



**Federal Accounting Standards Advisory Board**

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May 10, 2007

**TO:** Members of FASAB

**FROM:** Penny Wardlow, Consultant

**THROUGH:** Wendy Comes, Executive Director

**SUBJECT: Conceptual Framework: Elements—Draft Final Statement—TAB B**

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

At the March meeting, staff presented a draft final Statement on Elements showing proposed changes to the ED issued in June 2006. The Board discussed several issues at length, particularly the section on the “Effects of Uncertainty,” including the difference between uncertainty as to whether an element is measurable and uncertainty in the actual measurement of that element, as well as possible changes to the definitions of assets, revenues, and expenses. Staff also proposed modifications to the “Recognition” section in the ED and various proposed editorial changes for clarification, as well as the reasons for or against proposing modifications based on the comments of respondents to the ED. Several questions raised by staff in the memo accompanying the March draft were not discussed for lack of time. Board members agreed to send their responses to staff. Staff received responses from six members. Those responses and other Board member comments have contributed to the attached revised draft.

The document under TAB B-1 of this memo is a marked-up copy of the draft final Statement presented to the Board in March. (There is no clean copy this time.) The changes shown are changes from the *March* draft revision, rather than the ED. A copy of the ED is attached for reference under TAB B-2. This memo includes comments on the principal changes proposed in various sections of the March draft.

The objective of the meeting is to approve the draft Statement, BFC, other Appendixes, and the front material, such as the Executive Summary, subject to any modifications the Board makes. The next step is for the Board to consider a preballot draft of the final Statement.

## 1. Additions to Clarify the Role of Concepts Statements in the GAAP Hierarchy

Some members have questioned whether preparers, auditors, and others may be confused by differences between the definitions of Elements included in the new Concepts Statement and existing definitions previously issued by FASAB, and may be unsure which definitions to apply. Staff is proposing to clarify this issue in the concepts statement by including (a) an expansion of the discussion of the role of concepts statements and a brief discussion of the GAAP hierarchy in the “front” material titled “Statements of Federal Financial Accounting Concepts,” (b) a brief paragraph at the end of the Executive Summary on “Effect on Practice,” (c) a similar addition to paragraph 1 of the Introduction to the Statement, (d) a more extensive discussion of the issue in paragraphs 9 through 17 of Appendix B: Basis of Conclusions (BFC), and (e) a reproduction in new Appendix C: Generally Accepted Accounting Principles, of “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles” from the AICPA’s AU Section 411.

### 1. Does the Board agree with the additions concerning concepts statements and the GAAP hierarchy to:

- (a) The material titled “Statements of Federal Financial Accounting Concepts”?
- (b) The Executive Summary?
- (c) Par. 1 of the Introduction?
- (d) Pars. 9–17 of the BFC
- (e) GAAP Hierarchy (AICPA AU Section 411) as Appendix C?

## 2. Existing vs. New Definitions

Members also have questioned the reasons why the Board has not simply extended the use of current FASAB definitions of Elements or adopted the definitions of other standard setters, instead of developing new definitions. Paragraph 7 of the BFC lists the current FASAB definitions of *asset*, *liability*, and *revenue* that are included in statements of federal financial accounting standards and the definitions of *asset* (an alternative definition) and *expense* that are included in the Consolidated Glossary but have not been adopted in any final Statement approved by the Board. Paragraph 8 of the BFC lists the principal issues or problems that have been raised with these definitions and states that, with the definitions in this Statement, the Board has resolved or clarified those issues.

### 2. Does the Board agree that the definitions in this Statement are needed to resolve issues or problems raised with existing definitions in FASAB standards, and with definitions in the Glossary that have not been adopted in a statement approved by the Board?

## 3. Modifications to the “Recognition” section (begins in par. 5)

The modifications introduced in March were primarily to refer to the recognition criteria as “basic recognition criteria” and to add a discussion of “Additional Components of Recognition Decisions” and indicate that the Board would address these in a future pronouncement. There was not much discussion of these changes at the March meeting, but the Board seemed to agree

they are positive changes. Four of the six members who responded after the meeting to staff questions agreed with the modifications (one indicated he thought the addition of pars. 7 and 8 was unnecessary but he accepted it) and two members did not comment on this issue. Staff has made editorial changes to par. 6.

#### **4. Qualitative Characteristics and Existing SFFAC's**

Staff included in the March draft modifications to the front material "Statement of Federal Financial Accounting Concepts" to clarify the continued applicability of the qualitative characteristics and existing SFFACs. The six members who responded to staff agreed with those changes.

#### **5. Definition of an Asset**

The definition in the ED stated that the "federal government can control" the economic benefits or services embodied in a resource. At the March meeting staff proposed changing "can control" to "is able to control." Some members (including some of those responding after the meeting to the staff's questions in the March memo) indicated they were satisfied with "can control" or that "is able to control" is acceptable because it means the same thing. Several members at the meeting preferred to say "the federal government controls." Two members indicated that "controls" is acceptable as long as it is made clear that it does not mean that the federal government must be actively controlling the economic benefits or services in order to have an asset. Instead, the government must have the current capacity to control the economic benefits and services and deny or regulate the access of other entities. One member indicated at the meeting and in the response to staff that "controls" is acceptable, but it would be preferable to state that "the federal government controls access to the economic benefits or services."

Based on the responses received, staff is not sure that "controls" is a firm majority preference. However, staff has substituted "controls" for "can control" or "is able to control" in the May draft, as the Board requested in March. With that change, the proposed definition of assets (par. 17) now reads:

An asset is a resource that embodies economic benefits or services that the federal government controls.

The subsequent discussion of "Control by the Federal Government," which begins in par. 28 and most of which is the same as in the ED, clarifies that the government does not have to be actively exercising control.

The alternative proposed by a member of including "access" in the definition would result in a definition similar to the following:

An asset is a resource that embodies economic benefits or services to which the federal government controls access.

Staff is not sure that this alternative definition will avoid potential misunderstandings that “controls” means “is actively exercising control of the economic benefits or services.” However, including “access” in the definition brings the use of the term in the explanation of “Control,” which staff believes is an important part of the explanation, in line with the wording of the definition itself.

**3. Does the Board prefer the definition of an asset to state that:**

- (a) An asset is a resource that embodies economic benefits or services that the federal government controls.**
- (b) An asset is a resource that embodies economic benefits or services to which the federal government controls access.**
- (c) Some other wording?**

**6. Liabilities**

In the March draft, modifications were proposed to pars. 39 and 40 to conform to changes proposed in the recognition section. The Board agreed. The six members who responded to staff questions also agreed. Also in March, the Board reaffirmed its belief that the “Settlement” portion of the liabilities definition is an essential characteristic. Two or three respondents to the ED had questioned this. The six members who responded to staff questions reaffirmed their agreement. One of those members questioned the reference to the balance sheet in par. 39 in the context of recognition of a liability. In the current draft, staff has deleted the reference. The member also questioned whether the “agreement or understanding” between the federal government and the other entity “as to the events that would require the government to settle the obligation” referred to in par. 40 includes “statutory language committing the government to future payments.” Staff has added a reference to statutory settlement requirements in pars. 40 and 45.

**4. Does the Board agree with the addition of a reference to statutory settlement requirements in pars. 40 and 45?**

**7. Revenues and Expenses**

In March the Board discussed possible changes to the definitions of revenues and expenses. The staff presented four alternatives, all of which included a reference to increases or decreases in net position, with the goal of removing the references to borrowings in the ED definitions. The alternatives varied as to whether they included references to increases or decreases in assets and liabilities and whether they listed examples of revenues and expenses. Among the alternatives, members generally preferred Alternative 3, although several members thought the ED definitions could or should be retained. This was true also of the members’ responses to staff questions.

The following comments also were made at the meeting and or in the responses to staff questions. One member thought the definitions should refer to inflows and outflows of resources instead of increases and decreases in assets and liabilities. Another member

disagreed with that proposal because (a) the Board has defined assets and indicated that revenues derive from them, so the definition should refer to assets, not resources, and (b) inflows would not include increases in assets due to revaluations, such as of investments.

One member thought the explanatory paragraphs should clarify that “capital contributions” are not revenues and “capital distributions” are not expenses. The Board briefly discussed that issue but members were unsure that capital contributions and distributions exist in the federal government. Absent examples to work with, staff has no recommendations on that issue.

Two members were concerned that the proposed definitions could lead to inappropriate treatment of “contra” transactions. For example, tax refunds might be interpreted to be expenses, whereas they are reductions of revenues. One of the two members proposed that a solution would be for the document to indicate that transactions that undo prior transactions should be accorded the same treatment as the prior transactions. The other member believed Alternative 2 would address the concern by retaining in the definitions the examples of revenues and expenses.

Given that Alternative 3 appears to be the majority preference, staff has substituted it for the definitions in the ED. The revised definitions of revenue and expense are in pars. 52 and 53 of the May draft. Conforming changes have been made in the Glossary and in the Executive Summary. To address the concerns about “contra” transactions, staff has included examples of revenues and expenses at the beginning of par. 54, as well as the following sentence: “Reversals of transactions involve the same element as the original transaction. For example, a tax refund is considered a revenue reduction and not an expense.”

The staff’s change in par. 55 is to correct an error from the ED: the sentence should refer to increases and decreases in assets and not inflows and outflows of resources, because the Board has defined assets as particular kinds of resources—those that have two essential characteristics. Gains and losses would not increase resources that do not qualify as assets.

<p><b>5. (a) Does the Board agree with the proposed changes to the definitions of revenue and expense (pars. 52 and 53)?</b></p> <p><b>(b) Does the Board agree with the additional language at the beginning of par. 54?</b></p>
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## 8. “Effects of Uncertainty”

Much of the March session on elements involved discussion of the proposed changes to the “Effects of Uncertainty” section in the March draft. Members’ concerns focused on the phrase “results of measurement” and whether such results could be uncertain if an entity has concluded that an element is measurable, and whether the references in the first paragraph to materiality and cost-benefit were appropriate in the context of that paragraph. Also, some members were concerned with an addition to par. 59 but others agreed with it. The previous ending to paragraph 59 was “Items that meet the definition of an element, but because of uncertainty are judged not to

be measurable, are not candidates for recognition.” At the request of a Board member, the following sentence was added to the March draft to, in his view, “give the other side of the coin”: Conversely, items that, because of uncertainty, are judged not to meet the definition of an element are not candidates for recognition even if they are measurable.”

Staff has rewritten the section. Par. 57 discusses uncertainty within the scope of the Statement—that is, uncertainty about whether an item has the essential characteristics of an element and is measurable and, therefore, meets the basic recognition criteria. Par. 58 parallels the discussion of additional components of recognition decisions introduced in the “Recognition” section and covers uncertainties in those components. The additional components include measurement of an appropriate attribute and the point is made that measurement may include an assessment of the probability of future flows of economic benefits of services. Par. 59 addresses the effects of uncertainty. Staff has added mention of the possibility of reassessments and restatements to strengthen the paragraph.

<b>6. Does the Board agree with the revised section on “Effects of Uncertainty”?</b>
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## **9. Appendix B: Basis for Conclusions**

New paragraphs 7 through 17 have been added for the reasons stated under points 1 and 2 of this memo. Par. 34 and 35 on the definition of assets will be modified as needed once the Board has decided the definition of assets. Modification may be necessary also to par. 37, depending on the Board’s decision with respect to the definitions of revenue and expense and the addition after the definitions of examples of revenues and expenses and clarification of the treatment of “contra” transactions. Staff has added language in pars. 39 and 40 of the BFC to conform to the added mention of statutory requirements to settle obligations in the Liabilities section of the draft (point 6 in this memo. The remaining changes are editorial.

## **10. Appendix C: Generally Accepted Accounting Principles**

The content of Appendix C and the reason for proposing this addition are discussed in point 1 of this memo.

### **Additional Issues**

## **11. Intra-governmental Activity**

A Board member has questioned whether the definitions of elements, which are expressed in terms of the Federal Government (par. 10), are appropriate for or adequately cover intra-governmental activity, such as receivables, payables, and transfers between component entities. Previous discussions of how best to handle elements of component entities’ financial statements resulted in the “Entity Concept” section, which begins in par. 10. Par. 11 states that:

. . . An item that meets the definition of an element of the federal government is also an element of a component entity. It is recognized in the component entity’s accrual-

basis financial statements provided it meets the basic recognition criteria and the additional components of recognition decisions.

The treatment of intra-governmental activity also was addressed in the ED in pars. 14 and 16 and footnote 7 to par. 43. Respondents to the ED did not raise concerns about the applicability of the definitions to component entities or the treatment of intra-governmental activity in the ED.

However, staff believes it may be useful to revise par. 14, as indicated, to clarify the treatment by component entities of items that meet the definition of elements from a component entity's perspective, even though they are not elements of the consolidated financial statements of the federal government. Staff also proposes a conforming change to footnote 7 of par. 43.

<b>7. Does the Board agree that the proposed changes to par. 14 and footnote 7 of par. 43 clarify the treatment of intra-governmental activities?</b>
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## **12. Appropriations**

A member has questioned whether appropriations should be referred to as "revenues" or "like revenues" of component entities. (See par. 15 under "Entity Concept" and par. 32 of the BFC, which refers to the designation of appropriations in SFFAS 7 as "other financing sources" and explains the Board's conclusion that the distinction between "financing sources" and revenues is not conceptual but is a matter of display or presentation in a particular financial reporting model. The Board's conclusion in the ED was that appropriations are "like revenues" for the component entities but not for the government as a whole.

Absent further discussion of this issue, if the Board wishes, staff has no recommendations for changes to the draft.

## **13. Capital Contributions and Distributions**

As mentioned earlier in this memo, under Revenues and Expenses, a Board member has indicated that under the revenue and expense definitions, capital contributions and distributions might be considered, respectively, to be revenues and expenses. In March, Board members were unsure whether the federal government or its component entities have capital contributions and distributions and no examples were given.

Absent further discussion of this issue, if the Board wishes, staff has no recommendations.

## LIST OF QUESTIONS FOR THE BOARD

1. Does the Board agree with the additions concerning concepts statements and the GAAP hierarchy to:
  - (f) The material titled “Statements of Federal Financial Accounting Concepts”?
  - (g) The Executive Summary?
  - (h) Par. 1 of the Introduction?
  - (i) Pars. 9–17 of the BFC
  - (j) GAAP Hierarchy (AICPA AU Section 411) as Appendix C?
  
2. Does the Board agree that the definitions in this Statement are needed to resolve issues or problems raised with existing definitions in FASAB standards, and with definitions in the Glossary that have not been adopted in a statement approved by the Board?
  
3. Does the Board prefer the definition of an asset to state that:
  - (a) An asset is a resource that embodies economic benefits or services that the federal government controls.
  - (b) An asset is a resource that embodies economic benefits or services to which the federal government controls access.
  - (c) Some other wording?
  
4. Does the Board agree with the addition of a reference to statutory settlement requirements in pars. 40 and 45?
  
5. (a) Does the Board agree with the proposed changes to the definitions of revenue and expense (pars. 52 and 53)?  
(b) Does the Board agree with the additional language at the beginning of par. 54?
  
6. Does the Board agree with the revised section on “Effects of Uncertainty”?
  
7. Does the Board agree that the proposed changes to par. 14 and footnote 7 of par. 43 clarify the treatment of intra-governmental activities?