they are due, rather than bills of collection being prepared when the payment is made. We do know when the leases are due, leases are made, we have completely converted software systems. We had a dozen or so software systems that were used by BIA out in the field. They are being eliminated. It, basically, everything that you just read in that material weakness has or is being corrected, and will be completed by the end of this fiscal year. The conversion of all the agencies will be converted by next year.

Mr. Cason: But we still have a need to get a letter back to them.

Mr. Patton: Just one comment, and it's an observation: I want to make it clear that I voted against Statement 31, for reasons I don't think they should have to follow beyond the accounting that they're already doing, but my concerns here have mostly been regarding due process.

Mr. Werfel: One more point, and I want to be clear that this is not dispositive on the issue we just discussed. It's just something that I want to be brought to the attention of the Board. During our review of this standard, we were reviewing the deliberations surrounding this particular requirement to make sure that we got a sense of things, and in reading the record, there was a vote taken on paragraph 16, on this requirement, on the clarification of Standard 7, however you want to state it, with respect to accrual reporting, and the vote was 5 to 5, and the decision was made to keep the requirement in. So I sent a note to Wendy and said, "Can you help me understand this? We had a 5 to 5 vote, yet the decision was made to keep the requirement in the standard and move forward." The response back was that that vote was on whether or not to delete the paragraph in question, and so, 5 to 5 didn't survive, so we moved forward. So I was talking about this with OMB General Counsel, and he asked me to make a recommendation to the Board that in the future, we do not vote on whether to delete or not, because while it didn't happen in this situation, there could be situations where things are put into a draft -- staff level and then—not clear exactly how it got in there, but it's in there- and now you're voting on whether to delete, and a non-majority vote is carrying the day and keeping things forward. So there's a danger in terms of voting on whether to delete or not, and so I raise that as a process point. We learned of this in reviewing it, and it just added somewhat to the confusion surrounding this issue, and another point I would make was that because it's in the record and it is a little bit confusing, us re-looking at this issue allows us to at least clarify the voting record here on that particular item. So, just something for further consideration for the Board, that there is a danger, I believe, in voting on whether to delete or not to delete. We should vote on whether to include or not to include. I think it's safer, that for the majority will to be upheld in that regard.

Mr. Reid: What you are saying is, if we had taken that vote on whether or not to retain it, the answer would have been different. If you've got 5 to 5 on "should we keep this in" and you've got 5 to 5, you'd have a "No" vote, and the answer would be that you don't go forward.

Mr. Werfel: You don't go forward. Right.

Mr. Reid: As opposed to, "should we delete it?"

Mr. Patton: That was not the first time we would have seen that paragraph, and so in previous meetings we would have at least implicitly adopted it.

Mr. Mosso: As we're debating Board procedure, we didn't really need the Interior people to stay. Thank you all.

[Agenda session ended.]

- **Exposure Draft on Asbestos-Related Cleanup Costs**

Staff presented a summary of the ten comment letters received through July 25, 2006, on the exposure draft (ED) of Technical Bulletin 2006-1, *Recognition and Measurement of Asbestos-Related Cleanup Costs*. The ED was released on June 1, 2006, with comments requested by June 30, 2006.

Staff explained the layout of the briefing materials and indicated that, in accordance with the timeline presented in the May board materials, it plans to update the draft technical bulletin based on comments received and submit the revised technical bulletin to the members via email by August 14. Members will be given until August 25 to provide any additional comments before staff finalizes the technical bulletin. Members would then be provided a 15-day review period of the final technical bulletin, during which time members could object to the issuance of the technical bulletin. Staff reminded the board that a technical bulletin is a staff document and would be issued absent six Board member objections. No balloting is required.

Staff highlighted its recommendations for responding to the comments received and inquired if members had any specific comments on the comment letters or questions or objections to the staff recommendations.

Mr. Farrell noted that he agreed with the two respondents [and staff's changes in the supplemental briefing materials] that recommended that cost/benefit considerations not be explicitly mentioned in the technical bulletin.

Mr. Dacey suggested that the basis for conclusions include a better explanation as to why there is such a long implementation period for guidance that relates to a standard that has been in existence for so many years.

There was a brief discussion as to why cleanup costs are spread out over the useful life of the asset rather than recognized upfront.

There were no other objections to staff's recommendations.

> **CONCLUSIONS:** Staff will incorporate editorial comments received from members and submit another draft of the technical bulletin to the board members by August 14 for an additional round of comments before being finalized.

- **Steering Committee Meeting**

The Steering Committee met in closed session.

Adjournment

The meeting adjourned at 11:45 AM.

Attachment 1 - Mr. Patton's Remarks of July 26th

Current Events Close to Home: Some Thoughts on the Independence of FASAB and the Stability of FASAB Concepts/Standards in Light of Recent Developments

Jim Patton, FASAB Board Member, 26 July 2006

FASAB was originally structured with a majority of federal employees and with veto power held by both Executive and Legislative Branch entities so that important constitutional issues could be resolved. While 'public' members could participate and influence the outcomes via collegial, reasoned arguments, the Federal government retained sovereignty over the federal financial reporting requirements. One result of this structure was that (in at least one case), the Board did not include certain solutions to an issue in a standard because it knew those solutions would lead to a veto of the standard by one of the principals. This sort of self-censorship was a natural result of the structure of the Board and its processes.

Several years ago, the FASAB sought and received designation from the AICPA as a GAAP-standard setter for the federal government. One of the concerns of the AICPA was the real and perceived independence of FASAB. In order to accommodate those concerns the Board was eventually restructured to have a majority of public members (6) and a minority of Federal members (4). Veto power was retained by OMB and GAO, but the AICPA has indicated that if the veto power was ever used it would most likely rescind the FASAB's GAAP-standard setter status. The AICPA also said that it would periodically review FASAB to see if GAAP status should be retained. The last review was in 2004; next review is scheduled for 2009.

In recent months, the Board has continued its due process procedures on several controversial topics, including Social Insurance. In May 2006 the Board voted (6-4) to proceed with an ED which included a provision that some part of Social Security would be recognized on the federal balance sheet as a liability, with all four federal members voting against this measure. This outcome suggests that there is an important conceptual policy split within the Board. One question is how the Principals will respond to this split.

In one recent meeting, while discussing to the apparent FASAB intention to propose accrual of some amount of Social Insurance liability on the Balance Sheet, the representative of the Treasury on FASAB said that he "did not think the Board could survive having it go the way it is" (FASAB meeting minutes from March 2006). The implication of this comment is that if one wants the Board to survive we ought "to take another look at the issue". This was proposed even though we had considered and re-considered the topic for several years. I believe that this kind of comment impairs the independence of the Board by suggesting that it will cease to exist if the 'proper' solution is not reached.

In addition, while discussing the Social Insurance reporting issue directly with the Board at the May 2006 meeting of FASAB, the Comptroller General (CG) said that "the last thing in the world that I want is for a veto to be made on a standard…I hope it never happens, but feelings on this are pretty strong". The logical inference from this comment is that while the CG doesn't really want to veto a social insurance standard, he would be willing to do so. Presumably, that would mean the AICPA would withdraw its Rule 203 GAAP status from FASAB and the Board would revert to OCBOA…and the Federal government could revert to setting its own standards without the burden of satisfying the criteria that the AICPA imposes on GAAP-standard setters; e.g., "Independence" and "Due Process". While a 'veto' is within the rights of the Comptroller General (and the OMB Director), I believe that this kind of comment is a threat to the existence and independence of the Board. A more subtle danger is that Board members may be subject to self-censoring in anticipation of a potential veto or pressure by a principal in order to assure that FASAB survives.

More recently, FASAB passed a standard on Fiduciary Activities after several years of due process deliberations. Near the end of the sponsor's review interval OMB took a number of steps to request a last minute meeting for FASAB to reconsider the content of the Fiduciary standard. It also arranged for a change in the Memorandum of Understanding (MOU) so that the review period would be doubled. While the specific OMB concerns have not yet been revealed to the Board, these actions create the appearance that OMB was interested in reversing a majority position of the Board even after the Board's extensive due process deliberations had ended. Although these actions are within the technical rights of OMB, and differ from a threat to veto a standard, it does suggest that OMB was willing to try to overturn a majority position. [Note that the special meeting was not held, but that a special topic has been added to the July 2006 FASAB agenda]. I believe that this also constitutes a threat to the independence of FASAB.

I believe that these recent actions impair the perceived and actual independence of the Board. Federal members have made it clear that they do not intend to yield sovereignty to the FASAB and that they will act to prevent implementation of Standards and Concepts Statements that they do not agree with. As a result, even though the public Board members may be independent in spirit, the overall Board is not independent.

In addition to my concern about Board independence, I also believe that these recent actions threaten the stability of FASAB Standards and Concepts Statements, since some federal members can arrange to change the majority outcome either via veto, standards reconsideration, due process rule change, or selection of new members as openings occur. As preferences of individual federal participants may change over time, prior Concepts Statements and Standards would also be subject to change.

If the FASAB is not going to be an independent body producing conceptually sound, stable reporting standards for the federal government, perhaps it would be better to save the government some money and revert to federal government employees setting federal reporting standards as they see fit.