

FLASH!! SPECIAL EDITION!!!

To get the Exposure Draft discussed in the article below into the hands of respondents as soon as possible, we are attaching that Exposure Draft, *Deferral of Required Implementation Date for Statement of Federal*

***Financial Accounting Standards Number 4: Managerial Cost Accounting Concepts and Standards*, to this edition of the monthly *FASAB News*. Comments on the Exposure Draft are due by September 12, 1997.**

Effective Dates for SFFAS 4 and 7

Statement of Federal Financial Accounting Standard 4 (SFFAS 4), *Managerial Cost Accounting Concepts and Standards for the Federal Government*, issued in July 1995, became effective for reporting periods beginning after September 30, 1996. Statement of Federal Financial Accounting Standard 7 (SFFAS 7), *Accounting for Revenues and Other Financing Sources*, issued in April 1996, will become effective for reporting periods beginning after September 30, 1997. At its July 25, 1997 meeting, the Board discussed a request by the Chief Financial Officers Council to defer the effective dates of SFFAS 4 and portions of SFFAS 7 that deal with cost to reporting periods beginning after September 30, 1998.

Background

In the Exposure Draft for the managerial cost accounting standards, issued in October 1994, the effective date for the standards was originally proposed for the periods beginning after September 30, 1995. After considering respondents' concerns about needing additional time to secure funding, training, and development of costing activities, the Board agreed to provide a transition period for implementation of the standards to over a year from the date of the issuance of the standards. It

set the effective date for periods beginning after September 30, 1996. The Board believed the effective date should not be any later because cost information would be needed to meet the requirements of the Government Performance and Results Act. The Board also believed that the effective date was reasonable because the standards did not require having a sophisticated cost system in place; they allowed agencies to take a gradual approach to the development of cost systems, if necessary, while developing basic cost information through other means in the short term.

The Chief Financial Officers Council's Request

At the July Board meeting, Chief Financial Officers Council representatives, Arnold G. Holz, Executive Vice Chair, and Frank Sullivan, Cost Accounting Committee Chair, presented reasons supporting the Council's request to defer effective dates of SFFAS 4 and portions of SFFAS 7. They said most agencies are not in a position to implement the cost accounting standards. They believed the delay would be justified because: (a) the Joint Financial Management Improvement Programs's Managerial Cost Accounting Systems Requirements have not yet been issued, (b) the CFO Council's Managerial Cost Accounting Guide will not be

issued until later this Summer, and (c) the cost accounting information that agencies will need to meet the requirements of the Government Performance and Results Act will not be needed until Fiscal Year 1999.

Messrs. Holz and Sullivan said that many agencies need more time to develop a foundation for cost accounting. For example, agencies need to improve their core financial systems. Messrs. Holz and Sullivan also said that agencies need more time to define responsibility segments, that is, components of a reporting entity that are responsible for carrying out missions, conducting major lines of activity, or producing one or a group of related products or services. Well-defined responsibility segments should lead to more accurate reporting of cost information so as to better satisfy the reporting requirements of the Government Performance and Results Act. They emphasized that unlike other new accounting initiatives, managerial cost accounting needs cooperation from managers at all levels. All of these actions, they believed, required an extended education and training process.

The Board's Proposal

Board members generally expressed disappointment that agencies were not in a position to implement the cost accounting standards two years after they were issued. The Board discussed three approaches to the request: (1) do not change the effective date, (2) grant the request for a deferral of the effective date to two years from the current effective date, that is, for periods beginning after September 30, 1998, or (3) defer the effective date to one year from the current effective date, that is, for periods beginning after September 30, 1997.

After considerable debate, and with one Board member believing that the effective date should not be changed, the general consensus of the Board was to agree to postpone the effective date of SFFAS 4 for one year, to periods beginning after September 30, 1997. However, the Board encouraged agencies to implement SFFAS 4 earlier. The Board also agreed that there should be no change to the effective date for SFFAS 7. The Board's action recognizes that agencies may have encountered some difficulties in developing cost accounting data, but ensures that agencies remain on track for producing the necessary cost information required for agency plans under the Government Performance and Results Act, and for the preparation of the Fiscal Year 1998 financial statements as required by Office of Management and Budget Circular 97-01, "Form and Content of Agency Financial Statements." The Board also suggested that the Chief Financial Officers Council keep the Office of Management and Budget apprised of what steps agencies will be taking to meet the new effective date for reporting of cost information.

Since the effective dates of Statements of Federal Financial Accounting Standards are adopted through a due process, the proposed change to the effective date of SFFAS 4 will be submitted for public comment in an Exposure Draft. Because the current effective date of SFFAS 4 is upcoming, the comment period on the Exposure Draft must, of necessity, be short. Therefore, to speed up the mailing and response time, we are attaching the Exposure Draft to this newsletter.

For further information, contact Richard Mayo, 202-512-7356, or e-mail mayor.fasab@gao.gov.

Property, Plant, and Equipment

At the July Board meeting, two items on property, plant, and equipment (PP&E) were scheduled to be discussed: a) whether Coast Guard cutters and aircraft should be considered general PP&E or Federal mission PP&E, and b) finalizing the technical corrections amendment to Statement of

Federal Financial Accounting Standard 6 (SFFAS 6), *Accounting for Property, Plant, and Equipment (PP&E)*, and Statement of Federal Financial Accounting Standard 8 (SFFAS 8), *Supplementary Stewardship Reporting*.

Chairman Mosso said that the Board had received a request from the Coast Guard to postpone a decision on the classification of its cutters and aircraft. The discussion of the classification of Coast Guard cutters and aircraft centers on the multiple uses and treatments of those assets. Specifically, the questions are: 1) does the defense mission predominate (i.e., national defense PP&E), 2) does the civilian mission predominate (i.e., general PP&E), or 3) should there be an allocation of costs between defense and civilian missions? Since the issue was intertwined with the accounting for multi-use heritage assets (those heritage assets that provide reminders of our heritage and also are used in day-to-day government operations unrelated to the assets themselves), discussion of the Coast Guard issue was deferred until the discussion of multi-use heritage assets is held at a later Board meeting.

The Board then discussed the technical corrections amendment to SFFAS 6 and SFFAS 8. Discussions focused on whether the Board should rely on portions of the Department of Defense Selected Acquisition Report (SAR), a report to Congress on quantities and cost of Defense weapons systems, as a basis for satisfying the definition and reporting requirements for financial and stewardship information (quantities and flow data, or cost trends) on Defense weapons systems. The Board asked FASAB staff to research the components and use of the Selected Acquisition Report with Department of Defense personnel. At the next Board meeting, staff will present the results of the research to assist the Board in determining the classification and reporting requirements for weapons systems.

For further information, contact Rick Wascak, 202-512-7363, or e-mail at wascakr.fasab@gao.gov.

Social Insurance

At the May Board meeting, the Board had discussed the primary social insurance program, Old Age Survivors and Disability Insurance, otherwise known as Social Security (see *FASAB News*, May 1997, Issue 42). At that meeting, the Board requested that staff a) develop a statement of objectives to cover all social insurance programs, and b) draft a standard on the social insurance program of Medicare.

At the July Board meeting, staff presented a) a statement of objectives for social insurance programs; b) a draft standard on Medicare based on the Social Security draft standard presented at the May meeting, including illustrations of possible reporting formats based on sample data; and c) an outline for a future exposure draft of the social insurance standard. The Board generally approved of the draft material, and discussed the presentation of certain transactions among Federal governmental entities, or intragovernmental transactions, and their effect on a consolidated or governmentwide report on social insurance programs. It also discussed social insurance trust funds, the separate entities used to account for social insurance programs. The Board

requested that staff provide additional explanations of the intragovernmental transactions when producing the standard for governmentwide social insurance programs and the sample reporting illustrations.

The Board discussed the statement of objectives for the draft standard. Members generally agreed that the objectives should focus on the sustainability of social insurance programs as currently constructed. This focus on sustainability meets one of the Board's major objectives in the area of supplementary stewardship information, that is, whether future budgetary resources are likely to be sufficient to sustain public services and to meet obligations as they come due. Some Board members also suggested that an objective specifically addressing the current liability due and payable to beneficiaries or service providers be included.

The Chairman noted the difficulty in producing definitive criteria for social insurance programs and suggested limiting the scope of the standard to the predominant programs. He said that by focusing the criteria of the standard on post-retirement care for the general public, the major social insurance programs

such as Social Security, Medicare, Railroad Retirement, and perhaps even Black Lung could be captured, but diverse programs such as Unemployment Compensation could be eliminated. It also was suggested that another criteria, contributions by beneficiaries, could be used to narrow the field of social insurance programs to the major programs.

The Board directed the staff to continue

developing the standard, sample reporting illustrations, and criteria, for discussion at the September meeting. In addition, staff will present potential social insurance programs other than Social Security and Medicare for the Board's consideration.

For further information, contact Richard Fontenrose, 202-512-7358, or e-mail at fontenrosr.fasab@gao.gov.

Management's Discussion and Analysis

In response to an invitation from FASAB, Craig Olinger, of the Securities and Exchange Commission (SEC), briefed the Board on the SEC's experience with MD&A. Mr. Olinger is Deputy Chief Accountant of the Division of Corporation Finance at the SEC. He explained that the SEC's present rule requiring MD&A dated from 1980. Earlier guidelines for MD&A had often led to a rather mechanical analysis of changes in financial statements. The 1980 revision was intended to cause management to discuss the financial state of the company, as well as the financial statements, but practice remained narrow and mechanical in too many cases.

Assessing and Improving MD&A

To address this deficiency, in 1987 the SEC issued a concept release. It emphasized that the SEC's requirement for MD&A is intended to give investors an opportunity to look at the company through the eyes of management, with both a short- and a long-term analysis of the business of the company. The SEC wanted management to discuss the dynamics of the business and analyze the financial statements.

In 1988 and 1989 the SEC conducted a study to see if this goal was being achieved. SEC staff studied 360 annual reports and MD&A in depth. Most of the companies received substantive comments, many were required to amend their filings, and most of the rest agreed to make improvements in the future. Based on the study, the SEC concluded that compliance with the rule was the

problem, not the rule itself. Therefore, in 1989 the SEC issued further interpretive guidance to improve compliance. Among other things, this asked for more fundamental analysis of the reasons for important changes in financial statement items.

Forward-looking Information

The most significant part of that guidance dealt with required forward-looking information, and with the distinction between what is required and what is voluntary.

Both required disclosure regarding the future impact of presently known trends, events or uncertainties and optional forward-looking information may involve some prediction or projection. The distinction between the two rests with the nature of the prediction required. Required disclosure is based on **currently known trends, events, and uncertainties that are reasonably expected to have material effects**, such as: A reduction in the registrant's product prices; erosion in the registrant's market share; changes in insurance coverage; or the likely non-renewal of a material contract. In contrast, optional forward-looking disclosure involves **anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty**. (From Securities Act Release No. 6711, emphasis added.)

The SEC's guidance indicates that a disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to

management and reasonably likely to have material effects on the registrant's financial condition or results of operation.

For example, [the guidance] requires a description of the registrant's material "commitments" for capital expenditures as of the end of the latest fiscal period. However, even where no legal commitments, contractual or otherwise, have been made, disclosure is required if material planned capital expenditures result from a known demand, as where the expenditures are necessary to a continuation of the registrant's current growth trend. Similarly, if the same registrant determines not to incur such expenditures, a known uncertainty would exist regarding continuation of the current growth trend. If the adverse effect on the registrant from discontinuation of the growth trend is reasonably likely to be material, disclosure is required. Disclosure of planned material expenditures is also required, for example, when such expenditures are necessary to support a new, publicly announced product or line of business. (SEC's 1989 Interpretative Release on MD&A, pages 12-13.)

Put another way:

Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:

(1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.

(2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. (SEC's 1989 Interpretative Release on MD&A, pages 15-16.)

The study showed that many companies had assumed that a 12 month forward look was enough when discussing liquidity. The SEC said if the company has longer term commitments, it must

assess liquidity over a period consistent with the commitments.

Implications for Governmental Financial Reporting

"Liquidity" is not a major consideration for many federal reporting entities, but some observers may see analogies with concerns that do arise in government, such as the concerns with adequacy of future budgetary resources and sustainability of services, which are articulated in the third objective of federal financial reporting. The Board discussed similarities and differences in the governmental and for-profit sectors, and whether FASAB's exposure draft appropriately reflected the differences. Mr. Olinger observed that the exposure draft seemed to address the relevant issues.

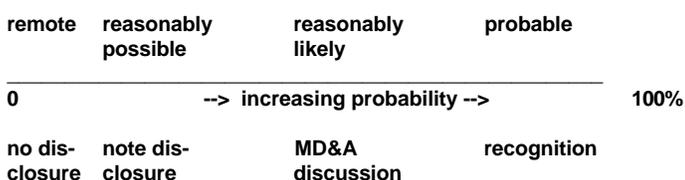
The Board also discussed its concern about assuring objectivity and balance. Mr. Olinger noted that this is a continual challenge in the private sector as well. The SEC continually writes review comments to remind companies that the discussion must have balance, with due consideration of negative factors as well as positive ones, if they exist. The Board discussed whether the GAO could be said to play an enforcement role in the government sector similar to the SEC's in the corporate sector. Some members noted the public scrutiny and checks and balances that exist in government.

"Reasonably Likely" and "Reasonably Possible"

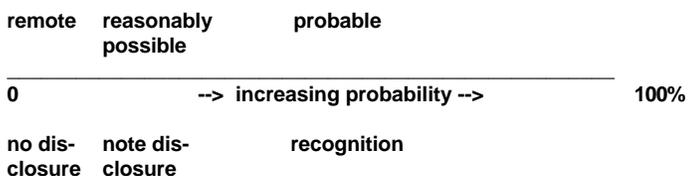
The Board discussed with Mr. Olinger the distinction among contingencies that should be disclosed under the criteria of FAS 5, those that should be disclosed pursuant to SFFAS 5, and the items that should be discussed in MD&A pursuant to SEC's guidance. Both FAS 5 and SFFAS 5 call for recognition of contingent liabilities for which the future effect is both "probable and measurable." Both standards call for note disclosure of contingent liabilities that are "reasonably possible" but that don't satisfy the "probable and measurable" criteria. Neither standard calls for disclosure of "remote" contingencies. A footnote in SEC's interpretative release says "reasonably likely" is not meant to

conform with any term in FAS 5: the SEC's "reasonably likely" guidance for MD&A is a separate standard.

The SEC, FASB, and AICPA have not attempted to define these terms, or materiality, in terms of quantitative rules. Some studies, including work GAO did during the aftermath of the savings and loan crisis, suggest that, in practice, preparers and auditors in the private sector often interpret "probable" to mean a subjective assessment of probability considerably in excess of 50%. This private sector practice might be diagrammed as follows:



On the other hand, FASAB has defined "probable" as "more likely than not," i.e., a subjective assessment of probability greater than 50%. This is expected to lead to practice that might be diagrammed as follows:



In this framework, there is less need to distinguish "reasonably likely" effects of known trends, demands, commitments, events or uncertainties from "reasonably possible" effects that are to be disclosed. For this reason, both SFFAS 5

and the FASAB's exposure draft on MD&A concepts use the term "reasonably possible" and do not use the term "reasonably likely." However, it may be necessary to distinguish the reasonably possible contingencies that managers of federal entities should discuss in MD&A from those that are disclosed in notes.

Although the Board has not reached final conclusions about MD&A, there does appear to be wide support for the notion that MD&A should be concise. This may imply that management should be given authority to select the most important of the "reasonably possible" contingencies that are disclosed in notes for discussion in MD&A. On the other hand, as some of the examples in the SEC guidance cited above demonstrate, the criteria for required forward-looking information about future effects of known trends, demands, commitments, events or uncertainties can imply a need to discuss some items that might not ordinarily be disclosed as contingent liabilities. Thus the MD&A may turn out to be narrower than the notes in some respects, but broader in others.

Mr. Olinger said that, despite encouragement from the SEC and "safe-harbor" provisions in law, most companies have been reluctant to provide forward-looking information and projections beyond the minimum required by SEC's guidance. At least in part this is attributed to concern about exposure to lawsuits from disappointed investors.

For further information, contact Robert Bramlett, 202-512-7355, or e-mail at bramlett@fasab.gao.gov.

Accounting and Auditing Policy Committee News

In July, the Accounting and Auditing Policy Committee (AAPC) held its first two meetings--July 16th and July 30th. The following paragraphs cover actions taken.

Charter and Operating Procedures Approved

As a result of the discussions at the two meetings, the AAPC approved its Charter and

Operating Procedures. The Charter includes the following mission statement:

The mission of the AAPC is to assist the Federal government in improving financial reporting through the timely identification, discussion, and recommendation of solutions to accounting and auditing issues within the framework of existing authoritative literature.

The Charter and Operating Procedures address topics such as selection of members, tenure, voting, and issue processing. Both documents are posted on the AAPC's home page on Financenet, <http://www.financenet.gov/aapc.htm>. The AAPC encourages the financial management and audit communities to become familiar with its operations and participate in its efforts.

Three Issues Added to the Agenda

The AAPC approved three issues for the agenda: 1) responsibility for providing legal representation letters; 2) determining whether environmental liabilities are probable and estimable; and 3) preparation and audit of interagency confirmations. These issues will be researched and developed by committee members and discussed at the September 12th meeting.

Illustrative Guidance

In addition to adding these issues to the agenda,

the committee discussed issuing illustrative nonauthoritative guidance. Because the AAPC's mission is to recommend timely authoritative guidance, the members concluded that the AAPC should not devote resources to issuing illustrative guidance.

The AAPC agreed that letters should be sent to the chairperson of the groups submitting the issues that were discussed but not added to the agenda. In some cases, the AAPC will recommend that the issues or papers be submitted to other groups, such as the Chief Financial Officers Council.

Future Meeting Dates

The AAPC meeting schedule for the remainder of 1997 is: September 12, October 9, November 13, and December 11. All meetings will be held in Room 4N30 of the General Accounting Office Building, 441 G St., NW, Washington. The AAPC plans to continue monthly meetings from 1:00 to 4:00 on the second Thursday of each month.

At the September 12 meeting, the AAPC will review draft technical guidance on the three issues added to the agenda at the July 30 meeting, and will review additional issues for addition to its agenda.

For further information, contact Dick Tingley at 202-512-7361, or email at tingleyr.fasab@gao.gov.

Agenda for Next FASAB Meeting

The next FASAB meeting will be held on Friday, August 29, 1997, at the General Accounting Office Building, 441 G St. NW, Washington, DC, Room 7C13, at 9:00 a.m. Items to be discussed include the technical corrections amendment to Statement of

Federal Financial Accounting Standards 6 and 8, and Management's Discussion and Analysis.

For further information, contact Dick Tingley at 202-512-7361, or email at tingleyr.fasab@gao.gov.

Comments on the FASAB News

If you have comments, questions, or suggestions on our newsletter, please address them to Lucy Lomax,

Editor, FASAB News, (address on masthead), or FAX, 202-512-7366, or e-mail, lomaxm.fasab@gao.gov.

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