

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
March 29-30, 2006
Room 5N30
441 G Street NW
Washington, DC 20548

Wednesday, March 29, 2006..... 1

Administrative Matters 1

- Attendance 1
- Approval of Minutes 2
- Other Administrative Matters 2

Agenda Topics 2

- Objectives..... 2
- Elements..... 6
- Application of the Liability Definition 7
- Social Insurance..... 8
- AAPC Operating Procedures and Charter 18
- Steering Committee Meeting..... 18

Adjournment 18

Thursday, March 30, 2006..... 18

Agenda Topics 18

- Department of Defense Update on PP&E Implementation 18
- Fiduciary Activities..... 19
- Implementing SFFAC 4 for the Financial Report of the U.S. Government 21
- Natural Resources 22

Adjournment 23

Wednesday, March 29, 2006

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Mosso, Messrs. Allen, Dacey, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen. The executive director, Wendy Comes, and general counsel, Jeff Jacobson, were also present.

Final Minutes on March 29-30, 2006

Mr. Marron, representing CBO, attended the meeting the afternoon of March 29th. Mr. Torregrosa represented CBO the morning of March 29th and the entire meeting on March 30th.

- **Approval of Minutes**

Minutes of the prior meeting were approved.

- **Other Administrative Matters**

Ms. Comes related the information regarding fiduciary activities provided at a meeting she attended with Mr. Mosso and Department of Interior representatives. A summary of that information is presented with the minutes of the fiduciary activities discussion.

The Board briefly discussed some of the articles in the March FASAB Clippings.

Agenda Topics

- **Objectives**

Staff presented the update on the Objectives project. Since the January 2006 Board meeting, staff has completed the remaining two summaries of the roundtable meetings regarding the objectives of federal financial reporting. Those summaries for the Stewardship and Systems and Control roundtable meetings were included in the Board materials, along with the summaries from the Budgetary Integrity and Operating Performance meetings. The Board discussed the Budgetary Integrity and Operating Performance summaries at the January 2006 meeting.

Staff noted that the roundtable meetings presented various issues. However, to develop meaningful recommendations to address some of the issues, staff would need the Board's decision on how to proceed with the objectives project. In each of the roundtable meetings, participants agreed that the federal financial reporting objectives were broad, but remain valid. Also, the participants did not feel that FASAB should limit itself by eliminating any of the objectives, and there were no suggestions that additional financial reporting objectives are needed. Thus, an important question that needed to be addressed was whether the Board believes that the federal financial reporting objectives should remain broad.

Should the Board decide to retain the current objectives, another matter that needed to be addressed was how to articulate FASAB's role in relation to such financial reporting objectives. Staff believed that Statement of Federal Financial Accounting Concepts (SFFAC) No. 1 continues to be a valuable statement of federal financial reporting objectives and is appropriate in the context of federal reporting requirements—Performance and Accountability Reports—now required of federal entities. However, staff believed there have been several issues identified in the white paper, roundtable

Final Minutes on March 29-30, 2006

discussions, and Board discussions that do need to be preserved in a formal Board document, such as an amendment to SFFAC 1. Staff recommended amending SFFAC 1 and developing and publishing “strategic objectives” or a “strategic plan” for FASAB that would be publicly available and updated periodically.

Staff noted that through discussions on the white paper, the board believed that SFFAC 1 needed to be amended. Amending SFFAC 1 would address areas such as evolutionary changes that have occurred in the environment and explicit language regarding FASAB’s evolution and comparative advantages as a GAAP standard-setter, including discussion on topics such as accrual based accounting, Board independence, and audit. Staff did believe that the broad objectives in SFFAC 1 may result in a lack of focus for FASAB and there would be benefit to articulating FASAB’s objectives or role in relation to the overall broad objectives. This could be accomplished in a strategic plan. The strategic plan affords flexibility because it would not limit future boards from pursuing additional objectives. The staff Discussion Paper provided additional information on the staff’s proposal and other alternatives for the Board’s consideration.

Does the Board believe that the federal financial reporting objectives should remain broad?

Board members discussed whether federal financial reporting objectives should remain broad and members noted concerns regarding one particular objective - Systems and Control. It was noted that the Systems and Control objective may not be a particularly useful objective for FASAB. There are groups whose main focus is systems and controls and FASAB seems to only have an indirect role in achieving the objective. Also, some believed that the Systems and Control objective does not stand alone. Instead, the objective could be a part of the other objectives.

Staff noted that the roundtable participants believed that all the objectives pertained to federal financial reporting overall, not simply the objectives for FASAB to achieve. Although FASAB seems to have an indirect role in systems and control, the roundtable participants did not seem to have concerns with the broad nature of the objectives. A Board member noted that FASAB does appear to have a comparative advantage in stating the objectives of federal financial reporting. The original Board did a lot of good thinking when developing the objectives and forums such as the roundtables are good ways to determine whether the objectives are still valid after gaining experience. In addition, it was noted that FASAB has had a direct role in achieving the systems and control objective. SFFAC 3 requires a discussion of internal control in the Management’s Discussion and Analysis (MD&A).

Some Board members noted that systems and control has always been a requirement in the federal government and they discussed that the objective does not necessarily state that FASAB needs to set standards related to internal control, but it is to assist report users in understanding whether the systems and control are adequate. Reporting on the adequacy of internal control enhances the credibility of the reports. Also, there is a history of requirements to inform readers on internal control, such as

Final Minutes on March 29-30, 2006

FMFIA and government auditing standards that require auditors to report on internal control.

Staff asked Board members to consider what type of message it would send if the systems and control objective was eliminated, especially in light of the current emphasis on strong internal control and given that constituents view it as a broad federal financial reporting objective. It was reiterated that the Systems and Control objective focuses on providing information on internal control and assisting report users in understanding whether internal controls are adequate, rather than focusing on standards for improving internal control. Board members agreed that the Systems and Control objective is an important overall objective for federal financial reporting; however, FASAB may not need to have a direct role in its achievement.

After discussing concerns regarding the Systems and Control objective, the Board agreed to retain the current broad objectives of federal financial reporting.

Articulating FASAB's Role in Relation to the Objectives of Federal Financial Reporting

Given that the Board decided to retain the broad objectives of federal financial reporting, the Board next deliberated how to best articulate FASAB's role in relation to such objectives. Staff recommended amending SFFAC 1 and developing a strategic plan as independent tasks to assist in addressing FASAB's role. Staff believed that SFFAC 1 should be amended regardless of whether the Board decides to develop a strategic plan. Before FASAB states what their sub-objectives are or which ones they are going to address, staff thought it would be appropriate to first clearly state the broad financial reporting objectives. However, Board members expressed concerns with competing priorities and how to best utilize resources.

Board members expressed reservations about proceeding to amend SFFAC 1. The staff proposed approach was to focus on amending certain areas of SFFAC 1 rather than amending the entire document. However, Board members were concerned about whether the approach would become an open-ended project without first having a strategic plan to help guide them. Some believed that once the document (SFFAC 1) is opened for review, the discussion could evolve into reviewing many areas, not just those originally intended. Regarding whether strategic planning and amending SFAC 1 could be conducted simultaneously, Ms. Comes noted that the board had previously agreed to accelerate the conceptual framework project. Simultaneously amending SFFAC 1 and developing a strategic plan would hinder this effort. Both staff members would be needed to engage in strategic planning and amending SFFAC 1. To accelerate the conceptual framework, one of the staff members would need to work on the objectives project while the other would begin working on another conceptual framework area – the federal entity.

Final Minutes on March 29-30, 2006

Also, it was noted that the proposed areas of revision (to SFFAC 1) do not require urgent attention, and neither strategic planning nor amending SFFAC 1 seem to rise to the level of importance as some of the Board's existing projects. Staff noted that roundtable participants also believed that FASAB should focus its attention on the current technical issues.

Regarding the strategic plan, Board members noted that a strategic plan would state the priorities of the Board over the short to medium term, but does not necessarily need to address all the objectives. The plan could focus on where FASAB has a comparative advantage and it could narrow the board's focus. Also, a strategic plan could provide flexibility in areas that the board would like to address in the future and a strategic plan would be good to prepare whether or not the board decided to amend SFFAC 1.

Conversely, strategic planning may require significant resources, including Board and staff time. Given this concern, some Board members believed that it would be best to define the scope of the strategic planning project. Information from other standards-setter's strategic plans may be helpful for this initiative. Other standard-setter's plans could be reviewed to identify commonalities and a summary of the features in strategic plans prepared. The Board could use the information to decide whether a full strategic plan that involves more than standard-setting issues would be the best approach to use at this time.

A Board member noted that one of the reasons for starting the objectives project was that the Board was concerned that they may not be meeting all the financial reporting objectives such as the Systems and Control objective. Concepts items that staff recommended (in the staff Discussion Paper) could be included in the white paper and then the Board could understand their objectives and new board members could read the white paper and understand how the board sorted out their role. Also, this would permit the board to move forward on more pressing issues and the Board would not be concerned with objectives like Systems and Control because that is being accomplished by others. Ms. Comes confirmed that this was the original purpose of the white paper and reiterated that once SFFAC 1 is subject to review, every word is "on the table."

One concern with the white paper was whether the document will be considered authoritative. It was noted that the white paper may not have authoritative status while a concepts statement involves full due process and may have more influence than the white paper. However, Board members noted that the FASAB could simply adopt the white paper. Staff could develop the white paper further, including some draft of FASAB's objectives within the broad objectives of financial reporting, and then the Board could decide whether to let the white paper stand or amend SFFAC 1.

Information from the Roundtables

In each of the roundtable meetings, the participants provided ideas for better achieving the objectives. One notable area of concern was the need to improve MD&As. In each of the roundtables, participants suggested that agency MD&As should be improved and they looked to FASAB to provide leadership in that area. Ms. Comes noted that there

appeared to be a lack of awareness regarding the work that FASAB has already done with respect to the MD&A. Board members agreed that information from the roundtables were beneficial and the ideas on how to better achieve the objectives would be helpful to use in future agenda-setting.

CONCLUSIONS: The Board agreed to retain the broad objectives of federal financial reporting. However, the different options for articulating FASAB's role in relation to those objectives required further Board assessment. Staff will continue to develop the white paper on federal financial reporting objectives and prepare an analysis of strategic plans from other standards-setters to assist the Board in its evaluation.

- **Elements**

Ms. Wardlow provided clean and marked-up copies of a preballot draft of a proposed concepts statement, together with a transmittal memo that listed the changes made since the January 2006 draft. New items in the clean copy included an executive summary, questions for respondents, and a glossary. The Board also received a memorandum from Mr. Patton and a staff response. Mr. Patton's memorandum advocated revision of the draft to explicitly incorporate additional aspects of "element existence uncertainty" in the recognition of elements, such as a probability threshold.

Mr. Mosso invited Mr. Patton to explain his concerns about the treatment of probability in the document. Mr. Patton said that Mr. Dacey had similar concerns and invited him to express his views. Mr. Dacey said that one of his concerns was whether the document clearly acknowledges that uncertainty is considered at the definition stage as well as at the measurement stage. The current draft alludes to uncertainty at the definition stage, but he is unsure whether the draft is clear enough on that issue. He asked whether the Board agreed that there is uncertainty at the definition stage and whether all members have the same interpretation of the language and are satisfied with the treatment of the issue. In response to Mr. Mosso's question, Mr. Dacey referred members to paragraph 7 and the last section of the document, which acknowledge that there is uncertainty at the definition stage.

The Board discussed Mr. Dacey's question and Mr. Patton's proposal, as well as how and where the issues of probability and uncertainty are discussed in the preballot draft. Messrs. Dacey, Patton, and Zavada said they would like to see changes or clarifications in paragraph 7 to reflect their respective views. After some discussion, and with the exception of Messrs. Patton and Zavada, the Board decided not to add probability thresholds to the draft or otherwise change the substance of paragraph 7. However, the Board made some editorial changes to paragraph 7, as summarized below.

The Board accepted the changes made to the January draft and made the following additional changes in the paragraphs indicated.

- In paragraph 7, delete the third sentence ("However, a formal probability assessment is not required."). In the phrase "a more formal probability assessment of

Final Minutes on March 29-30, 2006

inflows or outflows of resources” in the last sentence, change the word “formal” to “rigorous.” The Board asked the staff to make any necessary conforming changes elsewhere in the draft.

- In paragraph 60, delete the second half of the first sentence (“and formal assessments are not required when comparing items with the definitions”) and the first word (“Rather”) of the second sentence.
- In paragraph 43, delete the explanatory phrase in the first sentence (“namely the government and an entity that is external to the government.”).
- In paragraphs 1 and 3 and in the title of the document, change the phrase “elements of financial statements” to “elements of accrual-basis financial statements.”

Mr. Dacey said that imputed costs and revenues do not meet the proposed definitions of expenses and revenues. He did not propose changing the definitions, but asked the staff to find a way to refer to imputed costs and revenues in the document.

Mr. Dacey reported on his conversation with Mr. Attmore, chairman of the GASB, concerning identification of differences between the concepts statements on Elements being developed by each Board. Mr. Dacey suggested any differences should be brought to the FASAB’s attention. Ms. Comes said she had provided a list of the first principles in the FASAB’s draft to the GASB staff, who had agreed to send her a list of the first principles in the GASB’s draft. She expected to include a comparative analysis of the two Boards’ documents in the next distribution of materials.

Mr. Mosso asked the members whether the draft concepts statement is ready to expose for comment. All members agreed.

Ms. Comes indicated that the staff would prepare a ballot draft for circulation to Board members before the May meeting. She requested that members who wish to provide an alternative view should do so by April 14. Mr. Allen suggested that members consider proposing additional questions for recipients, rather than preparing an alternative view. Mr. Mosso asked members to provide any additional questions to Ms. Comes.

CONCLUSIONS: A ballot draft will be provided to the Board before the May meeting. The draft will incorporate the changes made at the March meeting and will include any alternative views or additional questions for recipients that members provide.

The Board adjourned for lunch at 12:00 PM.

- **Application of the Liability Definition**

Staff presented the board members with a copy of the packet that was sent to individuals in the federal financial management community, inviting them to participate in a task force on liability classification. The task force was approved by the Board as part of the revised project plan presented at the January 2006 board meeting. The task force invitation packet was sent to members of the Federal Financial Management

Final Minutes on March 29-30, 2006

Council and Financial Statement Audit Network, as well as several independent public accounting firms (IPA). Staff noted that it had received a fairly good response with representation from at least ten different agencies and IPAs, but hoped to receive more before the first meeting on Wednesday, April 12, 2006.

CONCLUSIONS: Staff will provide the board members with a summary of the first meeting of the task force at the May board meeting.

- **Social Insurance**

The staff objective for the social insurance session was to continue to discuss the remaining questions (nos. 19-24) as well as the draft exposure draft (ED) in general. Three of the remaining questions (19-21) dealt with Medicare as follows:

Question #19 – Does the Board agree that Medicare HI should be recognized at 40 quarters of work in covered employment (40 QC); or, should Medicare HI costs be spread evenly over the participant's working years in covered employment?

Question #20 – Does the Board agree that the accounting treatment for Medicare HI and Medicare SMI should be the same?

Question #21 – Does the Board agree that Medicare SMI should follow accounting standards for short-duration or long-duration insurance contracts?

With respect to question #19, the staff noted that the Board had decided at a previous meeting that an obligating event for Medicare HI occurs at 40 QC, but a question remained about cost recognition. For Medicare Hospital Insurance (Medicare HI or Part A) the benefit does not grow after 40 QC other than from interest on the present value obligation. A member had advocated allocating the Medicare HI cost over participants' working years instead of, as the ED proposed, recognizing the full present value of future benefits at 40 QC.

Mr. Reid said he favored spreading the cost over working lives because it is a better matching of cost and revenue and would be a fairer presentation. He noted that the government collects payroll tax for Medicare HI over the period of work in covered employment, and he said cost should be recognized over that period as well. He equated Medicare HI and Social Security and said the benefit should increase under both programs as work is completed in covered employment.

Mr. Allen said allocating the retirement benefit costs over working lives was acceptable to him. He said that although benefits are not earned equally each year, the cost could still be allocated to years of service. He said there is an element of Medicare cost that is incurred each year as the participant works. He said he supported the Board decision not to start the accrual until 40 QC.

Final Minutes on March 29-30, 2006

Mr. Patton said that the ED proposes characterizing social insurance programs as social benefit programs where benefits are not earned but rather conditions are met at 40 QC that constitute a liability. He said the liability is measured differently for Social Security than for Medicare HI because the benefits accumulate in the former program but not in the latter.

Mr. Zavada said he does not view social insurance benefits as accruing over time. He asked why age 65 was not considered as an option.

Mr. Patton noted that the Board's rationale for the 40 QC obligating event includes the notion that "staying alive" is not an obligating event.

Mr. Marron said he thought that 65 years of age is an interesting alternative obligating event for accruing these liabilities. He said that, from the economist's perspective, he viewed the first 40 quarters as the interesting ones for Medicare because that is the period over which the participants are essentially earning the benefit; and, if there were an accrual to be done, it would be to spread cost over the first 40 QC. He noted that the participant is fully vested at 40 QC, after which they are merely being taxed and are not getting anything in return. Conditional on the Board's decision that the first 39 quarters in the Social Security context do not get any charge against them, he said recognition at 40 QC seemed logical.

Chairman Mosso polled the members on the issue of recognizing the full present value of the future cost of Medicare HI at 40 QC versus spreading it over working lives. Messrs. Patton, Schumacher, Marron, Farrell, Allen and Mosso and Ms. Cohen voted in favor of recognizing the full present value of the future cost of Medicare HI at 40 QC. Mr. Reid voted in favor of spreading the cost over working lives. [The tapes did not register a vote from Messrs. Dacey and Zavada.]

The Board next discussed questions 20-21.

Mr. Allen noted with respect to risk transfer that the amount of risk being transferred to Medicare participants is 25 percent. He said that, to be consistent with the concepts being applied in the proposed standard, 75 percent of the cost of Parts B and D and should be treated the same as Part A because that is fully earned at 40 QC; and 25 percent of the cost should be treated as an insurance contract. He said the points for and against 40 QC and insurance recognition seemed equally balanced and therefore the 25-75 percent split might be something to consider.

Mr. Reid said he preferred the insurance model because amounts recognized when claims are incurred would be much less uncertain than those at 40 QC. He agreed that that rationale applied to all Parts of Medicare.

Chairman Mosso said he would like to get away from any insurance analogy. He said that at 40 QC the government has obligated itself to the four options, A, B, C, and D, and those options should be accounted for the same way using the present value of the net outgo. He cited the simplicity of this approach. The 25 percent required from Medicare participants would be a measurement issue.

Final Minutes on March 29-30, 2006

Chairman Mosso polled the members on the question of whether the Board agreed that the accounting treatment for Medicare HI and Medicare SMI should be the same, i.e., everything at 40 QC. Messrs. Patton, Schumacher, Marron, Farrell, Allen, and Mosso voted in favor of everything at 40 QC. Mr. Marron noted he saw no bright line between Parts A, B, and D. He added the caveat that 65 years of age should be considered as a liability date.

Mr. Dacey said he did not think an obligation accrues until people actually sign-up and pay their premiums. He added that he did not think the obligation goes beyond “due and payable.”

Mr. Zavada favored “due and payable.”

Mr. Reid said he had three objections. First, he favored measuring the obligation when people sign-up, which is what the ED is proposing now. Secondly, he preferred separating these programs and costs into an area that looks like something other than a liability but is still a credit [on the balance sheet]. Thirdly, if the obligation is recognized at 40 QC he would prefer these very large costs being spread out.

Ms. Cohen favored everything at 40 QC. She said she continues to see a distinction between Parts A on the one hand and Parts B and D on the other. She would continue with the current ED approach.

[Question #21 became moot since all Parts of Medicare will be accounted for in the same way as Part A. ...]

The Board next discussed **Question #22**, “Does the Board agree that sensitivity analysis should include the liability and expense amounts as well as the SOSI present values and exclude the cashflow projections?” The staff explained that sensitivity analysis in the draft ED for March 2006 had been revised to reflect comments from the Medicare actuarial staff and the Treasury Department. The Medicare staff suggested essentially a “principle-based” approach whereby the standard would require sensitivity analysis but not a specific methodology. This would allow experimentation and would allow best practices to develop. The current social insurance standard, SFFAS 17, requires, at a minimum, certain assumptions be analyzed and provides extensive pro forma examples that have become the de facto standard. The result has been voluminous reporting of questionable value.

Mr. Dacey noted the potential for inconsistent illustrations among the social insurance entities, but deferred to the Treasury Department on that issue. He noted the standard would provide flexibility. He mentioned that GAO and Treasury had discussed a working group to try to develop common measures.

Mr. Reid said that the governmentwide and component entity standards need to be consistent because Treasury gets its information from components. He said he had envisioned a graph like the one in the ED on page 42 that was taken from the Social Security Trustees’ Annual Report where a best estimate projection is contrasted with projections of lesser confidence levels. He said his objective is to illustrate the risk of

Final Minutes on March 29-30, 2006

variation in the projection. At a minimum he said he would like the data to be available to Treasury to show the effect of varying assumptions year-by-year. However, he noted that he normally favors allowing the entities flexibility because the result is usually better than a prescriptive approach.

The Board agreed with the approach in the ED. The Treasury Department member agreed to provide staff with a brief statement for the standard that would provide the needed FR parameters.

The Board next discussed **Question #23**, “Does the Board agree that expected value should be mentioned in the basis for conclusions?” Staff explained that the discussion in the ED’s basis for conclusions included several paragraphs on the concept of expected value in the context of the present value methodology adopted for the ED. The explanation concludes with the notion that “[a]lthough the FASAB appreciated the merits of the expected value approach and will consider it in future projects, the FASAB is not requiring it in this statement.” After discussing the paragraphs the members decided to delete them as non essential.

The Board next discussed **Question #24**, “Does the Board agree that the basis for conclusions ought to include a discussion of objectives? If so, are the draft paragraphs satisfactory?”

Mr. Farrell asked whether the standard ought to discuss the notion of sustainability. He mentioned that GAO was concerned about it as evidenced by their recent comments to the Board.

Mr. Dacey said that in the broad sense the proposed standard does not demonstrate sustainability. He said the liability is only part of the sustainability issue; it does not show the receipts or other information. He noted that the SOSI does show the receipts and displays other amounts that address the sustainability issue.

Ms. Comes mentioned that the FASAB requirement for management’s discussion and analysis addresses sustainability. It requires management to discuss possible future effects of existing currently known demands, risks, uncertainties, events, and trends. She noted that in her view this is where management draws conclusions and presents its perspective and that perhaps the discussion envisioned by the MD&A standard has not been attained.

Chairman Mosso asked Mr. Dacey whether, when he mentioned that the standard did not provide the whole picture, he was referring to other programs or just to the programs in the ED.

Mr. Dacey said he was referring to both. He noted that sustainability has been discussed in terms of specific programs as well as the government as a whole. He mentioned that Medicare Part A and Social Security are funded by taxes and there are measures that could indicate what the relative change would have to be to balance the program, which would be useful information about the sustainability of the program. Considering Parts B and D, he said the SOSI is demonstrating that there is a substantial

Final Minutes on March 29-30, 2006

gap between costs and premiums that will have to be filled by general revenues, but there are not comparable measures to illustrate the likelihood of revenues being available in the future to pay these benefits. He noted that there were a lot of different measures and it was something that needed debate.

Mr. Reid said that the Treasury Department was uncomfortable with the current draft standard. He said that some essential elements in the standard need to be rethought. He mentioned that the Treasury Department is uncomfortable justifying this as a liability. He cited one of the Treasury attorneys who has asked how this could be a liability if the government is not liable for it. He said the lack of an entitlement and the impact that liability recognition may have on how or if the program can be reformed is of serious concern.

Mr. Reid said Treasury would prefer calling it something else. He acknowledged that changing the concept from a liability to some other notion of accrued social insurance costs or some connotation other than a liability would be a major rethinking of the current positions. He stated that the current situation where essentially the government members were on one side and the public members on another is an unfortunate outcome. He said the Treasury was looking for a compromise that would result in a strong majority the benefit of which would be well worth the time it would take to go back and look at it

Chairman Mosso asked if Mr. Reid was saying it was a matter of terminology and display.

Mr. Reid said it goes beyond display. He said the Board needs to rethink the notion that social insurance is not distinct from things that are reported as contracts. With respect to social insurance the government has commitments or responsibilities or obligations but not liabilities. Mr. Reid said he would prefer very specific terminology, for example, "estimated actuarial social insurance benefits under current law." He said that the name should not imply that the participant is entitled to anything or otherwise create in the government's official financial statements something that the participant could cite in an argument as an obligation the government cannot change. He noted that the display should tell the story appropriately, but if the concept is based on a liability then it is still a liability regardless of display. He said that the distinction needs to be made in the standard between social insurance and liabilities. The government is not liable for this. It is a new category of responsibilities. From a practical perspective, he said this approach would meet a lot of the Board's objectives; it would show things in a way that is clear and satisfies some of the essential concerns.

He repeated that getting a solid majority behind this was essential. He said he did not think the Board could survive having it go the way it is. He said he thought that would be very dangerous. He asked the Board to take another look at the issue.

Chairman Mosso sought to clarify the concept. He asked about display first: would there be a line on the balance sheet but not under a liability caption.

Final Minutes on March 29-30, 2006

Mr. Reid said that there would be a credit on the balance sheet, that a credit was necessary since costs would be recognized. He said he did not think this approach would satisfy everybody's concerns, but it would eliminate the liability issue that concerned OMB, GAO, and Treasury. He said the amount would not be included in the liability total; it would be its own category; and there would be in a total at the bottom, for example, "liabilities and social insurance benefits and commitments and contingencies."

Mr. Patton asked if the amount included would be only that which was currently being talked about as the liability or would it include other parts of the commitments from the SOSI as well.

Mr. Reid said the amount would be whatever could be put in the standard. He said he could envision that there might be other things included as the Board moved forward that might be governed by other standards. He noted that more thought is needed regarding this category, but it would be a category distinct from liabilities. He said the standard would be clear that a liability is not being created; that the amount represents the accumulated costs of social insurance benefits, which are not entitlements. The crux of the issue is that social insurance is not an entitlement.

The Board discussed entitlements. Mr. Allen said social insurance programs are described as entitlements by, among others, Comptroller General Walker.

Mr. Reid said the FASAB has been clear up to now that these programs are not entitlements. They are subject to the will of the Congress unlike other federal programs where that is not possible; where the courts are involved and there are certain things are deemed beneficiary rights.

Mr. Allen said an entitlement program is not the same thing as a legal liability. He agreed that a right term was needed but doubted that there was anyone who has a misconception, first, that there is an expectation. He said accurate accounting should reflect the understanding of participants while communicating to them that this is not a legal right. He said accounting is not based on legal notions or statutes but rather on the economic substance of what is understood.

Mr. Reid said he would not disagree with the sentiments expressed by Mr. Allen.

Mr. Schumacher said he was sympathetic to what Mr. Reid said and understood it, but he asked how the Board would reconcile what Mr. Reid was asking with the liability definition in the elements project. He said that in the social insurance ED the Board is saying that this meets the definition of a liability, recognizing that there was a contrary minority view.

Mr. Zavada said the Board did not arrive at the ED position in the most logical way. He said he has been concerned about the process. The objectives should have been defined first before moving to social insurance. He said that one could argue that the approach moved in reverse order: social insurance was looked at first and then concepts were developed from that; but assuming it was in tandem, he said that tandem development is not the best way to proceed.

Final Minutes on March 29-30, 2006

In answer to Mr. Schumacher's question, Mr. Reid cited the elements ED, par. 7, that says "conclusions about the existence of an element require judgment as to whether, based on the available evidence, the item possesses the essential characteristics of that element." Mr. Reid said that he thought the Board could come to a judgment that, because of the ability of Congress to make changes, social insurance responsibilities were not a liability but something else. The standard would define that something else.

Mr. Patton noted that the something else would have to be an element and elements are not defined in standards. He said the elements project would have to do that.

Mr. Reid responded that he did not think the elements project would necessarily have to do it. He said that the standard could do whatever the standard wanted to do. He noted that from Treasury's and perhaps other perspectives, the proposal is not the theoretical choice based on all the work that has been done on elements up to now. He said a new category should be defined for which reporting could be developed that does not confuse these things with anything for which one has the right to sue. He added that the alternative highlights the issue and better matches revenue and cost in a way that will allow the Board to go out together with a rationale.

Mr. Zavada said there were a lot of creative options, a lot of ways to take the work that has been done and come up with an alternative that might have more support among the Board. He mentioned a schedule GAO has shared in the past.

Ms. Cohen said she found that hard to believe. She noted that the Board had been over the same discussion points many times and that it was not as if the thoughts of the government representatives had not been considered.

Mr. Patton agreed with Ms. Cohen and said, with due respect to the federal members' knowledge and preferences, he saw this as a threat to the independence of the Board. He said he could appreciate the federal members' position; but as a public member of the Board, he saw the proposal to go back to some earlier point and change elements for the purpose of avoiding a liability on the balance sheet as a real threat to the apparent and real independence of the Board. He said there may be such a threat, but that there also may be a threat to the existence of the Board if it goes the other way and accedes to the proposals that have been suggested.

Chairman Mosso said it would depend on what the implications of the proposal are. He said he would not object to changes in the wording or the placement of the line item, but the basic reasoning in the document was sound.

Mr. Allen agreed with Chairman Mosso. He noted the range of liability types and the possibility of a displaying them separately. He said he could accept the notion of treating the social insurance obligations as credit balances and developing an appropriate title.

Mr. Reid returned to Mr. Patton's point about the threat to the Board's independence. He said one should not draw an inference relative to independence, that no one at Treasury has any interest to impinge upon the Board's independence. He mentioned

Final Minutes on March 29-30, 2006

that certain people at the Treasury Department just feel like the conclusion that this is a liability is wrong. He paraphrased their position as one where as long as the Board stays away from the liability side, if it feels like the accounting is appropriate in certain ways, then do the accounting; but do not go across the line and say it is a liability when we have a situation where the statute and the Supreme Court have both come to a different conclusion.

Mr. Patton said he has had sympathy from the outset with the federal member's position. He noted that the liability that the ED is proposing to report does not tell the whole story. There is a much bigger story to be told and the rest of that story is not a liability; it is something else, some sort of commitment. He said he would like to reflect the whole story on the balance sheet. In order to do that one would have to go back to the elements project and redefine the elements that exist.

Chairman Mosso noted that the SOSI puts the liability in the context of other measures of other things and he asked Mr. Patton whether that was what he meant by a more complete picture.

Mr. Patton said it was and that some of those things belong on the balance sheet as some sort of commitment, which would make it more visible and more easily understood and would treat it as more important.

Chairman Mosso said that we should try to develop terminology that might satisfy the Treasury and see if it satisfies the members. He reiterated his belief that the elements document was sound and whatever the Board did with respect to social insurance would be, if anything, an exception; but hopefully no changes would be made in the concepts statement, that changes would be confined to the social insurance ED.

Mr. Patton noted that the Board had spent a lot of time on concepts statements to not be guided by them. Chairman Mosso agreed.

Mr. Farrell noted that many of his former clients took the same position with respect to accruing a potential legal settlement: that putting an amount on the books ruins their argument that they do not have to pay it. But he said recording a credit does not necessarily mean a legal liability; it connotes something different. So, he said he would object to the argument that putting something on the balance sheet means the government loses its legal basis.

Mr. Reid said their concern is that it would provide ammunition for folks who wanted to stop reform, and they might do that judicially.

Mr. Zavada noted the very, very large numbers that would be going on the balance sheet as a result of the new standard. He said they were beyond a balance sheet.

Mr. Farrell said Congress had agreed to pay all those amounts.

Mr. Dacey responded that there was no accrual on the debit side. He said that things keep getting added on the liability side, and asked rhetorically what the balance sheet

Final Minutes on March 29-30, 2006

meant. He noted that all the statements are equally prominent and therefore the balance sheet is no better than the SOSI.

The Chairman concluded the discussion by saying that there is a consensus in favor of considering other words than "liability" for the social insurance programs. He added that the Board was not back-tracking on what it had agreed to in the concepts statement or undoing the entire structure that had been developed, but would consider doing something with the terminology.

Staff confirmed that the focus of the changes in the ED would be the line item on the balance sheet and that the rationale for recognizing an obligating event at 40 QC would be retained. Also, the full cost would continue to be reported on the operating statement.

The Board discussed options for displaying cost. Mr. Reid said there are many options, for example, as annual operating cost; or as a separate statement; or as social insurance costs; or as line items on the statement of changes in net position; or as a direct charge to net position, which he characterized as the least attractive.

Mr. Zavada said OMB was receptive to the points Mr. Reid had made and to reconsidering this and coming up with an alternative. He said OMB is hesitant with a balance sheet presentation, which would control the statement of net cost as well. He said OMB would favor some type of an alternative off-balance-sheet schedule of responsibilities.

Chairman Mosso polled the members on the question of whether they supported the social insurance ED as amended by the decisions made at this session, setting aside the question of re-labeling the social insurance liability, which is up for further consideration. Messrs. Patton, Scumacher, Farrell, Allen, and Mosso and Ms. Cohen supported the ED. Messrs. Dacey, Zavada, Reid, and Torregrossa did not support the ED.

The Chairman asked staff if any other issues needed to be addressed. Staff mentioned that there had been a request that the staff consider using the new social insurance standard or other vehicle for a governmentwide standard for display of actuarial gains and losses. Staff explained that this was still an open issue.

Mr. Reid said that the issue should be fundamental to how actuarial gains and losses are recorded. Even though the scope of the standard is limited to social insurance programs, he said the issue could be addressed in general. He added that he was not wedded to having it in the social insurance standard. He said the goal is to have changes in assumptions treated differently than operating costs in order for users of financial statements to be able to see the basic programmatic cost trends separate and distinct from changes in assumptions. He noted that most of the additional cost from accrual accounting comes from actuarial projections.

The Board discussed the logistics for such a standard. Ms. Comes said that a separate exposure draft would facilitate respondents' comments, for some will focus so heavily

Final Minutes on March 29-30, 2006

on social insurance that display of changes in assumptions would be a minor point. She added that a separate track would also facilitate issuing a standard because the actuarial standard would not be encumbered by the social insurance project.

There were no objections from members to Ms. Comes' suggestion of a separate standard.

The Board concluded the session with a discussion of the next step in the project. A first draft of a ballot draft will be developed for the meeting on May 24th that would reflect the decisions made today.

CONCLUSIONS:

Question #19 – [A majority of the Board had agreed that Medicare HI should be recognized at 40 QC.] A majority of the Board decided that Medicare HI costs should not be spread evenly over the participant's working years in covered employment but rather recognized at 40 QC.

Question #20 – The Board agreed that the accounting treatment for Medicare SMI should be the same as for Medicare HI.

Question #21 – The Board decided insurance accounting for Medicare SMI, Parts B and D, was a moot point because these Parts are to be accounted for the same as Medicare HI, Part A.

Question #22 – The Board agreed to require sensitivity analysis of the liability, expense, and SOSI amounts, and to have a "principal-based" requirement that would not require a specific methodology.

Question #23 – The Board decided to delete the paragraphs on expected value in the basis for conclusions.

Question #24 – The Board agreed that the basis for conclusions ought to include a discussion of objectives and that the paragraphs in the ED are satisfactory.

A majority of the Board supported the social insurance ED as amended by the decisions made at this session. The next step in the project is to be a first draft of a ballot draft for the meeting on May 24th that would reflect the decisions made today.

The Board agreed to consider other words than "liability" for the social insurance programs.

The Board agreed to a separate exposure draft for actuarial display and reporting issues.

- **AAPC Operating Procedures and Charter**

Staff presented the Board with the proposed revisions to the AAPC Charter and Operating Procedures for review. The changes had been deliberated by the AAPC over several meetings and were unanimously approved by the Committee at its March meeting. The most significant change was restructuring the voting procedures from block voting to a majority vote structure. Other minor changes included updating titles and reorganizing the text. Mr. Mosso had suggested during the pre-briefings that the charter be further amended to allow the Board to give the AAPC affirmative approval on guidance as needed. This will provide flexibility to release guidance sooner than the normal 45-day no-object review period now required by the charter. Mr. Patton noted that it appeared to be a “disconnect” between the AAPC name which includes “auditing” and its mission which does not include providing auditing guidance. Staff explained that even though auditing guidance cannot be provided through the AAPC audit issues are considered when accounting issues are addressed by the Committee. Although several suggested changes were discussed, no changes were agreed upon by the Board.

CONCLUSIONS: The Board has 45-days to object to the amendments to the charter and operating procedures.

- **Steering Committee Meeting**

Ms. Comes updated the members on the Appointments Panel activities. In addition, the Steering Committee approved the hiring of a new administrative assistant as provided for in the budget.

Adjournment

The meeting adjourned at 4:00 PM

Thursday, March 30, 2006

Agenda Topics

- **Department of Defense Update on PP&E Implementation**

Mr. Richard Sylvester (Deputy Director, Acquisition Resources & Analysis for Property & Equipment Policy, in the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), Department of Defense) provided an update on the department’s implementation of SFFAS 23. He described two approaches to assigning values to property, plant, and equipment which would become general PP&E as a result of SFFAS 23:

1. The average unit cost approach is being used on about 300 programs for acquiring major assets like aircraft carriers, F16s and tanks. This methodology

accumulates total program costs from the inception of the program through 2006. This total is divided that by the total quantities over that period to arrive at an average unit cost assigned to each of the assets based on its placed in service date. That asset is then depreciated from that placed in service date through the useful life for that asset.

2. The group and composite approach is being used for about 120 programs. These programs result in non-major assets; things that are used with tanks or ships or airplanes. They may be for example a set of medical equipment that we would capitalize because either the assets within that group of equipment all exceeded our capitalization threshold or there was a mix of things. We used expenditures incurred in a particular year at the lowest level that we could do that and that was an annual cohort and then we depreciated that cohort based on the average weighted useful life of the things that were in that group and so the first year's cohort we depreciate over its useful life. The issue of retirements from the group has not been dealt with yet.

Mr. Sylvester indicated that the estimated costs were being reviewed and brought to the same valuation date. Once that process is complete, he says they will have established the military equivalent baseline which will have all the valuations updated to the right point in time with all the programs. He expects to establish this preliminary baseline at the end of June and put out third quarter financial statements. These estimates would then be refined and updated for a final baseline as of the end of fiscal year 2006.

Some remaining issues for DOD are:

1. Making it mandatory that contracts identify the type of good or service being paid for so that assets can be distinguished from expenses.
2. Ensuring that government furnished materials are effectively accounted for.
3. Training to ensure contract changes are effective.
4. Systems infrastructure to support SFFAS 6 compliance.

- **Fiduciary Activities**

Recap of Meeting at Department of the Interior

During the Administrative Matters agenda item on Wednesday, March 29, 2006, Executive Director Ms. Comes updated the Board on a meeting on March 28, 2006 attended by Chairman Mosso, Ms. Comes, and personnel from the Department of the Interior ("Interior Dept.") Office of Historical Trust Accounting: Mr. Ross Swimmer and three of Mr. Swimmer's staff members.

Mr. Swimmer and his staff explained that there are three U.S.-based service providers to trust departments at banks, and that they contract with one of the service providers, to use a system that is maintained by the service provider. All the data entry and management of the information is performed by Interior Dept. personnel or on-site contractors. The cost for the system is \$14 million/year. The system does not provide

for a consolidated financial report on an accrual basis. It supports individual beneficiaries' statements, as well as management of investments. They have added to the system a piece that is industry standard practice and was called for by the internal control report connected with the audit of the trust financial statements. The report cited a material weakness for not having an accounts receivable system. We also provided you with a copy of management's agreement to install an accounts receivable system. What the Interior Dept. representatives clarified at the meeting was that it is not a classic accounts receivable system; it is a "tickler" system for keeping track of payments that are due. It aligns with each beneficiary's account so that they are able to tell the beneficiary when their next payment should be coming in to their account. The service provider has communicated to the Interior Dept. representatives that it would cost millions over several years to convert to accrual.

Ms. Comes said that the representatives from the Interior Dept. that they spoke with seemed to have the impression that a fiduciary note in the Interior Dept.'s financial statements meant that they had to give accrual reports on an account-holder basis, so the discussion didn't get very far beyond that mis-perception and did not result in information about the cost to support only an annual accrual-based note disclosure.

The representatives from the Interior Dept. emphasized very heavily the analogy with bank trust accounting, and there was a brief discussion of the difference between bank trust accounts and external financial reports of a government entity. Ms. Comes and Mr. Mosso alerted them to the GASB¹ 34 model and practices by state and local governments. Ms. Comes said that it was a useful discussion for distinguishing between the financial reports that the Board governs and the individual statements for account holders.

Mr. Mosso said that as part of the Interior Dept.'s improvement of financial controls, they are using the so-called "tickler" system, but had no idea what it would cost to convert to accrual.

Mr. Torregrosa asked about the funding source of the annual system cost of \$14 million; Mr. Mosso replied that it was funded by the Interior Dept.'s budget.

Technical Assistance Received from KPMG

Ms. Comes added that on March 24th, staff received technical assistance from the accounting firm KPMG regarding accounting practices of real estate investment trusts. It was determined that real estate investment trusts follow FASB GAAP.² Ms. Comes noted that KPMG was very helpful in providing information to FASAB staff.

¹ Governmental Accounting Standards Board, Statement 34, which contains reporting standards for state and local governments; see <http://www.gasb.org/>

² Financial Accounting Standards Board, Generally Accepted Accounting Principles for private-sector organizations.

Final Minutes on March 29-30, 2006

Letters Received from SBA and SEC

Ms. Comes also noted that the Board members received additional briefing materials on fiduciary activities: recent comment letters from the U.S. Small Business Administration the Securities and Exchange Commission. There was also a Congressional hearing on the Indian Trust Funds held two days before the Board meeting, and a copy of the testimony by representatives of the Interior Dept. was provided to Board members.

Ballot Draft Finalized

At the Fiduciary Activities session on Thursday, March 30, 2006, the Board discussed and approved editorial changes to the Basis for Conclusions recommended by Chairman Mosso. The Board also recommended several minor edits, and requested ballots in order to vote on the proposed new SFFAS prior to the next Board meeting.

- **Implementing SFFAC 4 for the Financial Report of the U.S. Government**

Mr. Gary Ward, US Treasury's Financial Management Service, is providing staff support for this project and joined in the discussion. He reported on the responses to the exposure draft. Members commented that there was support for the proposal but also for the alternative view. Some members believed the responses supporting the alternative view believed that a summary report was needed and that disclosures required of component entities were too lengthy.

Mr. Reid reported that a summary report had been drafted. It was ten pages in length and primarily visual. He anticipated that the JFMIP principals would review the draft during April and he would have a better sense of whether a summary report would be feasible following that review.

Members discussed summary reporting by the components and whether there was a need for guidance. No conclusions were reached but continued monitoring of summary reports is desired.

With respect to the alternative view expressed by Mr. Dacey, some members wondered if the respondents understood the alternative view. Mr. Dacey believed there was some confusion but that the general notion that the consolidated financial report should be a condensed version of the component entity reports was supported. Some members noted that some of the disclosures being addressed were disclosures that were not capable of being condensed because they could not be added together.

Members agreed that referencing to agency reports was desirable but placed a burden on the users.

Mr. Mosso polled the members and there was agreement to move forward to finalize the proposed standards.

CONCLUSIONS: Ms. Comes noted that some respondents had raised specific suggestions regarding the wording as well as new ideas – such as references to websites. These would be addressed in detail in the first draft of a final statement of federal financial accounting standards. Members should expect to receive a first draft for review via e-mail with the objective of having either a pre-ballot or ballot draft at the May meeting.

Mr. Dacey provided members and staff with a copy of a Governmental Accounting Standards Board paper entitled *Why Governmental Accounting And Financial Reporting Is And Should Be Different From Non-Governmental Accounting*. He noted that it was an excellent paper.

- **Natural Resources**

The Board discussed a revised draft exposure draft (ED), entitled *Accounting for Federal Oil and Gas Resources*. In the ED transmittal letter to the Board, staff requested members' thoughts on royalty free production of oil and gas in the Gulf of Mexico. The proposed accounting standards for oil and gas resources would not result in separate recognition or disclosure of this royalty free production. Therefore, before discussions on the ED began, staff explained that, while it had not yet thoroughly researched and considered the issue of royalty relief, there were various options for addressing the issue. Staff provided a summary of the different options. After a brief discussion, the Board members agreed that more factual information on the royalty relief program was needed for discussion and asked staff to research for the next meeting what needs to be done to get an effective valuation of the royalty relief program.

During discussions on the draft ED, Board members agreed that staff should do the following:

- a. Review the definitions presented in the text of the proposed standards for possible relocation to the glossary.
- b. Prepare questions for respondents for incorporation in the ED that address:
 1. the level of information requested to be disclosed in the footnotes or displayed as RSI; and,
 2. the challenges posed by the use of the present (or discounted cash) value measurement attribute for measuring estimated petroleum royalties.
 3. the use of reserves classified as proved, probable, and possible to calculate the value of the Federal government's estimated petroleum royalties for capitalization on the balance sheet, instead of using only the proved reserves as proposed in the ED.
- c. Revise the paragraphs in the ED that address the "Rights to Future Royalty Stream Identified for Sale" to clarify how they should be accounted for and reported.

CONCLUSIONS: Staff will revise the ED based on comments from the Board members. In addition, staff will research the royalty relief program and develop a detailed factual information paper.

Final Minutes on March 29-30, 2006

Adjournment

The meeting adjourned at 12:15 PM.