

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
January 17-18, 2007
Room 7C13
441 G Street NW
Washington, DC 20548

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Wednesday, January 17, 2007

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Farrell, Jackson, Patton, Schumacher and Werfel, and Ms. Cohen. (Ms. Cohen attended Thursday's session by telephone.) Mr. Torregrosa attended the meeting for CBO member, Donald Marron. The executive director, Ms. Comes, and general counsel, Mr. Jacobson, were also present throughout the meeting.

- **Approval of Minutes**

The minutes were approved electronically in advance of the meeting.

- **New Member**

The Board welcomed new member, Norwood (Woody) Jackson.

- **Financial Report of the US Government**

Mr. Reid briefed the Board on the highlights of the FY2006 financial report.

Agenda Topics

- **Elements**

Ms. Wardlow presented a paper that addressed whether an assessment of probability should be explicitly required (a) as part of determining whether an item meets the definition of an element and (b) in the recognition criteria, and whether the Board should explicitly acknowledge the existence of a probability threshold in each case. Those proposals were made in the Alternative View (AV) in the Exposure Draft (ED) on Elements. The staff paper reviewed the responses to the ED, which were evenly divided in their support for the ED position or the AV position. The paper also discussed the current and developing Elements definitions and recognition criteria of other standard-setting authorities, including the FASB, the GASB, the Australian, Canadian, New Zealand, and United Kingdom boards, and the IASB/FASB joint project to revise their conceptual frameworks. The paper also included a list of issues that remain to be discussed before issuing a final Concepts Statement.

Mr. Torregrosa said he wished to amend the statement he made at the previous meeting on behalf of the CBO. He had supported the majority Board position that Congress's ability to change the law does not preclude the existence of a liability under current law. However, subsequently Mr. Marron indicated that CBO does not support that position.

The Board discussed different points of view concerning the meaning of "probability assessment" and at which stage(s) it should occur—definition, recognition, and/or measurement. Mr. Werfel said he thinks previous discussions addressed whether probability should be made explicit at the definition and recognition stages, whereas the staff paper suggests that the issue is whether there should be a specific or quantified assessment. Ms. Wardlow responded that the ED refers to the potential need for

judgment based on available evidence but neither requires nor precludes a formal assessment of probabilities. In contrast, the AV would require an assessment of probabilities, which she believes is more formal, particularly because the AV also would require acknowledgement of the need for a probability threshold.

Mr. Allen stated that probability would be assessed at the measurement stage, but probability assessments are not precluded at an earlier stage. However, if one performed a probability assessment at an earlier stage, one would conclude that there is no asset or liability if the probability when applying, for example, FASB Statement No. 5 (SFAS 5), is not “more likely than not.” That term has never been defined, but, GASB conducted a survey of CPA firms to find out how they apply “more likely than not,” and the range of applications is at a fairly high level. Those firms believe that something is “probable” somewhere around 75 percent or 80 percent. In that case, one would say that a 60 percent probability does not meet the definition of “probable” and therefore one does not have an asset or liability. In Mr. Allen’s view, that is the wrong point at which to make that assessment; it should be made at the measurement stage.

Mr. Patton said it could lead to inconsistencies if some entities make probability assessments at the definition stage and others do not. Mr. Allen responded that would depend on the evidence they have in different types of events or transactions. In some cases, it is clear that something exists, so a probability assessment is unnecessary. In other cases, one is not sure and that may be part of the evidence an entity is gathering. His personal view is that he would not want to preclude upfront the consideration of whether an asset or liability exists based on an arbitrary threshold, such as 75 percent or 80 percent, which he believes is being used when entities apply SFAS 5. One might be 50 percent or 60 percent sure one has an asset or liability and he would not want to preclude further consideration because of a CPA firm’s probability threshold. He thought the proper way to address the situation would be to apply FASB Concepts Statement No. 7 on future cash flows. If one has ten different events and probabilities of 30 percent, 50 percent, and 60 percent, one can easily calculate expected cash flows and that becomes the measure of the asset or liability, using probability.

Mr. Reid said that, regardless of where probability enters the equation, if the probability is zero one ends with no asset or liability. Whether he concludes there is a zero probability at the definition stage or the measurement stage he, as a preparer, needs documentation to justify to his auditors his conclusion about whether an asset or a liability exists and should be recognized. He would need to go through all the stages, regardless of where the probability assessment is made in order to prove that what he did was appropriate. Mr. Allen said there is no issue at zero percent; where it matters is at 40 percent. At 40 percent it is critical because one’s auditors may become upset if one says that one thought there was only a 40 percent probability of an asset or liability so the item received no further consideration. But, if one brings it forward and says that in measuring the item one applied 40 percent, one’s auditors can only question how one applied probability. Mr. Reid agreed.

Mr. Werfel was concerned about potential confusion in the preparer community from not making the Board’s approach to probability assessment explicit and from being

amorphous about when one does and does not assess probability. He also is concerned about the potential cost arising from that confusion and from continuing to consider items with low probabilities at the definition stage. Based on FASB materials, the staff paper referred to a lottery ticket as an asset because it has some expected future flow of resources. We know upfront that we do not want to spend a lot of time searching for lottery tickets throughout the government to ensure they are recorded on the balance sheet. He asked what signal the Board would send to the audit community if the Board moves from a definition where probability has been explicit to a definition where probability is no longer explicit. Would the Board be indicating that agencies should be a lot more diligent in applying the definition and recognize an asset or liability earlier than in the past? Mr. Werfel gave environmental liabilities as an example. He asked the Board to contrast a standard office building that has never had an environmental liability or cost associated with it, and where there is no record or evidence of hazardous materials, with a military property where weapons analysis and experiments have been conducted for years. Does the Board want the auditors to say that those two properties are exactly the same as to the amount of work that needs to be done in terms of an environmental liability assessment because one is no longer looking at probabilities and, therefore, both properties automatically have environmental liabilities? Mr. Werfel said that, if that is what the Board believes, the Board should recognize that there is a cost associated with that conclusion, and he is not sure what the benefit is.

With respect to Mr. Werfel's assumption about a lottery ticket, Ms. Wardlow clarified the FASB/ IASB joint proposed position concerning the definition of a liability and an asset, which is similar to the FASAB's position in the Elements ED and to other standard setters' position. In the definition of a liability, the liability is not the future flow of benefits or services, it is the obligation the entity has at the balance sheet date. Similarly with the definition of an asset, the asset is not the future inflow of benefits, it is the economic benefits and services embodied in the resource at the balance sheet date. When one looks at it that way, a lottery ticket definitely is an asset because what is needed is the capability of providing a future benefit. That is all that is needed and is what the Board is saying in the Elements ED. At the definition and recognition stages, one is not measuring the future cash flow or saying that it must be probable; there simply must be a capability of it occurring. One gets to probability when one has to value the items. Assessing the probability of a future outcome helps one to value the item. So, the proposed definitions of a liability of the FASB/IASB and FASAB are very different from the current FASB definition—which is that the liability is the probable future sacrifice. In the Elements ED, the liability is not the future sacrifice because it has not occurred, and the Board is basing the definitions on transactions that already have occurred. Ms. Wardlow thought there may have been some confusion among respondents to the ED because some of them appear to have focused on the current FASB definition and not the proposed FASAB definition when they wrote their responses.

Mr. Werfel said he understood Ms. Wardlow's comments but he thought they differed from Mr. Allen's earlier comments, in which he said one would act on a case by case basis and might or might not consider probability. He agreed that, when taken to its

logical extreme a lottery ticket is an asset. But, he asked whether the preparer has the flexibility not to take it to its logical extreme and to conclude that, although technically it is an asset, the probability of its having any value is so small that in the preparer's judgment it does not meet the definition of an asset.

Mr. Reid responded that, using probability, one might be able to carve out items and not think about them. However, one has to go through practically the whole process on everything that has the potential to be an asset or liability. If one is going to conclude that an office building has no environmental liabilities, one has to know whether it has no asbestos or other pollutants. One has to think about it even if most government office buildings are not in that situation. One has to be able to demonstrate to the auditor that the assessment was done properly, regardless of where probability is in the equation. Mr. Werfel responded that if one is looking at the asbestos, one is making a judgment call as to the probability of a liability. Mr. Reid agreed. Mr. Werfel continued that he did not understand how the elimination of an explicit notion of a probability assessment at the definition stage would change what Mr. Reid had just described. Mr. Reid said the logical procedure is first to make a list of the potential assets and liabilities. The fact that probability is in the definitions does not mean that an item would not be on the list, because an assessment still has to be made. Once the list of potential assets and liabilities is made, something has to be done with it to get to recognition, and where one stops and decides not to recognize something depends on many other factors. The preparer must make a list that covers the universe of potential assets and liabilities, maintain the list, and prove to someone else that the list is complete.

Referring to the environmental liability example, Mr. Allen said that the federal government must operate at a much higher plane than for-profit or not-for-profit entities or state and local governments, because those entities are not required to recognize an environmental liability unless some event has happened and the entity is aware that an environmental liability exists. The entity is not required to hire auditors to look for things that it is not aware of. Mr. Werfel asked whether the change in definition would result in more activity looking for evidence of liabilities because probability has been taken out of the definition. Mr. Allen responded that he did not know the answer for audits applied at the federal level, but for the other levels he referenced there would not be more activity than currently. When the Board sets standards, it will talk about the point when an entity must start disclosing something and when it must start recognizing something. When an entity starts recognizing something, probability becomes a very important factor in how the entity measures what it will recognize in the financial statements. Probability is part of measurement. The fact that the FASAB does not explicitly state that probability is part of the initial recognition gives the entity flexibility. If a probability assessment is required, the entity must list the whole universe and then conduct a probability assessment as to whether an asset or liability even exists. In Mr. Allen's view, that would cause much more work than if the entity believes it has an asset or liability, which starts the entity down the path that may lead it to decide whether or not to recognize the item. If the entity decides that it should recognize the item, then the entity would use probability in the measurement of the item.

In Mr. Patton's view, the Board majority's approach to recognition in the ED does not rule out virtually any cases. For example, a lottery ticket must be an asset because it has the capacity to provide future benefits, even if the probability of future benefits is very remote. The Board seems to have taken a lot of time developing definitions and recognition criteria that will not screen out what used to be called contingent assets, and the same can be said on the liability side. Mr. Allen asked Mr. Patton how he would apply materiality. With a large entity that holds one of the lottery tickets, that might be an issue. But it is not an issue with the federal government or any other organization Mr. Allen knows because preparers and auditors have their own assessments of materiality. Mr. Patton said that was a totally different issue from the conceptual foundation the Board is considering. The lottery ticket is just an illustration.

Mr. Reid said that one might disregard one lottery ticket. But if the entity has a thousand tickets there is a very high probability that one or two of them are worth something. Obviously there is an asset; the question is how does one measure it? Mr. Patton said Mr. Reid had just justified that there is an asset because of the high probability, which is what he was saying. Mr. Reid responded that one is measuring at that point. The entity decides not to look at one ticket but to look at the collection of tickets it has. Each individual ticket has the same characteristics; the only difference is in how one measures it. The characteristics are there at the beginning even though if one looks at one ticket it might be very highly improbable that it is worth anything. When one puts enough tickets together, one starts to come to a different answer, but the tickets are no different. Mr. Patton asked, what is the asset? Mr. Reid said the asset is the lottery ticket itself. Mr. Patton said that apparently the asset is the lottery tickets themselves and Mr. Reid is assessing the probability of the pool. Mr. Reid responded that he was just trying to measure the value, and that is where he is applying the probability. He started with an asset, which is the ticket, applied the recognition criteria, and concluded that the ticket should be recognized depending on the circumstances. He measures the item, including the probability of benefits, and comes to different conclusions in different circumstances. But either way, he starts with an asset.

Mr. Dacey was concerned about identifying what the substantive difference was between the majority and AV views. Speaking for himself as an AV member, he believes the AV proposes that in determining whether an item meets a definition and is measurable, one should make an assessment, whether one calls it an "assessment" or a "consideration" or something else. He does not intend entities to make a formal structured assessment for virtually everything that occurs; that would be cumbersome. In fact, he believes that in prior meetings he has spoken of "considering" probability rather than "assessing" it. He is also concerned about the use of the word "probability" versus "uncertainty." They are related because one does not have 100 percent certainty or 100 percent probability that something exists or is measurable. However, when one talks of probability it seems to lead very quickly to a focus on the measurement stage because probabilities are assigned when one measures something. Perhaps the word "probability" is what is driving the concern about how it is addressed. Personally he would prefer to refer to uncertainty, although they are similar concepts. In fact, the ED has a section on uncertainty, which allows that there is consideration of uncertainty in

the process of definition, recognition, and measurement. He would like to see less subtlety in the discussion of uncertainty about what it means and its role in the decision process. There may be a misimpression that the AV members are trying to include the word “probable” in the definitions. He does not believe that the Board has considered that and the AV does not propose it. Rather, it is a question of considering uncertainty in applying the definition.

In FASB Concepts Statement No. 6, there is a discussion in paragraph 47 of considering uncertainty in applying the definition and that paragraph is included on page 17 of the staff paper. Mr. Dacey said that paragraph 47 uses the word “assessment,” which he does not think he would use, but the paragraph talks about considering probabilities in applying the definition of an element. Mr. Dacey concluded that the Board members are not far apart on the issue, and some subtle changes to the FASAB document might at least satisfy him concerning application of the definition. There is a different issue with measurability, which he would like to discuss later. He does not believe the concepts statement should state “probable” or “more likely than not.” Rather, it should state that uncertainty is a consideration and there is a point at which uncertainty is such that an entity might decide an item does not meet the definition of an element.

Mr. Allen asked Ms. Wardlow to comment on paragraph 47 of FASB Concepts Statement 6 and said he does not think it is inconsistent with the direction the Board is going. Mr. Dacey said he does not think it is inconsistent either. That is why he is questioning the substance of the different views expressed by the ED (majority) members and the AV members—or at least the view he personally has expressed.

Ms. Wardlow explained that the FASB inserted “probable” in its definitions to avoid readers’ conclusions that one has to be certain that an item has the characteristics of an asset or liability. Footnotes to the definitions indicate that the FASB did not intend entities to apply the requirements of SFAS 5 concerning the assessment of probabilities. Paragraph 47 is intended to clarify the role of probability assessments. Ms. Wardlow read the paragraph to the FASAB members. She emphasized the portions of the paragraph that she finds most relevant to the Board’s discussion, including in particular the following: “. . . degrees of probability are not part of the definitions.” “. . . the degree of probability of a future economic benefit (or of a future cash outlay or other sacrifice of future economic benefits) and the degree to which its amount can be estimated with reasonable reliability that are required to recognize an item as an asset (or a liability) are matters of recognition and measurement . . .” and “Particular items that qualify as assets or liabilities under the definitions may need to be excluded from formal incorporation in financial statements for reasons relating to measurement, uncertainty, or unreliability, but they are not excluded by the definitions . . .”

Mr. Dacey indicated he is not saying that probability is part of the definitions. The statement says that in considering whether an item meets a definition one can consider or assess uncertainty, probability, or other factors. Ms. Wardlow asked why then did the AV talk about a threshold probability for meeting the definition? The AV proposes that

the thresholds would not appear in the concepts statement but would be included in individual standards. Mr. Dacey said his intent was that the concepts statement should acknowledge that there is a threshold but should not state what the threshold should be. There may be such a degree of uncertainty that a reasonable person considering the item would conclude that it really does not meet the definition or it really is not measurable.

Ms. Cohen asked Mr. Dacey whether his intent was to narrow the consideration of what meets the definition of an asset at the outset. Is his use of the words “threshold” and “uncertainty” to narrow down the items that might even be considered before one gets to recognition? Mr. Dacey responded that, yes, one could decide an item did not meet a definition because of the high level of uncertainty. Ms. Cohen said that, in other words, Mr. Dacey wanted to stop considering the item at the definition stage rather than at the recognition stage. Mr. Dacey said the discussion focused on explicit versus implicit consideration of uncertainty. He thought the Board agreed there is an implicit requirement in the statement. Mr. Schumacher said the statement does not prevent an entity from conducting a probability assessment. Mr. Dacey repeated his main point that he is not sure where the difference between the ED (majority) and AV positions lies, other than in a clarification of how uncertainty should be considered.

Mr. Farrell asked Mr. Dacey whether he agrees with paragraph 47 of FASB Concepts Statement 6 and would be satisfied with similar language. Mr. Dacey said he agreed, although the paragraph could be made clearer. Mr. Farrell thought the paragraph might add confusion. For example, the first sentence states that “To apply the definitions . . . commonly requires assessments of probabilities, but degrees of probability are not part of the definitions.” The sentence is saying one thing and then saying it does not really mean that and you really get to probabilities when you get to measurement. He was not sure what the paragraph excludes. Mr. Dacey thought it is saying that the definition does not include a particular threshold like “probable” or “more likely than not” or “60 percent.” He, as an AV member, does not propose that a threshold be included in the definition. He also does not think that kind of dialogue should be included in a concepts statement because it is less specific and is more of an acknowledgement that when one decides whether something meets the definition, one considers probability and uncertainty in applying the definition.

Mr. Jackson said he thinks of the definitions in the context of a class of transactions and does not have a sense of probability relative to the individual events that may occur. Thinking of the lottery ticket, it may well be that gaming “investments” should be considered assets, but as he thinks about individual gaming events, he thinks about the probability of winning. If that is 1 in 7.1 million, then he might not measure or recognize the ticket as an asset because the likelihood of winning is too remote. He thinks of the notion of definition as looking at broad classes of transactions and then getting into individual events that may occur and would be subject to separate probability or certainty assessments.

Mr. Werfel said it would help him to have an explanation of how one would expect preparers and auditors to approach a scenario under the current definitions and what

changes in behavior one should expect under the new definitions. Mr. Allen responded that the project was started because there were no definitions, so the concepts statement is not intended to change current practice. The Board acknowledges that many things are happening. The role of the concepts statement is to provide written definitions so that the Board would have a conceptual underpinning for what the Board believes is or is not an asset or liability. Mr. Allen said Mr. Reid or others may respond differently, but he does not see how there would be any change in practice. Mr. Reid said that the concepts statement might provide some guidance, given that there currently is no definition of an asset—there is a liability definition—and he does not regard the Board’s intent with the concepts statement as correcting abuses or solving problems. He sees the concepts statement as an educational document through which readers can be aware of the environment in which the Board works. No one would be required to make a change.

Mr. Patton asked Mr. Reid whether he thinks FASAB Statement 5 is consistent with the ED (majority) position. If not, the Board will need to change the standard. Mr. Reid responded that Statement 5 is a standard and the document on Elements is a concepts statement. No matter what happens with the concepts statement, Statement 5 will not change. Mr. Patton acknowledged that the concepts statement would not change standards. However, he thought that the Board sets concepts in order to guide future behavior. If the Board believes the ED (majority) position is inconsistent with Statement 5, then presumably at some point the Board would issue a standard that would be consistent with the concepts statement. Mr. Reid agreed that as the Board sets standards the concepts would provide guidance and that when the Board has, for example, specific liabilities that it is working with, the Board may issue modifications to the language as it applies to that specific situation. For example, if the Board is considering a specific standard and wants the liability definition to be a little closer, the Board might look at the concepts statement and conclude that its guidance implies a certain kind of language for inclusion in the new standard. Mr. Reid does not contemplate a sweeping change in liabilities but rather changes in specific cases.

Mr. Patton said he believes the only items of interest to the Board are contingencies, because everybody agrees that cash is an asset and accounts payable is a liability. Contingencies matter because that is where the uncertainty lies. His answer to Mr. Werfel’s question is that he believes Statement 5 is inconsistent with the ED (majority) position and that could well lead to downstream changes. Mr. Werfel said he has that long-term concern. He also has a short-term question about whether the preparer community will conclude that the statement on Elements is just a concepts statement and does not require any changes; it is foundational material and does not change Statement 5. Maybe the Board has that confidence but Mr. Werfel does not, because he believes that anything the FASAB does resonates and has ripple effects in the community. If the Board has a desired set of behaviors that it wishes to drive through the concepts statement, then it would be good to communicate that. If that is not the case and the intent is that the approach taken by preparers and auditors to balance sheet issues should remain unchanged after the concepts statement is issued, then he believes the Board should explicitly state that. Mr. Allen said it is really both things. If there is a standard, that remains unchanged. If there is not a standard, the concepts

statement guides the Board and auditors in dealing with an issue. If there is no standard, preparers and auditors can look to concepts statements to seek direction.

Mr. Reid said he is more concerned about whether the Board will follow the concepts in future standards. He does not believe that in the past the Board has felt constrained by concepts statements when issuing standards. Mr. Jackson said that in the early days of the FASAB, many of the standards emanated from an immediate crisis. Standards took all the Board's time. Without FASAB concepts statements, the Board and others looked at concepts statements of other standard setters when needed. Now, however, it is time for the Board to step back and develop some guiding principles, which is what this Board is doing. He is concerned, however, that the Board not drift far away from what he considers to be very thoughtful deliberative bodies that have worked through these issues in the past, unless there is a fundamental problem with what those deliberative bodies have done.

Mr. Farrell said that in his 30-year career in public accounting, he can hardly recall ever reading a concepts statement or adjusting his auditing behavior because of a concepts statement. Concepts statements are largely put together for the standard setters as a basis to reflect on when they set future standards. He does not believe there are a lot of CPAs combing through concepts statements to try to understand how to apply accounting concepts to financial statement items. He does not believe one will see large changes in the audit community because the FASAB is trying to put more details around how the Board sets standards. Mr. Schumacher agreed with Mr. Farrell and said his experience has been similar; one looks to the standard for specific guidance. Mr. Farrell said that, returning to the discussion of environmental liabilities, there is a standard that covers what should be done. The first thing the auditors do is request from the entity a list of all its underground storage tanks. The auditors do not ask at that stage whether it is probable that the entity has carried the underground storage tanks incorrectly. They wait until the measurement stage to try to determine those kinds of things and to put numbers on the liabilities. Auditors will always try to pull in the entire universe of the things they are dealing with, and that has nothing to do with this concepts statement.

Mr. Allen called for a break and said that after the break he would like to go around the table to hear members' views and the reasons for them in response to the two questions in the staff's paper. He found hearing the reasons for members' views particularly helpful.

After the break, Ms. Comes said that paragraph 60 of the FASAB ED is similar to paragraph 47 of FASB Concepts Statement 6, which Mr. Dacey discussed earlier. In Mr. Dacey's view, what is missing from paragraph 60 is the "flip side of the coin." In paragraph 60 it states that "Items that are judged to meet the definition of an element qualify for recognition . . ." Ms. Comes had suggested to Mr. Dacey and Ms. Wardlow during the break that the "flip side" could be explicitly added to paragraph 60 by inserting a sentence that states something to the effect that: "Items that are judged not to meet the definition of an element do not qualify for recognition." That would make it explicit that both sides of the coin are addressed. Mr. Allen asked how the new

sentence would fit in the paragraph. Ms. Comes responded that Ms. Wardlow would work with the language so that both the existing sentence and the addition fit with the reference to the possibility of disclosure of items that do not meet the definition of an element, or that meet the definition but are not measurable. Ms. Comes added that the new sentence would be an explicit acknowledgment that one may make a judgment that uncertainty about whether an item meets the definition of an element is so great that one would not recognize the item. One would not need to ask whether the item meets the second recognition criterion.

Mr. Patton asked how uncertainty would be included in the changed language, because the first sentence of paragraph 60 states that uncertainty is not part of the definitions of elements. Ms. Comes responded that the paragraph states that degrees of uncertainty are not part of the definitions, but uncertainty is the backdrop for the definitions. Both the definitions have a future element and the future is, by definition, uncertain. Mr. Dacey said that something about uncertainty should be added to the new sentence to tie it better into the second sentence of the paragraph. Mr. Allen said he assumes Mr. Dacey is comfortable with the second sentence because it talks about uncertainty of the existence of an element. Mr. Dacey responded that he likes the addition of uncertainty in the new sentence. Mr. Allen said he would like the addition to state: "Items that, due to uncertainty of the essential characteristics . . ." or something similar. He added that he likes the second sentence of paragraph 60 and wants to make sure that any addition later in the paragraph does not modify the second sentence. Mr. Patton commented that he likes the addition of more references to uncertainty.

Mr. Allen asked members with the ED (majority) view whether they are comfortable with the addition of the sentence later in paragraph 60 or whether it modifies the second sentence of the paragraph, which he does not wish to do. Mr. Farrell said he thinks the new material says the same thing as the second sentence. Ms. Comes agreed but said it is much more explicit. Ms. Cohen agreed that it is more explicit. Mr. Allen asked whether one could tentatively say, subject to further editing by staff, that the revised paragraph does not change the view of any member who supports the ED (majority) position and that it satisfies the concerns of the AV members. Mr. Dacey said the revision would satisfy him with respect to the definition issue, but he has other concerns about measurability which he would raise later in the meeting. Mr. Patton said the revision is a significant improvement but he is unsure about other concerns raised in the AV.

Mr. Werfel requested clarification of the difference between "degrees of uncertainty" and just "uncertainty," because he thinks the first sentence of paragraph 60 is contradicted by the rest of the paragraph. Mr. Allen asked Ms. Wardlow to respond. She said that the section on uncertainty is based on FASB Concepts Statement 6. She thinks that degrees of uncertainty and the notion of threshold probabilities are similar and that the height of the probability level is not part of whether an item does or does not meet a definition. Mr. Werfel said he would interpret that to mean that degrees of uncertainty are something quantifiable. Mr. Allen agreed and said they are more like the SFAS 5 criteria that have various degrees of uncertainty, such as "possible," "probable," and

other degrees. Mr. Werfel said he understood but the language and flow of paragraph 60 could be improved.

Mr. Jackson said he disagrees with the phrase “uncertainty about the existence of an element.” In his view, there is no uncertainty about the existence of an element. There is uncertainty about whether a certain transaction or other event gives rise to something that meets the definition of an element. That is the important consideration. Ms. Comes modified the first part of the second sentence of paragraph 60 to read “Uncertainty about whether a transaction or event gives rise to the existence of an element . . .” She asked Mr. Jackson whether, just as a place marker, the additional phrase “whether a transaction or event gives rise to the existence of an element” would capture his point. She suggested the Board not edit it at the table because Ms. Wardlow planned to return to the Board with a draft Concepts Statement, so the Board would have an opportunity to review the proposed edits at the next meeting. Mr. Jackson agreed that the addition to the second sentence gets his point across.

Mr. Allen said that one of the things he would like to do is to take more formal votes on issues. He asked Ms. Wardlow if the definition issue could be framed in terms of the recommendations for the definition stage in the staff paper. Ms. Wardlow read the staff recommendations, which, summarized, are that:

The Board:

- Should retain the ED decisions on this topic.
- Should not require (but should not preclude) a probability assessment at the definition stage.
- Should not state that a threshold probability conceptually exists and will be established in specific financial reporting standards.
- Should retain the references in paragraph 7 to uncertainty and judgment in determining whether an element exists.
- Should retain the following statement which is included in paragraph 18 (for assets) and paragraph 39 (for liabilities):

Those paragraphs [that is, paragraphs 5 through 9] also acknowledge the possibility of uncertainty about whether an item meets the definition of [an asset][a liability] and the need for judgment based on the available evidence. However, those paragraphs do not establish a threshold to be assumed in applying judgment.

- Should retain the discussion of the “Effects of Uncertainty” in paragraphs 57 through 61 of the ED.

[Staff comment: With regard to the last recommendation, at the current meeting the Board added some language to paragraph 60. The additions do not change the remainder of the recommendations.]

Mr. Allen asked the Board members whether they agree with the staff recommendations.

Mr. Patton said that his interpretation of the new sentence in paragraph 60 is that one should assess the uncertainty as to whether a particular item meets the definition and is measurable, and that if the uncertainty is large enough, one should conclude that the item should not be recognized. He said he thinks that captures the essence of that portion of the AV. Therefore, his response is “yes” and he thinks that maybe Mr. Dacey was right earlier when he said he could not understand why the two groups of members are so different when they seem to be so similar.

Mr. Schumacher said he had no problem with the draft the way it was before, but after reading the proposed changes, he has no problem with the additional wording, subject to further editing. It gives the appearance of being able to look at both sides, which he believes the Board majority always intended; the Board did not preclude it.

Mr. Dacey said that if the question is does he like the document with regard to the particular issue of definition, the answer is “yes”; the change to paragraph 60 would satisfy his concerns as expressed in the AV.

Mr. Werfel said he likes the modified language, but he does not know what the impact of this particular vote would be. Therefore, he would like to read the total document. Mr. Allen said the impact of the present vote is only to decide whether the staff should continue to move forward to prepare a draft document. This question on definition is a question that the Board asked respondents specifically to respond to. Mr. Werfel said he does not like withholding a “yes” or “no” vote. However, from his perspective, to cast his vote and OMB’s vote overall, he needs to become comfortable with the fact that the Board is not being explicit and has taken out the word “probable.” But, he believes that he and OMB are comfortable with the Board being implicit as long as it is very clear what the intent is, even though the Board has taken the explicit term (probable) out of the definition. He needs to deliberate on that a little more and cannot vote “yes” at the present time.

Mr. Reid said “yes.” He thinks the change to paragraph 60 is all right, particularly where it is placed. His primary concern is whether the Board intends to change the definition and add to it something that looks like probability, and he believes the proposed change clearly does not do that. The change is only a clarification and he is comfortable with that. He is a little apprehensive because he would like to see how the change fits with the broader context, but he thinks the language of the change is fine.

Mr. Torregrosa transmitted Mr. Marron’s apologies for not being able to attend the meeting. However, Mr. Marron, he, and other CBO staff had explicitly discussed the staff’s questions and they agree that CBO generally looks at things on an expected value basis, which comes in at the measurement stage. He is not sure how the changes seem to satisfy everyone when one side thinks that nothing has changed and someone else thinks there is a change but, leaving that aside, CBO agrees with the

staff's position.

Ms. Cohen said she was pleased with the original draft and does not object to the change.

Mr. Farrell said that he agrees with the staff's position. He does not believe that the change would move him, as an auditor or preparer, one way or another. He is not sure exactly what the Board has or has not clarified with the change. Mr. Allen responded that the way he would look at it is that the Board has not excluded anybody's implicit consideration. Mr. Farrell said that he believes people would be doing that anyway and Mr. Allen agreed.

Mr. Jackson said he is fine with the change to paragraph 60 and has no other comments at the present time.

Mr. Allen said he also supports the change.

Mr. Allen directed the Board's attention to the second question in the staff paper, which referred to the recognition stage. Ms. Wardlow read the staff recommendations, which, summarized, are as follows:

The Board:

- Should retain the two recognition criteria in paragraph 5 of the ED, namely (a) The item meets the definition of an element of financial statements and (b) The item is measurable—with "measurable" defined as "quantifiable in monetary units."
- Should not add a probability assessment requirement to the recognition criteria and should not consider related threshold probabilities.

[Staff comment: With regard to the first recommendation, at the current meeting the Board added some language to clarify the second recognition criterion. The addition does not change the remainder of the recommendations.]

Mr. Allen said that some people would not see much difference between the definition stage and the recognition stage, but others may see a difference.

Mr. Dacey said he appreciates the citations in the staff paper to other professional literature. He thinks the Board has discussed the issue before—that is, whether measurement should be something more than simply quantifiability. He believes that virtually anything is quantifiable in monetary terms and uncertainty is an issue with measurability as contrasted with measurement. He believes the staff paper confuses the two concepts in places. He observed that the other standards cited in the paper talk in terms of "measurable" and "reliable," two words that go together in almost all the definitions. In his view, reliability is tied in many of the discussions to uncertainty and other factors that may be present in determining whether or not an item is measurable. He feels even stronger in the measurability part than in the definitions that how

uncertainty weighs in to the measurement side needs to be explicit. Otherwise, he again would have concerns that measurability is simply not a threshold at all in terms of the way the Board is defining “measurable” as “quantifiable.” He is not saying that probability needs to be in the recognition criteria, but it does need to be considered in applying the measurability criterion.

Mr. Allen said he senses a movement among various standard-setting boards to shift the consideration of probability more clearly to the measurement stage, although he acknowledges that some boards also have it at the recognition stage. He thinks that movement may be a little different from the way Mr. Dacey has summarized other standards. Mr. Dacey responded that he realizes the FASB and the IASB are having deliberations that would move them towards a more expected value approach, which would move a lot of those considerations to measurement. But, they are not there today. Ms. Wardlow said there is no final decision yet, but the two boards are moving in that direction.

Ms. Wardlow said she wished to clarify that the Board has made a conceptual distinction between definition, recognition, and measurement of elements. From a practical perspective that is obviously somewhat artificial, because when one decides that an item meets a definition and can be quantified in monetary units, the next step is to measure it, and it is at that point that one decides whether the measurement is reliable and has other qualitative characteristics, whether the amount is material, whether recognition is cost-beneficial, etc. The division between recognition and measurement is a conceptual distinction to enable the Board to deal with the different considerations, particularly because the Board is not addressing measurement in this concepts statement. But recognition and measurement go together, and once one has decided that an item can be quantified, one measures it. One does not need to assess whether something is “probably” measurable; one measures it. If one does not think the measurement obtained is appropriate, satisfactory, or reliable then one does not recognize the item. In other words, satisfying the recognition criteria as defined in the ED is not the end of the line. It does not mean one is forced to recognize an item, because one cannot; one has to measure the item and that is another set of decisions to make. One has to decide what attribute to measure, what method to use, and whether one is satisfied with the measure before deciding to recognize the item. Ms. Wardlow said she thinks these considerations are important and she does not understand how one would assess the probability that something is measurable; why would not one just measure it and see what the result is?

Mr. Dacey said that was part of his concern. He regards the recognition criteria as the decision to recognize, and when that decision is made, the item is recognized at some value. He has concerns about deciding to recognize something based on the recognition criteria and subsequently deciding not to recognize it. Ms. Wardlow asked Mr. Dacey if it would be easier for him to look at the sequence as definition, measurement, and recognition. Mr. Dacey emphasized that he is talking about measurability. The decision as to whether one can measure an item, given whatever basis one wants to use—fair value, cost, or something else—comes before actually measuring the item. One can decide that certain things are not measurable. For

example, there is some debate over whether oil and gas reserves are measurable. But that is measurability, not measurement.

Mr. Jackson said one goes down a decision tree: Does the item meet the definition of an element? Then the question is: Is it measurable? And if it is, one goes through the measurement process and if it meets certain criteria, say, if it is material, then it is recognized. Mr. Dacey said he is viewing “recognized” as the decision. If it is recognized, then it is on the financial statements. Mr. Jackson said that the decision to recognize is the last decision. Ms. Comes said to Mr. Dacey that instead of “recognition criteria” one could talk about “criteria to be a candidate for measurement.” She asked him whether that was in line with the process he had described. Mr. Dacey said he appreciates that “measurable” is in the recognition criteria, but he does not think it has any meaning, the way the Board has defined it. It does not screen anything. Ms. Comes inquired about the measurability of unproven reserves. Mr. Dacey said he thinks the Board has debated whether those reserves are measurable. Obviously, if one decides they are measurable then one can measure them. CBO has provided some options for how to measure them, but that is “measurement,” not “measurable.” Mr. Dacey said that, to answer Ms. Comes’s question, the criteria would provide candidates for recognition, but if the Board is going to call them recognition criteria, maybe that is part of his concern. It seems to him that, if they are recognition criteria, one will recognize the item at some value on the financial statements. If the suggestion is to change the paradigm and call recognition criteria something different, that is a possibility. But, at some point in that continuum one will make a decision and maybe the decision is that the item is not measurable. One might have to start measuring it to get to that point, but at some point one will make that decision and that is a valid reason for not recognizing the item in the financial statements. One does that for contingencies when one does not know the amount, but knows the range. So, one decides not to recognize the item but to disclose it, because it has met the definition of an element but not measurability .

Mr. Allen commented that what Mr. Dacey said is exactly how he thinks things proceed; one decides whether one can measure something and if one cannot, then one does not recognize it. That is fine, but what the Board is saying, and what Ms. Wardlow is trying to say, is the majority view, which he [Mr. Allen] shares, and that is he does not want to say an assessment of probability is required at either the definition or the recognition stage. Mr. Dacey said that he does not think the second recognition criterion makes the point about recognition decisions adequately, because it simply says “measurable,” meaning “quantifiable in monetary units.” That does not evoke any considerations of uncertainty and there is not much uncertainty in his view. An item may be measurable but not measurable reliably. Mr. Allen responded that if it is not measurable reliably then it does not qualify for recognition. Mr. Dacey said that point is not made in the definition of “measurable.”

Mr. Jackson said he thinks he has a similar issue to Mr. Dacey’s. He thinks that deciding that something is measurable in monetary units is not sufficient to decide to recognize an item. One needs to be able to conclude that something is measurable in monetary units with sufficient reliability to be recognized. Ms. Wardlow said that the

document indicates that other considerations come into the recognition decision. There is the measurement stage, which the Board has not yet addressed and is another project. Mr. Jackson said he is interpreting what Mr. Dacey said, and he thinks he is almost caught at the measurement stage before he gets to the recognition stage. Mr. Jackson acknowledged that he might be misinterpreting that. Mr. Dacey said that one potential impact is that preparers will move into measurement before deciding whether or not to recognize. He thinks that is the way the document is set up and he is concerned about it. In his view, the AV does not call for a formalistic probability assessment, but certainly there is a degree of uncertainty that could exist in terms of measurability, and saying that an item is quantifiable does not by itself seem to adequately consider the possibility of uncertainty. Mr. Jackson agreed. Ms. Wardlow said she thinks paragraph 8 of the document is important because it points out that meeting both the definition of an element and the recognition criteria does not complete the process of deciding whether or not to recognize an item. Mr. Allen said it might be necessary to expand paragraph 8 to meet Mr. Dacey's and Mr. Jackson's concerns.

Ms. Comes recalled that she and Ms. Wardlow talked about measurability before the meeting and Ms. Wardlow had showed her a suggestion from one of the respondents to the ED. Ms. Wardlow read the suggestion which was to add the following sentence to the definition of "measurable" in paragraph 5: "An item is measurable if it can be determined with reasonable certainty or is reasonably estimable." Ms. Wardlow said there could be some issues with that wording—for example, with different interpretations of "reasonable"—but she has no problem with the addition. She does have a problem with adding the word "reliable," as the Board discussed at the November 2006 meeting. An additional problem with "reliable" is that the FASB and the IASB are in the process of removing that word and it seems difficult to support adding a word when those standard setters are removing it.

Mr. Dacey said his proposal is not to put it in the text but in the explanation, along the lines Ms. Wardlow has just suggested. Ms. Wardlow said she thinks the issue of measurability is more a negative question than a positive one. One can look at an item and conclude one cannot measure it—at least, not in dollars. One may be able to measure it in tons or some other measure if, for example, the item is natural resources, but the conclusion is the item is not quantifiable in dollars as needed for the financial statements. The issue is not how easy it is to quantify or how likely it is that one would get a good measure. One finds that out when measuring the item. One just concludes that one cannot quantify it. If so, then there is no need to go any further because the item cannot be recognized. If one concludes that one can quantify the item in dollars, then one goes to the next step, which is to measure the item. It is at that stage that one considers reliability and other qualitative characteristics. They definitely come into measurement, as the Board discussed at the previous meeting. Before deciding to recognize, one also would consider materiality and cost-benefit, as mentioned in paragraph 8 of the ED. She acknowledged that it is unfortunate that all three stages—definition, recognition, and measurement—could not be in the same document. If there is a way to word the recognition discussion so that it is clearer to readers that the measurement stage is missing from the document, that would be good.

Mr. Allen said he likes the additional wording on measurability and he does not think it would do any harm. He thinks it is implicit, but the words may help to put it into practice. It would put some constraints around the assertion that “anything is measurable,” because there are other considerations than being measurable. Mr. Jackson said the additional wording is helpful to him.

Mr. Farrell said he would like to add some practicality to the discussion. Earlier he and others had talked about measuring the U.S. forests, which currently are not measured on the balance sheet, although someone could apply some dollar value to them. But, the FASAB has a standard that says natural resources are not valued. So, the FASAB has excluded certain items from measurement by standard. He said that someone might suggest that one count the knowledge of the 100 members of the Senate as an asset. He thinks someone could fit that proposal into all the definitions the Board has developed in the ED and put a value on it. However, he does not believe that anyone will go out searching for assets such as that one as a result of the Board issuing this concepts statement.

Continuing with the forest example, Mr. Allen said one could put a tape around every tree and determine how many board-feet there are and therefore assess their value. But, this concepts statement may indicate that one cannot really do that with reasonable certainty. Mr. Farrell said he thinks everyone would agree that trees are assets. There is just no standard that states how they should be measured. Mr. Allen responded that the Board might decide they are assets and concede that one could measure their value but conclude that there is no practical way to do it. Mr. Farrell pointed out that the Board already has a standard that says that. Mr. Dacey asked Mr. Farrell whether his point is that even if one did measure the trees and assign a value, one might not recognize them for other reasons. Mr. Farrell said he is still questioning what the Board is trying to clarify. What is it trying to prevent by inserting additional language in paragraph 5? He agrees with the staff position that, yes, those items are out there, but one does not get to that point until one gets to the measurement section and the Board has not yet written that section. Mr. Allen commented that generally the Board would write that in a standard and Mr. Farrell agreed.

Mr. Patton said that the proposed additional wording in paragraph 5 would make the definition of “measurable” more constraining than it was before, when there was no constraint in the definition, because with enough imagination one could monetize anything. Mr. Dacey said one could not monetize everything reliably. Mr. Farrell asked Mr. Patton whether the revised definition would prevent recognition of the knowledge of the Senate. Mr. Patton said yes. Mr. Werfel said he understands “reasonable certainty” and he thinks the Senate example would not pass the test of reasonable certainty. However, he asked whether “reasonably estimable” would require one to consider cost-benefit as part of that? He wondered what “reasonably estimable” means and what would be an example of something that is not “reasonably estimable?” For example, maybe one could measure untapped oil reserves, but one would have to invest millions of dollars in equipment, which one would not want to do. Is that where “not reasonably estimable” comes in or does it come in at the measurement stage? Mr. Reid said cost-benefit is one of the additional considerations referred to in paragraph 8.

Ms. Comes said that one has to look at the role of concepts statements in the whole body of the conceptual framework. Typically, the concepts statements give boards the tools for deliberating. The qualitative characteristics are in Concepts Statement 1 and on many occasions members have said in a standard that something was not relevant or reliable, so even though it met recognition criteria they would not recognize it for those reasons. In Ms. Comes's view, the proposed addition to paragraph 5 is just a place holder for another reason to support a decision. It brings in reasonableness as a factor that the Board is able to consider as it sets specific standards. Cost-benefit is a reason and it links to the qualitative characteristics. It is all integrated. This is just another explicit place to give the Board members a hook. Mr. Dacey agreed and said that was a province of the concepts framework because at the standards level the Board would apply the concepts level to a particular item to determine whether it is reasonably estimable.

Mr. Allen said he would like to go around the table with the modified wording in paragraph 5, which applies to the recognition level. [The proposed modification is to add the following sentence to the ED definition of measurable in paragraph 5: "An item is measurable if it can be determined with reasonable certainty or is reasonably estimable."] Mr. Jackson said he agrees with the staff recommendation on recognition but he likes the change to paragraph 5. Mr. Farrell said he has no "reasonable certainty" that the change to paragraph 5 is necessary but he would accept it. Ms. Cohen and Mr. Reid said they agree with Mr. Farrell. Mr. Torregrosa said he agrees with the staff and the change to paragraph 5 is fine. Mr. Werfel and Mr. Schumacher agree with the change. Mr. Patton agrees and said the change makes a big difference to him.

CONCLUSION: The Board approved the substance of the proposed changes to paragraphs 5 and 60 of the ED and agreed that staff should modify the wording of those paragraphs as needed. Mr. Allen said that at the March meeting, the Board would look for a draft final document that would pull together the changes discussed and incorporate some of the recommendations of the respondents. The Board would discuss the draft in March and consider a final standard at the May meeting.

- **Financial Reporting Model**

Staff presented the Board with an update on the status of the financial reporting model project. Staff incorporated the Board's previous comments on an outline of a proposed concept statement regarding key components of the federal financial report. One key change to the outline was the addition of a discussion on management's responsibility for financial reporting. The Board discussed the notion of adding management's responsibility for financial reporting to the proposed concepts statement and determined that management's responsibility for financial reporting, along with the notion of fair presentation, should be discussed in possibly another vehicle rather than the proposed

concepts statement on key components of the financial report. However, additional research is needed to determine the appropriate means of articulation.

In addition, at the November 2006 meeting, Board members believed that the Board could begin to consider how to report performance information and staff could address the issue as part of the project. Accordingly, staff discussed plans for how to proceed with the project. The staff plans included two types of outreach activities - roundtable meetings to discuss agency Performance and Accountability Report (PAR) issues and an educational session on cost accounting. Constituents had recently raised concerns that PARs have grown too voluminous and that agencies are not developing cost information to integrate with performance reporting, such as reporting the cost of specific programs and the amount spent on achieving results. Staff proposed the outreach efforts as a way to inform constituents on existing FASAB guidance and to gather information on whether additional FASAB guidance is needed.

The Board noted that the financial reporting project involved many broad subjects which required analysis. Consequently, members believed that the project needed further development before proceeding with outreach activities, and staff should proceed with the project by reviewing the concepts supporting the existing general purpose federal financial report (GPFFR). Also, in the meantime, staff plans to serve as an observer on existing work-groups focusing on streamlining the PAR and integrating financial and performance information and inform the Board of areas where FASAB could provide a comparative advantage. Issues considered in the Board's determinations are as follows.

Management's Responsibility for Financial Reporting

Staff noted that management is responsible for the fair presentation of financial statements in accordance with generally accepted accounting principles (GAAP), and management is responsible for assertions that are implicit in financial reporting. Those assertions have an important role in determining what is presented in the financial report. However, much of the discussion on management's responsibility for financial reporting is found in auditing literature rather than in accounting literature.

Board members believed that management's responsibility for financial reporting should be discussed in accounting literature, along with the notion of fair presentation in accordance with GAAP (which is also primarily discussed in auditing literature). It was noted that the FASAB could articulate the GAAP hierarchy and what fair presentation means. However, a concept statement, such as the proposed concept statement on the federal financial report, may not be the best vehicle to discuss these topics. Board members noted that management's responsibilities should be discussed in a standard or other vehicle because concept statements primarily guide the Board in its standards-setting activities. The Board determined that staff should further research the management responsibility and fair presentation topics. The additional research would assist the Board in considering what would be the best vehicle (a standard, statement of

general principles, etc.). Mr. Allen also noted that management's responsibility and the GAAP hierarchy are subjects that may be candidates for a joint project with the Government Accounting Standards Board (GASB).

How to Proceed with the Project

The Board discussed how to proceed with the financial report project and the various issues involved. Members considered that linking cost and performance is an important topic and, as agencies continue to make improvements in financial reporting, there may be additional concerns about how to implement cost accounting. In addition, the growing size of the PAR and its usefulness for decision-making is a matter of concern.

Members noted that others in the financial reporting community are already engaged in addressing the PAR and financial and performance integration issues. Mr. Werfel noted that the Office of Management and Budget (OMB) provides guidance, such as OMB A-11, *Preparation, Submission, and Execution of the Budget* and A-136, *Financial Reporting Requirements*, that addresses similar topics as those included in the project. In addition, the financial reporting community has organized work groups that are discussing the concerns regarding integrating financial and performance information and streamlining PARs. For example, the Budget and Performance Integration Council and an OMB A-136 working group are reviewing these issues.

Given the efforts being initiated by others, it was noted that the Board could consider areas where it provides a comparative advantage. FASAB has a comparative advantage in that information required by a FASAB standard is subject to audit. FASAB standards are the core of federal GAAP and are the benchmark against which auditors provide assurance. It was noted that the Board could consider whether there is a need to subject performance information to some level of audit assurance.

Mr. Jackson noted that auditors are currently required to look at internal controls related to performance information and they have had that requirement for some time. Perhaps a pilot effort with others (GAO, OMB, CFO Council) could be undertaken to determine how to implement SFFAS 4, *Managerial Cost Accounting Standards and Concepts*, in a meaningful way. The pilot could be used to help develop some thoughts on changes to the standard. Mr. Farrell noted that agencies appear to have a problem in determining what to measure. However, the FASAB has provided agencies with a mechanism to assist them with that determination and the Board should not tell agencies what they should measure. The Board should focus on accounting issues and allow the working groups to complete their work, with FASAB staff participation. The Board determined that FASAB staff could serve as an observer on the existing working groups and inform the Board of areas where FASAB could provide a comparative advantage.

Members also acknowledged that although the current financial reporting model has provided some useful information and has helped initiate public discussion on some key

topics such as social insurance, there may be financial reporting objectives that have not been adequately addressed. Mr. Werfel noted that the FASAB has an opportunity to signal the priorities of the Board and integrating cost and performance information are currently important topics. Mr. Allen noted that federal financial reporting appears to have fewer constraints than state and local government and private industry. Statement of Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*, issued in 1993, discusses the importance of linking cost and performance and articulates the FASAB's view on the significance of the topic. Standards-setters such as the GASB only recently received approval to pursue performance reporting. Given that the Federal government has an active management improvement agenda and does not have the constraints of the three traditional financial statements, the federal government has a unique opportunity to convert financial statements into a very informative set of documents.

Mr. Reid believed that the Board should consider whether the existing statements such as the Balance Sheet and Statement of Net Cost are adequate and he noted that the financial report project offers an opportunity to explore innovative ways to present information to achieve the financial reporting objectives. Mr. Jackson added that if the federal government is not a going concern, is a balance sheet appropriate? He noted that the project should consider what information should be presented in financial statements and how that information should be conveyed. In addition, there may be a need to identify statements other than the existing statements.

However, members noted that before discussing what additional statements are necessary, there needs to be an understanding of the concepts that underlie the existing statements. Mr. Patton noted that perhaps the research should focus on drawing inferences about the conceptual foundations and criteria that underlie the key components of the existing financial report and then determine missing components that would help better achieve the financial reporting objectives. This approach would help the Board to consider vehicles beyond the existing reports.

Also, members believed that the project needed to develop further, before engaging in the proposed outreach activities. Mr. Schumacher noted that the roundtables and education session would be somewhat premature at this time, and Mr. Dacey noted that in further developing the project, it may not be necessary to rethink basic fundamentals that have already been discussed. He believed that the project should focus on the most important issues and the Board could decide whether it is addressing them. In addition, Mr. Farrell noted that the outline for the proposed concepts statement presents some broad topics and, perhaps the Board could focus on three key topics and decide how to proceed on those items.

Considering the Board's discussion, Ms. Comes noted that the financial reporting model project is one piece of the conceptual framework and that the concept statements are rather general. She pointed out that the core of the project is the review of the foundation of GPFFRs, currently known as PARs. Staff could review "where we are now," how that model ties to our objectives, and determine any voids. Consequently, the voids will derive from the objectives and the Board could explore, at a general level,

what might be said about the voids and how to fill them. For example, the review could answer some basic questions such as, "Is a GPFFR complete without performance information?" or "Is a Statement of Performance Measures a basic statement?" As the Board works through the voids, the results will inform future standards and missionary type work.

CONCLUSIONS: Staff will begin research on management's responsibility for financial reporting and the notion of fair presentation and will proceed with the financial reporting model project. Staff will proceed with the project by reviewing foundational concepts that support the existing general purpose federal financial report. In addition, staff will observe the activities of existing work-groups focusing on streamlining the PAR and integrating financial and performance information and inform the Board of areas where FASAB could provide a comparative advantage.

- **Sustainability Reporting**

The Board reviewed a briefing package that staff is preparing for task force members. A panel of technical experts will meet to develop recommendations for fiscal sustainability reporting for the Federal government. Subsequently, a panel of financial statement users and communications experts will meet to discuss how to make the information understandable and meaningful to readers.

Although a date in March 2007 had been tentatively planned for the first meeting, Mr. Reid noted that this timing may be difficult due to the finalization of the annual Trustees Report. Accordingly, staff will consider scheduling the initial meeting in April 2007.

Mr. Reid asked for an item to be added to the task force's agenda: the concept of a uniform, government-wide discount rate. However, Mr. Jackson and Mr. Patton noted that this topic is already the focus of a separate FASAB project. Staff noted that such a requirement would involve recalculating, rather than utilizing, information available in the Trustees Reports, the Budget, and elsewhere, but that the topic might be addressed at a high level during the consideration of assumptions. Staff requested that task force members representing the Treasury, OMB, GAO and CBO meet to plan a list of agenda items that could reasonably be covered in the one-day meeting of the "technical experts" group.

Mr. Patton suggested that the first question for the group might be "what is stewardship?" rather than how reporting on fiscal sustainability might fit into the current structure of the financial statements. Staff agreed that the latter question might be better addressed by the "communications" group or even left for the Board to address, and that the draft briefing package would be edited accordingly. Mr. Jackson and Mr. Allen agreed with the proposed edit.

Mr. Allen asked if the Board would receive progress reports regarding the task force meetings. Staff said that the Board would be briefed and would have the opportunity to discuss recommendations and plans at each Board meeting and between Board meetings during the process. Staff noted that task force members would have the opportunity to review any meeting minutes, recommendations, and discussion summaries for accuracy before staff forwards them to the Board.

Mr. Torregrosa said that Peter Orszag and Donald Marron wanted to make sure that the group addresses the issue of “uncertainty.” He said that he expected the technical experts to offer several different opinions and recommendations on the issues discussed. Mr. Allen noted that the reasons for the opinions would be almost more important than the opinions themselves in helping the Board in its deliberations.

Mr. Allen asked if the meetings would be taped. Staff replied that a recording would be needed by staff to be able to provide a detailed write-up of the discussions; however, staff does not anticipate producing a transcript or making the tape available to others, as this might inhibit the group’s discussions. Mr. Allen agreed, and he expressed the wish that a summary of the panel discussions at a recent CBO Director’s Conference might have been helpful to the Board in its deliberations. Mr. Torregrosa said that he would ask if there might be any internal notes available.

Mr. Dacey said that although staff was trying to pare down the number of issues to be addressed, he would like the group to discuss reporting on how certain “dashboard” indicators have changed from one year to the next. He said that the Alternative View proposal [see *Preliminary Views- Accounting for Social Insurance, Revised* [on the FASAB website at <http://www.fasab.gov/exposure.html>] would require a reconciliation that would show the causes of the changes from year to year. Also, he would be interested in hearing recommendations for the level of detail to present, and how to address funding issues.

Mr. Allen noted that the technical experts are volunteering their time to assist the Board, and that an effort would be made to cover as much ground as possible. Mr. Allen asked if there was any way that staff could encourage prioritization into the discussions of the two groups. Staff said that due to the very large quantity of detailed information that is available, the technical task force members would be asked to state which measures- preferably in order of priority- would be the most useful and meaningful to users, and should be included in financial statement reporting on fiscal sustainability. Staff noted that in spite of the information currently available in the Trustees Reports, the Budget and elsewhere, there are media reports indicating that journalists and members of the public expressed surprise at the information provided by Comptroller David Walker at “Fiscal Wake-Up Tour” presentations. Staff expressed the hope that information to be included in the Financial Report of the U.S. Government might effectively convey this information to the public.

Mr. Jackson noted that it was important to convey the seriousness of the problem to the public.

Mr. Werfel asked if Board members thought that staff should provide technical task force members with a copy of the “straw-man” example of a Statement of Fiscal Sustainability that is part of the Alternative View section of the Preliminary Views” document [cited above]. Staff indicated concern that might indicate to the task force members that the Board already has a preferred direction, and that some members of the “communications” group would not be familiar with what an “Alternative View” represents. Ms. Cohen agreed, and suggested that a courtesy copy of the entire Preliminary Views document could be sent to the technical experts group only. There were no objections to this suggestion.

CONCLUSIONS:

- Staff will continue to develop the briefing materials and schedule the first task force meeting.
- A copy of the Preliminary Views document, with reference to the illustrative schedule, will be sent to the “technical experts” group.
- The Board members representing GAO and Treasury will provide staff with name and contact information for their agency’s representative on the task force.

- **Natural Resources**

Staff, Rick Wascak, presented a revised draft of an Exposure Draft (ED) entitled *Accounting for Federal Oil and Gas Resources*. Staff stated that there were three major changes made to the ED since the Board discussed it at the November 2006 meeting. Staff added the objectives for the meeting were to:

- a. Review and discuss the draft ED.
- b. Gain feedback from the Board on the existing ED.
- c. Gain Board approval for circulating a pre-ballot ED.

Staff presented the first major change. Staff explained that the text of the ED was revised to establish a liability in conjunction with the recognition of the asset estimated petroleum royalties and revenue collections designated to be distributed to others, e.g., the states, the general fund of the U.S. Treasury, and other federal agencies. Staff added that the pro-forma transactions and financial statements were also revised to address the liability. Mr. Allen proceeded to ask the Board members if the revisions to the document pertaining to the recognition of a liability were adequately addressed. Mr. Dacey noted that the valuation of the asset estimated petroleum royalties was formula driven. However, the proposed methodology to be used to value the liability is based on collections expected to be distributed using the preceding 12 month average of collections that were actually distributed.

Ms. Comes explained that there were actually two parts to the liability. One part was the long-term liability based on the initial recognition and year-end valuation of estimated petroleum royalties. The second part of the liability is a short-term liability which is established closer to the time for pay-out for bonus bids and rents. Regarding the liability established in conjunction with the recognition of the estimated petroleum royalties, Ms. Comes explained the proposed standards for valuing the long-term liability was consistent with the 12 month period proposed in the formulas used to value estimated petroleum royalties. In regard to the liability established for bonus bids and rents, she explained the proposed standards permit the preparers of financial statements to use their own methodology.

Mr. Dacey noted he was concerned with using the percentage of collections distributed to others during the preceding 12 month period to value the long-term liability because he believed using that 12 month period may or may not reflect a reasonable approximation of the liability. Mr. Allen suggested the Board approach the issue a different way. That is, state that the liability should be identified and calculated based on an expected amount to be paid out. In addition, the proposed standards should

explain that one acceptable way of calculating the liability could be based on a percentage of the total collections that were paid out during the preceding 12 months. He added the principle was to have the best estimate of what is expected to be paid out.

Mr. Reid suggested that the proposal, to use the percentage of the total collections that were paid out during preceding 12 months, could be characterized as an example (in the Liability Recognition paragraph--19). That is, the paragraph could be revised to say "For example, the liability may be calculated using the percentage of the total collections that were paid out during the preceding 12 months". In addition, he suggested that a parenthetical phrase be added stating "other methodologies may be equally acceptable." Board members agreed with Mr. Reid's suggestion.

Staff noted that the second major change pertained to the Alternative View. Staff explained that an Alternative View to the proposed standards was noted in the transmittal letter, in a Request for Comments question, and in the Executive Summary. Staff added that the paragraphs presenting the Alternative View in the Basis for Conclusions were also referenced in these three sections of the ED. Mr. Allen stated that identifying the Alternative View in these three sections was a matter of principle to ensure reviewers were aware of the alternative view. Board members were in agreement with the changes to the three sections.

The third change pertained to question number three (Q3) in the Request for Comments section of the ED. Staff explained that Q3 was revised to ask how disclosure information and RSI would be used by financial statements users. Staff indicated that examples were added to the question itself and that text was also added to the Basis for Conclusions to support the question. Mr. Allen stated that he had a suspicion that someone would read the disclosure and RSI requirements without catching the nuance of the requirements. He explained that the nuance was that the disclosure and RSI information is being requested to be presented at the regional level. Mr. Allen suggested that a question be added asking how a user would use the regional information in contrast to information being presented for the federal government as a whole.

Mr. Jackson commented that, if the standards require that the information be calculated on a regional basis, it would stand to reason information would subsequently be available at a regional level. Therefore, if someone needed the information at the regional level they could get it. Mr. Farrell explained that, out of all of the disclosure and RSI information being requested, only one display is requesting information to be presented at a regional level. He said that his concern with the proposed disclosure and RSI information being requested is more than requesting it at a regional level. He added that some of the other RSI information being requested is offensive, for example, the Table presenting 10 years of historical information about the production and consumption of oil and gas. Mr. Patton suggested that another sub-question be added. Mr. Reid stated that he would not add another sub-question. He said he would simplify the Q3 background information and keep the existing sub-questions a, b, and c just as they are. Mr. Reid provided his suggested revisions to the Q3 background information. Mr. Allen indicated he was in favor of Mr. Reid's suggestion. However, Mr. Allen

suggested that a parenthetical phrase be added to sub-question a, which would refer reviewers of the ED “particularly to Table 1 and Table 2.” Board members were in agreement with simplifying the Q3 background information and adding the parenthetical phrase.

Mr. Allen asked if Board members had any additional comments or concerns with the proposed ED. Mr. Patton commented that he struggled with the amount of information presented in the question number 4 (Q4) background information. Staff suggested a revision to simplify the Q4 background information. Staff suggested that much of the information presented as background information for Q4 be deleted and inserted in an appropriate location in the Basis for Conclusions. Board members were in agreement with staff’s proposal.

For clarification purposes, Mr. Torregrosa suggested the phrase “as suggested in the alternative view” be added to question Q1.a.ii. Board members were in agreement with the suggestion.

Board members had no additional comments. Ms. Comes informed the Board members that a pre-ballot will be circulated before the next Board meeting.

CONCLUSIONS: Staff will revise the draft ED based on decisions made during the Board meeting and circulate a pre-ballot before the March Board meeting.

Adjournment

The meeting adjourned at 5:00 PM.

Thursday, January 18, 2007

Agenda Topics

- **Items Held for Remanufacture**

The Board approved Interpretation 7: *Items Held for Remanufacture*. The proposed Interpretation will be sent to the Board members representing OMB, GAO and Treasury for a 45-day review period. Upon completion of the review period, the Interpretation will be issued and will be effective upon issuance.

- **Reporting Gains/Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates**

The staff presented the following project schedule:

- January 2007: Board reviews revisions regarding expanding scope of ED
- January–February: Staff vets ED with affected agencies

- March 2007: Final draft of ED presented at March meeting along with comments from affected agencies
- April 2007: Staff makes final changes to ED and Board reviews a pre-ballot draft
- May 2007: Ballot draft of ED presented at May meeting
- June 2007: ED published
- June—October 2007: Exposure period
- October—December: Board reviews responses, possible hearing
- January 2008: Final standard issued, effective FY 2009

Display

Regarding the scope of the display standard, the Board discussed several options for identifying the type of assumptions for which changes would be displayed separately. The several members questioned the use of the word “major” (in ED paragraph 17) because it would be difficult to define.

Mr. Reid said the word “major” would devolve into a question of materiality and therefore the word probably is redundant.

Mr. Allen said he favored the staff recommendation #1 regarding “major” and “long-term” assumptions, but not recommendation #2 where the preparer is to consider materiality qualitatively, which he feels is an extremely gray area. He noted that FASB and GASB use the word “significant” in these situations, without defining it. He said he would use “significant” even though, technically, the standard would be covered by the Board’s standard materiality paragraph.

Mr. Reid said he did not think the word “major” would confuse anyone. He asked whether the Board had a policy not to use the word “significant.” He thought it did but here it seemed appropriate, and he preferred it to “major.”

Mr. Dacey said he was struggling with the principle behind the standard, although he (and Comptroller General Walker) fully supported requiring separate display for changes in assumptions. He said he was concerned about whether the ED clearly articulates the criteria for the separate reporting. His concern about the word “major,” or even the broad concepts, involves how to determine “significance.” For example, if you have the same type of assumptions in two programs that happen to be significant to one program but not to the other, does that mean different choices are made on whether changes in that assumption are reported “above the line” or “below the line”? He was concerned about using materiality as a criterion rather than a more discrete threshold, believing it would be problematic to apply. He saw a difference between the ED paragraph 19 and what the Board did before [in SFFAS 27] because for the latter the aggregate is shown and the decision involves what to display individually. Here the Board is saying that there are certain items that ought to be below the line. He said

there are two issues. First, he asked whether the ED was clear enough about which long-term liabilities are of interest. Secondly, he said there are other issues to deal with in the ED. He mentioned that “service cost” is not a clear component of some of the other liabilities.

Mr. Reid said he was satisfied with the materiality criterion even if that resulted in some changes being included above the line in operating costs.

Mr. Dacey asked whether the Board was saying that all changes in assumptions ought to be below the line unless they are immaterial.

Mr. Reid answered affirmatively.

Mr. Allen said that that would be the effect of the standard without more specificity.

Mr. Schumacher asked whether the potential of many line items on the statement of net cost was a concern and/or whether it would be problematic during consolidation.

Mr. Reid said it was not. The standard would entail a second page for the statement in any case. Regarding consolidation, he said standardization of line items would be needed for the footnote disclosure. The Board might want to look at summarizing certain kinds of things that go below the line, e.g., changes in the discount rate, demographic assumptions. He noted that it might be possible to get a finer look at that; and, instead of simply looking at it by agency, the Board may want to look at it by the type of change involved, assuming that the information existed. He stated that this would certainly add something to the understanding of what is going on with what he viewed as non-operational costs; or at least in a situation where a change affects the next fifty years and the total effect is reported in the current period.

Mr. Allen asked whether the term “long-range” would be sufficient.

Mr. Reid said he thought so, but he would like to hear from the affected agencies.

Mr. Patton suggested defining “long-range” and putting it in the glossary.

The Board discussed possible elements of a definition.

Mr. Reid suggested a distinction between changes in assumptions and changes in estimates. He said the latter are typically operating costs.

Mr. Allen said he wanted to isolate the truly long-term assumption changes so that they all could go below the line. He was concerned that, if all changes in assumptions were reported below the line there would be consistency issues; e.g., if an item was material last year it better be material this year. He said the focus should be on unusual changes in assumptions. He was concerned with reporting too many assumption changes.

Mr. Reid said the only option he saw was to specify how many future periods the assumptions affect.

Mr. Allen responded that he would like to convey that concept without specifying a number of years.

Mr. Reid responded that, since Treasury does not do these computations itself but simply accepts what the agencies provide, he wanted to be sure that the preparers are comfortable with the language in the standard – not only with respect to display but also regarding discount rates and other things. He wanted to correct a specific situation, not cause problems in other places that have stable records. He said one of the real values in this was that the computations be consistent from period to period and reveal the trends. The lack of transparency is one of his concerns regarding VA – he cannot see anything in VA’s numbers other than that, absolutely over time, the liability has gone up fairly substantially; but one year it is down, the next year it is up, and no sense can be made of it. He did not have that issue with the other programs.

Mr. Jackson said he did not like “major” or other adjectives. Everyone has his or her own definitions for these terms. He noted that the staff paper listed the programs and assumptions used in preparing federal financial reports. He suggested listing the programs and assumptions in the standard for which a separate display is required, e.g., pensions, veterans’ benefits, environmental liabilities. He also suggested including a question for respondents asking about the list approach versus an approach that used adjectives like “major” and “long range” for which no one knows the definition.

Mr. Allen said he had presumed the Board did not know all of the potential applications. However, if the Board did know them, then he was comfortable with a list. In that case, he said the standard could drop the materiality discussion and simply require separate reporting of gains and losses from changes in assumptions in all the listed cases.

Mr. Reid said that he would be more comfortable with that approach if DoD had a clean opinion. He was not comfortable with what DoD will find when it comes to the end of that process. He preferred general terms like “major” and “long term” because the preparer can use his or her judgment.

Mr. Dacey said he struggled with the question of whether there is a common characteristic. He suggested it may be discounted present value.

Mr. Schumacher suggested being specific about the major ones and, following Mr. Dacey’s suggestion, allow for any other programs using discounted present value.

Mr. Reid said he could agree with that approach.

Ms. Cohen said from her experience as an analyst she agreed with Mr. Reid about not knowing what will come up.

Mr. Jackson agreed with Mr. Schumacher's suggestion.

Regarding an "other" category, Mr. Werfel was concerned that programs would be included where the essence of the liability estimate is not based on traditional economic and demographic factors but more on risk factors and the assumption of risk; things like crop and flood insurance, terrorism and disaster insurance, and even pension guarantees and deposit insurance to a certain degree. He said one big concern or focal point for OMB is the difference between the budget deficit and net operating costs. He said reporting changes in traditional or actuarial assumptions help OMB analyze the difference. However, a broad standard could address estimates where risk is the basic driver of cost changes. He asked whether the Board wanted to keep the scope based on the traditional notions of "actuarial" estimates.

Mr. Reid said he saw those changes as changes in estimates, which he considered operating costs. He said he did not know how to avoid sweeping them in.

Mr. Werfel asked whether the Board should specifically exclude such changes in estimates just as it was excluding loans and loan guarantees. He noted Mr. Jackson's suggestion that the community might be confused.

Mr. Jackson mentioned that the distinction between controllable and non-controllable assumptions might be a criterion for deciding what to report above and below the line. He said one could then list the assumptions that are not controllable versus controllable, and that "controllable" and "non-controllable" would have to be defined. He preferred "controllable" to "major."

Mr. Allen asked whether the Board wanted to exclude certain assumptions or was interested in seeing the effect of "major" changes in all assumptions.

Mr. Reid said he was comfortable not using "major" and, although he prefers it, he said the Board had not favored using "significant" in the past. He said ED paragraph 3 was helpful; it seemed specific about the scope; it mentions "long range assumptions" that use "discount present value" and provides examples of the largest programs. He said he was comfortable with the language in paragraph 3 and with allowing preparers to decide what to display, and suggested dropping the reference to "liabilities in SFFAS 5" in paragraph 3, which would make the standard apply generally to long-range liabilities. He said preparers would have to use judgment regarding what is "long-term." He noted that programs are diverse and he did not think a list was workable.

Mr. Patton moved to remove the word "major" from the ED.

The Board voted 6 to 4 to remove the word "major."

Mr. Dacey asked whether the Board wanted to move the contents of paragraph 3 from the preface to the standard itself.

Mr. Reid asked whether the location of paragraph 3 made a difference.

Ms. Comes responded that introductory material is generally considered descriptive more than authoritative.

Mr. Dacey agreed.

Mr. Allen noted that paragraph 3 is the scope paragraph.

Ms. Comes responded that it is unusual for the scope not to be in the standard. She noted that she thought FASAB differs from GASB and FASB with respect to the scope paragraph, and she is planning to review the structure of FASAB documents and the consistency between documents.

Mr. Allen asked whether she considered the scope part of the introduction.

Ms. Comes responded affirmatively.

Mr. Reid suggested adding the long-term discounted present value phrase to ED paragraph 17, which addressed component entities.

Mr. Jackson said he would move the phrase “that employ long-range assumptions and discounted present value” in paragraph 3 to the first sentence of the paragraph. He suggested that the next sentence could list examples of the programs to which it applied. Thus, the phrase “that employ long-range assumptions and discounted present value” would be the key criterion to meet or hurdle to cross. He said the current wording could be read as being applicable only to liabilities found in SFFAS 5.

The Board discussed estimates of environmental liabilities that utilize long-range assumptions but not necessarily employ discounted present value in relation to the wording on paragraph 3.

Mr. Jackson said the “and” between “long range assumptions and discounted present value” could not be used if the standards were intended to be applicable to certain environmental liabilities.

Ms. Comes said that the standard for environmental liabilities had been a proxy for discounted present value; it assumed that the inflation rate on this type of clean up is going to be the same as your discount rate. She said, conceptually, the Board had not wanted to require the preparer to keep going through that exercise.

The Board discussed possible wording for the scope paragraph, paragraph 3.

Mr. Dacey asked for clarification regarding the Board’s position on environmental liabilities. He asked whether the Board was saying that the environmental liability is the

big item that is excluded from the separate display requirement via the discounted present value criteria that the Board thinks ought to be included below the line.

Mr. Jackson noted the staff position that the discount rate is a long term assumption and therefore, if the standard only refers to “long term assumptions,” it would capture the long-term program whether discount present value were used or not; in other words, environmental liability would be captured. He said that a footnote or the basis for conclusions could specify that the discount rate could be one of the long-range assumptions.

Mr. Allen said the Board tentatively said that some assumptions were under the control of management and should not be reported below the line and other assumptions were not controllable and should be reported below the line.

Mr. Jackson concurred that the Board should explore the concept of controllable and non-controllable assumptions.

Mr. Werfel noted that materiality would guide the preparer in deciding what to report below the line. He said that there was a larger question of policy to address in terms of how broad to make the standard. He said some preparers would consider contingencies, for example, and conclude that the display standard applies to them, while others would not. He said also that a cost/benefit question arising when adding data to the financial statements. He opined that clearly with post-employment benefits and environmental liabilities the benefits displaying the changes in assumptions separate from operating expense justified the cost; but not with some of the other things. He questioned whether the expansion of the scope of the standard was justified.

Mr. Reid said that separating gains and losses from assumption changes from the basic core expense of the entity would aid in the analysis of an entity’s operations. He noted that currently these effects are completely obscured.

Mr. Werfel agreed. He said his question was whether the Board could gauge how often the standard was going to sweep in certain liabilities throughout government. He posed a question about whether the Board would be looking at the display because it is material to a relatively small agency; and, if so, whether much was gained by having the breakout. He suggested that perhaps something is gained, but he did have the sense that the Board has had a full deliberation yet to talk about it. He said there seems to be a consensus on the Board that there is tremendous value for some of the large items, for example, post-employment and environmental. However, there is uncertainty about what agencies might deem as material, and the possibly of getting into a “nice to know” environment rather than one of useful information.

Mr. Allen said that the assumption is that if the entity is required to have audited financial statements there are users of those statements that are just as interested in the information as those who are interested in the Government as a whole.

Mr. Jackson suggested that defining “long term” might be productive. He suggested at least 5 years. He said that might eliminate some assumptions that the Board is not interested in.

Mr. Allen asked the members to consider the nature of the difference between something that could be an operating cost versus other gains and losses. He said, for example, regarding contingencies, the preparer is analyzing events that have already taken place that either have not been reported or that are in litigation. He contrasted that with change in law that significantly changes long-term costs, which would take place this year. He asked why that is not a period cost. He asserted that reporting it as a period cost would be distorting. He said that environmental liabilities, for example, are subject to changes in law that can change long-range assumptions and have a significant future impact; however, the law change is made this year.

Mr. Jackson said changes in law can necessitate changes in assumptions. Management has no control over that. Management does have control over all of those factors used to calculate period cost.

Mr. Reid wondered how many programs get changes every year by the Congress and noted that if you considered a legislative change a change in assumptions, then there could be dozens of programs reporting below the line. He noted especially the example of adding members to the covered group or geography or time to an environmental clean-up responsibility requirement. He said he would be reluctant to not call that an operating expense.

Mr. Jackson noted that all the cost would be period costs and the discussion is over where period costs are displayed.

Mr. Reid said he viewed changes in law that change the program as program changes rather than assumption changes.

Mr. Schumacher said you can disclose those separately above the line. Mr. Schumacher used the term “period costs” to characterize above-the-line costs.

Mr. Allen said he saw value in breaking out program changes above the line.

Mr. Reid said that the auditor would probably require note disclosure of material changes in the program in any case.

Mr. Allen said that program changes are not changes in assumptions, and the Board was successfully narrowing the scope.

Staff said it did not know how one would distinguish changes in assumptions that result from changes in law from changes initiated by an entity’s on-going review of variables. Staff said the examples mentioned would change assumptions, would be period costs, and would go below the line under this standard.

Ms. Comes said she was hearing a number of concerns. First, what types of liabilities does the standard apply to; second, what types of assumptions should have changes reported below the line versus those reported as operating costs above the line; and third, what is the universe – i.e., what is out there. She thought there was a great deal of consensus on the Board regarding the type of liabilities on which to focus; and a reasonable amount of consensus that there are at least two ways of looking at assumptions. She proposed that staff consult with affected agencies and develop some options.

Mr. Allen said he liked the staff's recommendation with respect to display question #1 but had a question regarding display question #2. He referred to ED paragraph 19 that provided guidance regarding materiality using the same language as in SFFAS 27. Mr. Allen said the qualitative references troubled him because they would destroy any preparer or auditor safe haven. He said a "qualitative" criterion would be a subjective standard.

Staff asked if deleting the word "qualitative" would render paragraph 19 acceptable.

Mr. Allen responded affirmatively. He said he liked the words "major" and "long-term" in paragraph 17 and said that paragraph 19 would not be necessary if the Board accepted the answer to Display Question #1, which was to list the programs and specify the amounts that are major. However, he said that since the Board was postponing its conclusion on Display Question #1 until after it heard from the affected agencies, it would be premature to answer Display Question #2.

Mr. Dacey said that he thought the distinction between operating and non-operating cost – or whatever you want to call them – that the Board had been discussing would set up criteria. He said materiality may or may not be superfluous at that point because that would change the focus from a materiality-based criteria to a more discrete criteria based upon the type of assumption change. He suggested holding the discussion of materiality until the next meeting.

Mr. Allen agreed.

Discount Rate Standard

Mr. Reid said he was happy with the discount rate language as long as it did not unsettle current practice. He wanted to hear from the affected agencies.

Mr. Schumacher said he was confused in the context of what Mr. Reid was saying yesterday about setting a standard discount rate for the entire government in the sustainability project.

Mr. Reid said that, philosophically, if you say that the discount rate should mimic the Treasury's borrowing rate, the agencies typically measure that using the rate Treasury pays on investments. This is also Treasury's expense on the debt side; so if an agency

has an investment with Treasury, that gives the agency an example of what Treasury borrowing rates are in that agency. He said the only problem with that is that because of the composition and the timing of those investments, every agency has a different rate. The Treasury Department obviously has one average rate regardless of where the money comes from. The question is, should all the programs have one government-wide rate for financial statement purposes, particularly for consolidation, recognizing that the actuaries may have other reasons why they may want to do different kinds of things and nuances that may go on in terms of their areas of expertise. He said that is why he thought that perhaps the sustainability task force would discuss whether that was a good idea or was feasible. He said he assumed actuaries are going to have problems with that. He noted that the draft ED gives you the opportunity to set the discount rate, but there would be different rates in different agencies if they use the composition of their own investments as Social Security and Medicare do for the trustees' report. He said it is something to explore with the actuaries since there are so many of them and they have obligations with respect to their opinions, which become part of the work on which the auditors rely.

Mr. Patton said the ED established Treasury's borrowing rate as the discount rate and it also invoked the maturities of the agencies own outflows. He said it was appropriate for agencies to have different discount rates and the ED language would support that.

Mr. Reid agreed that that would be the consequence of the standard. He said for the ED's purpose this is fine; you are going to have different rates. However, he noted that what happens in most programs is that the discount rate assumption doesn't change, at least not very frequently; and therefore there is some consistency from period to period as to how these computations are done. He added that, if in fact you say we are going to mark it to yesterday's interest rate, then that obviously introduces volatility that is not something Treasury can handle. He said that what the ED implies what the agencies will do is in fact what is being done in most agencies; there is only one major exception, at VA.

Mr. Jackson asked whether paragraph 23, which contains the main discount rate standard, should stand. He noted that it said the discount rate shall be the interest rate on marketable Treasury securities of similar maturities. His concern was that the actuaries or others might deem something else to be absolutely appropriate in their expert opinion; then there would be other reports being produced, maybe statutory reports, under the guidance of actuaries and others, that have results that are in absolute conflict with what is in the financial statements of a federal agency by virtue of paragraph 23; that caused him a lot of concern. The Board would be prescribing a Treasury rate when in fact others may find something else to be more germane, although he said he did not know that they do.

Mr. Allen said it was a legitimate question, but the question is whether one sees value in consistent application of a rate; and do you see value providing specific guidance. If not, and if one wants to let the preparer use the rate that their actuaries may calculate if it happens to be different, then the Board probably would have to talk about some

criteria. He said the easiest way is to tell them what the rate is. He noted the Board's prior discussions of the rate, and that the Board had tended to feel comfortable.

Mr. Jackson recommended, if the staff were going to go back to do some additional research, that there be some discussion, if there had not already been, with regard to whether that causes a problem. He suggested asking the actuaries at Social Security, VA and elsewhere if they could live with that in meeting their statutory reporting requirements.

Staff noted that there is a consensus throughout Government that the Treasury borrowing rate is the risk free rate. Although the agencies may prefer to use their own internal assets to determine the rate, the position presented in the ED is that that rate is inappropriate because agencies with the same cost factors end up with different amounts just due to the composition of their assets. This proposed rate would be the best rate for this specific purpose regardless of what the agencies actuaries prefer.

Mr. Jackson asked what if the actuaries did use a different rate in providing their various reports. He said, if the actuaries chose to use something other than the federal borrowing rate for their special-purpose reports and that was in conflict with the ED, then you would almost have a standard that some people could challenge on the basis that the experts are challenging it.

Mr. Allen said that if you have assets, a much more accurate rate of your pension liability, for example, is the rate of return on the assets you are holding. The reason why he was comfortable with the standard was because he understood that normally the benefit plans do not have assets and therefore the borrowing rate would be appropriate.

Mr. Reid noted that those that have assets have Treasury bonds.

Mr. Jackson noted that such assets are eliminated on the consolidated FR.

Mr. Reid agreed.

Mr. Allen said, as a rule, consistency is preferable unless there is a reason not to be consistent. The only reason he could think of not to be consistent was if an agency really did have assets, because the agency would have less of a liability if it set aside money to fund the benefit. He said the Board had to decide if government-wide consistency was more important than consistency within a given reporting entity based on some unique actuarial report or their own circumstances.

Mr. Reid said that given that fact that you have this professional group charged with the responsibility of making these calculations, and they need to certify they are comfortable with the amounts reported. He said the Board needs to be aware that that will produce some variability because of the individual portfolios, to the extent that they exist.

Mr. Allen asked if the portfolios really exist.

Mr. Reid said they did. The only agency he could think of that had no assets at all was VA. But the assets of the agencies are Treasury securities and therefore would be the same as the Treasury borrowing rate.

Mr. Allen asked in that case who would be hurt by paragraph 23?

Ms. Comes noted that that would come out in the exposure period.

Mr. Reid said that that was why he wanted to hear from the actuaries. If they were comfortable with the language in paragraph 23, then he would be too; if not, then we need to do something.

Mr. Allen said he would rather decide what is the Board's objective and what the Board is comfortable with and expose that through due process. For example, the Board's objective is consistency such that it wanted to define this; however, we would like to hear back regarding where it might do harm.

Mr. Dacey said the government reports \$83 billion in non-federal securities, most of which is PBGC. He questioned whether the PBGC would be affected by the standard.

Mr. Allen asked the Board, without a formal vote, whether it was comfortable going forward with the ED unless there are issues as the staff visited the agencies over the next several weeks. He said there would be a question on this point in the ED even if the vetting process did not result in agency concerns. He reiterated that he thought the Board was driven by a desire for a consistent rate.

Staff noted that that rate reflected the cost of borrowing.

Mr. Reid agreed and said that that rate could be an average and that Treasury calculates the average rate and it is available to agencies.

Mr. Allen asked Mr. Torregrosa if he saw the ED position as a reasonable rate based on the assumptions staff is talking about, i.e., that it ought to reflect the borrowing rate, or is there something philosophically flawed about that.

Mr. Torregrosa said that before CBO had its new director there were times when CBO staff thought it might be appropriate to have some adjustment in the discount rate to reflect market risk, but that is coming up for re-evaluation. Right now, the ED's basis for conclusions mentions cases where the riskless rate may not be appropriate, although not in paragraph 23. He added that at one stage he thought the Board was not trying to change actuarial practice other than VA, and then, when the scope was broadened, that does seem to be what the Board is doing.

Mr. Dacey said he thought that using the Treasury borrowing rate as the discount rate was a good general principle. He said a consideration might be that if this were the norm there would be some threshold to say that if you met other conditions you could use a different rate; maybe that would be appropriate, if it could be defined.

The Chairman asked if there were any objections to going forward with the ED, with understanding that more information would be gathered and there would probably be a question in the ED on the discount rate.

Mr. Dacey asked Mr. Reid about the second and third sentences in paragraph 23 which he characterized as talking about maintaining some stability in the rate, while the first sentence seemed to be causing some concern about establishing the actual basis.

Mr. Reid noted that the second sentence regarding the discount rate reflecting future long-term trends would be the kind of language that would tend to provide some consistency from period to period. He said he was not concerned with the relatively small inconsistencies between agencies in a given period. Rather, he was concerned about inconsistency from one period to the next in the same agency. He said he wanted to make some sense out of the total costs from that agency.

Mr. Torregrosa said he wanted to go back to Mr. Jackson's point. He was fairly certain that if the actuaries perceive this as a change in practice you are going to run into a major roadblock and he thought many may interpret this as doing so.

Mr. Jackson said he was not comfortable the way the ED is and would like to hear back from people. Referencing the audit standards, he said one of the aspects of long-term assumptions is the reasonableness. He said he would hate to prescribe something that others might deem unreasonable; that is, they might believe the assumptions would not produce a proper result. He mentioned the first sentence of paragraph 23 and said he was sensitive to what might be the result.

Mr. Reid suggested asking the agencies whether paragraph 23 was okay, presuming they are not going to be asked to change what they are currently doing; and, if they think it is going to make them change what you are doing, what edits would they give us that would be acceptable.

Mr. Allen said he was hearing enough to conclude that perhaps the first sentence in paragraph 23 is not the Board first choice. He noted that staff is asserting that the paragraph 23 is the right rate to use and that the Board was caught up between some people being comfortable conceptually that this probably is the right rate and other people's concern that we do not want to step on actuaries' toes if they conclude there is a different rate.

Mr. Reid said his concern with the first sentence is that he could read it to require a change every year to reflect Treasury borrowing rates for this year, and that was what he was trying not to do. He reiterated his desire to vet the ED with actuaries and to have them suggest language that in their view would be appropriate that the Board can evaluate against its objective. He agreed with Mr. Torregrosa regarding the possible push-back from the actuaries.

Mr. Allen noted the staff would get some tentative feedback and at next meeting the Board may be faced with some concerns over what should drive the Board to its tentative decisions. He said he wanted tentative feedback but that did not mean he

would vote to change the ED; it would have to be more than, well, that is not the rate we use.

Mr. Reid agreed but said his objective would be that at least the majority of the actuaries' concerns be satisfied before the ED is released, rather than have the actuaries respond negatively. He suggested finding an agency that could be used as an example of a discount rate calculation that the FASAB could live with and citing it in the standard as an example.

After lunch Mr. Werfel said that very early in the draft and at prominent points in the draft the reader is oriented to the fact that the reason why the Board is doing this is because discussion came up in the social insurance project. He noted that he had spent time looking for the linkage to social insurance before realizing that there wasn't any further discussion of the social insurance; the reason the reference is in the ED is merely to explain the timing. He thought this was confusing and suggested striking the reference. There were no objections.

Mr. Werfel also mentioned that he thought the description of the rationale for the display standard in paragraph A6 of the basis of conclusions was good and he preferred it to the paragraph in the executive summary and suggested replacing the former with the latter in the executive summary. There were no objections.

Best Estimate

Mr. Patton noted the use of "most likely" in paragraph 27 and said that saying that the "best estimate" was the most likely amount was just a change in labels rather than being an operational difference. He encouraged additional thought about what "most likely" in a range means. He noted the statistical possibilities, e.g., mode, mean; but he read the current paragraph 27 language as merely exchanging one expression for another.

Staff noted that the language could be made more technical since the current language is general. Staff noted that the source of paragraph 27 was FASB Concepts Statement No. 7 and that no other standard-setter had defined "most likely." Staff said that the standard would allow judgment and not preclude a statistical approach.

Ms. Comes said noted that it calls for the preparer's judgment. She noted that preparers had had issues applying "best estimate" during the last reporting cycle and suggested consulting them regarding what difficulties they are having applying the current definition.

Mr. Dacey agreed and said that there was a particular contentious issue at HHS this past year regarding the SOSI involving the meaning of "best estimate," and it got into questions of whether management's choice of reasonable assumptions is good enough. He said he had a slight concern if you suggest the standard is what in management's judgment is the most appropriate assumption because he did not think that is a standard that was workable.

CONCLUSIONS:

- The ED will be vetted with preparer and actuarial personnel.
- General decisions of the Board:
 1. The display standard will be general but list examples of the known programs.
 2. The concepts of controllable and non-controllable assumptions and operating and non-operating costs will be explored to distinguish the type of assumptions reported below the line.
 3. The VA volatility problem will be addressed without changing other actuarial practices.
 4. The standard should avoid requiring the discount rate to change every year.
 5. A decision on the necessity of a materiality paragraph is pending staff research for the March meeting.
 6. Paragraph 3 in the ED captures the Board's intention regarding the scope for the standard, at least tentatively, with two changes. First, the words "recognized in accordance with the provisions of SFFAS 5" will be deleted to clarify that the standard is not limited to SFFAS 5 liabilities but rather applies generally to long-range liabilities. Second, the words "and discounted present value" will be deleted from the last sentence of the paragraph so that the use of discounted present value is not a criterion for applying the standard. However, either the basis for conclusions or a footnote or both will explain that discounted present value is frequently employed in the long-range estimates on which the Board is focusing; and if it is not employed, the entity is still required to display the effect of changes in other long-range assumptions. Also, paragraph 3 will be removed from the introductory section to the body of the standard.
 7. More information is needed on the issues involved in a standard defining the phrase "best estimate."
- Specific changes in the ED directed by members:
 1. Delete the words "and discounted present value" from paragraph 3.
 2. Delete the reference to "liabilities in SFFAS 5" in paragraph 3.
 3. Delete the word "major" from paragraph 17 and anywhere else it may appear in this context in the ED.
 4. Delete the word "qualitative" from paragraph 19, the materiality paragraph.
 5. Delete references to the role of the social insurance discussion from the ED.
 6. Move the contents of the scope paragraph, ED paragraph 3, from the introduction section to the body of the standard.

7. Add a question for respondents regarding the list of short-term or otherwise explicitly exempted assumptions in paragraph 18.
 8. Add an explanatory sentence to paragraph 1A to make is parallel subsequent paragraphs.
 9. Replace the explanatory paragraph in the executive summary with the essence of paragraph A6 as a better expression of the purpose of the display standard.
 10. Add a definition of “short-term” and “long-term” for the Board’s consideration, possibly based on number of years.
 11. Develop the footnote disclosure for the FR.
- Staff initiated edits:
 1. For the Board’s consideration, change “service cost” to “annual cost increment” were appropriate because “service cost” does not capture all annual incremental cost. The phrase “service cost” is used in pensions, other retirement benefits, and other situations where service is provided in exchange for a deferred benefit, but does not always express incremental cost clearly in other programs.
 2. Add a question for respondents regarding the definition of “best estimate” in paragraph 27.
 3. Add paragraphs explaining the effect on prior standards.
 4. Change the dates in the ED to reflect the project new schedule.
 - **Entity**

Staff presented the Federal Entity Project Plan, which was included in the Board materials as Tab G. Staff explained the project is part of the overall Conceptual Framework Project. Staff explained that the project is expected to last approximately three years and the project plan identifies issue areas that will addressed in the project as well as milestone dates. The project plan also includes several appendices that contain pertinent excerpts from existing concepts, standards, and other reports that relate to the entity and consolidation issue from U.S., national and international standard setters that will be analyzed in greater detail throughout the project.

The project plan included the following issue areas that will be researched by staff:

- Definition of entity / reporting entity
- Guidance / characteristics for identifying reporting entities
- Criteria for including entities / boundary of the entities
- Criteria for consolidating entities

- Reporting on other relationships--joint ventures, non-profit partnerships, other relationships that lead to an assumption of federal support without consolidation being required, etc
- Potential disclosures

Staff requested the Board's feedback on the scope of the project, overall approach of the project, and issue areas identified. Staff also requested that Board members suggest other issues that should be considered in the Federal Entity Project.

Overall, the Board members agreed with the Federal Entity Project Plan. Board members agreed that there are a number of entity issues, including a lot of unique government relationships that will need to be considered. Board members suggested that staff consider the following:

- reporting financial activities for which an entity may be responsible
- "unit of analysis" issue as it relates to the kinds of "things" that would be included in an entity—other entities, activities, guarantees, functions, etc
- criteria for including the "things" noted above and how they would be included in financial reports
- often by law or regulation, a certain activity is required to publish a financial statement
- federally funded research development centers
- public-private partnerships in other countries
- situations where the government is contracting out things that used to be a government function
- Boards, councils, etc. that are not considered part of the federal government because they are not in the Budget, yet the President appoints the members
- consider what type of "related party disclosures" should be to disclose information about unique relationships (not be part of the federal entity)
- implication of the language in the Accountability for Tax Dollars Act

CONCLUSIONS: Staff will move forward on the Federal Entity Project. Staff plans to focus on the "unit of analysis" issue as it relates to the kinds of "things" that would be included in an entity—other entities, activities, guarantees, functions, etc. Staff will also begin research on Issue 1: Definition of Entity / Reporting Entity.

- **Steering Committee Meeting**

With respect to the budget, Ms. Comes indicated that the FY2007 budget would be affected by appropriations to each of the agencies providing funds to FASAB. She will keep members posted on budget issues.

Adjournment

The meeting adjourned at 2:15 PM.

