FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
August 26-27, 2015
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, August 26, 2015

Attendance

The following members were present throughout the meeting: Mr. Allen, Messrs. Dacey, Granof, McCall, Reger, Showalter, Smith, and Steinberg. Ms. Ho was represented by Ms. Ann Davis throughout the meeting. The executive director, Ms. Payne, was present throughout the meeting. General counsel, Mr. Marchand attended on August 27th and was represented by Mr. Jason Kirwan on August 26th.

Agenda Topics

- **Educational Session**

To support the Board's discussion of performance reporting and gain an understanding of how the Board might support performance reporting, staff provided a background paper based on earlier task force input on performance reporting and convened a panel. The task force work raised the following important questions:

a. What is the right scope of performance information to present in financial reports;

b. What performance information complements the financial information; and

c. What is the added-value that financial statements can provide about performance information?

Also, the task force discussed the various challenges to aligning budget, cost, and performance information and the need to ensure the quality of the data. They discussed that there are different: definitions of a program; measurements of "cost" (accrual versus budgetary bases); and systems that track budget, accrual, and performance. To initiate steps to improve performance reporting, some suggest focusing on the "building blocks" – a common definition of a program and a common measurement basis for reporting on results. FASAB's survey of other countries' practices supported the notion that budgeting and accounting should apply the same measurement basis.

1st Consequently, agreement on the building blocks would help integrate the information and contribute to effectively communicating performance information. Also, the key items of a performance report would need to possess certain attributes. The CFO Council and the Council of the Inspectors General on Integrity and Efficiency discussed the importance of enabling stakeholders to observe how agencies are managing their resources to achieve goals and that integrity, reliability, and utility are important qualities of reported data.

2nd In addition, other standards-setters, such as the Governmental Accounting Standards Board (GASB), developed qualitative characteristics of performance information to be used in preparing performance reports. Providing guidance on the qualitative characteristics of performance information would assist in developing reports that effectively communicate results.

At the meeting, the Board discussed performance reporting with panel members:

- Jason Bossie, Director of the Office of Performance Management and Deputy Performance Improvement Officer, Small Business Administration (SBA)
- Mark Bussow, Performance Team Lead, Office of Management and Budget (OMB)
- Holly Donnelly, Director, Performance Management Center, Department of Labor (Labor)
- John Kamensky, Senior Fellow, IBM Center for the Business of Government

- Jon Stehle, Board Member, American Association for Budget and Program Analysis and Strategic Performance Management Lead, MITRE
- Sarah Veale, Assistant Director, Strategic Issues, Government Accountability Office (GAO)

The panel was asked to share their perspectives regarding:

a. What progress has been made in federal performance reporting?
b. What gaps exist in federal performance reporting and how should those gaps be addressed?
c. What should be the role of FASAB guidance in helping to address gaps?
d. What is the added-value that financial statements can provide about performance information?

Mr. Bossie believes the Government Performance and Results Act Modernization Act (GPRA MA) brought substantial strides in creating a framework and driving decision making. He indicated that SBA integrates performance and financial information through strategic objectives. Three gaps that remain are (1) the definition of a program, (2) data quality standards, and (3) integration of program evaluations into the budget and financial reporting processes.

Regarding the definition of a program, the absence of a definition makes it challenging to identify costs and benefits for evaluation and reporting purposes. He noted that the required program inventory allowed agencies flexibility in identifying programs. Rather than defining a program consistently across government, agencies developed approaches suited to their environment. SBA identified programs based on the customer served such as contractor or disaster victim. A systematic approach to "program" is needed to integrate performance and financial reporting.

Regarding data quality standards, he indicated a lot of work has been done and performance data is often self-reported. There is room for improvement in the quality and completeness of the data.

Program evaluations should be integrated with the budget and decision making processes. Also, performance evaluations should be integrated with financial reporting. There are inter-agency working groups addressing this challenge.

He advised that FASAB should play a larger advocacy role and reach out to the Congressional and OMB stakeholders. While SBA has a good high level discussion of performance in its MD&A, there needs to be greater granularity to understand the cost associated with performance.

Mr. Bussow acknowledged there are no easy answers but believes the GPRA MA is a significant improvement. It created stronger internal use processes for performance information, brought structure to cross agency priority goals and changed the dialogue to be more data driven, and increased the number of agencies engaging in data driven priority goal reviews. The improved dialogue will lead to higher data quality in the future.

Strategic reviews are scheduled and the next round of strategic plans will be key.

Performance.gov has increased the frequency of reporting and public access to reported information. It also serves as an internal accountability mechanism because responsible officials are featured on the site. Breaking the paper – static – format has been an advancement.

Standardizing the timelines across agencies has improved the process. Having a common structure across agencies has been helpful.

He noted the development of a consistent performance management structure supports integration efforts. Greater granularity of information – through tools like USAspending.gov - is the key to supporting decision making. There are few audiences for information aggregated at the component entity level. We should prioritize and build on efforts for greater granularity.

He identified the following gaps:

1. Lack external customers with the sophistication needed to use information. Congress is a key stakeholder. Some have great passion for data but others tend not to focus on performance management data including financial data. Even Congressional stakeholders do not seem to realize how much information is available. As a result, demand for information does not equal supply. Some do not seem to realize that so much information is available. One solution may be to develop trusted intermediaries to analyze and pass on data. The need to increase demand should be addressed before any additional resources are invested in supplying external reporting.

2. The structure of the budget and financial reports does not map well to how programs are delivered. Outcomes are delivered by multiple programs. Clearly, program is the mechanism to link data from the budget, financial, and performance systems. How to define a program to provide that linkage is a challenge. Currently, reporting seems to prioritize comparability – consistency across organizations - rather than the depth needed to meet individuals' needs for decision making. He sees this as a management reporting challenge. Comparability across organizations in the federal government is not as great a need. Meeting the challenges of accountability and decision making for specific programs require tailored approaches. He believes FASAB is well positioned to assist in this area.

Ms. Donnelly agreed with Mr. Bossie. She further noted that data quality is a major challenge. The quality – and therefore value – of performance information is not near the quality of the financial data. The standards present in the accounting world are not found in the nonfinancial performance world. She had pushed for expansion of the audit to performance but auditors resist because of the rigor of the standards. She suggested that audit guidelines could be loosened to accommodate performance audits. There is a need to bring the rigor of accounting and auditing to the performance side. She noted the lack of resources to address this in the diverse management environments found across an agency.

The granularity of information derived from managerial cost accounting is needed to support efficiency measurements. The ability to track the use of labor would allow analysis of administrative (non-mission) burdens. Currently, she is not able to quantify direct labor time on mission and non-mission efforts.

She noted that the change from Performance and Accountability Reports (PARs) to Agency Financial Reports (AFRs) allowed the agency to provide output data quickly (by the November 15th deadline). She has been disappointed in the questions – or lack thereof- posed about the outputs. Then they report broader (outcome) information in the Annual Performance Report (APR) in connection with the budget submission in February. This encourages integration of the budget and performance information.

Mr. Kamensky surmised that the earlier assumption that supplying good performance and financial information would be enough has been proven false. He explained that the CFO Act brought useful discipline to the agencies. Based on his involvement in the Mercatus reviews of performance reports and the AGA CEAR reviews, he found that the APRs are uneven in quality and set low targets. The AFRs are generally unsatisfying. He used Labor as an example and noted they discuss the PBGCs performance while failing to alert the reader to the financial challenges ahead. One must really dig in and ask questions.

He noted data is there but story telling is lacking. GPRA MA promises some improvement by moving from annual to periodic reporting; the financial reporting community should consider this as well. He also thought a tiered reporting model would be helpful. Different audiences need different levels of information. Using strategic objectives – or programs - to organize financial statements would be helpful. This level comes closest to budget decisions. He opined that a one-size fits all definition of program would not really be helpful.

Consideration ought to be given to how others are presenting and using data. One ought to ask whether citizens value the data. He pointed to TSA's use of YELP reviews as an example.

Mr. Stehle addressed the role of financial reporting and suggested that the absence of readership for the agency financial reports should not be a major concern. He acknowledged that the audited financial statements bring confidence in the data but encouraged a greater role for financial reporting. It can create a foundation of understanding this is good data that we can then do something with. He reminded the Board that all the discussion of performance and program is likely to change in the next administration. Agency priority goals will change.

What people want to know is the outcome – did you get the job done? He questioned what role accounting has in reporting on getting the job done. We ought to find ways to increase the demand by showing people how to use good data. It's about encouraging agencies to think, and if it's four-page citizen-centric reports, great, raise that up. If it's graduate students presenting to you on a regular basis about the research they're doing with the AFRs, excellent. Let's find ways to highlight the information that's out there so we can use it.

He also wondered where the DATA Act will take you? Does the program manager change use of data in a new generation? He encouraged an understanding of the use of unstructured data.

Ms. Veale indicated that there are four themes identified through GAO's evaluation of GPRA MA implementation – cross-cutting issues and collaboration, ensuring that performance information is useful and used, aligning daily operations with results, and how performance information is communicated and how transparent it is.

She noted two recent GAO reports. In the first, they reported on seven practices that can help ensure agencies conduct effective strategic reviews. The second report was on data-driven reviews and GAO found that 21 of 22 agencies surveyed reported holding in-person data-driven reviews and said that these reviews had a positive effect on progress towards agency goals, collaboration among officials from different offices or programs within their agency, the ability to hold officials accountable for progress and efforts to improve the efficiency of operations. In asking whether use of performance information has improved, the GAO explored what key drivers influence its use. They found that management commitment was key and the validity of the data affects its use.

Program inventory revealed the inconsistent definition of a program. Inconsistency affects the usefulness of the inventory. She noted that the Comptroller General testified in July regarding how best to merge Data Act purposes and requirements to develop a program inventory. She suggested a role for FASAB in this effort may be to connect the performance and financial reporting.

Ms. Veale also discussed an upcoming GAO report on public reporting on the quality of performance information for selected agency priority goals. She said that GAO generally found that selected agencies were not transparently reporting this information on data quality in their performance plans and reports, and on Performance.Gov.

Members thanked the panelists for their opening remarks. The key points discussed included:

- To support the need for more granular data and integration, the unit of analysis must be established.
  - Is a program a subset of agency (may support management) or activities across the federal government (a broader view of all the dollars and performance measures around a concept)?
  - The ultimate goal with information is how to get the information used, not how do you get it standardized.
  - Strategic objectives seems to be a promising approach to disaggregating information.
  - The DATA Act should allow users access to reasonably accurate data that they can use to create reports. In the future, analytical tools may be developed but the lowest unit of analysis needs to be identified. Guidelines are needed.
  - There are many outcomes that are of interest to internal and external users and some believe this is the most useful unit of analysis. It is stable over time whereas agencies and programs may change over time.
  - A program may be a workable intermediate level.
    - Standardizing across diverse operations is not as useful as an approach aligned with how citizens and the Hill discuss operations (for example, the proposed Taxpayers Right-to-Know Act[1] may take this approach).
    - Some noted that granularity is not an either/or solution. If one identifies with a program then one must know that a program supports five or six outcomes.
- To support integration of budget, cost, and performance, cost accounting is needed.
  - A challenge for program evaluation is that so much cost is external to the federal government. For example, grant recipients incur costs in excess of the grant. In addition, the timing does not align well – a grant may be made months or years before an output or outcome results.
  - Where labor is the primary cost, cost accounting should be easier.
  - Absent integration at a low level, the department would not have the ability to report or manage. They cannot assess value added.
  - While some bureaus do a good job at cost accounting and performance reporting, others do not. This may be attributable to IT systems. Some evolve in the field and become widely used and therefore improved. Others do not have the resources for IT improvements. For example, some performance data can only be extracted when a system is shut down and others still track data on index cards. Resource shortages constrain training and auditing as well.

[1] S. 282 (passed on May 6, 2015) would amend federal law to increase the amount of information about federal programs that the Office of Management and Budget (OMB) provides online. The legislation would require that each program administered by a federal agency be described on the agency's website, including the number of people served by or benefiting from the program, the number of federal employees and contract staff involved, and links to reviews of the program including those by the Government Accountability Office (GAO) and Inspectors General.

- Generally, public sector management is viewed as a continuous cycle of budgeting, specifying operating objectives, managing to those objectives, reporting and auditing, and informing the next budget. Panelists were asked if this holds true.
    - Agency priority goal processes fit that model. Execution of the model depends on the level of chief operating officer commitment.
    - Timelines for the model are challenging. The cycle is much longer in the federal government than in the private sector.
    - The audit framework for performance information is not as integrated as it should be. It is to the side of the management framework.
        - Some suggested an effort to target the right level of validation of information through audit. The rigor employed by the current audit framework and culture is not appropriate to the performance reporting model.
        - Some are concerned that audit may discourage collection and use of information.
    - The budget process is evolving given the reliance on continuing resolutions and the move to enterprise risk management.
- For external reporting, the group discussed the role of performance measures in agency financial reports and the government-wide report as well as meeting the needs of users.
    - It may be helpful to break the cost of the federal government into the 350 or so outcomes desired across government but you also need to consider the cost of doing so versus alternative sources that are reasonably accurate. For example, the budget provides analytical information useful for that purpose.
    - The cost of tying financial information to outcomes seems prohibitive. Critical challenges include the many sources of funding (federal and other) that support an outcome, the timing differences between financial and performance data, and the quality issues around performance data.
    - An initial step may be to ensure performance.gov information links to and aligns with agency financial reports.
    - Another possibility is to incorporate financial information in the budget given that the financial information is available before the performance and budget information is submitted. Challenges to doing so include the significant time lag on performance data (two or three years) and the quality issues. Currently, the budget does include actual spending data but it does not receive as much attention as it should. Also, it seems right to have the performance information in the budget submission rather than the financial report since it informs policy through budgeting.
    - With regard to the reporting model project, some noted that trying to meet both internal and external users' needs seems impossible.
        - Most citizens will not use a financial statement but would use the results from a sophisticated analyst; just as most stockholders do not read company financial reports but do rely on analysts.

- The financial statements serve to hold the agency CFO accountable for doing his or her job well.
- The cost of the annual financial statements should be reduced by shrinking the reporting burden to that minimally necessary to support a control framework so that more attention can be paid to programmatic reporting that people care about.
- Greater investment in managerial cost accounting would payoff more quickly than investments in agency financial reports. The resulting information would be more useful to both internal and external users.
    - Defining a “program” is a precursor to cost accounting.
    - Cost accounting is an iterative process – go to the next level and then the next level of detail.

Mr. Steinberg noted that the original federal financial reporting objectives were written before the GPRA was established and were driven by OMB at the time. The point was that reporting spending without information about outcomes is not helpful. People must be able to relate spending to results.

Mr. Allen thanked everyone for a very informative discussion.

- **Reporting Model**

The Board discussed a draft concepts statement regarding an ideal reporting model and agreed to include several enhancements. The Board acknowledged that the draft repeats guidance from earlier concepts statements, and should do so. They also agreed that it should include introductory statements discussing what the Board intends to accomplish and how the concepts presented relate to the Board’s earlier conceptual guidance. Also, the Board discussed the issues that the concepts statement should include regarding performance and cost information, primarily the timing differences in reporting performance, budgetary, and financial information.

In addition, the Board appeared to support the idea of clarifying FASAB’s role in relation to the objectives of financial reporting. The concepts statement should include a discussion regarding the reporting objectives for which the Board, as a GAAP standards-setter, might have a direct versus supportive role. Board members also agreed that the concepts statement should include a diagram or picture depicting the relationship between financial reports, including financial statements, disclosures, and required supplementary information, and other financial reporting sources. However, the Board determined that it is not necessary to add illustrative financial statements to the concepts statement and will pursue issuing an exposure draft concepts statement before the December 2015 meeting, assuming that it fully addresses all the concepts the Board has identified for inclusion.

Introductory Statements

The Board agreed that introductory statements should be presented before each section of the concepts statement. The statements should inform the reader on what the Board is trying to accomplish and how the concepts relate to earlier concepts statements, particularly those discussed in Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting. Board members will provide staff with edits to the proposed introductory statements.

Mr. Showalter noted that each of the introductory paragraphs should state the objective that the Board is trying to accomplish with respect to that section. For example, the introduction for the performance section should state the objective for that section.

Mr. Granof noted that the introduction should not be a summary but should set forth why the Board is issuing the guidance and what is the Board trying to accomplish. In particular, it should indicate its relation to earlier concept statements, such as SFFAC 1.

Mr. Dacey noted that the concepts statement should include more references to what the other concept statements already say so that the reader can distinguish the new concepts from existing ones.

Mr. Smith noted that the introduction to the overall concepts statement should discuss that the Board is trying to develop a new reporting model and explain what the statement is going to address. Also, the introduction could explain how the Board is going to be addressing items that are in other concepts when we get to the reporting model and what it is not. Consequently, the introduction could provide a roadmap of where the Board is headed – what problems are within the scope and those that are outside of the scope.

Mr. Reger asked whether: 1) the Board should state that it is not defining a program, but another entity should; and 2) when another entity does define a program, the Board believes certain items should be displayed, tracked, or accounted for at the program level? Messrs. Steinberg and Smith agreed and Mr. Steinberg noted that the Board's research shows that most people want the information by program.

Performance and Cost Information

Board members indicated that the concepts statement should discuss the timing of performance information versus financial information. Mr. Steinberg noted that the timing differences concern performance versus spending, not performance versus budget because budget is just a plan to spend. Agencies may never spend funds. The concept statement should state that there is a timing difference and why there is a timing difference. Agencies provide funds to states or local governments and the results may not come for several years. Mr. Reger noted that performance information is needed at the same time as the budget execution information – an agency that spent funds should discuss what citizens got for the money spent.

Mr. Dacey added that agencies issue detailed performance information along with their budget justification information. However, they issue this information after the financial statements have been prepared. Also, the performance information is included in a summary report which is not required by generally accepted accounting principles. Therefore, it would be helpful for the concepts to discuss this condition and the expectations regarding where performance information might best reside - in the financial statements or in some other document – and what information should be in the statements.

Mr. Allen noted that SFFAC 1 seems to suggest trend information. The operating performance sub-objective 2B states, "…efforts and accomplishments associated with federal programs and the changes over time and in relationship to cost…"

With respect to the proposed guidance in the concepts statement (paragraph 80), Mr. McCall stated that input is a performance measure that should be added to the list of measures helpful to present.

Mr. Showalter noted that accomplishments should be added to the introduction for the performance information section.

Ms. Payne stated that, based on the discussion regarding performance, the introduction to the performance section should include the role of cost information in performance, and discuss whether performance information is complete without cost, given that the concepts discuss the need for information on efficiency and effectiveness.

Members discussed relating performance, budget, and cost. Mr. Allen noted that a paragraph is needed regarding the value of performance in a budgetary context. The performance reporting panel indicated that performance information adds value to the budgetary process. Mr. Steinberg added that, as a citizen, he is primarily interested in outputs and outcomes. Cost is a secondary consideration. Also, since agencies do not have cost systems, they will push back on reporting efficiency and cost-effectiveness measures. However, Mr. McCall noted that cost is important to users. They would want to know the cost of student loans versus simply knowing the number of student loans issued.

The Relationship between Financial Reports and Other Financial Reporting Sources and the Role of the Board in Relation to the Reporting Objectives

Board members agreed that the concepts statement should include a diagram or picture depicting the relationship between financial reports, including financial statements, disclosures, and required supplementary information, and other financial reporting sources. Also, the Board generally agreed that the concepts statement should include a discussion regarding the reporting objectives for which the Board, as a GAAP standards setter, might have a direct versus supportive role.

Mr. Allen asked Board members to reconsider the June 2015 decision to remove a section of the concepts statement that discussed FASAB's priorities in relation to the reporting objectives. At that time, the Board decided that the section was not needed because the Board's priorities are already documented in its Strategic Directions document and those priorities are subject to change. Mr. Allen noted that the reporting objectives are broad but the Board has a direct role in addressing some objectives and an indirect role in others. While the Strategic Directions document discusses where the Board has a responsibility, most may not be aware that the Strategic Directions document exists.

Ms. Payne explained that the objectives concern financial reporting in its entirety and Statement of Federal Financial Accounting Concepts (SFFAC) 1, Objectives of Federal Financial Reporting, includes statements about FASAB considering how accounting standards can help meet the broad objectives. The Board is tasked with considering how each standard serves the objectives, rather than attempting to achieve each of them. Ms. Payne also discussed statements in SFFAC 1 that discuss the Board's role relative to the objectives. As the Board develops the current concepts statement, it should be mindful of what it has already said in SFFAC 1 and be consistent with those statements to reduce the likelihood of confusion. Also, if the Board decided to remove items from its scope, it should be clear about: who is going to fill the void; why the Board does not have a role; and whether the Board would ever have a role.

Mr. Showalter noted that the concepts statement should reflect where the Board might have a direct versus supportive role. It should help future Board members.

Mr. Smith noted that the topic should only relate to the issues that the Board is addressing in the concepts statement. The Board should be discussing a more defined concepts statement, so everyone knows what the reporting model would be. Items that are not included in the reporting model or that the Board is not addressing should not be discussed.

Mr. Dacey noted that he would focus on discussing how GAAP reporting "fits" into the broader context of the financial reporting objectives. He considered it important to clarify the boundaries of GAAP reporting.

Mr. Reger indicated that he supports the notion of a diagram that illustrates the relationship between financial reports and other financial reporting sources.

Ms. Davis also supported a diagram and noted that it would be helpful to show where GAAP "fits."

Mr. Steinberg noted that the discussion should be included in the introduction to the concepts statement.

Mr. McCall noted that the Board should say where it has a direct versus supportive role. It is not clear that the existing reporting model has been fully implemented. However, it would be helpful to identify where we are trying to bring about more clarity.

Mr. Granof believed that it would be helpful to include the topic in the concepts statement. He noted that the statement should include a discussion of how the Board determines whether to be directly or indirectly involved in an area. It may be a cost versus benefit decision. Useful information may be costly for an agency to prepare and for individuals who look to gather the information. So, the government has to decide whether to incur that cost or leave it to the individuals to incur. Today, making information available on the Internet helps reduce the cost of obtaining information and information that the Board may have previously required for financial statements may not be necessary.

Board members also discussed the objectives for the project and why the Board decided to develop a concepts statement. Mr. Steinberg noted that the existing model is discussed in the form and content guidance and several years ago the Board heard complaints from some that the financial statements in that model were not very useful. Users sought cost, budget, and performance information and the Board decided to start a project to develop a new reporting model that would encompass those items. However, the Board could not envision what the new statements would look like. As a result, the Board decided to develop a concepts statement rather than a standard.

Mr. Steinberg noted that the challenges in developing a concept statement are: determining what should be in the model; explaining why the items should be included; and writing the guidance in sufficient detail so that a standard can be developed by FASAB or the Office of Management and Budget can provide form and content guidance.

Mr. Showalter noted that the concepts would create a roadmap to show where the Board is going without issuing requirements in a standard. Mr. Dacey added that discussing concepts helps to start discussions and determine the different views. Also, the Data Act information will have a tremendous role that may not have been contemplated in some of the Board's earlier concept statements. Some are considering how to relate the detailed data from different sources to the information presented in the financial statements.

Mr. Reger noted that the Data Act creates other ways of reviewing government data. Various groups will be developing applications to present the data and their own reports. Rules or guidelines will be needed so that users can distinguish which reports to believe and which not to.

Next Steps

The Board generally agreed that it is not necessary to add illustrative financial statements to the concepts statement and supports the goal of issuing an exposure draft before the December 2015 meeting. The guidance should provide a level of flexibility for developing standards and the Board should move as quickly as possible. However, some members noted that it is premature to decide whether illustrations are needed and whether a statement that fully addresses all the concepts the Board has identified for inclusion can be ready before the December 2015 meeting. The purpose and complexity of the statement are not clear at this time.

Conclusion: Board members will provide their edits or comments to staff and staff will prepare a revised draft for the October 2015 meeting.

- **Public-Private Partnerships (P3)**

Mr. Savini began the session by asking members to turn to TAB C and provided a brief overview of the revised standards, subsequent email member comments/edits to the TAB C materials and an updated graphic illustration emphasizing the different filters contained in the revised standards.

Members generally agreed with all the edits contained in the TAB C materials summarized on page four of the transmittal memorandum. Areas discussed by members included:

1. Deletion of the term “contractual” from the definition of P3s. Some members were concerned that the deletion may not be sufficient to ensure arrangements lasting five years or more are considered P3s. Deletion of “contractual” was accepted but members sought clarification about the length of the arrangement. Staff was asked to include discussion about expectations that the arrangement would last five years or more. (Similarly, staff was asked to clarify that the disclosure requirements applied to the life of the arrangement would be the “expected” life of the arrangement and also reveal how the expected life was determined.)

2. Mr. Dacey proposed an edit to paragraph 23d regarding disclosure of remote risks. He suggested inserting “Disclosure of remote risks of loss should be limited to those that are included in the terms of the contractual P3 arrangements or transactions.” General Counsel advised that the revision would exclude risks such as contract oversight and other general risks not addressed explicitly in the written contract. After discussing this difference, six members preferred to accept Mr. Dacey’s wording or something similar to it.

The following summarizes Board discussions concerning each of the questions presented on pages five and six of the staff memo.

1. Does the Board believe that the Summary provides an adequate overview of the Standards? If not, what changes or edits should staff consider in this regard?

   The Board generally agreed with the Summary as written and will have an opportunity to provide non-technical changes during the pre-balloting and balloting processes.

2. Does the Board believe that the revised Basis for Conclusions adequately expresses its views concerning each major section of this appendix? For example, Major sections re-deliberated include: P3 Definition, Scope, Applicability and Exclusions, and Materiality.

   The Board generally agreed with the Basis for Conclusions as written and no significant exceptions were noted other than to (1) at A16: more fully explain why arrangements with other governments (state, local and foreign) are excluded, (2) at A22 and A32: make edits to conform with the standards, and (3) at A36: discuss how an entity should determine the expected life of the P3 arrangement or transaction.

3. Does the Board believe that the implementation date (proposed to begin after September 30, 2018 with early adoption permitted) is reasonable in light of any other potential Statement currently being considered by the Board? If not, what date would members advise we adopt?

   The Board generally agreed with the implementation date and will have an opportunity to provide non-technical changes during the pre-balloting and balloting processes.

4. Does the Board believe that the revised illustration fairly depicts the decision process preparers should follow when implementing the requirements of this Standard? If not, what changes would you advise be made?

   Although the Board generally agreed with the revised illustration, two members via email suggested comments to (1) extend the first filter to paragraph 18, and (2) delete materiality language in the last box and refer to disclosure requirements. Members will have an opportunity to provide non-technical changes during the pre-balloting and balloting processes.

   Conclusions: Prepare a revised Statement to pre-ballot in September.

- **Leases**

Ms. Valentine opened the lease discussion by stating that the objective for the current session is to update the Board on GASB's progress on their deliberations on their Lease project. The Board had previously directed staff to use the GASB Lease Preliminary Views (PV) as a platform for developing the FASAB standards on non-intragovernmental leases.

Ms. Valentine provided the Board with eleven discussion items that staff compiled from the last three GASB lease discussions (April, June, and July 2015). Staff noted that the eleven issues represent those lease topics that GASB either changed its position from the November 2014 Lease Preliminary Views document or topics that FASAB will need to have further discussions on as the exposure draft is developed. The following discussion items were presented to the Board.

- Defining “nonfinancial asset”
- Intangible (lease) assets
- The role of “control” in determining whether a transaction qualifies as an asset
- Service concession agreements
- Bargain purchase options
- Month-to-month holdover periods
- Probability threshold
- Lessee renewal/termination options
- Fiscal funding clauses
- Lease liability remeasurement
- Allocation of consideration to multiple components

Due to the meeting time constraints, Chairman Allen asked staff to identify those specific issues that members had raised and talk about those. Ms. Valentine informed the Board that she received three questions from Mr. Showalter on the discussion paper.

Mr. Showalter’s first comment related to FASAB adding a definition of “nonfinancial asset” to the standard since the term is used in the proposed definition of lease. FASAB has tentatively decided to define lease as – a contract or agreement that conveys the right to use a **nonfinancial** asset (the underlying asset) for a period of time in exchange for consideration. The Board also tentatively decided that if a federal entity leases a **nonfinancial** asset as an investment, the lessee should consider the lease as a financing purchase and not apply the requirements of the lease standard.

GASB tentatively agreed to define “nonfinancial assets” as “an asset that is not a *financial asset*, as the term is defined in *Statement No. 72, Fair Value Measurement and Application*[2]. Nonfinancial assets include land, buildings, use of facilities, materials and supplies, intangible assets, or services.”

FASAB does not currently define financial asset or nonfinancial asset. Staff recommended that the Board adopt the GASB definition in the proposed lease standard for clarity.

Mr. Dacey and Mr. Showalter both questioned using such a definition. Mr. Dacey suggested just giving examples or asset classes of nonfinancial assets, if a clearer definition cannot be developed. The Board asked staff if federal leases would go beyond the scope of capital assets (real and personal property). The Board asked staff to comeback with options to defining nonfinancial assets.

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[2] In GASB Statement No. 72, Fair Value Measurement and Application, a **financial asset** is defined as follows:
Cash, evidence of an ownership in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option).

Mr. Showalter's second comment related to when the lessee is assessing their options to extend or terminate the lease. Mr. Showalter stated that it was not clear what the staff recommendation was. The GASB PV proposed that the probability of the lessee exercising the option to extend or terminate the lease should be at the probable threshold. During redeliberations, GASB has tentatively agreed to change its PV proposal and change to a greater threshold from "probable" to "reasonably certain." The GASB also tentatively agreed to change its PV proposal from "probable" to "reasonably certain" with respect to when certain lease payments should be included in the measurement of the lease liability.

Staff noted that the FASAB "probable" definition equates to "more likely than not" and "reasonably certain" has an even higher threshold than GASB's "probable (likely to occur)." Since FASAB previously noted that it was comfortable with the differences between our "probable" and GASB's "probable," staff recommends not accepting GASB's change to "reasonably certain" and staying with the FASAB "probable" definition, because there seems to be no compelling reason to introduce a new term for the sake of a higher threshold. The Board did not disagree with staff's recommendation.

Mr. Showalter's third comment related to lease liability remeasurement. Mr. Showalter asked the staff to explain why they did not agree with the GASB conclusion. During redeliberations at the June 2015 meeting, GASB tentatively decided that a lease liability should not be remeasured solely for a change in an index or rate, but that such a change would be factored into the remeasurement if the lease liability already was being remeasured for another trigger. Then in July, GASB considered whether the exception to report such a change directly in the flows statement should continue. Accordingly, the portion attributable to the lease term change would adjust the lease asset because it changes the service utility of that asset, and the portion attributable to the index or rate change, if it is attributable to the current period, would go to the flows statement. GASB staff believes requiring this separation would result in more burden on governments.

During the July redeliberations, GASB tentatively decided that the exposure draft should not carry forward the provision from the PV that the effects of a lease liability remeasurement due to a change in an index or rate used to determine variable lease payments that relates to the current period be recognized in the flows statement and instead proposed to recognize such changes as an adjustment to the lease asset. The GASB change was primarily for cost-benefit concerns.

The GASB PV states that for the changes in measurement due to a change in index or rate, that change is seen as a period cost. That is because the factors that caused the change in that rate are attributable to events in the period of the change.

Mr. Granof further explained GASB's rationale for the change and explained his reasons for disagreeing with the change in the GASB decision. Mr. Dacey noted that in essence, the remeasurement is trying to adjust the liability and the asset to the values that they would have been if the revised index were in place at the time the lease was originally valued and would appear to primarily affect prospective cash flows.

GASB staff recommended that the effects of a lease liability remeasurement due to a change in an index or rate used to determine variable payments be recognized (the portion attributable to the index or rate change, if it is attributable to the current period) as a period cost that would go to the flows statement. Staff disagrees with this change and believes that the PV proposal is more appropriate.

Chairman Allen reminded the Board that there was agreement to align the lease standard with GASB for the non-intragovernmental standards unless there is a specific and significant reason to deviate from GASB.

Ms. Payne reminded the Board that all of these issues will be brought back to the Board for more discussion before the exposure draft is finalized.

- **Draft Annual Report and Three-Year Plan**

Ms. Valentine and Ms. Payne briefed the Board on the draft annual report. The report will celebrate the Board's 25th anniversary and has a few special features. The members commended Ms. Valentine on the 25th anniversary features.

Members provided the following suggestions:

1. Update the narrative discussion of the performance survey results to align with the numeric results. Also, revise the chart to show positive results first.

2. Clarify the nature of the 2012 improvements efforts mentioned.

3. Add a statement on the budget chart indicating that the 2016 amounts depend on the outcome of the budget process.

4. The statement that the Board's mission and operating procedures were not revised should be stated positively.

5. Streamline the listing of members so that all members can be included.

6. Streamline the objectives of the tax expenditure project.

   Conclusions: Revisions will be made and circulated for comment prior to the October meeting.

- **Internal Use Software**

Ms. Wu opened up the internal use software session with an introduction of the background for the IUS implementation guide, and informed the Board on the results of meetings with the OMB and the program managers from selected agencies. She briefed the Board that the implementation guide was drafted based on the highlighted common issues identified across the federal agencies, it helps clarify terminology, introduce new terms and provide sample IUS practice across the federal government IUS process.

The implementation guide Exposure Draft (ED) provides greater detail about applying existing guidance for determining the cutoffs for the capitalization of software development and other areas. It also addresses some of the new types of computing arrangements, such as cloud computing, shared services, agile software development, and spiral software development. Board members agreed that the draft was ready for exposure and provided the following comments:

- Mr. Showalter discussed that he had a comment related to the service contract guidance not referencing to an existing standard and concurred on the changes made on the updated implementation guide ED.

- Mr. Steinberg suggested that future implementation guides could be written in three bullet points or three little headings of current guidance, variations, and suggested guidance.

- Mr. Dacey and Mr. McCall each pointed out one clarification need on the new IUS developments' Agile Method and Spiral Model illustration tables. Staff agreed to take another look at the tables to see if those tables clearly illustrate the concept.

Conclusions: Staff will make changes based on the inputs from the meeting and perform pre-ballot procedures to issue the IUS implementation guide ED.

- **Steering Committee Meeting**

Ms. Payne presented the updated budget for FY2016 ($1,956,018) and 2017 ($1,996,942). She noted that these amounts include across the board and performance based salary increases which are unavoidable. The amounts needed to maintain the approved staffing level cannot be offset against other areas such as contracts or grants as larger departments do. The savings from administrative changes are intended to mitigate this to the degree possible.

Ms. Davis indicated that Ms. Ho questioned how we can justify increased funding when most agencies are facing budget reductions.

Adjournment

The Board meeting adjourned for the day at 4:45 PM.

Thursday, August 27, 2015

Administrative Matters

- **Approval of Minutes**

The minutes of the June meeting were approved prior to the meeting.

Agenda Topics

- **Risk Assumed-Insurance Programs**

Ms. Gilliam opened up the risk assumed-insurance program session directing the Board to Tab H.

I. <u>The following was discussed in relation to updating the titles for the exchange and nonexchange categories by removing the word "revenue" and replacing it with the word "transaction," to read:</u>

1. Exchange ~~Revenue~~ Transaction Insurance Programs Other Than Life Insurance
2. Nonexchange ~~Revenue~~ Transaction Insurance Programs
3. Life Insurance Programs

Mr. Allen asked in what category programs that fall between exchange and nonexchange would report. Ms. Gilliam explained that each program's transactions are defined by SFFAS 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting. If premiums are collected as a result of a contract, then the program would fall in the exchange category. If there are provisions for utilizing other funding then that would be disclosed in the proposed footnotes. If the government demands the funds, outside of a contract, that would fall in the nonexchange category. Mr. Allen agreed.

Ms. Payne explained that staff recommends including the word transaction instead of revenue because there are exchanges that are other than revenue, such as employee benefits. She also noted that staff will include a comprehensive definition for each category.

Mr. Showalter questioned whether the word "transaction" was necessary in the description of the transaction. Mr. Granof said that Exchange Insurance Programs is not descriptive enough. Mr. Dacey is also concerned that a footnote stating Exchange Insurance Program might not be that clear and cause confusion. Mr. Showalter was okay leaving the word "transaction" in the terms.

The Board agreed to include the word transaction instead of revenue.

Mr. Steinberg then asked if, for consistency, we should include “Other Than Life Insurance” in the nonexchange category. Ms. Gilliam explained that it was included only in the exchange title in order to distinguish the exchange and life insurance standards.

Ms. Payne said that staff did not find any nonexchange life insurance programs in the current suite of programs, but that does not mean there will not be any in the future. Mr. Reger suggested removing it from the exchange title. Mr. Dacey did not agree, noting that when listed together the titles worked, but when discussed separately could cause confusion.

> A vote was taken to: 1) keep the titles the same, 2) add “Other Than Life Insurance” to the nonexchange category title, or 3) remove “Other Than Life Insurance” from the exchange category.

There was NO majority vote for any of the options; therefore, the titles will remain the same, with the only change being the word transaction instead of revenue.

II. <u>The following was discussed in relation to the proposed standards for the life insurance programs category, which Ms. Gilliam noted map to the ones approved for the exchange and nonexchange transaction categories.</u>

Mr. Allen asked why staff only discussed the component level in this memo as opposed to also including those that may affect the governmentwide report.

Ms. Gilliam explained that staff wanted to get the standards for all three categories approved and then include the governmentwide standards in the exposure draft. Mr. Allen emphasized that the level of detail captured at the governmentwide level should be less detail than the proposed standards for the categories. Staff agreed.

A number of members were concerned with the number of life insurance disclosures, noting that they may not be materially necessary.

Ms. Gilliam noted that this document was vetted through the task force with no adverse comments. Agencies are presenting information as best they can in accordance with their interpretation of SFFAS 5, which is causing inconsistent presentations. For example, OPM uses six and a half pages with approximately 30 mentions about life insurance, while VA uses four pages, both offering different charts to explain life insurance liabilities.

Ms. Payne noted that the diversity of agency presentations and measurements led staff to rewrite the disclosures for life insurance programs, relying heavily upon current FASB disclosures. However, staff will work to reduce the list if the Board thinks a disclosure(s) is not relevant for government life insurance programs. For example, FASB included certain information to support assessments of liquidity and the federal government may not be as concerned with liquidity.

Mr. Showalter said that because this is a risk assumed standard these disclosures should focus on the risk assumed elements of these programs and not everything about the programs.

Ms. Gilliam referenced John Kamensky, a panelist for the Reporting Model Performance Information Discussion on August 26, 2015, who noted how difficult he found it to read and understand financial statements and to understand the entire story. She noted that the proposed disclosures help to clarify and tell the risk assumed story.

If programs collect premiums that do not cover losses, then the government assumes the risk for paying additional amounts with tax payer funds, either through appropriations and/or borrowing/interest paid. These disclosures will help to tell the risk assumed story consistently.

Mr. Smith noted that commercial entities are encouraged to disclose what is relevant based on minimal standards. In order to not overburden the agencies, he suggested that staff take the same approach for the government disclosures. For example, there is too much detail requested for the cash surrender value disclosure in paragraph 23.h; loans outstanding would probably not be material to note separately. Therefore, he recommended just disclosing a net value. Mr. Allen agreed.

Mr. Reger said that despite how robust the financial statements, are we cannot tell if we have assumed more or less risk. Therefore, the standards should help the reader to understand what risks these programs have assumed and what outcomes have been achieved in a clear and concise manor.

Mr. Dacey is concerned with the different levels of reporting in that the footnotes at the insurance program level may be appropriate, but at the department component level may be disproportionate.

Ms. Payne asked if the Board would like to see wording that allows more flexibility with the disclosures, for example, if certain factors exist, then a disclosure would be required. Mr. Allen likes the flexibility but agrees with Mr. Dacey that disclosures should be streamlined for component level reporting.

The Board agreed and directed staff to streamline the disclosures based on the risk assumed outcome.

Mr. Dacey noted that he is concerned that the categories do not distinguish between short and long-duration.

Ms. Gilliam noted that using the portfolios for disclosures does allow agencies to break out groups depending on different durations. .

Ms. Payne added that private companies can choose to renew contracts at new durations and market pricing terms to support solvency and profitability. However, agencies are often locked into stated pricing/terms by law verses market forces, which may or may not cover incurred losses.

Therefore, staff did not think that commercial short- and long-duration definitions fit the proposed federal models and proposed disclosures allowing agencies to build assumptions about participation and premium rates into their portfolio groupings. She requests that the Board factor in this information for future discussions.

Mr. Dacey noted that today's discussion focused on the long-duration model for life insurance programs where a stream of payments is locked in and expected to continue over a long-duration contract and is, therefore, discounted for present value. However, some of our products may be short-duration term life insurance and may not fit this model.

In addition, any long-duration exchange contracts other than life insurance will not fit the current model in that category because the liability for losses on remaining coverage calculates the cash flow for settling claims during the open contract period against unearned premiums which have already been collected. For long-duration contracts, there are no proposed disclosures that account for the expected present value for all future claims to be paid, less future premiums to be collected, like in the life insurance programs category.

Mr. Dacey said that it comes down to the measurement issue and that there can be unintentional results if the disclosures do not separate these different durations within the approved categories. Therefore, he requested that staff continue their research in this area, including the FASB updates—as they become available—on the long-duration model in relation to the IASB standards, in order to ensure that the longer duration contracts within the exchange transaction insurance programs other than life insurance category and short-duration term life insurance contracts within the life insurance programs category are clarified with additional information.

Staff agreed and Mr. Allen dismissed the session.

> **Conclusions:** Staff will update the draft based on the guidance provided and explore options regarding the disclosure and duration issues.

- **Department of Defense Request- Opening Balances**

Ms. Batchelor began the session by explaining that the purpose of the session was to make decisions on issues regarding the Draft Statement, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*. Mr. Norwood (Woody) Jackson joined the Board meeting by phone. Briefing materials previously provided to the Board included the comment letters, a summary of the issues, recommendations and proposed changes and a Draft Statement.

Ms. Batchelor explained that she received comments from several Board members. Based on those comments, she worked with Mr. Jackson to prepare two documents—a one page handout that showed significant suggested changes and a complete updated Draft Statement that included all suggested editorials.

Ms. Batchelor directed attention to paragraph 11 in the handout. She explained that after further discussions with members in the audit community, staff recommended paragraph 11 be changed as follows:

> 11.Because the reporting entity may have multiple component reporting entities using various valuation methods simultaneously, deemed cost ~~may~~ <u>should</u> be based on one of or a combination of <u>the following</u> valuation methods~~, including~~:
>
> a. Standard price (selling price) or fair value
>
> b. Latest Acquisition Cost (LAC) Method
>
> c. Replacement cost
>
> d. Estimated historical cost (initial amount)
>
> e. Actual historical cost (initial amount)

While the intent was to be permissive regarding methods; staff considered that an unacceptable method could be used. In addition, during interviews with DoD, no other method came up that they were using so it appears the list is inclusive of all methods. Therefore, staff recommended the language be changed to "should." Ms. Batchelor explained that paragraph A15 in the basis for conclusions was updated to reflect the change.

Mr. Allen asked if the Board members had any questions or concerns or objections. There were no objections to the change.

The next change in the handout related to the amendments section. Mr. Showalter recommended the discussion of deemed cost be moved to the beginning of paragraph 18a. of the Statement (and paragraph 26a. of the amendments of SFFAS 3). Mr. Showalter explained that he believed the discussion of deemed cost should come earlier in the amendments of SFFAS 3 because that is the key point of the alternative valuation. The Board agreed with the suggestion to move the discussion of deemed cost to the beginning of the amendments of SFFAS 3.

Mr. Dacey explained that he was trying to understand the logic for adding the language regarding when the alternative valuation method would not be used (paragraphs 5 and 18.a.ii.) that was similar to what IPSASB had used. He understood that IPSASB had used it because it took into account that some governments had been on a cash basis. He would argue that DoD has presented financial statements in accordance with GAAP in the past.

Mr. Dacey believed that paragraphs 4 and 18.a. regarding when deemed cost could be applied is sufficient and clear. It provides for using deemed cost (1) for the first-time or (2) after a period during which existing systems could not provide the information necessary for producing such GAAP-based financial statements without use of the alternative valuation method. Further, it provides that the application of this Statement based on the second condition is available once per reporting entity.

After discussion, the Board agreed that the additional IPSASB language is not necessary and could lead to confusion.

Mr. Steinberg asked about obsolete inventory and whether revisions were needed based on the respondent's comment. Ms. Batchelor explained that obsolete inventory is addressed in SFFAS 3 and must be valued at net realizable value. After a brief discussion, Mr. Allen noted that it did not appear to be an issue and asked if other members had comments or issues. No other members believed that obsolete inventory was an issue to discuss further.

Mr. Dacey explained that he had concern with repeating terms within the definition that are used in the text of the standard around the defined term. He used the example of "unreserved assertion" and suggested that the Board define it in different terminology and review how it is used in the text of the standard. After discussion, the Board agreed to change the definition to "unconditional statement."

Mr. Dacey also suggested that the definition for unreserved assertion should state which line items it is referring to. Staff explained that the definition that is included will be in the glossary and should be generic or open so that it may be used for other purposes as needed. However, staff will determine if more specific language needs to be added in other places, to state which line items or to which specific Statement it applies.

Ms. Batchelor explained that all member comments received to date were included in the revised draft provided to members at the meeting. She explained that all members providing comments stated they were prepared to move to a pre-ballot draft statement.

Mr. Allen asked if there were any other comments on the document. There were no other comments and all members agreed to move to a pre-ballot. Members thanked Mr. Jackson for his support on this project.

Conclusions: After considering comment letters, summary of issues and staff recommendations, proposed changes and a Draft Statement, *Opening Balances for Inventory, Operating Materials and Supplies (OM&S) and Stockpile Materials*, the Board approved staff recommendations and agreed to several changes in the meeting to the Draft Statement. The Board agreed to proceed to a pre-ballot draft of the document and further due process to issue the Statement.

- **Department of Defense Request- General PP&E**

Ms. Batchelor began by explaining that the purpose of the session was to consider options regarding baseline estimates of general property, plant, and equipment (GPP&E.). Ms. Batchelor explained that the Board discussed the issue at the June 2015 meeting and considered certain options. The Board agreed to develop a Statement to provide a cost effective approach for DoD. It was agreed that FASAB staff would work with DoD and facilitate meetings to gather input from their auditors. In addition, the issues related to all GPP&E, including real property, military equipment and land can be addressed in one Statement.

Ms. Batchelor explained that since the June meeting, staff held a brainstorming session with DoD representatives, an auditors roundtable meeting, prepared a list of options, and developed a list of recommendations where the Board might provide guidance or amendments to reduce the cost of implementation by area for the Board to consider.

Ms. Batchelor explained that the briefing materials contain information on each of those areas and DoD representatives are also present to answer questions as needed. The Board acknowledged Ms. Jenkins, Director of Financial Improvement and Audit Readiness from DoD's Office of the Under Secretary of Defense (Comptroller) and suggested she come to the Board table. Ms. Batchelor suggested moving through the questions in the staff memo, starting with real property.

Mr. Granof explained that he wanted to discuss an issue before the Board discussed the details of the recommendations. He questioned why DoD requested the project or in essence he is unsure as to the need for this project. He believes that DoD cannot accomplish the tasks at hand to prepare auditable financial statements, so they will need to footnote whatever is done. He asked what the difference is if that is provided in the statements or the auditor's opinion. He suggested that by FASAB actions, the Board is a co-conspirator by supporting what is being done. One could suggest that we are in essence, redefining GAAP so that the DoD can get an opinion. To any knowledgeable observer, however, FASAB would be defining DoD's incorrect estimate as what constitutes GAAP. Mr. Granof questioned why FASAB should be doing this instead of DoD accepting the opinion they may receive.

Mr. Allen explained that auditing standards speak to appearance. He believes that the positive message that it sends to work through these issues is important. Mr. Granof explained that he has an issue with deeming something incorrect as correct. Mr. Allen suggested that accountants are often considered out in left field for even using historic cost, so maybe it is not that incorrect.

Mr. Reger explained that the Board is seeking to help DoD establish a starting point. We have to recognize that we would all be better off if they have starting a point so they can build a control environment around that. With the control environment, then everything else will fall into place. The starting point is just that, the more important thing is the robust internal control environment process that will be in place. Mr. Granof indicated that he understood that benefit. Mr. Allen explained that the proposal made in June appeared to result in additional work and understate costs but the proposals now would not and that may be closer to replacement cost.

Mr. Showalter explained that FASAB would not be the first standard setters to provide a starting place for implementing a standard; you have to provide organizations a starting point. Mr. Smith agreed, he explained it is similar for new acquisitions. He said you have to do something for balances so you can get them to a clean opinion. You do not want them in a qualified state for several years. Mr. Smith explained that this is practical and makes sense.

Mr. Granof suggested that something should be included in the basis for conclusion to document this discussion. Mr. Allen agreed.

He suggested that the Board move to the staff recommendations by area.

Real Property (excluding Land)

Ms. Batchelor explained that real property is the area of the original request from DoD. Specifically, DoD requested clarification whether capital improvements are included when estimating the historical cost of GPP&E. Capital improvement projects related to real property assets have not been reliably tracked in systems so it is difficult to determine the date they were placed in service and establish a valuation baseline. All systems that the DoD has utilized for acquisitions of real property and capital improvement projects have either never been audited or when audited had significant deficiencies or material weaknesses related to them.

Ms. Batchelor recommended use of an approach similar to inventory--deemed cost for real property opening balances. For example, real property could be valued at replacement cost, estimated historical cost, or fair value. She explained that DoD currently uses PRV (a replacement cost model) for management but not financial reporting purposes. This valuation would be in current year dollars and not deflated to the in-service year. PRV is inclusive of capital improvements.

Ms. Batchelor explained that DoD supports FASAB's recommendation. She explained that the Board members providing comments were supportive of the recommendation.

Mr. Steinberg asked Ms. Jenkins if DoD will have the systems in place once they make the unreserved assertion for real property? He added that like the inventory standard, this proposal would be similar in that DoD would only have one shot at using this type of election to establish opening balances. Ms. Jenkins stated that yes, after drawing the line in the sand, DoD should be ready to be compliant with SFFAS 6.

Mr. Allen asked if there were any other questions. Then he asked if there were any objections to staff's recommendation to use deemed cost for real property opening balances. There were no objections.

Land

Ms. Batchelor explained that DoD has indicated records of the cost of land are not adequate. (While plant replacement value is being used for facilities, the cost factors exclude land.) Land records are centrally managed but not in a structured, searchable manner. If deeds can be located, they generally provide the price paid upon transfer of the deed (historical cost). However, land holdings have expanded over the decades through multiple small purchases so there are many records. Also, deeds may not be complete – there may be gaps in contrast to the area controlled by the services. There may also be gaps in court records given the length of time involved.

Ms. Batchelor explained that DoD will incur considerable cost to identify or estimate the historical cost of land and land rights. Because land is not depreciated, the benefits of capitalizing it are primarily in the period of acquisition. That is, the cost of the land is identified so the acquisition can be evaluated and the period operating costs not overstated. The ongoing benefit is that accountability for the asset is established.

Staff recommended the Board provide for prospective capitalization of land, but require disclosure of physical units for currently held land. She noted that there had been Board members with comments on this recommendation.

Mr. Steinberg suggested that if the Board does select units for reporting land, it should be acres. Ms. Batchelor agreed and explained that the question to the Board was at a high level to obtain general agreement for the recommendation. Specifics such as that would be provided as staff develops the language for the draft standards.

Mr. Granof questioned what would knowing the total acres of land at DoD tell anyone. He questioned if that information was useful. Mr. Allen explained that it is a starting point and provides accountability.

Mr. Allen believes there would be a value in capitalizing something, whether it was $XX dollar per acre. He explained that is not a stable number, the federal government is always making land swaps.

Ms. Payne explained that Stewardship Land is not on the Balance Sheet. The Balance Sheet presents only the cost of land acquired for the purpose of constructing general PP&E. Therefore, the ability to assign a cost to the land swaps is already quite limited.

Mr. McCall asked if it would be difficult to determine the valuation of the land. Ms. Jenkins explained that determining the valuation is difficult. She explained that one must also consider the constant Congressional pressures not to spend resources on looking back on the past.

Mr. Smith asked if the current standards are based on the nature of what the federal government does. If so, then why not have a standard that says because we are the federal government, we do not capitalize land. He believes there is some inconsistent logic. For example, if we are saying that it is because of historical cost and it is not worth the effort to get it, then it would make sense to put a small value on land.

Staff explained that fair value would not approximate the value of the land given the vast holdings of the federal government. When SFFAS 6 was established, the Board thought that management tools might emerge that charge for the cost of capital used by agencies. If that happened, capitalization of land would inform the cost of capital calculations.

Mr. Reger asked DoD if they could fulfil the requirements the Board has suggested. Ms. Jenkins requested Mr. Coffman speak about the systems responsible for accountability of land. Mr. Coffman explained that in 2009, DoD started a process to validate their installation boundaries. Each service has to review the interior of each fence line and validate each parcel of land to determine the interest or how the federal government acquired that land—donated, revisionary, condemnation, war, etc. He explained the Army completed a $3 million effort and is currently obtaining deeds. He explained the challenge is digitizing the records that have been sitting in warehouses and other locations. He explained when there are gaps in records, it takes time to go to courthouses and so forth.

Mr. Reger asked if DoD would be in a position to provide the acre information including parcel or support as required for the financial statements. Mr. Coffman said the services would be comfortable providing the number of acres, but they might be uncomfortable with what supports it—such as the parcels and interests that make up those and underlying documentation. He explained that DoD may not be ready to assert interests at the parcel level until 2019.

Mr. Allen asked that each Board member provide their position on the issue and whether they support the staff recommendation.

Messrs. Granof, McCall, Reger, Steinberg, Showalter, and Ms. Davis supported the staff recommendation assuming that physical units meant acres. Mr. Allen explained that he had wanted more but agreed with the staff recommendation. Mr. Dacey and Mr. Smith abstained. Based on the votes, the majority of the Board supported the staff recommendation for prospective capitalization of land, and disclosure of acres for currently held land.

~Lunch~

Internal Use Software (IUS)

Ms. Batchelor explained that DoD does not have a complete inventory of its IUS. She added that costs of IUS have not traditionally been captured or documented consistently. In a letter included in the Board materials, DoD requested that IUS be implemented prospectively given the initial SFFAS 10 implementation provisions (prospective implementation).

Ms. Batchelor explained that DoD would incur considerable cost to identify or estimate the capitalizable amount of IUS. This would take limited resources away from establishing systems and processes to properly account for IUS on a go forward basis. She recommended the Board provide for prospective capitalization of IUS. She explained this was similar to the decision by the previous Board to provide prospective implementation when SFFAS 10 was issued. Paragraph 36 provides "Cost incurred prior to the initial application of this statement, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized, had this statement been in effect when those costs were incurred."

Mr. Allen asked about the feedback thus far. Ms. Batchelor explained that members responding thus far have been supportive. He stated that he supports the recommendation and considering materiality, it is hard to view this as an item that would be material for DoD.

Mr. Dacey asked the main reason for taking a different approach for IUS compared to other categories. Ms. Batchelor explained that IUS is a soft asset that is harder to inventory than tangible assets. Also, it typically has a shorter useful life than the other areas discussed.

Mr. Allen asked if there were any other questions. Then he asked if there were any objections to staff's recommendation to provide for prospective capitalization of IUS. There were no objections.

Equipment

Ms. Batchelor noted that staff has not gathered as much information in this area. Equipment is a broad category that consists of hundreds of thousands of assets. However, it appears that the military services are not planning to use deflated replacement cost for equipment. Instead, budget and other records would be used. DoD does not have procedures in place now to accurately account for 2014 or 2015 capital acquisitions (but indicated in their proposal that records after October 1, 2002 are more reliable than those before).

Ms. Batchelor explained that based on discussions at the auditor roundtable, SFFAS 35 will provide the basis for estimating costs to be capitalized each year going forward. Meaning, some services are not planning on establishing a systematic transaction-based approach to identifying the cost of new assets. From the Auditor RoundTable meeting, there was concern with the fact that SFFAS 35 allows for estimates to be used in the future and DoD may continue relying on estimates without actually addressing the problem of fixing systems to get cost accounting information and historical cost information. Some suggested FASAB rescind provisions of SFFAS 35 to discourage reliance on estimates for future acquisitions.

Ms. Batchelor recommended use of deemed cost for equipment opening balances. For example, equipment could be valued at replacement cost, estimated historical cost, or fair value. She explained that based on feedback thus far, Board members were supportive of the approach.

Mr. Allen asked if this category included military type equipment. Staff said that it did include what members would describe as military equipment. Ms. Payne explained that there is a long history on the topic of “military equipment” or “national defense PP&E” going back to when the Board issued SFFAS 6, SFFAS 8, SFFAS 23 and so forth. In reality, it was more difficult to classify items between general and military equipment than one would imagine. Also, deciding what should be reported for them was a challenge. Clearly most people are still interested in the cost of the assets when you are acquiring them and how long they will last. That information is available through the current standards.

Mr. Steinberg explained that was a short answer because it has been a very complicated issue over the years. Ms. Payne agreed, but stated that the purpose of the discussion is not to redeliberate the go forward accounting standards for military equipment.

Mr. Steinberg noted that DoD’s proposed options were more complex and difficult than FASAB’s staff recommendation. Ms. Batchelor explained that staff did not receive DoD’s paper with options until the day before the Board materials were distributed. Therefore, there was little time to gather feedback or discuss. Since providing DoD with the Board materials, DoD has expressed support of FASAB’s recommendation. Ms. Jenkins explained that they originally took a more conservative approach to address issues discussed at the previous meeting. After reading the staff recommendation, they are in full support of using the deemed cost approach.

Mr. Allen asked if DoD had performed a capitalization study or if there were different threshold levels by category. Ms. Jenkins explained that a study had been performed and there were different levels by service. For the entire DoD, as well as the Air Force and Navy, the capitalization threshold is $1M. The capitalization threshold for the remaining branches and services (including the working capital fund and general fund) is $250,000.

Ms. Davis asked whether the services are planning on establishing a systematic transaction-based approach to identifying the cost of new assets. Ms. Jenkins explained that not all components are planning on doing it in the near future. She explained that they are waiting on the new ERP capabilities. Ms. Jenkins explained that in the interim, it will be a manual burdensome process. There will be requirements that as they issue contracts that the capitalizable costs are listed separately from the expense and they are captured in a construction-in-process account and allocated to assets upon delivery.

Mr. Allen asked when the system capable of capturing the information would be ready. Ms. Jenkins explained it would be 2019 or later, as it would require the acquisitions system along with other areas such as contract writing, logistics, financial and so forth be integrated. However, they can separate the capitalized costs in contracts and do other manual work with assets as they are delivered.

Ms. Jenkins explained that one challenge they deal with is trying to get a good understanding on what full cost means in this area. Some of the military equipment involves multiple contracts and then it involves oversight and overhead with multiple contracts. Considering there is not a full blown cost accounting system in place, it becomes a challenge.

Mr. Steinberg asked if this was an area that FASAB needed to provide guidance. Ms. Payne noted that FASAB had recently done Technical Release 15: *Implementation Guidance for General Property, Plant, and Equipment Cost Accumulation, Assignment and Allocation* but it may not have gone to the level of detail needed. Staff can discuss it with DoD to see how it can be expanded. Mr. Steinberg suggested that it be discussed at the next technical agenda session.

Mr. Reger asked if he brought an item up now, if it is reconsideration at this point. Mr. Allen explained that if his question relates to an issue from this meeting it would not be reconsideration because the Board is in the same meeting. Mr. Reger explained that he had more questions on the issue of land that was discussed before lunch.

He asked what would happen if we put the land on the books at $1 per acre so as to create accountability for transactions and so forth that occur. Mr. Allen explained that all of the other assets are used up, so you need something to get the cost of service. He added that all the rest are self-correcting. In the case of land, it is not used up so you really do not have that cost of service. Mr. Reger explained he was concerned that there are lots of properties that the federal government will never sell. How do you impose accountability and enforce recordation of transactions that relate to the land.

Mr. Smith noted that the purpose of the standard was to address valuation, so for the Board to say you do not record it for baseline, then it appears inconsistent to say record it for new acquisitions. The material land is already in the financial statements, and we are suggesting that land not be recorded and disclosed in the footnotes. Any new acquisitions at this point would not be material compared to land that we already have, so why not just disclose the new acquisitions as well. Mr. Smith suggested that the Board make a standard for the federal government that you expense land when it is acquired. Mr. Granof agreed and said that is more consistent.

Ms. Davis suggested that there is $11B in land for DoD (and $13B for other Departments) that would need to be considered if the Board considered making a change in the standards.

Mr. Showalter asked whether previous Boards considered this issue when deliberating about standards for land. Ms. Payne explained she recalled the Board was concerned about the cost of capital; therefore, the option of expensing land was not seriously considered.

Ms. Payne noted one option is a valuation method based on current values (fair value) for land that has been used by OMB in the past for their Analytical Perspectives tables. It used models to establish fair value rather than the specific fair value of an acre of land. Ms. Payne suggested that staff could consider several options based on readily available information and bring that to the Board. These options (such as something from the OMB report, or a certain dollar value) would not involve significant additional work by DoD but would be a math exercise per acre and the results.

Mr. Reger asked if staff could do further analysis of the broader government-wide issue. Ms. Payne agreed but cautioned the Board that this is a capital asset standard that will require a 45 session day congressional review. She did not want to delay a response to DoD.

Mr. Allen suggested moving ahead with DoD based on the recommendation but also concurrently research the broader issue. Mr. Dacey agreed that more information should be gathered on the broader issue as we move forward.

Ms. Payne suggested that a question could be asked in the exposure draft. Mr. Steinberg suggested that if the Board selects to use a current value for land, he would like a question that some land in the CFR is valued at historical cost and some is at current cost.

Mr. Dacey explained that since there needs to be exploration before a decision is made, staff should consider standard rates to assign and the Board consider the broader implications.

Mr. Allen agreed and asked that staff bring a developed standard based on the approved recommendations and research the land issue.

Conclusions: After considering options regarding baseline estimates of general property, plant, and equipment (GPP&E) the Board agreed to the following:

- Allow deemed cost (estimated historical cost, fair value, replacement cost) for all general PP&E.
- Provide prospective treatment for internal use software and land.
- Acres of land would be disclosed.

Staff will develop standards based on the recommendations for the October Board meeting. The Board also requested staff research the broader issue of land and potential implications or change at the government-wide level.

- **Tax Expenditures**

Ms. Payne introduced Mr. R. Alan Perry (Financial Auditor, Financial Management and Assurance, GAO) to the members and reminded them that he volunteered to support the tax expenditure project. She commended him for his hard work and success supporting the task force on a complex project.

Mr. Perry briefed the Board regarding progress made by the task force and areas of consensus as follows:

1. A background paper intended to introduce readers of the exposure draft to the complex topic of tax expenditures is almost complete.

2. Because task force members have varying backgrounds, they devoted time to developing a common understanding of the intended users and structure of a financial report and audit implications for information in the various sections.

3. Survey results revealed consensus around information to be included in the MD&A section. The universe of information needed is generally agreed upon. However, there are diverse views regarding placement of more detailed information in either required supplemental information or management's discussion and analysis.

Members asked whether the task force would consider (1) options for recognition and (2) component entity reporting. Mr. Perry indicated that future meetings would focus on these aspects. Early discussions suggested that recognition might need to be considered in a later phase given the nature of the information. Some members encouraged consideration of the whole spectrum of possibilities.

Adjournment

The meeting adjourned at 4:00 PM.