

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
August 17-18, 2005
Room 7C13
441 G Street NW
Washington, DC 20548

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Wednesday, August 17, 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 approved electronically before the meeting.

- **Other Administrative Matters**

Ms. Comes explained two useful features of the FASAB website. The briefing materials are available in advance of the meeting at <http://www.fasab.gov/meeting.html>. Each active project has a page presenting the project objective and a summary of each Board meeting discussion

of the project including related briefing materials. The pages can be found at <http://www.fasab.gov/activeprojects.html>.

Agenda Topics

- **Public Hearing and Update on Fiduciary ED Responses**

Speakers at the public hearing on August 17, 2005 were:

Department of Defense:

Zack Gaddy, Director of the Defense Finance and Accounting Service

Department of the Interior:

Debra Carey, Office of Financial Management,

Bert Edwards, Office of Historical Trust Accounting

Margaret Williams, Office of the Special Trustee for American Indians

A transcript of the public hearing is being prepared and will be made available on the FASAB website. Below is a summary of the major points covered at the public hearing.

Department of Defense: Zack Gaddy, Director, Defense Finance and Accounting Service, Department of Defense (DoD)

Mr. Gaddy discussed two concerns: the interpretation of the exclusion of unearned revenue from the fiduciary reporting requirements, and the transfer of certain appropriated funds into the Foreign Military Sales Trust Fund.

Mr. Gaddy said that paragraph 13 of the exposure draft, which excludes unearned revenue from the proposed reporting requirements for fiduciary activities, should be clarified so that it does not appear to exclude deposits held in trust for foreign governments in the Foreign Military Sales Trust Fund.

Mr. Gaddy also discussed non-repayable credit funds appropriated specifically to fulfill international agreements. He said that it was the DoD's position that even though the funds originated as appropriated funds, once they were expended from the originating appropriation to the Federal Reserve Bank interest bearing account or the FMS Trust Fund, the funds meet the definition of fiduciary activity.

Department of the Interior: Debra Carey, Bert Edwards, Margaret Williams

Ms. Carey noted that some receivables, such as land-use rents based on agricultural production or number of grazing livestock, were not reasonably estimable, and requested language limiting the accruals for speculative amounts.

Ms. Carey also requested language limiting the definition of fiduciary activities to those which issue periodic statements to account owners and receive an independent audit of the fiduciary activity.

Ms. Carey also suggested that paragraphs 142 and 276 of SFFAS 7, regarding Minerals Management Service Collections, be left intact or rescinded rather than amended by the proposed fiduciary standard. She said that there are implementation difficulties regarding SFFAS 7 that might be best addressed as part of the Natural Resources project or some other FASAB project.

Ms. Carey also said that a detailed comment letter will follow, including comments on the sample footnote disclosure

- **Objectives**

Staff team members Melissa Loughan and Ross Simms presented the Objectives agenda item. Ms. Loughan introduced the agenda item and discussed the team's progress. The staff team determined that it would be most productive to move forward with planning the Objectives roundtable meetings prior to addressing some of the other areas that may ultimately be included in the white paper. She then provided an overview of the staff team's plan for conducting the roundtable meetings.

Overview of Plan for Conducting Roundtable Meetings

Ms. Loughan noted that the staff team would provide roundtable participants with the current version of the draft white paper. The draft white paper presents the participants with background information on the current status of the project, major changes in the federal environment since the Board issued Statement of Federal Financial Accounting Concepts (SFFAC) 1, and how the roundtables will play a part in the Board's consideration of the objectives. She also directed the Board member's attention to the staff team's Plan for Objectives Roundtables (Tab B 2) and noted that the team plans to conduct four roundtable meetings - one for each objective of federal financial reporting. All the meetings would be completed by the end of calendar year 2005. Next, Ms. Loughan discussed the draft participant's packages (Tab B 3) for the roundtable meetings planned for September 19 and 28, 2005. At these roundtable meetings, the staff team plans to discuss the Budgetary Integrity and Operating Performance objectives, respectively. The staff team will provide the Board with the participant packages for the remaining roundtable meetings (Stewardship and Systems and Control) at the October Board meeting.

Mr. Farrell asked for clarification on whether roundtable attendance was by invitation only and whether only the federal government board members will be invited to attend. Ms. Loughan explained that in order to limit the number of attendees and facilitate the productivity of the meetings, the staff team would invite the participants. The number of participants planned for the roundtables would range from 10 to 12, but the number does not include Board members or their representatives. Instead, staff plans to invite federal staff members from the sponsoring agencies that are experts in the subject area being discussed during the roundtable. Ms. Comes also explained that cost is the most significant barrier to combining board meetings with the roundtable meetings.

Draft White Paper

Mr. Patton pointed out that page 3, paragraph 4, of the draft white paper,¹ appears to indicate that the emphasis of the roundtables will be on narrowing the financial reporting objectives from a universe of four. However, some roundtable participants may desire to discuss expanding the objectives to possibly five. Ms. Loughan noted that Chairman Mosso also observed this matter and the staff team plans to revise the paragraph.

Also, Mr. Dacey noted that there are two aspects of the Objectives project: 1) identifying whether the objectives of federal financial reporting, which are broad and not necessarily confined to the board, remain valid and appropriate; and 2) consider the extent of the Board's involvement in achieving those objectives. The materials that will be provided to roundtable participants appear to be combining these two aspects. It may be helpful to clarify that there are two separate aspects.

Mr. Patton noted that within the objectives of the board, multiple products could be prepared in addition to GAAP standards and concepts. The roundtables could consider the possibilities of issuing a document that is other than a GAAP standard, such as a research report or less formal guidance that is suggestive in nature. Ms. Comes added that GASB has completed a qualitative characteristics of performance measures product and issued it to their constituency. However, the product was not a part of GAAP and could be offered as an example for the roundtable participants. The staff team agreed to explore the types of products that the Board could issue during the roundtables. This could be accomplished by adding an additional question for the participants to consider.

Mr. Dacey noted that the matter discussed in paragraph 5 of the draft white paper² is broader than as presented. The paragraph only discusses that the Board may exclude objectives that may not be relevant to FASAB. The paragraph could be expanded to discuss that the extent or nature of the board's involvement in the financial reporting objectives may vary. Also, Mr. Schumacher noted that he has some editorial comments on the draft white paper that he would provide to the staff.

Ms. Loughan noted that the board will not be able to review the white paper and participant's package before the first roundtable. Mr. Simms explained that the staff team plans to send the first set of roundtable participant's packages on September 5, 2005, before the next Board meeting which is scheduled for October 2005.

Mr. Patton commented that he liked the impact analysis paragraphs included in the white paper. The analysis helped answer the question, "so what?" Also, they helped focus attention

¹ The paragraph states, "The ultimate focus of this white paper is on narrowing down the four reporting objectives listed above so that Board objectives are clearly identified. The white paper presents the consensus views of the Board regarding specific objectives or sub objectives established in SFFAC 1, chapter 4, which are not to be addressed through federal financial accounting standards."

² The paragraph states, "Objectives or sub objectives may be excluded because they were determined to be poorly aligned with the Board's mission or not a high priority for the Board in the near-term (five to ten years). Potential reasons for excluding objectives or sub objectives in the near term include the fact that others have made or are making progress in meeting the objective or sub objective, the Board's structure, processes and authorities do not support meeting the objective or sub objective, or other objectives or sub objectives are deemed to be more important."

and should be used in the future. Chairman Mosso agreed that the impact analysis paragraphs were helpful.

Ms. Loughan explained that the staff team plans to summarize the results of the roundtable meetings and incorporate them into the final white paper. The white paper will be the basis for proposed changes to the financial reporting objectives or the Board's strategic plan. Also, the staff team plans to make transcripts of the meetings available to Board members.

Draft Participant's Package

At the October Board meeting the staff team plans to provide the Board with the set of participant's packages for the Stewardship and Systems and Control roundtables.

It was suggested that someone from one of the budget committees attend the Budgetary Integrity roundtable and obtain their feedback. Mr. Zavada added that it would be interesting to hear their perspectives in terms of what they rely on for assessing budgetary integrity. An OMB budget expert should attend as well.

Mr. Jacobson suggested that if the participants are not familiar with FASAB, the cover letter to the participant's package should explain the mission of FASAB. The staff team noted that they verbally communicated with each of the participants and that the participants are familiar with FASAB. The staff team will include FASAB Facts in the participant's package to help explain FASAB's role.

Regarding the role of FASAB, Mr. Dacey noted that FASAB standards subject information to independent audit. In the past, the Board may have required the disclosure of certain information in order to achieve some level of assurance that the information was reliable. Subjecting information to audit differentiates FASAB standards from other reporting requirements. Chairman Mosso commented that the purpose of the Statement of Budgetary Resources was to subject budget information to audit.

Ms. Comes commented that in the federal arena the budget is the most frequently referenced information and failing to discuss the budgetary resources provided may result in an incomplete report. Ms. Comes commented that the Systems and Control objective also includes the notion of indirect improvement, particularly improvement in systems and controls. Basically, as FASAB requires more reliable information that is subject to audit, entities may need to improve their systems and control. This notion can be explored more directly during the Systems and Control roundtable. Mr. Dacey added that for roundtable participants that are not familiar with FASAB and financial reporting, it may be helpful to explain the types of actions the Board has initiated and why the actions were taken, in addition to the history of the Board. Participants should consider whether there is a need to have a level of reliability attached to information. Whether the information should have a level of reliability may depend on the level of importance the participant places on the information.

Mr. Zavada stated that having the information subjected to an independent review in terms of the Statement of Budgetary Resources was a key objective for including the report as a principle financial statement. The budget information, on an account-by-account basis was already presented in Treasury and OMB reports. Making the Statement of Budgetary Resources a principle financial statement added further integrity to the report. Mr. Dacey agreed and commented that various reports may exist, but they may not be validated and the question then becomes, "what is their value?" Explaining the benefit of a FASAB standard

(comparative advantage) may be helpful to those not familiar with financial reporting. Chairman Mosso noted that one of the purposes of the white paper was to explain the comparative advantage that differentiates FASAB from others.

Standards and Objectives Analysis

Ms. Loughan discussed the Standards and Objectives Analysis included in Tab B 4 for the Board's reference. Board members previously requested an analysis of how the standards relate to the financial reporting objectives. Staff intern Nicholas Dorsey prepared the analysis and it indicates whether a standard explicitly references an objective or whether the objective was implied. Chairman Mosso stated that currently FASAB standards state the objective that the standard addresses. Mr. Dacey noted that many standards have an indirect affect on the Systems and Control objective. Standards require agencies to develop the appropriate structure or process necessary for reporting the required information. There is an indirect correlation between the standards and the Systems and Control objective. Statement of Federal Financial Accounting Standards 4, Managerial Cost Accounting Concepts and Standards may be a standard that directly relates to the requirement to develop a system of cost accounting. While Ms. Loughan noted that the analysis will not be provided to participants, Chairman Mosso stated that Mr. Dacey's point should be discussed when staff plans to prepare the package for the Systems and Control roundtable.

CONCLUSION: Staff will incorporate the board's recommended changes into the draft white paper and roundtable participant's packages and will proceed with the scheduled roundtable meetings.

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

(This discussion was moved up from its scheduled start time of 1:00 PM due to the availability of time.)

Ms. Ranagan began the session by giving a brief background on the project (for the complete history of the project, please refer to the FASAB Active Projects page at <http://www.fasab.gov/projectsresearch.html>) and a summary of the staff papers to date (seven project fact sheets and four in-depth analyses of potential obligating events for the following programs: Food Stamps, Medicaid, Temporary Assistance to Needy Families, Supplemental Security Income, Milk Income Loss Contract; Feed Grains Direct and Counter-cyclical Payments, and the Corporation for National and Community Service's Service Award Liability).

At each meeting, the Board has brought up differences in how they would like to account for the liability. One of the fundamental differences is whether the liability is the future sacrifice itself or the stand-ready obligation to make that sacrifice.

Ms. Ranagan noted that some of these fundamental disagreements between the Board members have continued without resulting in any definite decisions or votes on how they would consider accounting for the programs presented. As a result, she feels that continuing to review individual programs one by one would probably not result in the timely settlement of some of these differences, and therefore staff resources could potentially be diverted to something else.

Ms. Ranagan presented three options for continuing on this project:

- Present educational sessions on IASB and FASB work on expected values and obligations;
- Begin developing an operational approach to different classes of liabilities; and,
- Divert staff resources to another project.

Ms. Ranagan noted that the current staff paper contains some background information on what led to these options as well as an operational view of the liability definition. However, she indicated that she would first like to get the Board's opinion on whether they would like to see this project continue, if they feel that the project is moving in a timely fashion, or if they think it would be better to divert staff resources.

Ms. Ranagan indicated that the staff recommendation is to divert resources to a different project.

Mr. Zavada said he saw this project as an opportunity to prove out some of the concepts that it was developing in the social insurance project, to take some of those characteristics that social insurance has and apply them to other non-exchange programs, and see if the Board could find some framework that works for other programs. He said that is how he saw the project's goal and if the Board has not been able to do that successfully, he wonders if that in and of itself doesn't tell the Board something, or isn't informative to them, in terms of the characteristics that the Board is applying to social insurance. Even if the Board is successful in applying the characteristics to social insurance, it is still left with a lot of ambiguity in relation to other non-exchange type programs unless it continues this project and finds a way to come up with some classes or categories or some type of additional framework to assess these other programs.

Mr. Zavada said that his concern is, just because the Board has not been able to reach a consensus or find the right framework, he does not believe that the thing to do is just to abandon the project. He said the Board should continue to search for that framework, for those characteristics that might have broader application.

Mr. Reid said he can concur with the staff recommendation, but would like to see some further information on expected values and obligations.

Mr. Farrell said it seems like this research project is not helping us define liabilities. He thinks looking at these various programs is showing the Board that there are differing measurement issues that it is faced with. Once something passes the liability test, it falls into a couple of different categories. They all meet the definition of liability, but then how does one measure them? Maybe the project has moved into helping measure the different types of liabilities rather than helping to define liability. Maybe it should move forward on the measurement side of the issue.

Mr. Mosso noted that sooner or later the Board will have to address programs not individually, but in groups, because we could never hope for such standards for every federal program.

Mr. Dacey said he found the brainstorming helpful to elicit ideas and thoughts in a concrete way on specific programs. He said he found it good to get the different views of the members, but it has raised a number of issues that the Board needs to think about in terms of how to apply the definition of a liability to non-exchange transactions. Mr. Dacey said he would be a little reluctant to postpone this project, because he thinks it is an integral part to understanding whether the definition is appropriate in all cases. Some of the nonexchange transactions have conditions and some do not; there is a continuum where one could perhaps generalize some broad requirements. He said he would be in favor of continuing the project, but generalize what the Board talked about, crystallize the issues, discuss the issues, and decide what the Board's preferences are.

Mr. Dacey, Mr. Zavada, and Mr. Farrell said they were comfortable with option two (develop an operational approach to different classes of liabilities).

Mr. Patton said he agrees completely with Mr. Dacey and would suggest that the selection of the classes is a critical step, because that would feed into Ms. Wardlow's effort to figure out what facts and circumstances one ought to pay attention to in various settings. So the dimensions of those classes would be a very challenging choice.

Mr. Torregrosa agreed with option two.

Mr. Reid said option two is fine with him as well, but he would like the classes to be large representative groupings, not fringe cats and dogs, but the stuff that is right in the middle so that the Board can see what the issues are, and if there are issues there, the Board needs to identify them.

Ms. Cohen said she believes it is valuable to move to the broader view, rather than each little technical detail of various programs.

Mr. Zavada said he would agree with Ms. Cohen and Mr. Reid; without those broad categories, the Board is taking a program by program look that is just too burdensome.

Mr. Mosso summarized that the Board seems to be leaning to alternative two.

Mr. Schumacher agreed.

Mr. Mosso said if there is no objection to that, the Board will proceed with alternative two. There were no opposing voices.

Ms. Ranagan asked if the Board members would like to see the alternative classes proposed before proceeding. There was general agreement around the table.

Mr. Dacey said to also think about whether there are discrete classes or just concepts that would apply to everything. To some extent, perhaps the only difference between a conditional offer and a firm offer is the condition itself, and how would one treat that in terms of an analysis. Perhaps it might be a continuum rather than discrete types of transactions.

CONCLUSION: Staff will research potential classes of liabilities and present a list of options for the Board to consider.

The Board adjourned for lunch at 12:00 PM. Elizabeth Robinson, former member from the Congressional Budget Office joined the members for a farewell luncheon. Members expressed their appreciation for Ms. Robinson's service and acknowledged her contribution to the deliberations.

- **Implementing SFFAC 4 for the CFR**

Allan Lund (Financial Management Service) led the discussion. (The session started 1.5 hours early – Gary Ward of FMS joined Mr. Lund after about 45 minutes of discussion.)

Mr. Lund began by indicating that this project is intended to implement SFFAC 4. At the June meeting, a draft exposure draft was presented to the Board that included all of the disclosures that Treasury has identified for elimination or modification pursuant to the concepts articulated in SFFAC 4. That draft exposure draft has been revised to include the Board's decision about using criteria to select examples of agencies disclosing information no longer required at the government-wide level. Also, Executive Director Wendy Comes has revised the draft exposure draft in places to strengthen the focus on notions contained in SFFAC 4.

Mr. Lund continued by indicating that the materials provided for today's discussion are a changes marked copy of the revised draft exposure draft and a clean copy of the revised draft exposure draft.

The objective is to determine what further revisions need to be made to the revised draft exposure draft to allow the preparation of a pre-ballot draft exposure draft. Mr. Lund finished his opening remarks by noting that Mr. Dacey has identified many proposed revisions. (Mr. Dacey's proposals had been e-mailed to board members in advance of the meeting – all board members were provided with copies of the e-mail that contained the proposals.) Mr. Dacey indicated that the proposals he was presenting were those of GAO (not just his proposals). The following are GAO's materials provided to the Board:

In response to discussions at the June board meeting, GAO agreed to provide the following input related to the CFR Requirements Relief Project for the Board's consideration at the August meeting. GAO initially provided these comments to the Department of Treasury on July 25th. The following reflects minor editing and formatting changes to such information.

1. To provide language to clarify the agencies that should be reported in the CFR, we propose to replace "examples" where used in individual disclosures in the draft ED with "a listing". New paragraph 27 elaborates on considerations for identifying agencies to list.

2. To propose language to require the disclosure of significant or unusual items, which are proposed to be deleted by the ED for the selected disclosures, we propose language similar to the following:
 - Material, unusual items should be disclosed in the notes to the financial statements in the CFR, to the extent not otherwise specifically required. Such items would include:
 - transactions or events, material individually or in the aggregate, that are new or unusual or that materially affect the basis for determining the amounts or classification of information in the financial statements (e.g., changes in accounting methods, restrictions on the use of assets, new contingencies, new types of goods or services provided at substantially less than cost, changes in significant assumptions, changes in legislation, new programs), or
 - material changes or trends in the composition of financial statement line items or components thereof.

Disclosure of such items is important to the users of the financial statements and is critical to the fair presentation of the financial statements in the CFR.

3. The following table (not included in these minutes) provides
 - (1) disclosures that GAO believes should be retained for fair presentation of the CFR and illustrative language to help visualize what such disclosures might look like (for context, the illustrative language incorporates high level descriptions of each disclosure item), and
 - (2) proposed clarifications of certain information included in the ED.

Area of Discussion	GAO Proposal	Illustrative Language (highlighted areas of text in the CFR or are similar to language in the CFR but edited to suggest more useful information.) For context, the illustrative language includes high level descriptions of each disclosure item.
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Disclosures Proposed to be Retained

Inventory	<p>Require disclosure of the general composition of inventory items and the basis for determining inventory values, including the valuation method used, any cost flow assumptions, and the relevant revaluation or loss allowances.</p> <p>(Note: the illustrative wording is based on the DOD's FY 2004 report, which represents 99% of reported gross inventory.)</p>	<p>"Inventory items are principally comprised of DOD materiel and include military equipment spare and repair parts and fuels held for sale to the military services. Current inventory is reported at an approximation of historical cost using latest acquisition costs and gains and losses but is transitioning to the moving average cost method. A revaluation allowance is applied to inventory held for repair to report only condemned inventory as excess, obsolete, and unusable. Condemned inventory is revalued to zero because the potential scrap value is greater than the potential scrap value."</p>
Operating Materials and Supplies	<p>Require disclosure of the general composition of the items and the basis for determining operating materials and supplies values, including the valuation method used, any cost flow assumptions, and the relevant revaluation or loss allowances.</p> <p>(Note: the illustrative wording is based on the DOD's FY 2004 report, which represents 96% of reported gross operating materials and supplies.)</p>	<p>"Operating materials and supplies principally include military equipment, ammunition, tactical missiles, and engines. Operating materials and supplies are reported at acquisition cost, and moving average cost. A revaluation allowance is applied to operating materials and supplies held for repair (such as engines) to report only the cost of those repairs and reports only condemned and unserviceable. Condemned material is revalued to zero because the potential scrap value is greater than the potential scrap value."</p>
Stockpile Materials	<p>Require a disclosure of the general composition of the items, any restrictions on the use or sale of stockpile materials, and the basis for determining stockpile values, including the valuation method and any cost flow assumptions.</p> <p>(Note: the illustrative wording is based on the Department of Energy's FY 2004 report, which represents 93% of the reported stockpile value.)</p>	<p>"Stockpile materials consist mainly of crude oil held in the Strategic Petroleum Reserve, the Northeast Home Heating Oil Reserve, enriched uranium, which are held by the Department of Energy. The Department of Energy's Petroleum Reserve can be sold only with the approval of the United States. The Department of Energy has 19,755 metric tons of enriched uranium. Part of the uranium is restricted from sale to the commercial market until 2012. The stockpile is recorded at historical cost except for certain nuclear materials in excess to the Department's needs, which are recorded at fair value."</p>
Property, Plant, and Equipment	<p>Require disclosure of the estimated useful lives and depreciation methods for each major class, and capitalization thresholds.</p>	<p>Property, plant, and equipment (PP&E) used in Government operations is reported at historical cost. Depreciation and amortization expense is reported on the balance sheets except for land, unlimited duration land, and certain intangible assets."</p>

		<p>Buildings, structures, and facilities 3-</p> <p>Furniture, fixtures, and equipment 3-</p> <p>Software 2-</p> <p>Assets held under capital lease len</p> <p>Leasehold improvements len</p> <p>Other PP&E va</p> <p>The category of PP&E consists of tangible assets in software, and other assets used to provide goods a software, have capitalization thresholds that are ge \$100,000. Software generally has a capitalization t \$1,000,000. Multi-use heritage assets are recogniz PP&E in the basic financial statements and addition heritage assets is included with the heritage assets</p>
Accounts Receivable	Provide information about factors affecting the collectibility and timing of taxes and other revenues, to the extent material to the CFR, due to the significance of such revenues to the CFR.	

Proposed Clarifications to the ED

Foreclosed Property	Insert "..., including a description of the types of property held," after "...broad description of foreclosed property..."	Foreclosed property consists of various assets, primarily acquired by the federal government in satisfaction of payment of a claim under a guaranteed or insured which are held for sale, are included in net loans re property is valued at the net present value of the pro associated with the property. Pre-1992 foreclosed pr adjusted to the lower of cost or its net realizable val valuation allowance.
Seized Property	Insert "..., including a description of the types of property held," after "...broad description of seized property..."	"Prohibited seized and forfeited property results prim investigations. Seized property is not considered an transfer of ownership to the Government has not oc in the Government's financial statements; however, stewardship responsibility until the disposition of the judicially or administratively forfeited or returned to Types of seized property include illegal drugs, firear general property, vessels, aircrafts, and vehicles, as currency is defined as monetary instruments that an

Custodial Activity	Replace “for the reporting period” with “for each period presented	This information is already reported in the CFR.
Direct Loans and Loan Guarantees	Replace with “The CFR should provide a broad description of direct loans and loan guarantees. Additionally, for each direct loan and loan guarantee program, the CFR should provide (1) the face value of loans outstanding, (2) the long term cost of loans and guarantees outstanding, (3) net loans receivable for direct loan programs, (4) the amount guaranteed by the Government for guaranteed loan programs, and (5) the subsidy expense for the reporting year. A general reference to agencies that comprise direct loans and of loan guarantees.	This information is already reported in the CFR.

Regarding GAO's proposals in paragraph 1, Mr. Dacey indicated that he was generally happy with paragraph 27 of the draft ED but preferred a listing of agencies. The intent is to list agencies with significant disclosures regarding items no longer required at the government-wide level. After some discussion it was agreed to add "significant" to paragraph 27 and remove "examples" from requirements for individual items.

Regarding GAO's proposals in paragraph 2, Mr. Dacey indicated that the language addressing his concerns is open for modification but there are 2 issues: (1) the substance of the proposals and (2) the language to be used. Mr. Dacey noted that the concerns addressed pertain only to disclosures to be eliminated or modified by the draft ED. Mr. Farrell opined that GAAP already broadly covers this concern at the financial statement level. Mr. Reid indicated that the story can't be told without including the types of things addressed by GAO's paragraph 2 proposals but the level of detail required is not helping to shorten the report and is detrimental to the intended audience. The detail can be found in agency reports. Also, the preparer could never demonstrate compliance with the requirements of GAO's paragraph 2 proposals since the preparer would have to prove a negative. GAAP requires that the preparer tell the story about what caused the changes in balances between years but having to say something about everything included in GAO's paragraph 2 proposals is contrary to the notions of SFFAC 4. References to agency level reports are intended to address such detailed disclosures.

Mr. Zavada suggesting cross referencing MD&A. Mr. Reid indicated that MD&A covers items included in GAO's paragraph 2 proposals. Mr. Dacey suggested that there will be inconsistent disclosures if the concerns articulated in GAO's paragraph 2 proposals are not addressed for items to be eliminated or modified. Mr. Lund noted that as a general matter, the CFR is not disclosing items that cannot be readily aggregated so the inconsistent treatment concern is not problematic.

Mr. Reid indicated that this is not an area of abuse – Treasury is anxious to tell the story consistent with the notions contained in SFFAC 4 (a more condensed report). What is being eliminated goes beyond balances – lower level detail.

The Board voted not to change the draft ED but include in the BFC the notion that disclosures about significant unusual items needed to tell the story about changes in balances between years will be included in the CFR.

Regarding GAO's paragraph 3 (1) proposals, Mr. Dacey noted that the disclosures GAO wants retained are generally limited to a couple of agencies. Mr. Reid indicated that Treasury has no intention of deleting disclosures currently included in the CFR. (The table prepared by GAO

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indicated that most of what GAO wants retained in the disclosure requirements is already being disclosed in the CFR.) Mr. Reid noted that he wants to talk with the Board in the future about a smaller report (not a substitute for the CFR). Mr. Reid noted that some disclosure requirements that GAO wants retained involve considerable variability (e.g., useful lives 3-75 years) and are not helpful in the context of a government-wide report.

Mr. Dacey proposed making the draft ED clear that the items addressed by GAO's paragraph 3 (1) proposals that Treasury is currently disclosing will not be deleted. That still leaves the remaining issues covered by GAO's paragraph 3 (1) proposals. Mr. Reid responded that Treasury wants to retain flexibility in this area so that scrubbing can be done for items that the preparer may be doing on a voluntary basis. Mr. Mosso asked if Treasury's position is that the items identified by GAO (that exceed what the proposals in the draft ED require) that Treasury is currently doing not be required? Mr. Reid answered affirmatively.

Ms. Comes called the Board's attention to paragraphs 28 – 29 in the draft ED that respond to GAO's concerns but at a less detailed level. Mr. Reid indicated that those paragraphs take the place of specific requirements. Ms. Comes noted that the level of disclosure is different. Mr. Mosso noted that the disclosures contemplated by paragraphs 28-29 are less detailed. The Board voted to not change the draft ED.

Regarding GAO's paragraph 3 (2) proposals, Mr. Dacey indicated that these are proposed clarifications. The first three of the 5 clarifications involve adding requirements to the draft ED that would require descriptions of the types of property held for foreclosed property, seized property, and forfeited property. Mr. Reid suggested not changing the draft ED so that only broad descriptions of such property would be required. The Board agreed. Regarding custodial activity, Mr. Lund indicated that the intent of the draft ED was to require disclosures for the current year and the prior year. Thus, Treasury agrees with GAO. Regarding the final item in GAO's table involving direct loans and loan guarantees, Mr. Reid indicated that disclosures for each program is overkill and Treasury seeks to retain the flexibility presented in the draft ED in deciding how to aggregate such programs. Mr. Zavada indicated that what is included in the CFR should mirror agency disclosures. Mr. Dacey indicated that GAO wants the current level of aggregation retained – what Treasury is doing now. Mr. Reid noted that it would be easier to keep that level of aggregation than to change it but Treasury wants the flexibility to make adjustments. Mr. Dacey noted that the language in the draft ED could result in reducing the aggregation to one line. Mr. Reid indicated that Treasury has no intent to change what it's currently doing. The Board voted not to change the proposal in the draft ED.

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Ms. Comes noted that the accounts receivable item in GAO's table (the section pertaining to disclosures proposed to be retained) was different than the other items in the grouping just discussed. She wanted to confirm the Board's position on the issue. Mr. Reid explained that the receivables are minor in comparison to the revenue and that the disclosure calling for information on the collectibility of receivables was misdirected. The Board decided not to require this disclosure.

Mr. Mosso asked the Board what additional changes should be made to the draft ED? Mr. Patton indicated that the standards are hard to read and there should be a cross reference to Appendix B. Ms. Comes indicated that she would work with Mr. Lund on structuring the draft ED so it is easier to read. Mr. Patton also indicated that paragraphs 37 and 38 should indicate what changes related to the differing rationales reflected in those paragraphs. Mr. Farrell indicated that paragraph 37 could discuss specific proposed changes and paragraph 38 could discuss the remaining proposed changes generally. Mr. Lund indicated that this revision will be made.

Mr. Mosso noted that the next action will be the preparation of a pre-ballot draft exposure draft.

- **Steering Committee Meeting**

The Steering Committee received the FASAB proposed budget for FY 2007. Mr. Farrell noted his belief that additional resources were warranted for FASAB. He reminded members of the committee that in prior years, the Board had been able to hold meetings in connection with professional association conferences. Committee members agreed to confer within their agencies regarding the proposed budget and will be prepared to approve the budget at the October meeting.

Adjournment

The meeting adjourned at 3:15 PM.

Thursday, August 18, 2005

Agenda Topics

Note: The Board began with Elements at 9 AM. At 10 AM, the Board welcomed outside guests to address Natural Resources and subsequently resumed discussion of Elements. The Natural Resources minutes are shown following the complete discussion of elements. In addition, the Board broke for lunch from 11:45 to 12:30.

- **Elements**

Ms. Wardlow presented a partial draft of a proposed concepts statement on *Definition and Recognition of Elements of the Financial Statements*. The draft comprised (a) a brief discussion of the purpose of Statements of Federal Financial Accounting Concepts (SFFAC); (b) an Introduction that explained the purpose of the concepts statement and defined the terms *elements*, *recognition*, and *recognize*; (c) a section that established and discussed recognition criteria and the distinction between meeting the definition of an element and qualifying for recognition in the financial statements; (d) a section on definitions of elements, including definitions of assets and liabilities and discussions of the essential characteristics of each element; the section also indicated where definitions of net position, revenues, and expenses could be placed in a future draft; (e) a section on the effects of uncertainty on definitions of elements, their measurement, and financial reporting in general.

Accompanying the draft was a memorandum to the Board which commented on each section of the draft and posed some questions for the Board. Staff also had provided to the Board a copy of an Exposure Draft of proposed *Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*, issued by the International Accounting Standards Board (IASB) in June 2005. The IASB's Exposure Draft included the notion of "stand-ready" obligations, which was included in the draft SFFAC. However, the Board did not discuss the IASB's Exposure Draft.

The Board's discussion of the draft proposed concepts statement focused on responding to fifteen questions that were included in the cover memo and followed the sequence of the draft. The first question was:

1. Does the Board approve the discussion of federal financial accounting concepts (page 1 of the draft)?

Responding to Mr. Mosso, Ms. Wardlow confirmed that the staff proposed to include a similar discussion at the front of future concepts statements to help readers understand the purpose and content of the Board's conceptual framework. Such a discussion had not been included in previously issued concepts statements. The Board generally approved the inclusion of the discussion but suggested some changes.

Mr. Mosso agreed that, as stated in the discussion, the Board is the most direct beneficiary of concepts statements. However, he would like to see more emphasis on the use of concepts statements by preparers and auditors, especially when they are addressing situations not covered by standards. Mr. Dacey said that idea was included in the draft; however, he agreed there should be a better balance between the references to guidance for the Board and guidance for preparers and auditors. Mr. Mosso agreed and added that he would like to see the Board discuss at some point whether and how to make concepts statements authoritative.

Mr. Patton suggested deleting the word "financial" from the heading (Statements of Federal Financial Accounting Concepts) of the discussion because the Board also

addresses cost accounting issues and has issued a cost accounting standard. Mr. Mosso said it was a good suggestion, but one would need a word to qualify “accounting” because the Board is not dealing with budgetary accounting. Mr. Dacey wondered whether the title should refer to “reporting,” rather than “accounting.” Ms. Comes said that the concepts statement on objectives is titled *Objectives of Federal Financial Reporting*, but the statement is classified and designated as a “Statement of Federal Financial Accounting Concepts,” as are the other concepts statements that the Board has issued. No decision was made to change the designation of concepts statements. Ms. Cohen and Mr. Farrell suggested some editorial changes to a sentence referring to the purpose of concepts statements and the Board did not object. There also was no objection to Mr. Patton’s suggestion that the reference to SFFAC 1 should be deleted. The Board then turned to question 2.

2. *Does the Board agree with the definition of*

(a) *“elements”?* (par. 2 of the draft concepts statement)

(b) *“recognition” and “recognize”* (par. 4)

Mr. Patton suggested changing the term “economic things” in paragraph 2 and Ms. Cohen and other members agreed. The term refers to subdivisions of elements that are not themselves elements. Mr. Patton thought that “things” implies a limitation to potential assets with physical form, which is not the intent. Other members proposed “segments” or “components” and Mr. Mosso indicated that staff should choose a suitable alternative to “things.”

Mr. Mosso said that the last sentence of paragraph 4 (“For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements.”) is important because people tend to focus on recognition and forget that it also implies derecognition. The Board then proceeded to question 3.

3. *Should the proposed concepts statement include a definition of “net position”?* (par. 3)

Ms. Wardlow explained that the draft did not have definitions of elements other than assets and liabilities. She believed that the Board intended to include definitions of revenues and expenses, but she was uncertain about including a definition of net position. She thought that a term like “net position” might be associated with a particular kind of financial statement or the current reporting model. Also, in her view, the treatment of net position in the document would be limited to defining it as the difference between assets and liabilities, unless the Board wished to address the current model and issues that would lead to a discussion of current status and possible subdivisions of net position. Because of these uncertainties, she had indicated a place where net position could be defined in the document and had raised the issue for the Board to discuss. Question 4 (*“Should the proposed concepts statement include a*

definition of 'cost' and 'net operating cost'?) addresses a similar issue. She recommended that in answering these questions the Board consider whether such definitions would take the Board too far into discussing the current model and issues that are more appropriately addressed in a statement of standards than in a concepts statement.

Mr. Mosso thought it would be useful to include a definition of "net position" because the constituency does not necessarily understand that equity, or whatever term one uses, is the difference between assets and liabilities. This is particularly so when the amount is subdivided as the FASAB has required in certain standards. Constituents may not understand that net position or equity has no inherent definition; it is derived from assets and liabilities. He thinks that everyone uses the term "net position" in federal statements, but he asked whether the Board wants to adopt that term as a formal definition. Mr. Farrell questioned whether net position is an element or a result. Ms. Cohen and Mr. Mosso said it is a result.

Mr. Dacey said that net position in federal financial statements is different from net equity in business financial statements, so it is important to define it. It is not entirely a residual because it has component parts, such as unexpended appropriations, although he is unsure whether that should be included in a concepts statement. Responding to Mr. Farrell's question, Mr. Dacey said that net position is an element. Mr. Mosso noted that the FASB treats equity as an element. Mr. Dacey opined that the issue is whether the Board is covering the major items that are in a financial statement and he noted that the FASB defines equity as an element. Ms. Wardlow said that there was more reason to do so in the private sector, because of shareholders' interests and the need to clarify the difference between equity and liabilities. She thought the situation was different for the federal government. In her view, unless the Board wished to describe a particular model in the concepts statement, it would be difficult to say much about net position other than it is the difference between assets and liabilities. If the Board decided to discuss components of net position, would it not be addressing issues or standards of display and items that the Board has decided that entities should report? Mr. Dacey said that the Board intended to discuss whether certain items, such as actuarial changes, should be reported as part of net position, so he thought it was important to define net position in the concepts statement. He agreed that net position is quite different from equity in the commercial model, and that might be something that should be discussed somewhere, though maybe not in the concepts statement.

Ms. Cohen commented that she believes the GASB uses the term "net assets" rather than "net position." Mr. Patton said that if he were interested in having commitments become an element, and if the Board says that net assets or net position is assets minus liabilities, would that not make commitments a subset of net position? Mr. Mosso agreed but Mr. Patton said he did not think of commitments that way. Mr. Schumacher suggested to Mr. Patton that commitments are subsets of liabilities. Mr. Patton disagreed, saying that commitments are distinct from liabilities. Mr. Dacey thought it would depend on how the Board defines net position. If the Board defines it as simply assets minus liabilities, then commitments are a challenge. However, if the Board

defines it by components, such as cumulative budget results and cumulative results from operations, and part is unexpended and part may be earmarked . Mr. Patton responded that would result in the dilemma described by Ms. Wardlow: one would be implying a particular model and the definition would be like a standard. He thought it would be safer to call net position net assets and define it as a residual amount.

Mr. Reid asked Mr. Patton whether he was concerned that existing standards that focus on net cost imply a particular model, and that this might somehow prevent changing it? Mr. Reid thought that the way the Board is presenting things now is consistent with its original intent to focus on net cost, and as soon as you indicate you are going to look at net cost, it implies something completely different for things like revenue. Federal government reports do not have a revenue statement. There is a statement of changes in net position and net cost and other things are rolled into it. So, if you focus on net position as just assets minus liabilities, you are focusing on one side of the equation, but you are not focusing on what caused net position to go from point A to point B. The statement we have now focuses on those things. Mr. Reid described the current statements and their effect on information in the statement of changes in net position and said that information may be added in the future, for example as a result of the Social Insurance project. If the Board is content with that kind of presentation, then the definition maybe should reflect that. He would be interested in a clarification of what one should call that net change. If net position is reduced as a result of net operating cost, then net operating cost is somewhat equivalent to the term "deficit" or "non-budgetary deficit." He thought that was something it would be useful to define because it is not inherently clear to constituents that you are talking about a total and not about a discrete element. Currently, when one talks about the accrual-based deficit, one uses the term "net operating cost," and a surplus is called "net operating revenue." It is not immediately clear what that means. Ms. Wardlow asked whether a concepts statement on elements was the place to define those terms. Mr. Reid responded that he was unsure.

Mr. Mosso concluded that something should be included in the proposed concepts statement about net position because it is a key term, even if it is simply defined as the result of comparing assets and liabilities. He thought that "net position" fits the federal government better than "net assets." Mr. Patton agreed provided it can be done in a way that does not imply a particular accounting model. He thought it might be difficult to do that. Based on Mr. Reid's description of the current model, it seems that such a cost-tracing model might not have room for commitments. The Board may decide that it does not wish to report commitments, but he would not wish to rule out the possibility.

Mr. Mosso asked Mr. Patton whether he was distinguishing between commitments and contingencies, which are included in the notes. Mr. Patton said that commitments are not liabilities; they are similar to amounts called responsibilities in the Consolidated Financial Report. Mr. Reid said it would depend on how one defines the universe of credits. If it includes only liabilities, then something results from that in net position. If you define the universe as including liabilities, responsibilities, commitments, contingencies, and so forth, then you get a different number. Therefore, he was unsure

that the net position side of the equation necessarily would limit one to including or excluding certain classes of credits. Mr. Mosso commented that you can include anything as long as the statement balances. Mr. Reid agreed, saying that double-entry bookkeeping forces that result. Mr. Patton said he thinks of commitments or responsibilities as a separate element—a building block rather than part of some residual. Mr. Reid responded that, as a building block, it would be a credit, not a debit, and you would take the different building blocks that you have with credit balances and you would compare those with the debit balances and the result would be net position. But a building block also would have implications for what you do on the flow statements. So the double-entry entry part of it calculates net position rather than simply obtaining it by subtracting one element from another.

Mr. Patton said he hoped that Ms. Wardlow could write this in a way that does not commit the Board to a particular model. Ms. Wardlow said she thought the discussion would have to be brief because if one included potential components of net position, that would lead to including potential components of liabilities and assets, which inevitably would result in the construction of a particular model. She said she thought that the view of net position as a residual should be emphasized or, as stated in paragraph 3 of the current draft, it should be stated that “net position, revenues, and expenses derive from the definition of assets and liabilities.” Referring to question 4, she thought the Board should not include definitions of “cost” and “net operating cost” because it would connote a particular model. Mr. Patton repeated his concern that the definition of net position should not imply a particular model. Ms. Wardlow responded that the recommended approach would be clearly consistent with the accounting equation, which is not a particular model but something that everyone accepts and the Board is not trying to change that. However, within the accounting equation, one can break things down in different ways and one can achieve a lot of things through different displays. One probably would not want to say that in a concepts statement, although it might be appropriate to say that the concepts statement is not dictating a particular model. Mr. Patton said he would like to have that statement in the document.

Mr. Mosso indicated that, based on the previous discussion, the Board’s answer was “no” to both question 4 (*Should the proposed concepts statement include a definition of “cost” and “net operating cost”?*) and question 5 (*Are there other elements of financial statements required by the current financial reporting model that should be defined in the proposed concepts statement?*). The Board then turned to question 6.

6. Does the Board generally agree with the presentation and discussion of the recognition criteria? (pars. 5 through 9)

Ms. Wardlow summarized the reasons she had given in the cover memo for placing the section on recognition criteria in the draft before the section on definitions of elements. Mr. Mosso agreed with the placement, saying that the separation of definition and recognition are not intuitively obvious to many people. Placing recognition first and defining it helps the reader understand that there are two pieces, and then they are discussed individually. Mr. Dacey thought there should be more discussion of

measurement, because there are really three areas: definition, recognition, and measurement. Mr. Zavada agreed with identifying the three areas. Ms. Wardlow asked for a clarification, because there are only two recognition criteria: (1) the item has to meet the definition of an element and (2) it has to be measurable. Without measurement, there would not be recognition. The next question might be: How does one measure elements? However, she recommends that issue not be included in this concepts statement. It might be addressed in a future concepts statement or in individual standards. For these reasons, she was uncertain what else she could say about measurement in the current concepts statement.

Mr. Zavada asked whether one could simply lay out the framework without further discussion. Ms. Wardlow said she thought that was what was done in the current draft. Mr. Patton said that he thought some measurement considerations were covered in the section of the draft on the "Effects of Uncertainty." Ms. Comes said that the concept of choosing a measurement attribute is in paragraph 6 of the draft. It says that one has to choose a measurement attribute, but that would not be addressed in the current concepts statement; it would be addressed later. Mr. Dacey said he did not read the section on recognition criteria as giving the broad introduction to definition, recognition, and measurement that he would like to see. Mr. Mosso suggested that it might be possible to include something in the Introduction. Mr. Zavada said that it would be helpful to make it clearer why the discussion of recognition criteria is placed ahead of the section on definition.

Mr. Zavada raised another concern. He thought that the separate section on uncertainty is good, but he does not like the way it is disconnected from definition and recognition. He would prefer to see the uncertainty discussion built into the discussions of definition and recognition. He acknowledged that the Board had agreed at the previous meeting to try a separate section, but he thought that uncertainty is too intertwined with definition and recognition to be presented separately. Mr. Mosso asked whether Mr. Zavada would place the discussion of uncertainty earlier in the draft, perhaps as part of the introductory material. Mr. Zavada said he was proposing to make uncertainty part of the discussion of definition and recognition, rather than leaving it as a separate discussion. Ms. Wardlow asked whether it would still be one section and Mr. Zavada said he did not object to that.

Mr. Farrell said that he believes the section is separate from the discussions of recognition and definition to make the point that uncertainty is pervasive in the preparation of financial statements. It is not relevant to these particular items—recognition and elements—it is just pervasive and one has to acknowledge that. So, the Board is not trying to embody it in the definitions or confuse the definitions. At the end of the draft, the Board is just acknowledging that there are pervasive issues of uncertainty whenever one is dealing with financial accounting matters. This was his recollection of the Board's discussion of having a separate section on uncertainty. Mr. Zavada agreed that was one way to address the issue, but the Board now has a "stripped out" definition of liabilities since the Board has taken out the notion of probability and there is little or no discussion of it. For assets, the Board has added

some things that have increased the clarity of the definition. He thinks uncertainty can be treated separately but it would be better to put it all together and discuss uncertainty in both recognition and definition.

Ms. Wardlow said that the discussions of the definitions of assets and liabilities are cross-referenced to the section on uncertainty, so one is aware that it exists. However, given the Board's decision not to include a reference to uncertainty in the definition itself, it would be difficult to interweave a discussion of uncertainty into the discussions of the definitions. She thought one could bring the entire section on uncertainty forward and perhaps include it as part of the Introduction, although its importance suggests the need for a separate section. That would then push the two main points of the document—recognition and definition—further back in the document. So, where to place the section on uncertainty is a dilemma. She thought the cross-referencing was helpful in that it reminds the reader that uncertainty is an important issue and will be discussed later in the document. If that is not sufficient, then she would try to place the section earlier in the document and see if that would help.

Mr. Reid referred to paragraph X6 of the section on uncertainty and noted that it made reference to measurement. He wondered whether a shorter version of the section could be included in the section on recognition criteria because he views uncertainty as part of measurement. He thought that was the conclusion of the Board and the reason for removing references to uncertainty from the definitions. The more certainty there is, the more reliable the estimates are. Nevertheless, there is a point where uncertainty is so great that a decision is made not to recognize the element. Therefore, maybe the discussion of measurement and uncertainty should be combined in the section on recognition. Mr. Schumacher asked Mr. Reid whether he was talking about the last sentence of X6 or the whole paragraph. Mr. Reid said he was referring to the paragraph and noted that it discusses limitations, one of which is uncertainty. His understanding of it was that entities can have assets and liabilities but they are not always recognized because it is not certain enough that they will be realized. He thought that consideration would be better placed in the first section than split either side of the definitions. He would bring forward the whole section on uncertainty, maybe shorten it, and weave it into the points made about measurement in the section on recognition criteria. Mr. Farrell said that he would bring forward only paragraph X6 and leave the remainder of the section at the end of the document. Mr. Schumacher agreed with Mr. Farrell.

Mr. Mosso said that he thought Mr. Zavada's point was that uncertainty affects definitions as well as measurement. The Board has found in looking at various programs that, even with the proposed definition of a liability, it was hard to decide whether there is a present obligation, so there is uncertainty in that sense. Mr. Zavada agreed that he was saying that there is uncertainty in the liability itself, in its definition as well as in its measurement. He wonders whether when the Board was thinking about uncertainty in measurement it was not thinking enough about uncertainty in definition. Mr. Dacey said he has a similar concern about two concepts of probability. One is assigning probabilities to outcomes and measurement where, for example, you think

there is a 20 percent chance that something might happen. There is an issue there because you can measure it, you can assign an expected value to it, but is that sufficiently probable for us to recognize it? That is not a measurement issue because we can measure the element. There is a second piece which asks whether there is a threshold at which you do not think it is sufficiently probable that you will make the payment or realize the benefit, so that you would not recognize the element. So, there are two probabilities involved there: one is a minimum threshold for recognition, if the Board is trying to get at that, and the other is including risk and uncertainty in the mathematical model for calculating the amount. He had seen discussions of measurement uncertainty in staff papers but not of minimum thresholds for recognition.

Mr. Patton asked Mr. Zavada whether his point was that there is uncertainty about meeting the definition, or recognition, or measurement. Mr. Zavada responded that uncertainty weaves through all three things, but the Board seems to have said it is measurement only. He disagrees with that and wonders how one could insert the concept of uncertainty into all three considerations. Mr. Patton said that a majority of the Board had decided to remove probability from the definitions. So that leaves uncertainty only in recognition or measurement. Mr. Mosso said there are two kinds of uncertainty and maybe they are being mixed up. One is the uncertainty of the future, but when you are talking about definitions, the notion is the uncertainty of the present. It is a question of what you have in this situation or set of circumstances, which is not a future consideration. Mr. Zavada disagreed. He thinks it is uncertainty of settlement of the liability and the liability itself, and then there is a measurement uncertainty—how you can go about measuring a liability. They are both in the future. Mr. Patton said that his comment has a practical implication because if the majority of the Board says that probability, and therefore uncertainty, is not part of the definition, it will be very hard to weave uncertainty into the front of the document where definition is a major component. Uncertainty could only be included in recognition or measurement. Mr. Zavada agreed that was the decision that was voted on, but then the Board had agreed to address uncertainty in a particular way in a separate section. That is what the current draft does. He thought the Board could revisit that decision.

Ms. Wardlow said she thought there was general agreement that there is uncertainty as to the existence of a liability as well as uncertainty as to the amount. So, the document is not trying to say there is no uncertainty about existence. She thought the Board had agreed at the previous meeting that a separate section on uncertainty would cover both kinds of uncertainty. However, the point would be made that the place where uncertainty or probability is assessed is in measurement. You draw a conclusion about whether an item meets the definition of an element or not without actively assessing probability. You reach a conclusion based on the best evidence that you have. You know that you may be wrong, but you do not assess a probability at that point. The next step is recognition or, rather, measurement since meeting the definition is the first of two recognition criteria and that criterion has been met. Measurement is where you take probability into account.

Mr. Dacey said it was possible to measure many things, but then the next issue is whether the element is material and should be recognized. The draft includes a reference to materiality and qualitative characteristics in paragraph 7 of the section on recognition criteria. Perhaps those references also need to be expanded. Mr. Dacey asked whether the Board would want to recognize an element that was very low on the probability scale—say, 10 percent. He is not aware of the Board's position on this because at the last meeting the decision was to move probability to measurement, but he did not think the Board had distinguished between measuring probability and deciding whether it was high enough for recognition. He reiterated his belief that there are two kinds of probability. He is not sure whether the Board wished to address it, but he believes there is a level of probability below which the Board would not wish to recognize an element.

Mr. Mosso said that one would have to decide case by case. If it is 99 percent probable that you will get zero and one percent that you will get something, one might think that is too low, even though under an expected value approach, one could put a dollar value on it. Mr. Dacey agreed and said that was the point he was making and he wondered what the Board's position is on setting a threshold of probability for recognition. Mr. Patton said that currently the Board has only two criteria: the element is either measurable, which you say is possible because of its expected value, or it does not meet the definition of an element. Those are the two recognition criteria. Does that imply that probability is back into definition? Mr. Dacey said he liked the idea of including a notion of probability in the definition, but he was unsure whether the Board's intention in moving it to measurement was to preclude the possibility that one would exclude something merely because it had a very low probability of occurring.

Mr. Reid said that, from a practical standpoint, both things are intertwined. Taking a lawsuit as an example, suppose that you have someone's judgment that you are likely to lose the suit and there is an amount involved that has been requested. So, you are likely to lose the suit and you make a judgment as to the amount that will attach to that. As Mr. Dacey points out, you may have another suit that, in the judgment of the attorneys, you are extremely unlikely to lose, but you have an amount. We have a process where we say that we do not recognize an amount if, in the judgment of the attorneys, it is below a certain threshold. So, those two things are bound up in the same process. Everyone would say you have a liability in this case, when looked at on a global level. In other words, looked at in terms of the universe of lawsuits, there is clearly a liability other than zero that it would be appropriate to record. In contrast, looking at lawsuits individually, one faces these different decisions. Mr. Reid said he was referring to measurable events where the probability is a question mark that affects a decision whether to recognize the event or not. He thinks that realistically one puts the two things together and concludes that one is in the middle, which is where one has difficulty. Typically, cases with a 99 percent probability are not the issue. It is when one concludes there is a fifty-fifty chance, and even if the other side wins we do not think they will get what they have asked for. Do we want to recognize something? Or do we think that it is more likely than not that they will prevail and the question is the amount they will get? One tends to look at these things together when deciding an amount to

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record. Mr. Reid said that was the best example he could give; there is a lot of uncertainty as to the existence of anything and also a lot of uncertainty as to the amount.

Mr. Dacey thought the example illustrated the issue well. We have some lawsuits that are alleging material claims that we and the attorneys believe are not probable. Under the current model, if it is not probable we do not recognize it and we do not attempt to assess an amount. We disclose a range of amounts in the notes. He wondered whether the Board was intending to change the model to suggest that not be the initial threshold, that one would look at the case and assess there is a 10 percent chance of losing the case and we can measure that and recognize the liability. Under the current model, when you get to probable, then you start assessing how to measure the probability, and what is the likely amount we would pay if we lost the case. Mr. Reid said he thought that under the current model we are doing exactly what is laid out in the draft concepts statement. We are not assessing in terms of deciding how big the potential sandbox is. We do not look to probability at all. We say either we have the case or we do not have the case. In other words, when you define a liability, you say here are the elements of it, and that becomes the universe. Then you start with that universe of items and you shrink that, based on the probability of the outcome, and then there is a further assessment of an amount once you determine an item is probable. And that is the hierarchy it seems we would go through with what is laid out in the draft. You have a potential liability. Then you go down to probability and conclude that it is very unlikely that you would actually pay something and you would not record anything and probability becomes part of that measurement exercise.

Mr. Mosso said materiality is what keeps people from doing unreasonable things. If one percent probability is \$1 billion, we would probably think that is material and recognize it, but if it is \$10 . . . Mr. Patton said that was a quite different model. Mr. Reid said that with lawsuits, for example, you start with the same idea, that you have a liability. Every time someone files a lawsuit you have a potential liability. You start with the universe of lawsuits and you have to determine whether you will record anything for any of them, but you have them all laid out on the table. Then you go through the exercise of considering how likely it is that those bringing the suit will prevail and if they do prevail, what will be the amount. Mr. Reid said that he sees that as the same concept as is discussed in the draft. We have talked before about casting a broad net and then you have an actual process that you are required to go through to determine whether or not you will recognize anything under this potential liability.

Mr. Mosso concluded the session at 10:15 a.m. in order to proceed after a brief break to the presentation of representatives of the Department of the Interior on natural resources. The session on Elements would resume after that presentation.

The Elements session resumed after lunch, at 12:30 p.m.

Mr. Mosso said that he thought the Board had spent enough time in the morning on the issue of uncertainty. He asked Ms. Wardlow to try to weave some of what is in the

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uncertainty section into other places in the draft. He would like to keep that section on uncertainty, although he did not mind whether it came first or last in the draft. But, maybe some of the material could be worked into other places, perhaps with a cross-reference. He then said the Board should move on to question 8.

8. Does the Board agree with the revised definition of an asset? (par. 11)

Mr. Mosso said the revised definition is very succinct and easy to understand. Mr. Zavada thought that changing “could” to “embodies” in the definition adds more certainty to what is an asset. In contrast, the draft seems to go in a different direction for liabilities by taking out probability. He wondered if both definitions should not go in a consistent direction. Ms. Wardlow confirmed that she had taken the word “could” out of the definition of assets, but part of the reason was the Board’s decision to remove probability from both definitions. She thought the asset and liability definitions were quite parallel, although the words are different because the two elements have different essential characteristics. She did not see where one definition had greater certainty than the other. Mr. Reid agreed. He thought that both definitions are succinct. On the liabilities side the definition includes the phrase “to provide” assets or services and there is some very specific language. On the assets side, he agreed with Mr. Mosso that the definition is very succinct and to the point, and then it is followed up immediately with a discussion of some uncertainty which is fine. Just because you define an asset does not mean that you go to the next step; you have some judgments to make about it. He thought the two things together were excellent.

Mr. Mosso said he did not understand Mr. Zavada’s point about the definitions. He thought both were simple statements. He asked Mr. Zavada whether he was including some of the discussion in his comment. Mr. Zavada responded that he thought that when the Board took uncertainty out of the asset definition, it added clarity, but he thought that the removal of uncertainty from the liabilities definition moved it in the opposite direction. Ms. Wardlow said she had not changed the liability definition much from the previous meeting. She had edited out a couple of words but they did not relate to probability. Probability had been removed earlier from the liability definition. Mr. Zavada asked if that also was true of the notion of “little or no discretion.” Ms. Wardlow said she thought that notion had been removed two meetings ago. Mr. Zavada said he was comparing the current definitions of asset and liability with previous versions. Ms. Wardlow agreed that the Board had considered several versions of both definitions over a long period of time. Mr. Mosso said that he thinks that making the definitions declarative sentences without any implication of uncertainty is an improvement. He thinks the definition should be what the element is now. If one continues along the lines Mr. Zavada is thinking of, then one brings in uncertainty because nothing is as certain as a simple statement like the definitions. But he thinks the definitions are very easy to understand.

Mr. Mosso asked members whether there were any objections to the asset definition (question 8). Mr. Dacey said he had questions concerning paragraphs 15 and 16 but was unsure whether this was the time to bring them up. Ms. Wardlow said those

paragraphs are covered by question 9, but they could be addressed now, particularly if the Board did not have further comments on question 8.

Mr. Patton said that paragraph 15 refers to an asset as a resource that possesses two essential characteristics, and the first characteristic is “it embodies economic benefits or services that can be used in the future.” He wondered whether “can” is a probabilistic statement. Mr. Schumacher said he thought the sentence meant that the benefits or services “are able” to be used in the future, as opposed to “may” be used in the future, which would be probabilistic. Mr. Patton thought it was the resource that would be used, not the benefits or services. Ms. Wardlow said that the Board is looking at the benefits and services as essential characteristics that distinguish between a simple resource and a resource that qualifies as an asset. So, it is the benefits and services that can—meaning “are able to”—be used in the future. But, there is no certainty at this point that the benefits and services actually will be used in the future. One cannot know that at this time. Mr. Patton questioned why one would not simply place a period after “services.” Mr. Mosso responded that he did not understand Mr. Patton’s concern about the last part of the sentence (“that can be used in the future”). He asked Mr. Patton whether he thought the last phrase was unnecessary, or conveys something that the Board does not wish to convey. Mr. Patton said it looked to him like a probability statement and he did not see what the Board would gain from it.

Mr. Mosso asked Ms. Wardlow what she thought. She said she did not see the problem. It should be clear that the item embodies economic benefits and services that have not been used. Otherwise it would not be an asset; it would be expensed. So, there is a notion that these things are able to be used in the future and she did not see the harm in saying that. If one deleted the phrase, she would hope that the implication still would be there. Mr. Patton said he sees “can” as something like “could.” Ms. Cohen disagreed, saying that “could” is not the definition of “can.” “Can” means “is able to.” Mr. Mosso said he did not see a parallel with “could” and thinks “can” is a very positive statement.

9. Does the Board agree with the substance and coverage of the discussion of the essential characteristics of assets? (pars. 14 through 31)

Mr. Dacey said he would like to confirm his reading of paragraph 18. He thought it was talking about a situation where an entity manages collections and those receivables would qualify as assets. He asked whether that concept is similar to what the Board currently refers to as “custodial-type” assets. Ms. Wardlow said she was uncertain about paragraph 18. Based on her experience with State and local government, she thought the situation described was like an “agency” or “custodial” situation. Therefore she had difficulty concluding that the receivables in question are assets of the entity that is making the collections for another entity.

Ms. Comes said she had asked Ms. Wardlow to include paragraph 18. She acknowledged that the conceptual foundation is not yet well developed. However, the situation is not just custodial in the sense that agency A performs a service but does not

have a collecting office, so it asks agency B to do its collections. It is more pervasive than that. For example, the IRS is set up to administer the tax code and yet receives no benefit from the revenues it collects. It places them in the general fund at the Treasury. There are also agencies that perform services and collect the receivables that derive from those services, and yet they are not able to use those receivables to finance their activities; they have to obtain an appropriation to finance next year's operations. So, they also turn their receivables in to Treasury. There are a myriad of cases where the cash flows from receivables do not end up with the agency that manages the receivables. She thought that State agency situations are quite different from the situation she was addressing in paragraph 18. As an accountant, she had difficulty concluding that the IRS would not have a receivable on its books, or that someone running a business but unable to keep the proceeds would not also track the receivables on their books as an asset. Ms. Comes said she was trying to find a conceptual explanation for this phenomenon. These agencies have all the management responsibility and often produce the service that creates the revenue, and yet they do not receive any economic benefit from it.

Mr. Dacey said the situation would cover the areas where entities are currently recording custodial assets. He wanted to clarify whether that was the intention in paragraph 18 in terms of the concept or if anything is being changed. Ms. Comes said her intention was to preserve the current treatment, and Ms. Wardlow is uncomfortable with the conceptual foundation. Ms. Wardlow said she did not see how the treatment fits the proposed definition of an asset. She could understand that, from a standard-setting perspective, one might agree that these receivables should be reported as assets because of management involvement or a similar reason, but she did not see how the treatment could be explained in a concepts statement. She did not know how to respond to someone who asks: If the entity is not receiving any economic benefits or services from the receivables, then how do they meet the definition of an asset that appears in the same document?

Mr. Reid thought it was a question of the level of entity. He was trying to operate on two levels, one of which is the practical side of the issue. If the entity that is collecting the money does not record the asset, then the asset would not be recorded at all. The consolidated statements for the government would be missing those assets, because there would be no way to determine the information for the consolidation process. He was not conversant with the custodial side of reporting and he is not sure of the dollar amount that is reported in custodial statements as assets or liabilities, because there is no custodial statement at the consolidated level. He would like to be clear that the assets need to be recorded and he thinks paragraph 18 is addressing that. Whether the entity reporting the assets is actually realizing them is irrelevant. The fact that there is an asset there and the benefits can be realized means the asset must be recognized. Mr. Farrell commented that if Treasury were to record the receivable, it would not receive the benefit either. Mr. Reid said that the net effect is that the debt situation is adjusted for the actual receipts. If the receipts are up, then the amount of debt that you need to refund the amounts that are maturing plus whatever is needed is changed by the deposits that are made through the custodial side. He admitted that there are

amounts called general government revenues, which means they do not affect spending authority. He said that the other kind of revenues, which are seen on the statement of net cost as offsetting the expenses, tend to be the kind—one can never say they are—that allow the agency additional spending authority by the amount of the collection. The amounts that come through the custodial side tend not to do that and become simply general revenues of the government. Mr. Dacey said that Treasury has a custodial tax receivable and a liability to the general fund because it is not the Treasury's money either. Mr. Reid agreed.

Mr. Dacey said that he agreed with the concept in paragraph 18, but it is a matter of fitting it in with the definition of an asset. Because virtually every entity this would apply to is a controlled entity, there may be a separate concept that involves the division of responsibilities between these controlled entities, and maybe that is a special case because it does not seem to quite fit the definition.

Mr. Zavada wondered what the practical consequence would be of the last sentence of paragraph 18—"Therefore, the resource claims (accounts receivable) qualify as assets of the entity assigned management responsibility." He wondered who would record the receivable, for example, in the case of the Highway Trust Fund. He thought that currently the receivable is recorded by the Department of Transportation, but the last sentence of paragraph 18 seems to suggest that Treasury would record it. Ms. Comes asked whether he thought that instead of "assets of the entity assigned management responsibility," it should say "assets of the entity assigned collection responsibility." Mr. Reid said the entity with collections would transfer them to Treasury. He thought the sentence says that the entity assigned responsibility for the Highway Trust Fund is really the Department of Transportation. Ms. Comes said she thought that also. Mr. Reid and Mr. Dacey briefly discussed the procedures for recording revenues collected by the IRS.

Ms. Comes acknowledged that some rewording of paragraph 18 was necessary to achieve the desired result. However, there is the conceptual issue of whether the paragraph should be written so that the receivables meet the definition of an asset, or should the Board simply acknowledge that the recording of this type of asset on the books of the responsible component entity would be achieved through standards? She said she was trying to find a conceptual argument to the effect that the entity, by managing these collections, provides a service; the assets help the entity provide services, and the entity therefore receives some sort of benefit. But it is a difficult argument to make. Mr. Reid said that Ms. Comes's discussion in paragraph 18 was close to achieving the desired result. He thought the receivables did fit the definition of an asset, because the definition does not say that the benefits have to accrue to the agency that is recording the asset. Mr. Schumacher said he thought the definition did say that because it refers to the entity controlling access to the benefits and therefore being able to obtain them for itself.

Mr. Patton asked why the situation described in paragraph 18 is not a custodial situation. Ms. Comes said it was custodial in some cases but not in others. For

example, the SEC collects fees and cannot keep all of them. The fees go into the general Treasury and then the SEC receives an appropriation to cover their operations for the next cycle. Mr. Patton asked why the fees the SEC collects are not a custodial asset of the SEC. Ms. Comes responded that the collection is not on behalf of another specific agency. Mr. Reid explained that there are custodial collections, but virtually no agency, other than perhaps the Department of Defense, operates bank accounts. The deposit goes into an account managed by the Financial Management Service. That Service, through the Federal Reserve, consolidates all those collections and provides reports. There are about 2,000 places where these situations occur. Those transactions are fed back to the agencies. So, the source of original entry is the lockbox itself that is managed by Treasury for virtually every situation like that in government. Then the funds are consolidated and the agencies are informed. On the expenditure side, it is just the opposite. The agencies are the source of original entry and they advise Treasury when and how to make the expenditures. So, even though the entity that is receiving the funds and recording the custodial activity has no cash, these in effect become internal transactions that are eliminated in the consolidation. The cash is retained. The custodial activity, if it represents an asset at the agency level like a receivable, is consolidated. The agency would not have the asset. The agency collected the cash, but it is physically not their cash. If the cash generates budget authority, their budget authority goes up. If not, the amount simply appears as a custodial receipt and there is a section of their statements where these custodial transactions are reported. In consolidation, the total appears as miscellaneous receipts from all the agencies.

Ms. Cohen asked whether the IRS collects all taxes, including excise taxes, gas taxes, and so forth. Mr. Reid said the IRS collects those taxes, but he would not necessarily say they collect all taxes. He explained the general procedures with tax returns and estimates. The information about the deposits of most taxes generally comes from the IRS and is based on estimates. In response to a question from Ms. Cohen about agency fees and charges, Mr. Reid took the Park Service as an example and explained that some amounts result in additional budget authority but others are miscellaneous revenues of the government. Mr. Mosso said that one thing that is certain is that they are receivables of the federal government and have to be recorded somewhere. Mr. Reid agreed and reemphasized his earlier comment that, from a practical perspective, if the agency does not record the receivables, the Treasury would not know about them or would have very limited knowledge for including them in the consolidation.

Mr. Patton said that, as already pointed out, there is a conceptual disconnect between that conclusion and the definition of an asset. Ms. Wardlow asked whether, when the agencies record receivables, the offsetting entry is a revenue or a liability. Mr. Dacey said that the IRS records a liability, but he did not know whether all agencies do that. Ms. Comes explained that the standards provide that an entity that earns revenue—the SEC, for example—recognizes revenue regardless of whether the entity keeps it or not. When the revenue relates to their operations, they recognize it and then record a transfer-out to the central books. When they collect revenue that is not related to their operations, they do not recognize revenue. They record a receivable with an offsetting

liability. Ms. Cohen asked if there were then transfers to Treasury. Mr. Reid said there were transfers to Treasury in both cases, but they are recorded differently, depending on whether the agency can spend the money or whether it is a general receipt and not available to the agency. Mr. Schumacher asked whether he is correct in assuming that one kind would be reported in the agency's statement of net cost and the other would not. Mr. Reid agreed. Ms. Cohen asked whether, in the case of the SEC, what they can spend has nothing to do with what they collect; the collections are given to the Treasury and then the SEC receives an appropriation. Mr. Reid confirmed that, in the case of the SEC, the two transactions are completely separate; the revenues they collect have nothing to do with the size of their operations. The revenues they collect are reported in their financial statements, in a custodial statement that separates them from what is occurring in their operations. Mr. Farrell asked whether he is correct in concluding that the credit entry for the agencies is either accounts payable to the Treasury or revenues, depending on which category the transaction falls into. Mr. Reid and others agreed. Ms. Comes said that in the financial statements of the twenty-four largest agencies there are only six custodial statements. She believes that most of the agencies have some sort of miscellaneous receipts that are transferred to the Treasury. So, not everything is captured in the custodial statements. Mr. Reid agreed and said there is a fairly strong supposition that part of the reason that, in consolidations, the eliminations do not balance is because there are agencies that have custodial activities that are immaterial and no credit for those activities is reflected in their statements because the amounts are too small.

Mr. Mosso said that the Board should leave it to Ms. Comes and Ms. Wardlow to word the issue appropriately. Ms. Comes posed an additional question. She said she had attempted to link the situation and the definition of an asset conceptually by saying that the entity's receivables are used to provide services and therefore qualify as an asset of the entity. Another approach is to say that the situation is an exception, which would be similar to the Board's decision in Statement of Federal Financial Accounting Standards No. 1 to provide for the recognition of non-entity assets, which most of these receivables would be. So, if the Board and staff cannot find a conceptual way to qualify the receivables as entity assets and fall back to the exception approach, would the Board prefer to do that in a concepts statement or in a statement of standards?

Mr. Reid said that, without fully considering all aspects, he would be inclined to say in the definition that the entity is the government as a whole. He would make it clear that one is not talking entirely about a specific item if it relates to the entire entity. Ms. Wardlow said that the draft already contains a paragraph on what is meant by "entity." The paragraph states that the entity can be the federal government as a whole or it can be a component entity. She thought that definition was needed and was reluctant to confuse the issue. Mr. Mosso suggested saying something like the statement Ms. Wardlow had cited, namely, that in the definition "entity" can be either—we have a collecting entity or the government as a whole—and then explain that in paragraph 18. Ms. Wardlow said that would refer back to paragraph 10 which defines the entity. That solution would mean that the receivables meet the definition of an asset of the federal government, but it would not explain how they would be an asset of the individual

agency. Mr. Reid said that was his concern when the Board started talking about this issue; the recording was left optional at the agency level and mechanically, the way the government works, that would not be a good outcome. We need to require that the asset be recorded by the agency because there currently is no structure for recording it at the government as a whole level and the asset simply would be omitted. He thought it would be a more cost-effective solution to require the asset to be recorded at the lowest level, even if that entity does not receive the benefit from the asset.

Mr. Jacobson asked whether it would be possible to require the entity that controls the resource to record the asset, and the benefit could be either to that entity or to the federal government as a whole. That would fit many of the circumstances that the Board has been discussing. If you define the word entity as either the federal government or a component entity, you encounter more problems, but you do not necessarily want to redefine the word "entity." Ms. Wardlow said it might be possible to take that approach, but it brings us back to Ms. Comes' question: Does the Board want to do that as an exception in a concepts statement? The Board might have reservations about putting a major exception in a concepts statement. Or would the Board do it through a standard? Mr. Jacobson said he was not suggesting building an exception into the concepts statement, but building the situation into the concept itself. One could say that "An asset is a resource that embodies benefits or services to the federal government or an entity thereof that the entity can control." You have defined "entity" to be . . . Ms. Wardlow said that "entity" is already defined in paragraph 10.

Mr. Farrell suggested rewording the second essential characteristic of an asset in paragraph 15 to read: "Second, the entity can control access to the economic benefits or services and, therefore, can obtain them for itself *or the government as a whole* and deny or regulate access of others *outside the government*." Mr. Reid thought the change was an improvement. It would give something to point to in indicating that the agency should book the asset. Board members discussed various aspects of the proposed change, but no decision was made. Ms. Comes pointed out that it was difficult to make changes at the table without considering the effects on other concepts in the draft. Ms. Wardlow said possible changes would be considered, but in her view paragraph 10, which defines the entity, is critical to understanding the definitions. If one begins to specify in other paragraphs which particular type of entity is being addressed it would create problems and become very confusing. As currently drafted, the definitions apply to any entity, as that term is defined in paragraph 10. So, she did not think the Board would want to make particular cases where in one paragraph the entity is a component entity and in another paragraph it could be either the government as a whole or a component entity.

Mr. Reid thought that part of the issue here was that there is an operational component that qualifies the situation. In other words, the entity has to be the main organization that is responsible for the activity as well as it being an asset and as well as the entity being a component of the general government that receives the benefit. It is more than just the existence of an entity; the entity has to be the principal operator in the way that Ms. Comes defined it, as a collector as opposed to the manager of the trust fund, even

though the entity does not keep the money. Mr. Mosso asked Mr. Reid whether the main point is that whoever is assigned responsibility for collection should record the asset, whether they use it or not. Mr. Reid agreed. Mr. Dacey said it would not have to be the actual collector. It might be the entity with responsibility for managing the funds, although there could be an initial collector first.

Mr. Patton asked in what sense the receivable would be an asset to the managing entity? Mr. Reid said it is an asset of the federal government. Mr. Patton agreed with that, but said if he is producing an agency financial statement, in what sense is that receivable an asset to his agency? Mr. Reid said he was not sure whether it would be reported now as a custodial receivable or as a non-entity receivable. Mr. Patton said he thought the idea of a non-entity asset is not a good one, given the definition of an asset. Mr. Reid said he had not looked deeply enough into that issue and was not sure. Dr. Patton said he would urge the Board to find a conceptual solution rather than make an exception. In his view, the Board is working to build the concepts and if the definition of an asset does not work in an important situation, then maybe the definition should be changed, or maybe the Board just has to live with the results of this not being an asset to that entity. Mr. Reid thought that, because the change is a nuance, it might be better to make it in the characteristics than in the definition.

Ms. Comes thought that if the characteristic is changed, then the change also would have to be included in the one-sentence definition of an asset. The one-sentence definition says that the entity can control the benefits or services and in this case the entity could be the Highway Trust Fund or the Transportation Department, or it could be the government as a whole, depending on which set of statements one is looking at. So, she thinks that Mr. Patton is raising a good point. In trying to find a conceptual justification, her only thought so far is that the receivables help the entity provide a service and therefore they provide a service to the entity. The situation is not just Highway Trust funds, it is pervasive in that moneys often flow into an entity or are provided by that entity's operations but do not remain with that entity. Sometimes the amounts are large, so relying on materiality would not be adequate. If the notion that the receivables are useful in providing services by the entity is not an acceptable conceptual justification . . .

Mr. Farrell asked where tax revenues are recorded. Mr. Reid said generally in the Treasury, in IRS. Mr. Farrell said that IRS cannot spend the revenues, so the Board will face the same issue when it addresses revenues. Mr. Farrell added that he agrees with Ms. Comes that this is a pervasive issue and also affects revenues. Ms. Comes agreed that, for example, the SEC would not be recording its fines and penalties and filing fees if they are not also recording the receivable, and it would be odd for the SEC not to report what its collections were. Mr. Farrell said that somehow the Board needed to get the concept of an entity with management responsibility into the definition. Mr. Reid again expressed his concern that if agencies do not record receivables as assets, the information might not be available to the Treasury. Mr. Mosso asked if the agency books a liability at the same time that it books a receivable, then why would not the receivable be an asset of the agency, because it would use that asset to liquidate the

liability? He added that he was unsure whether the agencies book a liability. Mr. Reid said he thought the credit could not be unexpended authority so it would have to be a liability, but he was unsure of the mechanics. Mr. Farrell said that procedure would contradict the characteristic in the draft, which says that they can deny or regulate the access of others. He did not think that, for example, the Park Service could refuse to give money to the Treasury. Mr. Reid said that the process was the opposite; the money would be deposited with the Treasury, and the Treasury would notify the agency that the money had been received, and the agency has to record it. The Board discussed the mechanics of various situations.

Mr. Mosso said the Board should move on and let Ms. Comes and Ms. Wardlow try to work out a satisfactory solution. Ms. Wardlow said that, before moving to the next question, she would like to mention a change to paragraph 20 that was proposed at the pre-briefing meeting. The proposal was to change the word "right" to "ability" in line 10 and change "has a right to" to "can" in line 12, with related editorial changes. The Board did not object to the change.

Mr. Dacey raised the issue that the references to leases in paragraph 19, as examples of an entity having an asset even though it does not own the property, might be interpreted to apply to all leases. The Board briefly discussed different kinds of leases and accepted Mr. Farrell's suggestion to change the phrase "when property is leased" at the end of paragraph 19 to "under certain types of lease arrangements." Also with reference to leases, Ms. Wardlow said there was a proposal in the pre-briefing session to change an example in paragraph 27 to one related to leases. The example to be changed referred to a situation where the federal government might own highway equipment but grant to a state full control and use of the economic benefits and services for the life of the equipment. The conclusion was that in those circumstances the state should report the asset. The Board briefly discussed the case and similar situations and agreed to substitute an example about leases. The Board then proceeded to question 10.

10. Does the Board agree with the examples of factors to be considered in assessing whether an entity has a constructive liability? (par. 33, lines 9 through 15)

Ms. Wardlow explained some editorial changes to paragraphs 32 and 33 that had been proposed during the pre-briefing session. The Board did not object to the changes. It was proposed that, where appropriate for consistency, similar changes would be made in other paragraphs of the draft. Mr. Zavada asked the meaning of "mutual understanding" in line 11 of paragraph 33 ("whether the entity has reached an agreement or mutual understanding with another entity. . .") Ms. Wardlow responded that it was intended to cover situations where the two entities have essentially agreed what their respective responsibilities are, although there may be no formal agreement. Mr. Reid said one could view "agreement" in two ways: (1) that there is a meeting of the minds or (2) that there is a formal document, and he believes that the wording is intended to ensure that readers understand that you do not need a formal document.

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Mr. Zavada thought that “agreement” would encompass both of Mr. Reid’s examples. Mr. Reid agreed but said it might not be as clear and some might argue that you need a formal document.

Mr. Jacobson said that the suggestion had been made in the pre-briefing to take out the word “reached” (line 11) and merely say “have an agreement or understanding” because some might interpret “reached” to indicate a formal document. Mr. Zavada suggested just saying “agreement” and deleting “or mutual understanding.” Ms. Cohen thought that if the reference is limited to “agreement” she would think it meant a signed document. Mr. Farrell suggested substituting “whether an entity has agreed with another entity.” Mr. Zavada said that was fine and Ms. Cohen said she could go either way. Mr. Jacobson said that one consideration was whether the Board wished to include situations where two parties do not have direct communications with each other, but, given the totality of the circumstances, they are in exactly the same position in terms of their view of their relationship and prospective dealings with each other. An agreement connotes two parties directly dealing with each other. “We agree” is different from “we have a common understanding of the circumstances.” Mr. Mosso said that environmental liabilities might be a case where you do not really have an agreement, but when you undertake some activity, you have an understanding that the law will require you to do something. That understanding does not sound much like an agreement, but it is binding.

Mr. Reid said he likes the language the way it is in the draft (including both terms, “agreement” and “understanding”). He concurred with Ms. Cohen that “agreement” sounds like something written and “mutual understanding” sounds like something that may not be, and by including both terms, both situations are covered. Mr. Mosso asked whether other members wished to change the wording and, hearing no responses, he concluded that the language should refer to both agreement and understanding.

Mr. Patton said, with reference to paragraph 33, that while he acknowledges that the Board is preparing a concepts statement and not a standard, he thinks that the factors listed as aiding a judgment as to whether a liability has been incurred are not particularly useful for judgments about federal programs and liabilities. He would like to add more specific—but not program specific—guidance for certain classes of liabilities that are prevalent within the federal government. For example, on the previous day, the Board had discussed in Ms. Ranagan’s project (Research into Application of the Liability Definition) the possibility of developing some classes of liabilities that would enable the Board to make some broader-based statements than going through individual programs. So, for example, in the draft concepts statement, he would suggest including some statement about benefit programs, and factors to consider might include whether measurable eligibility criteria have been established and whether individuals or entities have substantially fulfilled the criteria. Without mentioning a specific program, that is a very broad class of liabilities and it would provide more guidance to readers. There may be other kinds of categories that could be developed, but he thought the current language in paragraph 33 did not provide much guidance.

Mr. Mosso asked Mr. Patton where he would place something like that. Mr. Patton said the last sentence of paragraph 33 goes from “Factors” in line 9 to the end of line 15. He would reword a sentence from paragraph 38 of the draft to read: “A present obligation is incurred when an entity takes a specific action that commits or binds itself and affects another entity.” He said that establishes what a present obligation is. Returning to paragraph 33 (line 9), he would say “Factors that may affect the conclusion that a present obligation exists include relevant aspects of the legal framework within which the entity is constituted.” Except for the addition of “that a present obligation exists,” that sentence is already in paragraph 33. Then he would add “For example, for federal benefit programs, factors to consider would include whether measurable eligibility criteria have been established and whether entities or individuals have substantially fulfilled the criteria.” Mr. Patton said that is a general class of potential liabilities for which the Board can provide generic guidance as to the factors to consider.

Mr. Farrell said that at this point (paragraph 33) the draft has not even got to “present obligation.” At this stage of the discussion, the document is just talking about the legal framework and the fact that a liability may or may not be in law. Mr. Zavada said he had the same idea as Mr. Patton, but he thought it would be better placed in the discussion of present obligation, somewhere around paragraph 39. Ms. Wardlow said it would be possible to work with something similar to Mr. Patton’s suggestion in paragraph 33. However, it would be incomplete if the discussion did not do what is attempted in paragraph 33, namely explain that there are obligations that can be traced to a specific law or regulation, and then there are other items that we conclude are obligations, based on the totality of the factors that we are looking at. At the previous meeting, the Board indicated it would like to include some examples of factors that one would look at. She said that in one of the early drafts of this section, there were examples in the paragraph that included benefits. They were taken out because of the Board’s concern that the paragraph sounded as if it was talking about Social Security and other benefit programs, and it was close to setting a standard. Ms. Wardlow added that it might be possible to get around that difficulty, but she would not like to use the term “present obligation” before the section on the definition and essential characteristics of a liability, where the term is defined. Also, the notion of constructive obligation, even though the Board has decided not to use the term, ought to come before the definition of a liability. The section on legal framework [paragraphs 32 through 34] is leading up to the definition of liability. If an example in that section would help and the Board would like to have something about benefits, she would work on that, but, in her view, the example should not be in paragraph 33 and the term “present obligation” should not be included in that section.

Ms. Comes said she was concerned about putting an example of a benefit program in paragraph 33 because that paragraph is set up to talk about roughly how to assess items that do not have much foundation in law, rather than coming from specific legal or regulatory requirements. She thought that Social Security, Medicare, and Medicaid are very specifically founded in legal requirements. The Board is not creating some mutual understanding that is not in the law. We are not suggesting that the Social Security Administration is just doing something that they have done in history and therefore have construed they should continue to do. They are doing what is required by law. Ms.

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Comes said she did not object to the specific language that Mr. Patton has suggested or having something like that in the document, but she thinks that paragraph 33 is not the right place because it addresses constructive liabilities and she does not see those programs as clear-cut examples of constructive liabilities. Mr. Patton agreed. However, he said that language similar to his proposal belongs somewhere in the document.

Ms. Comes said she agreed with Mr. Patton's suggestion but she thought Ms. Wardlow was the best judge of where the added language should be placed. In paragraphs 39 and 40 the draft sets some boundaries. At the end of paragraph 39 there is an example of an unconditional promise and clearly there is an obligation. At the end of paragraph 40 there is an example of an exchange. So, it seems that a non-exchange, benefit-type example could fit there. Mr. Patton said he would rely on Ms. Wardlow's and Ms. Comes's judgment. Mr. Mosso cautioned that the term "benefit program" is a lightning rod and comments in response to the exposure draft are likely to focus on one sentence and not the total picture. Ms. Comes added that it does not really resolve the issue of what it means to substantially meet conditions, and the Board would continue to debate that issue. Mr. Mosso said he did not object to an example of some kind, but he urged caution to avoid giving the impression that the Board has prejudged the outcome.

Mr. Patton asked some questions about whether consideration of the factors listed in paragraph 33 would lead to the conclusion that the entity had a liability. He cited, for example, "agreement or understanding with another entity" and "relevant precedents." Ms. Wardlow said the first probably would suggest that the entity has a liability, but conclusions from considering relevant precedents could go either way. In the past, in similar situations, the entity may have assumed it has a liability or it may have construed that it did not have a liability. Also, precedents do not dictate future action. The factors are mentioned as examples of things that should be considered in their totality as aids to judgment when one cannot point to a specific law or regulation in deciding whether there is a liability or not.

Mr. Reid recalled that earlier in the meeting the Board had struck out the reference to new legislation and regulations in the last factor, but it had not removed the rest of that factor which would now read "current circumstances that may affect the entity's activities or incurrence of obligations." He suggested saying "changes in current circumstances" to emphasize that one is not talking about the status quo but is referring to something different that has happened. After some discussion, the Board decided to delete the last factor entirely. Mr. Farrell suggested that, since the factors listed are examples and there could be others that an entity should consider, that point would be clearer if the sentence beginning in line 9 said "Factors that may affect that conclusion [that a liability has been incurred] include *among others* . . ." As an alternative and because of the different interpretations of "include," Mr. Jacobson suggested that the sentence begin "*Examples of factors* . . ." Ms. Wardlow agreed that would clarify the issue.

With regard to examples of non-exchange transactions, Ms. Wardlow said that would be a positive addition. Earlier drafts had included some examples in paragraph 33, but the Board deleted them. She thought it might be possible to include some examples

somewhere around paragraphs 39 or 40, but clearly within the discussion of “present obligation.” In that case, it might be good to refer back to paragraph 33 to clarify that the non-exchange examples do not necessarily refer to actions that are a direct requirement of law. Mr. Zavada said it would be helpful to have some examples of non-exchange programs, especially if it could be done by class of liabilities. Mr. Reid said that was part of Ms. Ranagan’s project. Mr. Mosso said the Board may not have developed its classes of liabilities in time to include them in the draft concepts statement. Mr. Zavada said a concepts statement lays out a broad framework. Mr. Mosso responded that it would take time for Ms. Ranagan to develop the classes.

Mr. Mosso asked Ms. Wardlow what was the next topic. She mentioned a wording change in paragraph 41, which had been proposed during the pre-briefing session. Consistent with removing “reached” from the phrase “reached an agreement” in other places in the draft, the suggestion was that the last sentence of paragraph 41 should begin: “If the entities do not have an agreement or understanding” instead of “If the entities have not reached an agreement.” There were no objections. Mr. Zavada said he was confused by the variation in some terms. For example, the draft refers to an “unconditional promise” and to an “agreement,” which he thought meant the same thing, so there seemed to be an inconsistency in the use of terms. Ms. Wardlow said that no inconsistency was intended; the words were used to cover different situations. One might have a promise where there is no formal agreement, but there is an understanding with the other party. One of the points made in the draft is that, to have a liability, there must be two entities involved. An entity does not incur a liability just by making a promise; there must be an agreement or understanding with the other party. Mr. Zavada said he did not understand the meaning of each of the terms “promise,” “agreement,” and “understanding.” Ms. Comes said that Ms. Wardlow was saying that a promise is part of having an understanding. Ms. Cohen said she concluded that an “unconditional promise” is the same as a guarantee and one of the other discussion papers talked about an unconditional promise to stand ready.

Mr. Mosso asked whether the Board was ready to move to question 11. Ms. Wardlow responded that question 11, on the definition of a liability, was very important and she would include anything major that the Board wished to raise under questions 12 or 13, which cover the substance and coverage of the discussion of, respectively, “Present Obligation” and “Settlement of the Obligation.” With the earlier discussion of uncertainty, the Board had already covered questions 14 and 15 on the substance, coverage, and proposed placement of the draft section on the Effects of Uncertainty.

11. Does the Board agree with the definition of a liability (slightly shortened but otherwise unchanged from the previous draft)? (par. 35)

Mr. Torregrosa, representing the Congressional Budget Office, said that the CBO likes the definition of present obligation. Mr. Reid said he does also. Mr. Mosso asked for other comments on the definition of a liability, acknowledging that the Board had discussed it briefly earlier. Mr. Zavada said that he would prefer to see a reference to uncertainty or probability in the definition, as he had mentioned earlier. Mr. Mosso said

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they would try to accommodate some of that earlier request, not in the definition itself, but somewhere in the supporting argument.

Mr. Torregrosa said that he had discussed with Ms. Robinson the deletion of the paragraph in a previous draft which explained that the fact that Congress can change the law does not affect the existence of a liability, if the definition is met. They think it is important to include that point in the discussion of “present obligation.” He does not think it is a measurement or probability issue because he does not believe one can measure on anything other than current law and everyone has different expectations of what Congress might do. So the issue should be in the present obligation section, rather than in the uncertainty section. He would suggest the issue be included in or just after paragraph 38. In response to Mr. Mosso’s question, Ms. Wardlow said the issue could be addressed in the present obligation section.

Mr. Farrell said that earlier in the meeting the Board had referred to unconditional promises, which are mentioned in the last sentence of paragraph 39. He is concerned that the term “unconditional” might be read so literally that if there is any condition at all attached to something, it would not be considered as a potential liability. Mr. Mosso suggested deleting “unconditional” from the sentence. There was no objection. Mr. Dacey said that the same sentence referred to “incurring a liability,” but he thought it should refer to incurring an obligation because the paragraph is talking about only a piece of the definition of a liability. In relation to the same sentence Mr. Zavada asked whether, when the government agrees to defend another country, that is a promise to provide resources, like a treaty, in the context of the last sentence of paragraph 39? Mr. Reid said he thinks so, but it is not measurable. It is something he would want to look at, but if one could not assign a value to it, it would not be recognized. It might be disclosed or reported in some other way. Ms. Cohen agreed.

Mr. Patton said that seemed to be the “stand ready” concept and Mr. Reid would record a liability for the stand ready aspect. Mr. Farrell said you would not necessarily record a liability, but it might meet the definition. Mr. Reid confirmed that he would go through the steps. The first is whether it meets the definition of a liability. He might conclude that it does but then conclude that he cannot assign a value to it. Therefore, he would not recognize it but it would be a liability. There is a promise and, in the case of a treaty, there is a written promise.

Mr. Patton said he believes that a present obligation cannot exist unless the conditions associated with the obligation are met. Mr. Mosso said that is why this is a category of “stand ready.” You do not have to have the event; you have made the promise “In case X happens, I will come in and defend you.” It is a guarantee. Mr. Patton said that one of the international boards [IASB] has proposed that if you are sued you have a present obligation, and the obligation is to stand ready to obey the court’s ruling. He asked Mr. Mosso whether he would agree that is a present obligation? Mr. Mosso said yes. Ms. Cohen said that what the IASB means is there is a present obligation to meet the judgment if you lose the suit. Mr. Patton said they are not saying “if” you lose the suit. Ms. Cohen responded that there is no judgment to meet if you do not lose. Mr. Patton said the question is: Is there a liability when the lawsuit is filed?

Mr. Jacobson said you would do an assessment, and if you concluded that you were going to lose . . . Mr. Patton said that is a probability assessment. Mr. Reid said he would argue yes; there is a liability. Then you go through the process of assessing whether it is likely you will win or lose, and if you lose, how much? Ms. Comes said, and Mr. Reid agreed, that would be part of the measurement process. Mr. Patton said he thinks that, if that is a liability, it is a huge expansion of liabilities. Mr. Reid asked what would happen if you did nothing; you were sued and you did nothing. You simply did not respond. Mr. Patton responded that presumably you would lose. Mr. Reid said that certainly is a possibility once the suit is filed; something is happening as a result of being sued. Mr. Zavada said this recalled Mr. Reid's earlier example where he would list all the cases and not every case is a liability. Mr. Reid said that every case is a potential liability and every one has to be valued. You cannot just consider the ones you want; you must look at all of them. Mr. Dacey said that this suggests we would be calling a lot of things liabilities that we would not call liabilities under current definitions, because we screen them for probability before we call them liabilities. Mr. Reid agreed and said that was part of the discussion the Board had about casting the wide net and then weeding them out. Mr. Zavada said that the question here is whether there are certain conditions that have to be met, once you cast that net, to have a present obligation.

Mr. Jacobson said that the Board's proposed definition is that an obligation is a duty or responsibility. Would there be a duty to provide assets or services to someone simply because they filed a suit? He would say no. If you graft the definition of present obligation into the definition of a liability, then a liability is a present duty or responsibility to provide assets or services. He does not believe that, when someone files a suit against him and he does not find the suit meritorious, he has a duty to provide anything. Mr. Schumacher asked if Mr. Jacobson was saying that you do not have to stand ready until the facts present themselves that you have an obligation. Mr. Jacobson agreed. Mr. Reid said it was in dispute whether you have an obligation or not. It is not certain; it is in dispute. Mr. Farrell said to Mr. Jacobson that his "present duty" would only come about as a result of the judge making a ruling. Mr. Jacobson said it would also come about if he assessed that it was probable he would lose. Mr. Patton said he would make the same argument about the Milk Support program; there is no present obligation until the milk goes below a certain price. Mr. Zavada agreed. There is a second screen that one has to go through to arrive at the present obligation. Mr. Reid said that if one is sued, there is an obligation at that point to assess the situation.

Mr. Mosso said that the Board needs to develop the "stand ready" notion. He pointed out that insurance companies book liabilities on a stand ready basis; they are stand-ready organizations.

Conclusion: Mr. Mosso asked Ms. Wardlow what she proposed for the next meeting. She said she would make the proposed changes in the draft, try to accommodate the requested addition or rearrangement of certain material on uncertainty, try to resolve the issue of receivables recorded by component entities with management or collection responsibilities, include some examples of factors to consider when assessing the existence of liabilities under federal benefit programs, include some examples of non-

exchange transactions, and add proposed definitions of net position, revenues, and expenses.

- **Natural Resources**

Staff, Rick Wascak, introduced Mr. John Wood, Energy Information Administration (EIA), and Mr. Dan Fletcher, Department of the Interior (DOI). Staff explained that each would first like to give some introductory remarks, followed by discussions on the questions contained in the issues paper in Tab C of the binder.

Mr. Fletcher stated that, from the Department of the Interior's perspective, he wanted to make sure what the objective of the project is. He added he believes that the objective is well defined. That is, reporting a net asset based on a calculation using the price of oil and gas, proved reserves and royalty rates. Mr. Fletcher said that the Department works with quantities of proved reserves and royalty rates regularly and that they were not a challenge. However, the pricing component could be complex. He suggested that the pricing component be kept as simple as possible. Mr. Fletcher also stated that the measurement dates and times for calculating and reporting the net asset be kept as simple as possible. Mr. Fletcher said the Department looks forward to having increased accountability and increased reporting that is of value to users of the financial statements.

Mr. Wood stated that his understanding is that the purpose of the project is to monetize as an asset the royalty interest that the Federal government has in the proved reserves under its control. He said the term proved reserves is the one oil and gas resource that you can count on with almost certainty that the estimated amount will be recovered in the future under today's technology and today's price. He added that the estimated volumes in aggregate are very reliable. Mr. Wood explained that in the prior definition of proved reserves, proved reserves were described as an amount of oil or gas you would get with reasonable certainty in the future. Presently, the Society of Petroleum Engineers, the World Petroleum Congress, and others have adopted a definition for proved reserves that is couched in a "probabilistic" sense rather than the "reasonable certainty" sense. The probabilistic sense is that there is a 90% probability the estimated accumulation of oil and gas contained in the ground will be produced.

Mr. Wood stated that the estimated amount is almost always a conservative estimate. What this means is that 9 out of 10 times you will get at least the estimated amount. He said more often than not, you get more. He added that in the aggregate, the likelihood that 90% will be produced is very high. The larger the group of fields you aggregate, the higher the probability that you will get that estimated amount. For example, the regional average price, the regional average royalty rate, and the regional average proved reserves are numbers that will be known with relatively high precision in reasonable periods of time.

Mr. Wood stated that the EIA issues a report containing aggregated volume information for crude oil, natural gas, and natural gas liquids. The report is issued in the month of

September containing volume information as of December 31 of the preceding calendar year. Mr. Wood explained that the information contained in the report has a 99.999% probability that there is at least the physical volume that is estimated. When you want to put a value on the physical volume, you multiply it by a price. Mr. Wood explained that the Securities and Exchange Commission³ (SEC) wants to know the volume of proved reserves and the price at the end of each year from producers. He said he believes you should have a longer historical period to get an average price because the price is volatile and volume is not.

For example, if the annual average price of a barrel of oil was \$16, the volume of proved reserves would be valued at \$16 at year end. However, if the price of a barrel of oil dropped to \$8 at year end, the volume of proved reserves would be valued at \$8 a barrel at year end and because the price of a barrel at year end dropped to \$8 the volume of proved reserves also may drop because it may no longer be feasible to recover the reserves under existing economic conditions. Therefore, the proved reserves could not be reported at year end since proved reserves are limited to those that are economically recoverable at the price on the date of the estimate. However, as Mr. Wood noted, a \$12 increase in the price of a barrel of oil over the previous week demonstrates the volatility of the price.

Mr. Dacey asked if there is any time-frame or some type of measure for when oil reserves will be removed from the ground. Mr. Wood responded that each well has a production profile and the EIA reviews them on an individual basis; however, estimates done on an individual basis are not good. If estimates were done on 500 wells, that would be a good estimate. If estimates were done on a larger number of wells, that would be a very, very good estimate. In addition, he said he doesn't believe that you would want to take information from individual wells and add them up. He said that there are about 45,000 fields in the U.S. and about 1 million wells. Also, it would be difficult to get individual wellhead price for wells because of transportation costs. A regional average price can be used.

Mr. Farrell asked if proved reserves vary greatly based on the price of a barrel of oil. Mr. Wood responded that "vary greatly" would mean to vary greater than 25%. He said the answer is no, it does not. Once proved reserves are established, they are not really subject to price variation of oil and gas. He added that proved reserves do not vary from year to year.

Mr. Reid noted that, with regard to conservativeness, the volume of proved reserves doesn't change much even after a number of years of production. He asked if the formula or calculation having a probability rate of being produced could be changed. For example, instead of the 90% probability rate, make it a 50% change. Mr. Wood

³ Staff note: Proved reserves are defined by the SEC as "those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods and governmental regulations." Economic assumptions include prices and costs at the date the estimate is made.

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answered that it could be changed; however, there would be a lot of assumptions needed and having a large number of assumptions could be very confusing.

Mr. Reid said he thinks that using the 90% probability rate for proved reserves is only part of what there may be in the ground. He asked if the “possible” and “probable” reserves could also be reported. Mr. Wood said that he would recommend using only proved reserves. Mr. Reid said that he would argue against discounting of proved reserves because what is being reported is not everything that is there. Mr. Wood noted that the rule of thumb is that you would sell proved reserves for 1/3 of the estimated value of existing proved reserves.

Mr. Zavada asked if you were doing a 20 year forecast of proved reserves, wouldn't that forecast draw some of the possible and probable resources into the forecasted number. Mr. Wood answered that it would.

Mr. Patton asked if Mr. Wood could explain the term “adjustments” which is used in the EIA's formula for calculating estimated proved reserves. Mr. Wood explained that in the formula, you start with last year's estimated proved reserve number and go through the calculation. He said the term “adjustment” is used as a balancing term. Mr. Patton asked what the magnitude of the adjustment is. Mr. Wood answered 1%.

Mr. Mosso noted that the SPE had made a presentation that indicated a 30 year production timeframe for a well. He asked Mr. Wood if he had any comments about the 30 year timeframe. Mr. Wood responded that he would be cautious in adopting a typical life cycle shown in the SPE 30 year timeframe. He explained that the implied 30 year life for a well uses an exponential 10% decline rate. However, because of advanced technology, the decline is more hyperbolic. That is, you produce more of the proved reserves in the first few years of the production well. For example, the production in the first year may be 25% of the reserves, the second year may be 15%, and so on. In addition, because of advanced technology, production from a well can be prolonged and the original estimate of proved reserves is generally exceeded.

Mr. Mosso thanked Mr. Fletcher and Mr. Wood for participating in the Board meeting.

CONCLUSION: Staff will begin developing an Exposure Draft.

- **Social Insurance**

The staff presented 10 questions along with recommendations for each. Staff noted that the most of the questions essentially are seeking agreement in principle. Details would be specified as the drafting progressed.

- 1. What attribute should be measured for social insurance? Staff recommended present value.**

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The Board discussed the mechanics of the present value calculation for Social Security. Mr. Farrell noted that the 40-quarters obligating event would result in the first 10 years work in covered employment being recognized at 40 quarters. Mr. Reid said that the calculation calls for averaging the participants' highest 35 years of wages. In instances where participants have only 40 quarters (or 10 years) of wages, 25 blank or zero years would be included in the average.

Mr. Patton said the discussion was taking Social Security as more like a pension plan than anything else. He said Social Security is not a pension that a person earns; it is not a salary.

He said that another way to look at Social Security is as a social program. For the latter, an obligation is incurred at the obligating event, which for the Board majority is apparently 40 quarters. The obligation is for the amount the person will get eventually, and it is unclear why the projected amounts that the person is likely to earn in covered employment in future periods are excluded. Mr. Patton noted that one can project actuarially what people will do over future periods; and, since the social program exists now, why not project the likely payments of that social program when the person starts to collect.

Mr. Reid replied that Social Security benefits are calculated a lot like a pension plan's and that is why the cost calculation here looks a lot like a pension plan.

Chairman Mosso said Mr. Patton was suggesting the closed group number. Mr. Patton agreed.

Mr. Zavada said that the staff paper had only been available for a short period of time and he had not had time to consult with SSA or HHS on the different questions, which he wanted to do before weighing-in. He wondered if the Board would not benefit from an exchange, for example, with the chief actuaries, Steve Goss from SSA, and Rick Foster from HHS. He noted that some of the issues go beyond accounting into actuarial projections. Staff agreed and stated that it planned to attempt to arrange for representatives to address the Board and/or comment on early drafts of the standard; but staff needed to develop the issues further and obtain the Board's preliminary decisions in principle before doing so.

The Board agreed with the staff recommendation with respect to question 1.

2. Should OASDI and Medicare liabilities include projected amounts in excess of the current statutory limit? The staff recommended including the full cost and full liability to the participants.

Mr. Torregrosa said that, since the Board is using current law as the basis for liability decisions and current law specifies that funding is cut off, CBO does not agree with the staff recommendation. The projection should be based on what is available.

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Mr. Dacey said he perceived the law to be somewhat different than for other programs. The law does not say that the participants will receive these benefits until the participants dies, but that to the extent of the resources available. He noted that this is similar to other appropriation laws. He emphasized that this limitation is communicated to the participants.

Ms. Cohen acknowledged the statutory limitation and the communication and public awareness of it; but she said there was a great deal of skepticism about this among the American population, the media, and elsewhere. For example, everyone is also aware that in the past adjustments have been routinely made to ensure full payment and correct the situation. She concluded that it is up to the Board to decide what it wants to show as an obligation based on the Board's purpose.

Mr. Dacey said that he, as an accountant, did not want to predict what Congress would do. He said that if the Board wanted to go follow current law, then this is a different situation than the normal program where the Board debated whether there would be an appropriation in the future. This was a fundamentally different funding mechanism.

Mr. Jacobson added that the federal government frequently recognizes liabilities for which funding is not yet legally available.

Ms. Comes said she did not know whether the Board had ever based liability recognition on whether funding was available. However, this was a bit different in that the benefit schedule is being controlled by a cap, as Mr. Dacey noted. Regarding the Board's objective of showing the accruing cost each year, she said that, as a taxpayer, she would like to see the portion of benefits earned each year for which funding is not likely to be available.

Chairman Mosso opined that both the funded and unfunded obligation would have to be shown.

Chairman Mosso asked how the Board felt about the staff's recommendation regarding question #2, i.e., reporting full cost, with some kind of disclosure about the statutory limitation either as Ms. Comes suggests or a footnote or some other approach.

Mr. Patton said he does not think funding should drive the liability and therefore preferred full cost.

Mr. Schumacher favored full cost with a disclosure or reduction or some other disclosure of the limitation.

Mr. Dacey preferred considering the unique characteristics of this program and not project amounts in excess of the statutory limit. Although supporting accrued liabilities for other unfunded programs, he felt this program was unique because of the public communication that full benefits will not be paid in the future. However, he did want the full exposure or responsibility for the federal government to be communicated in the SOSI.

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Mr. Zavada said he did not think you can ignore the statutory limit. It involves probability.

Mr. Reid said he did not agree that you limit the computation to the statutory limit. Doing so would be incomplete. However, something will need to be said about it.

Mr. Torregrosa confirmed his earlier statement that CBO does not agree with the staff recommendation. The projection should be based on what is available.

Ms. Cohen said she favored full cost but recognition of the statutory limit was probably appropriate.

Mr. Farrell said he was concerned about the inconsistent application of concepts. The Board had said that current law should govern, and the possibility that Congress might change the law to lessen or eliminate the liability should be ignored. Now the exact reverse situation is presented where current law does limit the liability and the Board would be choosing to ignore current law.

Ms. Cohen noted that current law does not limit the benefits per se. The projection shows a shortfall, but the projection is based on assumptions and estimates and may be change. Current law merely makes it a self-financing program.

Chairman Mosso said he favored full cost with disclosure.

Chairman Mosso polled the Board. A majority agreed with the staff recommendation, with the statutory limitation reported either on the face of the statements, in the footnotes, or some other alternative.

3. What assumptions should be used in projecting cash flow? The staff recommended a general requirement as in SFFAS 5 with a reference to actuarial standards of practice.

The Board agreed with the staff recommendation.

4. How should uncertainty be illustrated? In addition to the recommendations regarding display, disclosure and RSI, the staff recommended exploring the use of "expected present value" as an alternative to present value based on the "best estimate."

With respect to sensitivity analysis, Mr. Reid said he had a personal preference that the SFFAS 17 requirements for the CFR and the entities not be continued. He said that sensitivity analysis currently consumes about 30 CFR pages and they mean very little. He would prefer to deal with uncertainty in the footnotes by saying, essentially, that this is an estimate and that estimates vary. He also would like to considered paring back some of the stewardship information in SFFAS 17. He offered the Defense Department disclosures regarding military pensions as an example of good information.

The members agreed that the SFFAS 17 should be reviewed in the Social Insurance Liability Project. Mr. Reid said that publishing SFFAS 17 had been an educational experience for the Board. It had been a tremendous success and prepared the Board to improve the presentation. He said the Board now knows that some of the information required by SFFAS 17 is important and some is less so.

The Board agreed with the staff recommendation and decided that the exploration would not be part of the Social Insurance Liability Project.

5. What should be recognized as social insurance expense or “cost”? The staff recommended four components for Social Security and Medicare Hospital Insurance (Part A) and, for Medicare Supplemental Medical Insurance (Parts B and D), the staff recommends essentially using insurance accounting.

Mr. Patton noted that page two of the staff memorandum contained the statement that “[t]he present value (or actuarial present value) of future outflows attributable to obligating events occurring in the reporting period,” and the first page said “[a] majority of the Board has tentatively decided that the obligating event for Social Security ... and Medicare Hospital Insurance (HI) occurs when participants meet the 40-quarters of work in covered employment (or equivalent) condition.” He said the combination of these statements does not work unless we say that work in covered employment after 40 quarters is also an obligating event.

Mr. Reid suggested saying “current year service and obligating events.” He said that would cover the 40-quarters event and the yearly increments. He said he would argue that the service is not an obligating event, that there is already an obligation that is being incremented.

Mr. Patton said the whole tone of the discussion had been that the participants “earn” benefits, that there is not a liability until the work is actually done.

Mr. Reid did not see an incompatibility between the obligating event and the growth of the obligation.

Mr. Patton said that he thought the logic of the Board’s position required recognition of the entire obligation at 40 quarters.

Chairman Mosso opined that Mr. Patton’s approach would result in the recognition of the closed group number.

Mr. Dacey said he also saw a comparison issue between the staff recommendation for measuring Social Security as an incremental cost versus the SMI approach. He said he took a different approach than CBO. He thinks the future revenue should be included because he thinks it is a realistic assumption that they will be paying the premium when

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they are getting the benefits. He said he did not know why that was not being recommended for Social Security as well.

Mr. Torregrosa said that CBO does not distinguish between Social Security and Medicare Hospital Insurance, Part A, on the one hand and Medicare Supplemental Medical Insurance (SMI), Part B, on the other – setting aside the SMI drug benefit, Part D, for the moment. Thus, CBO would reject the insurance accounting approach for SMI, Part B, and in particular would not count any future premium income in the estimate because that would not be done for Social Security. He said CBO would also accelerate the recognition point for SMI to 40 quarters.

The Board discussed the rationale for a different obligating event for SMI in the course of which Mr. Torregrosa noted that the vast majority of those eligible to sign-up for SMI do so. CBO sees Medicare programs as very similar. The particular financing differences are not important given the Board's majority position.

The staff concludes that the Board agreed with the staff recommendation.

6. What should be recognized as the social insurance liability? The staff recommended that liability be the accumulated cost.

Chairman Mosso polled the Board. A majority agreed with the staff recommendation that the liability is the accumulated cost.

7. What should be displayed for social insurance on the statement of net cost, balance sheet, and other statements? The Social Insurance project staff recommended a total amount for cost on the statement of net cost and liability on the balance sheet representing all components of accrued cost and liability. The totals could be disaggregated by, for example, age cohort, and/or by degree of uncertainty, and/or by "service cost" plus interest on the liability and actuarial gains and losses.

The Board did not have an opportunity to address this question at this time.

Mr. Reid suggested a separate presentation for actuarial gains and losses for social insurance and all other programs where they are significant. He said he has a very strong preference for not commingling operating expenses with changes actuarial assumptions; and, for finding some place other than the statement of net cost to put the effects of changes in assumptions. He said he also has a strong preference for applying this principle universally, not just to social insurance.

Mr. Farrell asked if Mr. Reid meant that the effect of the changes would be amortized to expense. Mr. Reid said, no, he preferred that actuarial changes never be reported on the statement of net cost. Mr. Schumacher added that the effect would eventually be reported there, that it was a timing difference.

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Mr. Reid said his goal is to display the components of a change in the liability rather than aggregating it in one number. This would highlight, for example, frequent changes in assumptions that have little economic justification. He said he wants to avoid having hundred billion(s) dollar swings affecting the statement of net cost. He prefers that the latter display the cost of running the government for a year. The actuarial changes should be reported somewhere but not commingled with operating cost.

Mr. Reid said there would be several choices for displaying actuarial gains and losses when they arise. He suggested, for example, that they could be capitalized and amortized; or, they could be booked directly to a statement that displays these effects, which could be closed to net position; or they could be displayed as a line item on the statement of changes in net position so that, in effect, they do not hit the operating cost in the year the changes in assumptions occur. He said that changing the bottom line on this statement to "operating cost" would be a possibility. He asserted that, if the new assumptions are right, the cost would close through the statement in the normal course of business.

Mr. Reid would like to see the display options reflect these possibilities.

Chairman Mosso said he preferred that actuarial gains and losses not be reported directly to net position. They ought to flow through a statement.

8. What should be disclosed about social insurance in the notes? The staff did not recommend anything at this time.

The Board did not an opportunity to address this issue at this time.

- 9. What should be done with RR Retirement, Unemployment Insurance, and Black Lung Benefits? Staff recommended the following:**
- a. Railroad Retirement – analogize to OASDI and SMI.**
 - b. Unemployment Insurance – continue to apply SFFAS 17**
 - c. Black Lung Benefits – continue to apply SFFAS 17**

The Board did not have an opportunity to address this issue at this time.

10. What is the reporting objective for social insurance? The staff recommended that the objective should be to report the costs incurred in during the reporting period based on obligating events in that period.

The staff concludes that the Board agreed with the staff recommendation.

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CONCLUSION: A majority of the Board generally agreed with the staff's recommendations regarding questions 1 through 6 and 10. The Board did not have an opportunity to consider questions 7 through 9.

For the October meeting staff will provide:

1. Pro forma illustrations and other analysis regarding display and disclosure alternatives as discussed in questions 7 and 8 above. The staff notes that most members seemed to support reporting the statutory limitation on payments either on the face of the financial statements, in a footnote, or elsewhere.
2. Further discussion of annual and accumulated cost recognition at 40-quarters compared to recognizing the full future net obligation at 40-quarters as suggested by Mr. Patton. This will include consideration of how to characterize both the 40-quarters obligating event and subsequent work in covered employment that increments the obligation. For example, whether such increments should be characterized as obligating events, as in the phrase "future outflows attributable to obligating events occurring in the reporting period," or as a function of measurement.

Adjournment

The meeting adjourned at 4:15 PM.