FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 5-6, 2005
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, October 5, 2005

Administrative Matters

- ### Attendance

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

The general counsel, Jeff Jacobson, and executive director, Wendy Comes, were also present.

- ### Approval of Minutes

The minutes were distributed with revisions marked. No further changes were requested and the minutes are approved.

- ### Other Administrative Matters

Ms. Comes distributed a revised draft of the exposure draft regarding consolidated financial reporting and a cover memo identifying the changes. The draft is schedule for discussion on October 6th and the objective is to finalize the exposure draft.

The CBO representative will be Donald Marron, incoming deputy director, effective in mid-October.

Agenda Topics

- ### Objectives

Staff team members Melissa Loughan and Ross Simms presented the Objectives agenda item and the team discussed their progress.

<u>Status of Roundtable Meetings on the Objectives of Financial Reporting</u>

Staff members have completed two of the four roundtable meetings on the objectives of federal financial reporting. Staff completed the first meeting on the Budgetary Integrity objective on September 19, 2005, and completed the second meeting, regarding the Operating Performance objective, on September 28, 2005. Transcripts of the meetings will be prepared and staff will analyze the meeting results and prepare a summary. The transcripts and staff summary will be made available for Board member review. Also, the staff analysis will be included in the white paper upon completion of all the roundtable meetings. Overall, participants at both roundtable meetings acknowledged that the financial reporting objectives were broad and they offered ideas for better achieving them.

<u>Meeting Materials for the Remaining Roundtable Meetings</u>

The schedule for the remaining roundtable meetings are as follows:

Stewardship	-	November 29, 2005
Systems and Control	-	December 6, 2005

Board members reviewed the staff proposed meeting materials and provided input. Regarding the materials for the Stewardship objective, it was noted that there should be some discussion on whether the board should be involved in financial analysis issues, such as whether the nation's future well-being is being properly managed, or should FASAB focus on financial reporting. Also, if FASAB should be involved in financial analysis, who should decide what should be analyzed?

Regarding the Systems and Control materials, the materials should prompt discussion on whether the new OMB Circular A-123 goes far enough when considering the Sarbanes-Oxley requirements for public companies. There was interest in knowing the financial reporting community's perspective on this matter.

> **Conclusion:** Staff will proceed with conducting the remaining roundtable meetings and incorporate the board's recommended changes into the meeting materials.

- ### Elements

Ms. Wardlow explained that her transmittal memo listed issues and the Board would discuss each.

Question 1: Does the Board agree with the "Entity Concept" presented in paragraphs 10 through 15 and its application in the remainder of the draft?

After discussion regarding the need to adopt a definition references the federal government (rather than individual component entities), members discussed whether the asset and liability definitions should be parallel (for example, by including "federal government" in the liability definition) and whether additional guidance was needed on assigning assets and liabilities to component entities. Members agreed that the approach Ms. Wardlow used was preferable to crafting definitions for component entity assets and liabilities, that the definitions should be parallel, that some improvement to the explanatory material regarding assignment to component entities was needed, and that the usefulness or role of "non-entity" assets in meeting the mission of component entities should be explained.

Question 2: Does the Board agree with (a) the separate references to uncertainty in the sections on Recognition Criteria and Definitions of Assets and Liabilities (pars. 17 and 40) and (b) retention of a shorter version of the separate section "Effects of Uncertainty" at the end of the draft?

Members discussed the nature of uncertainty – that there is uncertainty regarding existence as well as uncertainty regarding measurement. Some members – Messrs. Patton, Dacey and Zavada preferred that a probability be made explicit through changes to either the recognition criteria (for example, by adding a third criterion linked to "more likely than not") or in the discussion of measurability (for example, by adding a threshold probability before an item is considered for measurement). A poll of members was taken and Messrs. Schumacher, Farrell, Reid, and Mosso and Ms. Cohen preferred the current draft. Some indicated that the concerns being raised were more appropriately addressed in standards. CBO did not express a preference on the issue.

Ms. Wardlow will proceed with the draft as written.

Question 3: Are the references to grants, subsidies, and financial assistance appropriate and sufficient? (Pars. 36, 42, and 43) If not, what does the Board wish to add and where should it be added?

Members tentatively approved the new wording in the referenced paragraphs.

Question 4: Does the Board agree with the content and location of the material on Congress's ability to change the law? (par. 45)

The CBO representative noted that CBO would prefer to see a discussion of Congress' ability to change the law in the section addressing the existence of a present obligation.. CBO believes the Board should explain the difference between "expressions of intent" and "laws" which some may view as a Congressional expression of intent. The discussion was not conclusive and Ms. Wardlow will consider potential revisions.

Question 5: Does the Board agree with the definition and discussion of net position? (pars. 51 through 53)

The Board concluded that the text in par. 53 regarding the general practice of identifying components of net position should not include examples.

The Board decided to drop par. 52 regarding potential differences between net position and stockholder's equity. During the discussion, some members preferred to address the usefulness of net positions as an indicator of sustainability and others believed it was not necessary in an accounting document. The majority preferred to drop the paragraph.

In par. 51, the Board decided to replace surplus and deficit with positive and negative.

Question 6: Does the Board agree that the Board should discuss issues raised by the content of SFFAS 7 before considering definitions of revenues and expenses in the concepts statement on Elements?

Members discussed the potential need to amend SFFAS 7. One member expressed the desire to replace any “revenue” definition in SFFAS 7 with the new definition as soon as the concepts are finalized. Ms. Comes explained that she was not sure whether there would be a practice implication and that she did not envision making existing standards consistent with concepts immediately upon the issuance of a concepts statement. This is consistent with the preamble to the concept statement that provides that concepts and standards may be inconsistent and these inconsistencies would be resolved in due course. No other members expressed concern with that plan but expressed a desire to receive information regarding the language in SFFAS 7.

The members discussed the notion of distinguishing gains and losses from revenues and expenses. Some opined that it was impossible while others expressed interest in developing concepts that make the distinction. Ms. Wardlow will provide a staff paper on the issue.

Question 7: Does the Board agree with the revised discussion of “Statements of Financial Accounting Concepts” on page 1 of the draft?

The members approved the draft discussions with no changes.

Question 8: Are there other changes that the Board wishes to make to the current draft?

The last sentence of par. 43 provided an example of an unconditional non-exchange agreement to provide financial support creating a present obligation. Members were concerned that this may be too close to standard setting. They preferred not to draw conclusions on the existence of obligations in non-exchange transactions. Other members believed the inclusion of a non-exchange transaction was important conceptually. The Board agreed that Ms. Wardlow should attempt to present a generic example (neither exchange nor non-exchange) and address the meeting of conditions as establishing a present obligation. This would leave to future Board deliberations any decisions regarding whether meeting all or some conditions establishes an obligation.

The Board discussed the notion of stand-ready obligations but did not resolve the issues. Staff will provide a copy of the recent Financial Accounting Standards Board's invitation to comment on the topic and address the issue in later papers.

> **Conclusion:** Ms. Wardlow will revise the draft, develop a paper on revenues, expenses, gains and losses, and address stand-ready obligations.

• Social Insurance

At the August meeting the Board agreed with staff recommendations for issues 1-6 and 10 identified in the August staff memorandum. The objective of the October 2005 session on social insurance was to discuss the alternatives for issues number 7 and 8, i.e., display, disclosure, and required supplemental information (RSI).

Regarding issue #7 on display, the staff recommended:

Balance Sheet

A single liability line item and a reference to a revised statement of social insurance (SOSI). No changes in the "net position" section.

Statement of Net Cost (SNC)

Line items for service cost and interest on the obligation displayed as separate components of "operating cost;" and actuarial gains or losses and prior service costs, if any, be presented as a separate component after operating cost, but as part of the total cost on the SNC.

Statement of Changes in Net Position (SCNP)

No changes.

Statement of Social Insurance

Revising the SOSI to display an amount reported as the liability amount on the balance sheet and other new subtotals.

Board agreed with the staff recommendations. The breakout on the SNC should distinguish changes in actuarial assumptions from all other costs. A breakout of service cost and interest on the obligation is necessary.

Regarding issue #8 on disclosure and required supplemental information (RSI), the staff recommended the following note disclosure:

- Actuarial present value of benefits accrued by participants with less than 40 quarters of work in covered employment.
- An open group projection showing the excess of future benefit payments over resources over 75 years, i.e., the funding shortfall.
- Components of the change in the liability account, and
- Assumptions (for all line items and SOSI).

Board agreed with the staff recommendations.

For RSI the staff recommended retaining the current SFFAS 17 RSI except for the sensitivity example. Staff recommended replacing the current sensitivity analysis with a stochastic model to be designed with the assistance of SSA and/or other experts. The members also discussed other types of sensitivity analysis for consideration and requested additional examples.

Regarding issue 9 on what should be done with RR Retirement, Unemployment Insurance, and Black Lung Benefits, the staff recommended that for the initial draft of the exposure document the accounting for Railroad Retirement benefits be analogous to Social Security and Medicare; and for Unemployment Insurance and Black Lung Benefits, the SFFAS 17 requirements will be continued. The members did not object to the staff recommendation.

The staff also presented three questions arising from the August 18 meeting. The first question asked whether the only "obligating event" for social insurance is meeting the 40 quarters condition; or, whether increments in the liability for work after 40 quarters should be described as obligating events. The staff recommended one obligating event: 40 quarters. The cost increments after 40 quarters would be characterized as a function of the required measurement procedures. Cost is the present value of the benefit that the participant will receive based initially on 40 quarters of work in covered employment and incremented thereafter by each additional quarter-month-day of work in covered employment attributable to the reporting period. The liability is the accumulated cost. The Board did not object to the staff recommendation.

The second question dealt with Medicare Hospital Insurance (HI) cost recognition. Since the Medicare HI participant has met the conditions to receive benefits at 40 quarters, should the present value of the full obligation be recognized at that point or attributed to years of service over his or her working life? Staff recommended recognizing the present value of the entire obligation at 40 quarters. The goal is for the service cost component of expense to be the actuarial present value of benefits attributed by Social Security's benefit formula to (1) 40 quarters of work in covered employment and (2) subsequent quarters (or months or days) of work, in the periods that these are attained. For Medicare, no additional expense is attributed to subsequent quarters of work. The Board did not object to the staff recommendation.

The third question involved the application of insurance accounting to Medicare Supplementary Medical Insurance (SMI). Specifically, should SMI be considered a short- or a long-duration insurance contract? The answer will affect the measurement of the cost and liability. Staff recommended that SMI be treated as short-duration insurance. This recommendation is and for some time will remain tentative. Social insurance issues and insurance accounting are complex subjects. The accounting concepts in this project are expected to develop and be refined as the project continues. The Board did not object to the staff recommendation.

The chairman asked the members to convey additional comments, if any, to staff individually.

> **Conclusion:** Staff will provide a draft ED for the January 2006 meeting based on the above conclusions and additional input from members.

- **Steering Committee Meeting**

The committee met in closed session to consider vacancies on the Board.

Adjournment

The meeting adjourned at 4:00 PM.

Thursday, October 6, 2005

Agenda Topics

- **Invitation to Comment on the Technical Agenda**

Update on IASB Lease Project

Staff member Monica Valentine started the discussion by giving an update on the International standard setters' progress on their lease project. Ms. Valentine informed the Board that the leases project is not considered an active project on the International Accounting Standard Board's (IASB) agenda but as an active research topic. The lease project is currently being lead by the United Kingdom's Accounting Standards Board (UK-ASB). The UK-ASB staff had just briefed the National Standard Setters (NSS) group on the current status of the lease project in late September 2005, the UK-ASB staff paper was provided to the Board. The UK-ASB staff member also provided a timeline in the staff paper that would be presented to the IASB and the UK-ASB sometime in October 2005. The timeline proposed a final research document to be released in June 2006.

> **Conclusion**: Based on the update provided, Chairman Mosso proposed that FASAB continue to follow the progress of the international standard setters and postpone adding the leases project to the FASAB agenda until more progress is seen with the IASB/UK-ASB project. The other Board members agreed with Chairman Mosso to postpone the lease project.

Technical Agenda Decisions

The Board considered comments to the technical agenda invitation to comment. Consistent with respondents' views, the Board decided that the top two priorities would be accelerating the conceptual framework and addressing issues relating to the federal entity. Ms. Comes explained that the conceptual framework is currently staffed by two project managers and one contractor. This represents an increase of one staff member over the original plan. This increase resulted from the cancellation of an ongoing project – stewardship investments – during the early summer.

Members expressed a desire to see progress on the issue of the appropriate source for GAAP as well. Ms. Comes proposed that this be addressed through staff level guidance such as a technical bulletin or staff implementation guidance.

> **Conclusion:** Ms. Comes will provide project plans for review at the January meeting. Staff will begin work on the appropriate source for GAAP as soon as possible.

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

Staff opened the discussion by briefly summarizing the following three potential options for establishing liability classes:

1. Option 1 – Apply New Liability Definition to Current SFFAS 5 Liability Classes
2. Option 2 – Apply New Liability Definition to Liability Classes by Transaction Type
3. Option 3 – Apply New Liability Definition to Liability Classes by Relationship Type

Staff stated that after considering the advantages and disadvantages to selecting each option and the degree of flexibility, effectiveness, and feasibility that might potentially result from choosing each of the options, the staff recommendation is that the Board members select option 2.

After a brief discussion, Mr. Mosso took a poll of the Board members regarding their preferences for the three options. The following chart indicates the preferences of the Board members:

Member	Option 1	Option 2	Option 3	Additional Comments
Cohen	X		X	Option 1 or 3; something broader than 2.
Dacey	X			Would like a broader, conceptual discussion of commonality between the transaction types. He would prioritize categories 2 and 4 (nonexchange transactions and government-acknowledged events) within option 1.
Farrell	X	X		See where the detailed listing by transaction type in option 2 fits into the broader categories of option 1.
Patton	X			Thinks that option 2 is too detailed a cut; every possible transaction should be put into one bucket and every single type of transaction should be placed into a category with no overlap.
Reid	X	X		Start with what is in the standard (option 1) and see how the detailed listing by transaction type in option 2 flows into it.
Schumacher	X			Option 1 is more palatable but we have to consider the hybrid exchange/nonexchange transactions. We may have to consider expanding the nonexchange category; for example, there could be six classes rather than four.
Torregrossa	X			Option 1 is acceptable but explain how it is consistent with the liability definition.
Zavada	X			Do not want to get into a detailed program by program discussion.

The Board members overwhelmingly selected option 1 as their preference; however, several of the Board members that selected option 1 noted that even though they were selecting option 1, they recognized that option 1 would still require some revision or enhancements to what is contained in SFFAS 5. Staff suggested providing members with a revised list of liability classes based on option 1 with the different transaction types in option 2 incorporated. The Board was in agreement with staff's suggestion.

> **Conclusion:** Staff will provide members with a revised list of liability classes based on option 1 with the different transaction types in option 2 incorporated.

- ## Fiduciary Activities

The comment period for the exposure draft (ED), *Accounting for Fiduciary Activities,* closed on August 30, 2005. Fourteen written responses and two oral statements raised numerous major issues with the proposed standard. The following issues are those that involve possible changes to the reporting requirements proposed in the ED. Technical changes (to improve the clarity of the ED and/or to correct typographical errors) will be included in a marked-up draft in the Board's briefing materials for the January 2006 Board meeting.

1. *Reporting requirements for fiduciary activities that issue separately audited financial statements*

The Board discussed whether the reporting requirements for the Federal component entity should be different for fiduciary activities for which separate audited financial statements are issued. Currently, this would apply to the Thrift Savings Fund and the two (tribal and individual) Indian Trust Funds.

Conclusions:

- The Board agreed with staff recommendation that the Federal component entity's note disclosure should disclose the audit opinion on the separate financial statements, and that staff should draft more precise guidance to clarify that the audit opinion to be disclosed is the opinion regarding the fair presentation of the financial statements, and also provide specific instructions for cases where the audit opinion being disclosed is anything other than unqualified.
- The Board agreed with staff recommendation that the Federal component entity's note disclosure should include information about how the reader can obtain a copy of the separately audited financial statements.
- The Board decided that if the separate financial statements for the fiduciary activity have a fiscal year-end other than September 30th, the fiduciary note disclosure could display information from the most recent audited financial statements.

2. *Seized monetary instruments*

The Department of Justice (DOJ) noted that "seizure for forfeiture" might not meet the intended definition of fiduciary activities because the Federal government has certain rights to the assets, including interest income on seized monetary instruments. However, a separate response from the DOJ Office of Inspector General (OIG) indicated agreement with the ED that seized assets are fiduciary in nature.

Conclusion:

- The Board decided that staff should contact the DOJ and the DOJ OIG to clarify the nature of the government's ownership interest in seized assets.
- The Board decided that if the discussions with DOJ indicate that ownership interest is split between the Federal government and the non-Federal party, then staff should draft clarifying language to indicate that seized assets do not meet the definition of fiduciary activity. Staff would also make conforming corrections to other parts of the ED, such as deleting references to seized assets in the illustrative disclosures and in the amendments to existing standards.

3. *Basis of Accounting*

The Board discussed the fact that the financial statements for the Indian trust funds are prepared on a cash or modified-cash basis, and not on an accrual basis. Staff recommended that there should be no exemption from generally accepted accounting principles, which include the accrual basis of accounting. A 5-to-4 majority of the Board voted to retain the requirement for generally accepted accounting principles. However, one member in the majority indicated that he needs information about cost/benefit and might change his vote.

Staff noted that if the Board decided to propose exempting fiduciary activities from generally accepted accounting principles, that the ED would likely require re-exposure.

Conclusion:

- Staff will request a cost estimate from Interior to develop accrual accounting for the Indian Trust Funds.

4. *Fiduciary Activities Involving Several Agencies*

Staff recommended that whenever (a) several Federal component entities are involved in administering a fiduciary activity, and (b) each Federal component entity is reporting only the part for which it is responsible, that each component entity should identify the other component entities that are involved in administering the fiduciary activity.

Staff also noted that the DOJ requested an exemption for instances that are managed in a "central fund," such as the one maintained by DOJ, but staff and the Board concluded that since seized assets are not fiduciary in nature, this issue would no longer apply.

Conclusion:

- Staff will add a requirement that when a single fiduciary activity is managed by several component entities, reporting only each component entity's part of the activity, that each component entity should identify the other component entities.

5. Proposed Effective Date

The proposed effective date in the ED was periods after October 1, 2006. Staff noted that several respondents recommended a later effective date.

Conclusion:

- The Board decided that the effective date should be for periods after September 30, 2008.

• Implementing SFFAC 4 for the CFR

Members approved the revised exposure draft by voice vote. The vote will be confirmed via e-mail following the meeting.

• Natural Resources

Board members discussed the staff proposed formula for valuing the estimated value of the Federal government's royalty share for proved oil and gas reserves on lands under the control of the Federal government, referred to as "estimated petroleum royalties." The value of estimated petroleum royalties would be calculated by multiplying the estimated aggregated quantity of proved oil and gas reserves by the national average well head price for natural gas, or the national average first purchase price for oil, times the national average royalty rate.

Mr. Terregosa commented that it seems a lot of information that's available is not being used. He said a regional average price and regional average royalty rate certainly were available and would give better information. He added he thought it's too early just to move to the national averages. Mr. Terregosa explained that Congress may want to securitize some of the royalty revenues, that is, to sell a stream of future royalty revenue. He said he'd like to see the standards have some requirement to account for royalty streams that were sold below value; and, to have some idea of whether the nation was better off or worse off with the transaction. He added that he thought the national averages weren't going to allow that. As a result of using the national averages he and other Congressional Office (CBO) representatives feel that not all the available information is being used.

Ms. Comes suggested that the standards could have a more precise requirement when something was identified as being for sale. She added that the standards could require a precise valuation for the piece that was intended to be sold or had been sold so that the gain or loss is more accurately captured. Ms. Comes explained that staff would analyze the factors that would go into valuing a royalty stream identified for sale and come back with a proposal for revaluing at the time leases are classified for sale or upon sale.

Board members agreed with the staff proposed formula for valuing the Federal government's estimated petroleum royalties. In addition, the Board members agreed with Ms. Comes' suggestion of adding a requirement in the standards to address a royalty stream identified for sale.

> **Conclusion:** Staff will develop a draft Exposure Draft (ED) for the January 2006 meeting. Staff will analyze the factors that would go into valuing a royalty stream identified for sale and come back with a proposal for revaluing at the time it's classified for sale or the time it's sold. The proposal for revaluing a royalty stream identified for sale will be incorporated in the oil and gas resources accounting standards.

- ## Steering Committee Meeting

The Steering Committee reviewed additional changes proposed for the AICPA transition team letter. The members agreed to provide any further changes to Ms. Comes following the meeting.

Adjournment

The meeting adjourned at 3:00 PM.