FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
March 21-22, 2007
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, March 21, 2007

Administrative Matters

- **Attendance**

The following members were present throughout the meeting except as noted: Chairman Allen, Messrs. , Farrell, Jackson, Marron (Mr. Torregrosa represented Mr. Marron on Thursday), Patton, Schumacher, Steinhoff and Werfel (Ms. Hug represented Mr. Werfel from 9 to 10 AM on Wednesday), and Ms. Cohen. The executive director, Ms. Comes, and general counsel, Mr. Jacobson, were also present throughout the meeting.

- **Approval of Minutes**

The minutes were approved electronically before the meeting.

Agenda Topics

- **Elements**

The Board received a draft final Concepts Statement on Elements, a first draft of a basis for conclusions, and an explanatory memorandum. The draft Statement incorporated changes to the Exposure Draft (ED) as the Board had requested at previous meetings. Ms. Wardlow said she was proposing additional changes in the "Recognition" section to clarify that the Statement does not address all of the factors that enter into recognition decisions. In particular, measurement issues would be addressed in a future Board pronouncement. She proposed that the two "Recognition Criteria" referred to in the ED should be renamed "Basic Recognition Criteria" and that a brief discussion should be included of "Additional Components of Recognition Decisions," which would not be addressed in the current Statement. She also proposed changes in the "Effects of Uncertainty" section for consistency with the Board's requested changes and with the revisions to the "Recognition" section, and to simplify the section. The proposed revisions to the "Recognition" and "Effects of Uncertainty" sections had been reviewed by Mr. Allen and Mr. Dacey before the draft was distributed to the entire Board. The draft final Statement also included proposed wording changes to the asset, revenue, and expense definitions.

The Board memo included questions for the Board on the principal staff recommendations. Mr. Allen suggested that the Board respond to each question in turn. In response to the first question, Mr. Steinhoff said the proposed modifications to the "Recognition" and "Effects of Uncertainty" sections satisfied Mr. Dacey's concerns. Mr. Allen reminded the Board that the modifications discussed at the January meeting and those proposed by the staff are intended to accommodate the concerns expressed in the alternative views to the ED. It is important to know whether the proposed changes meet that goal, because after discussion of the complete draft a question for the Board will be whether any member or members will dissent to the Statement. Mr. Patton said that he was one of those with an alternative view in the ED and he agrees with the proposed modifications.

Mr. Jackson questioned the second sentence of paragraph 57:

Consequently, some items may not be recognized (although they may be disclosed) because of uncertainty about whether they meet the definition of an element, their measurability, the results of measurement (including the probability of future flows of economic benefits or services to or from the items), the materiality of the measured amounts, or the benefit versus the cost of recognizing them.

He questioned how the results of measurement could affect recognition. In his view, the notion of probability or uncertainty would be captured in assessing whether an item is measurable. Once one has concluded that an item is measurable or reasonably estimable, one measures the item and it should go without saying that the item would be recognized in some way. Mr. Allen disagreed. He said that, for example, inventory is measurable, but the actual measurement may be found not to be reliable. Mr. Reid said another example would be a lawsuit in process or a judgment under appeal. One can measure the amount of the suit or that has been awarded. Then the next step is to assess the probability that the payments will be made. If the assessment is that it is not probable that the judgment will be upheld or that the amount awarded will be paid, one must decide what should be recognized. That is what paragraph 57 is saying. It is not that the amount cannot be computed; the question is what is the liability, what actually is the outcome. The assessment of probability after one makes the original measurement is something else, beyond simply whether one can calculate an amount.

Mr. Jackson said that Mr. Reid's comments helped him. He understood that uncertainty about future events could cause one not to recognize something. Mr. Farrell said that the words "results of measurement" do not necessarily get to what Mr. Reid was explaining. Mr. Reid said that the results of measurement presumably include whatever estimate of probability one has. If the probability is zero, then the measurement equals zero. He thought that maybe there is some redundancy in the wording that could be removed, but he is unsure what change should be made. Mr. Jackson said he would flag the paragraph for further consideration. Mr. Allen responded that he would like to resolve the issue of whether there is a distinction between measurability and the results of measurement. If Mr. Jackson's view is that there is not a distinction, the Board needs to make a decision, because the Statement treats measurability and measurement as two different issues. Measurability is something that one needs to decide as part of deciding whether an item meets the definition of an element. Measurement is a separate issue that the Statement does not discuss. The Board will address it in a different statement. Mr. Jackson said he understood Mr. Reid's reasoning, but as Mr. Farrell said, the words "results of measurement" may not get to that point. Mr. Jackson said he thinks the "results of measurement" is an absolute. In the earlier examples, one knows the amount of inventory or claims, but the outcome of a series of events is different. What is the likelihood of having to settle the claim?

Mr. Allen said that the issue is one of several potential recognition issues mentioned in paragraph 57. Materiality may be an issue. One may decide something is measurable; then one measures it, but one does not recognize it because it is not material. Mr. Jackson said that he thinks litigation is covered by the term "their measurability." That is where notions such as "probable" and "more likely than not" come into play. It is not possible in many cases to measure what the outcome will be with respect to litigation. So, "their measurability" deals with things like litigation.

Mr. Farrell referred members to the last sentence in paragraph 60:

The additional components are measurement of an appropriate attribute, which includes an assessment of the probability of future flows of economic benefits or services, and assessments of the materiality of the item and the benefit versus the cost of recognizing it.

This sentence states the same as paragraph 57. He thinks the sentence supports Mr. Jackson's point that it is redundant because it is saying that measurability and the results of measurement are not two different things. Ms. Wardlow said that the wording of paragraph 57 might need to be clarified but paragraphs 57 and 60 are supporting that measurability and measurement are two different things and that assessments of probability are part of measurement, not measurability. She referred members to paragraphs 5 and 7, which present the Board's decisions in that regard. Paragraph 5 states that the basic recognition criteria are that the item should meet the definition of an element and should be measurable. Paragraph 7 discusses additional components of recognition decisions that are not addressed in this Statement, including measurement. Paragraph 7 states that measurement may require an assessment of the probability of future inflows and outflows of economic benefits or services. Mr. Farrell agreed with Ms. Wardlow's explanation.

Mr. Jackson suggested that some of the language from paragraph 7 might usefully be included in paragraph 57. He continued to be troubled by the phrase "results of measurement." Ms. Wardlow asked whether it would be help to remove the parenthetical statement about probability and refer to "definition, measurability, the resulting measure, materiality, and cost-benefit." Mr. Farrell suggested using the terms defined in the glossary (Appendix B)—that is, referring to "measurement" and "measurable" rather than "measurability." Mr. Allen agreed that the differences between the definitions of the two terms in the glossary are exactly the points that staff is trying to make in paragraph 57. Mr. Reid said that one could remove the parenthetical reference to probability. Mr. Patton said that the Board had spent considerable time trying to agree and clarify that probability is not part of measurability, and he believes that many people, not having shared that process, will think that probability is included in the term "measurable" if the parenthetical reference is removed. He would advocate that if the word "measurement" is used, the Board should retain the parenthetical expression "(including the probability of future flows of economic benefits or services to or from the items)" to remind readers that it is at the measurement stage that probability plays a role. Mr. Allen said he appreciated Mr. Patton's comment because the initial difference among Board members was over the point that Mr. Patton just made. Mr. Patton added that the parenthetical phrase was needed for clarity because it sounded as if Mr. Jackson was going down the path of saying that probability is part of measurability. Mr. Reid said that paragraph 7 states specifically that probability is part of measurement. Mr. Jackson reiterated his belief that the parenthetical phrase in paragraph 57 refers to measurability. In his view, when looking at paragraph 7, if measurement deals with probability, then measurability also deals with probability. It may be difficult or impossible to measure something if one cannot measure the probability of the event occurring. He said that, although he had his view, he was not trying to force the Board in another direction.

Mr. Marron asked what would be lost by removing from paragraph 57 the phrase "results of measurement." The paragraph has "measurability," which captures probability and whether one can determine well enough the amount; "materiality," which says that if the amount is too small it may not be recognized; and benefit-cost, which says if it is too much trouble, the item may not be recognized. He wondered what aspect of "results of measurement" is left. Ms. Comes gave a price-support program as an example of "results of measurement." There clearly is an obligation to honor price supports if prices go in the wrong direction, but we do not know whether prices will go in the wrong direction. If one chooses different measurement attributes, the results of measurement will be different. If one chooses settlement cost, a historical cost notion with the cash out, and one decides the probability, as usually assessed by accountants, is more likely than not, one would assign a zero. Some might argue there is no liability; others might argue there is a liability with a zero value. But, if one chooses a fair value approach and one obtains an expected cost and finds it is not zero, one would assign a dollar value. It probably would not be a number that would match any outcome, but it would be today's fair value and one would recognize that dollar amount. The issue here is does one think the zero means that one did not recognize a liability or does one think that one recognizes a zero liability? The reference to "results of measurement" is a place-holder for that sort of decision-making process.

Mr. Allen agreed. He said that in essence Ms. Comes was saying that when one is deciding whether one potentially has a liability in the circumstances she described, is a contingency potentially measurable? And if one believes that one may be able to measure it, one can say that it may meet the criteria for a liability. What the definition is intended to do is to start there. One says that it meets the definition of a liability if it meets the criteria, including that it is measurable. But, then the Board will have a separate project which will examine what is the right measure to apply. As Ms. Comes said, at present we have a measure adopted initially by the FASB (FASB Statement No. 5), which says if there is not a pretty high expectation of something in an individual case, so that if you have thirty cases and each one of them does not meet a high probability of, maybe 75 percent on average, then the amount to be recognized is zero. It does not mean that there is not a potential liability, but measuring it that way it is zero. But the FASB in its Concepts Statement No. 7 has said there is a superior measure which they intend to start using. It is called expected cash flows, where one would then have the ability to measure something, even if there is only a 20 percent probability of thirty different cases. If one uses expected cash flows one would recognize a number, but if one is using "more probable than not" one would not recognize any number because some of the thirty cases do not meet that requirement. The FASAB is saying that decision will be made once the Board issues another document on measurement. That is not the same as a decision about whether an item is potentially measurable, as part of deciding whether one has an asset or liability.

In response to a question from Mr. Marron, Mr. Allen explained that probability is not included in the initial definition or recognition criteria. Probability comes into how one calculates an amount for an item that meets the recognition criteria and therefore is a candidate for recognition. One may conclude that one has a liability but be unable to recognize it because, under the “more probable than not” theory, one may have a zero amount because there is not a high enough probability of the outcome to recognize a liability. The Elements Statement is separating the two issues and saying that one may have an item that meets the definition and basic recognition criteria, but that is independent of determining probabilities in measuring the item.

Mr. Werfel said that if Mr. Allen’s statement is correct, then he is confused by the last sentence of paragraph 59. He likes the sentence and does not wish to delete it. The last two sentences are:

Items that meet the definition of an element, but because of uncertainty are judged not to be measurable, are not candidates for recognition. Conversely, items that, because of uncertainty, are judged not to meet the definition of an element are not candidates for recognition even if they are measurable.

Taken together, these sentences seem to address probability at both ends: when one initially makes the determination that an item meets the definition of an element and again when one reaches the measurement stage. He believes that is the right approach, but he does not understand why the Board is making the effort to make these distinctions when the original definition refers to “a probable future outflow.” The Board has removed the word “probable” and substituted many more words to say essentially the same thing. He added that perhaps he is misreading paragraph 59.

Ms. Comes responded that the problem with having probability in the definition is that it forecloses an expected value approach to measurement. It is not consistent with a market-value approach. It suggests one is looking at individual results and items as opposed to groups. At Ms. Comes’s invitation, Ms. Wardlow added that the FASAB’s proposed definition is identifying a present obligation, for which one must then decide what measurement attributes and methods should be used that may or may not include a probability notion. However, the current FASB definition, which, as the Board is aware, the FASB is in the process of changing, states that the liability is the probable future sacrifice of assets, which means that one is obliged to include probability in that notion. The FASAB is saying that the liability is not the probable future flow. It is the present obligation at the balance sheet date. That is what one is trying to measure. It is the situation now, not what the future outcome may be. Ms. Comes added that, at the measurement stage, one still has the option to measure the historical cost or take an expected value approach. With the FASAB’s formulation, one does not foreclose the measurement options. Mr. Werfel asked whether one could stay with the old definition. Ms. Comes responded that the Board and constituents are used to them, but for example, under the federal standards an expected value approach is taken with direct loans and loan guarantees, which is not really consistent with the FASB definition. Also, the staff has looked at the draft IASB/FASB definitions and FASAB’s definitions are remarkably similar to them. So, FASAB is not departing from the world of accounting into something else.

Mr. Werfel asked whether he was reading the last sentence of paragraph 59 incorrectly. Mr. Allen said he thought the sentence was an addition and asked Ms. Wardlow to comment. She responded that the sentence was added by Mr. Dacey. Mr. Dacey was particularly interested in the Board's discussion at the January meeting to the effect that this paragraph (paragraph 60 in the ED) should be better balanced. For an item to be a candidate for recognition, the two basic criteria must be met. After that come the actual measurement, materiality, and cost-benefit issues discussed earlier. All this paragraph and much of this section are doing is to repeat what is stated in the "Recognition" section. Mr. Allen said that the last sentence of paragraph 59 appears to be saying that an initial assessment was made that an item was not measurable, so it was not recognized. But then it says that, even though one has made that assessment, one had the ability to measure it. Ms. Comes suggested deleting "even if they are measurable" at the end of the paragraph. Mr. Jackson said that the sentence appears to indicate that, even if an item is measurable, uncertainty may mean it is not recognizable. If the item is measurable, then what is uncertain about it? Mr. Patton responded that the uncertainty is about whether the item meets the definition. Ms. Wardlow said that the problem she has with the last sentence is that she believes one would not even consider whether an item is measurable if one has already concluded that it does not meet the definition of an element. But, Mr. Dacey was making this point at the January meeting and again in response to the draft revisions that she sent him, to the effect that he thought the last sentence would balance out the paragraph better by giving "both sides of the coin." Mr. Allen said he thought the addition did not give both sides of the coin and Mr. Jackson said he thought it was contradictory.

Mr. Reid said that if one is uncertain about whether an item meets the definition of an element, it may have nothing to do with probability. It just means that one is uncertain about meeting the definition. Ms. Comes added that Research and Development (R&D) is a classic example. R&D may not be accepted as an asset, even though most people believe something will be obtained from it. Mr. Reid said it was not an issue of probability. R&D is measurable because one can add up the expenditures, but that does not seem to have anything to do with probability. The issue is whether it is an asset or an expense.

Mr. Werfel said he disagreed with Mr. Jackson that measurability automatically brings certainty. There might be things that one can measure with great precision, but the fact that the government will have to make the payment at some time may be very uncertain. If one recognizes something because it is measurable, even though it has a zero percent of happening, one is misstating the financial statements. Mr. Jackson responded that one can make up any scenario and measure it. But, whatever one is measuring should have some degree of certainty. One should not be measuring something that one believes is unlikely to occur. Mr. Reid said it is a matter of the difference between calculation and measurability. The measurability includes the probability of whether the item will be paid. One can calculate a measure. But, the issue is, one must incorporate probability before one gets to measurability. Mr. Reid said that Mr. Patton advocates that probability be included in the definition. Others advocate that it be included in the measurement calculation. Mr. Allen responded that the Board is not prejudging the attributes that will be measured or the methodology that will be used to measure something. Until one gets to that point, one does not know the role that probability will or will not have in how an item will be measured. That is how he reads the document. It says that, to be a candidate for recognition, an item must meet the definition and be measurable in dollars. That is the focus. One can say something is measurable but cannot be translated into dollars, so it is not measurable and does not meet the definition.

Ms. Wardlow gave natural resources as an example. One may know the length, depth, or volume of a resource but be unable to quantify it in dollars. Mr. Jackson said he may know that he has X resources but he cannot extract them. So, in his view, the measurability would include the probability of being able to extract the natural resources. That would lead to applying a cost fact to what he could extract. The measurability issue includes a notion of the likelihood of an event occurring. Once past that consideration, he would take the result and measure it. Mt. Allen responded that once the Board gets to the measurement project, Mr. Marron, for example, would say that more of those natural resources ought to be recognized, because there is a method of measuring them. But, the majority position may be to choose a different way to measure the resources and not the measurement of expected future cash flows. That is a discussion for the future about how one measures something. The initial decision is: We have an asset; it meets the definition and we have concluded it is measurable. The next phase of the project then asks what method one ought to use for measuring the element. That is when probability comes into play.

Mr. Jackson said he was not sure Mr. Allen's comments resolved the problems he had with the phrase "results of measurement." Mr. Allen acknowledged that the last sentence of paragraph 59 was inconsistent with what he had just said. Mr. Jackson said he was referring to paragraph 57. Mr. Allen asked Ms. Wardlow to add to his comments. She said that, regarding paragraph 59, Mr. Dacey wanted to express the issue in the way he saw it, as a balance of two aspects of uncertainty. Mr. Reid said if the item does not meet the definition for any reason, not just because of uncertainty, then even though one can measure the item one does not recognize it. Mr. Patton pointed out that the title of the section is "uncertainty," and that is why uncertainty is referred to. Mr. Jackson pointed to the phrase in the middle of paragraph 59: "because of uncertainty are judged not to be measurable." Probability of future flows is an uncertainty factor; to him the probability of future flows is synonymous to some extent with uncertainty. Ms. Wardlow referred to paragraph 6, which states that: "The existence or measurability (or both) of many assets, liabilities, and other elements may not be certain, but the definitions and basic recognition criteria in this Statement do not require certainty," and the paragraph talks about the need for judgment. With regard to measurement, the Board is referring to the fact that one may need to measure probability. With definition and measurability, one is not measuring probability. One is saying that one may not be certain whether one has an asset or liability and one makes a judgment call. One is not measuring the probability that there is an asset. When it comes to actually measuring something, one is likely to measure the probability of future flows and that is factored into the number one comes up with, which is very different from whether something is measurable or not.

Mr. Allen said that the ED was written pretty clearly to begin with and what staff is trying to do with the draft final Statement is to respond to varying concerns. If one reads paragraph 57 without that attempt, it is just a basic statement that addresses uncertainty. Items may not be recognized because of uncertainty. That is basically what the staff is saying. Now the Board has added a lot of words, starting with the discussion in January. Mr. Allen said he could see some words that he did not remember from the January discussion. Mr. Patton said he believed some words were added to clarify what the uncertainty is about, and that is the central adjustment that has been proposed to what Mr. Dacey and he were thinking about this document; that is, that the Board needs to clarify what the uncertainty is about. There can be uncertainty about measurability and there can be uncertainty about meeting the definition. He said he was strongly in favor of retaining the proposed explanations.

Mr. Allen said he also was in favor except for the last sentence of paragraph 59, as Mr. Werfel had pointed out. He did not understand how something could not meet the definition because it is not measurable when one has measured it. Mr. Patton said that if something is not a present obligation it does not meet the definition of a liability, and yet some features of that item could be measurable, and that is the case the paragraph is trying to rule out. Mr. Allen said that in his view if something is measurable then it meets the definition. Ms. Wardlow explained that the first criterion for recognition is that the item should meet the definition and the second criterion is that it should be measurable. Paragraph 59 is saying that if the item meets the definition of an element (number one) but is not measurable (number two), then it is not a candidate for recognition. Mr. Dacey had said that he also would like to include the complement of that statement—the “other side of the coin”—that an item that is measurable (number two) but does not meet the definition (number one) is not a candidate for recognition. Mr. Jackson said the beginning of the document says that there have to be two things to have an element: the item meets the definition of an element and it is measurable. All paragraph 59 does is restate what is already stated in paragraph 5. Mr. Patton responded that it adds the notion of uncertainty, which has been central to the extended debate by members with an alternative view in the ED.

Mr. Allen observed that it has been said that R&D does not meet the definition of an asset. In other words, the FASB says that it probably meets the definition, but it cannot be attributed accurately enough to the ultimate products to be capitalized and associated with them, so it should all be expensed. Ms. Wardlow agreed and added that the FASB has not said that R&D is not an asset or will not result in an asset, but from a practical perspective, one cannot determine what kind of R&D will result in an asset and what kind will not, and therefore the entire amount is expensed. Mr. Allen said he thinks that is an issue of measurability. He was looking for an example of something that does not meet the definition but is measurable. Ms. Comes said that with regard to meeting the definition one looks at whether there is or is not a benefit, whether there will be a resource or not. She views R&D as something where one is not sure what the outcome will be. Mr. Jacobson suggested training programs as an example. A training program is a resource that embodies economic benefits and under the human capital rubric it meets the definition of an asset, but it is not measurable. It meets the "other side of the coin" notion reflected in the last sentence of paragraph 59. Mr. Allen said he was looking for something that goes the other way: it is measurable but does not meet the definition of an element. Mr. Werfel said he could think of millions of cases where something is measurable but is not a present obligation. For example, Congress is currently contemplating a new bill that would pay subsidies to farmers in certain circumstances. The cost has been calculated as X, but the bill has not yet passed, so the subsidies can be measured but no present obligation exists.

Mr. Steinhoff said he does not think the last sentence of paragraph 59 is the real issue. Assume that the bill passes and there is a series of Supreme Court challenges to it, because there is uncertainty as to whether the Act is constitutional. In that case, one could determine that the subsidies are measurable, but it is uncertain whether they will be paid. If one determines that the payment is uncertain, even if one can measure it, a liability would not be recognized. Mr. Jackson said he did not have a problem with paragraph 59; his issue is with paragraph 57. Mr. Werfel said he did not have a problem with paragraph 59 either. His concern was with the notion that the assessment of probability is not part of measurability. Ms. Wardlow said that, with regard to Mr. Allen's request for an example, paragraph 22 provides one on the asset side. Mr. Allen responded that he is very comfortable with paragraph 22; he had not previously thought much about items that one can measure but that are not assets because one cannot control access to the benefits.

Mr. Werfel said he thinks Mr. Steinhoff's example is important. The bill has been signed into law and one can measure expected outflows, but the Supreme Court may declare the law unconstitutional. Regardless of whether one makes a judgment call about which way the Supreme Court will go, he asked whether it is not relevant, before putting a liability on the books, to evaluate the fact that the Supreme Court might strike the law down and that by recognizing the liability one might be overstating liabilities. For example, in interviews with a wide range of attorneys and constitutional scholars, they all say there is a 98 percent chance that the law will be struck down, but it is measurable. In that situation, what is the right thing to do and, more important from his perspective, what is the section on "Effects of Uncertainty" saying should be done?

Mr. Allen said if the law is passed, it states that there is an obligation, and the money is set aside, the obligation becomes a candidate for being a present obligation or a liability; that decision still has to be made. The law says the money is owed to a third party and the amount is known, so he would say that the obligation meets the definition of a liability. In his opinion, the next phase of the project is to decide whether anything should be recognized and that is where probability is taken into account. If the scholars say there is a 98 percent chance that the law will be struck down, then the answer is no. If they say there is a 50 percent chance, the decision still may be no. Mr. Farrell said that one does not get that guidance from the Concepts Statement on Elements; it comes from FASB Statement No. 5. Mr. Allen responded that his point is that in the case under discussion, he would say the law has been passed, an appropriation has been made, and there is a current obligation to pay, say, local governments. The issue is should an obligation be recognized, and he would say yes. Mr. Farrell said that in his view the Statement says that the definition of an element has been met. Mr. Allen agreed. He added that the next part of the project will address how the element is measured, and the Board may say that, in this case, if expected cash flow will be used, even if there is a two-thirds chance that the amount will not be paid, the liability may be recognized. Mr. Farrell said that this Statement does not address that. Mr. Allen responded that that is the point he is trying to make: those decisions will be made in the measurement phase of the project. This document, with the new wording that has been added, says that in this case, which he believes Mr. Werfel or Mr. Steinhoff is making the point for, the obligation does not even meet the definition of a liability, because there is a possibility or probability that the money may not have to be paid. This is the struggle that the Board has had from the beginning. To Mr. Allen, that is a second phase decision. The possibility or probability that payment will not be made does not mean that the obligation is not a candidate for recognition. It meets the definition, there is a present obligation based on the law, and that is as far as the Elements Statement goes. If it meets the definition and it is measurable, which it is because there is an appropriation, then that is all this Concepts Statement covers. Later, before anything can be done with that, the Board has to decide what the right measurement is and that will be addressed in the next project. And that is the fundamental difference that some members have. In their view, it would not be a candidate for recognition based on the law passing when a probability consideration exists.

Mr. Jackson referred the Board to line 33 on page 1 of the Executive Summary, which states “The item must be measurable, meaning a monetary amount can be determined with reasonable certainty or is reasonably estimable.” He believes that probability is included in that and, going back to paragraph 57, he does not understand how the probability of future flows gets into the results of measurement. The result of measurement is a function of whether one can reasonably estimate something and be reasonably certain it will occur. All of that comes into a conclusion with regard to measurability. If one determines that one cannot measure the amount with reasonable certainty, that is the end. There is no need to try to measure the item because one has already determined that it cannot be measured with reasonable certainty. If one considers social insurance, it is arguable that there is no way those obligations can be met. Mr. Reid said to Mr. Jackson that, in his view, the phrase “the results of measurement (including the probability of future flows)” in paragraph 57 is, at worst, redundant because it is included in measurability. Mr. Allen asked Ms. Wardlow why that wording was included and whether the Board decided on it at the previous meeting. Ms. Wardlow responded that the basic changes the Board made were to paragraph 60 of the ED, which is paragraph 59 in the current draft, and she proposed the other changes to enhance consistency with the changes in the “Recognition” section and to round out the section. The original paragraph 57 was written in more general terms. Most of it came from FASB Concepts Statement No. 6 and it was talking in more detail to the point that the government may have recognized an expense or a revenue for some items that later were discovered to meet the definition of an asset or liability, or vice versa. It was discussing all the uncertainty and what might be the result of doing that. She thought that, given the changes proposed to the "Recognition" section and in new paragraph 59, it was unnecessary to retain all of that discussion. It seemed outside the realm of what the Board was trying to say with "Recognition."

Mr. Allen referred again to the definition of "measurable." He said that when one says that something can be "determined with reasonable certainty," it seems to introduce a probability notion, whereas he thought the Board had initially said that probability is part of measurement, not measurability. Ms. Comes said that the words acknowledge that most people when making accounting decisions do not draw a bright line between recognition and measurement. Some academics have argued that it is a false line and the Board should abandon it. The Board previously defined "measurable" as "quantifiable in monetary units." Members with an alternative view in the ED thought that definition was not a barrier, that everything could be measured. Her view was that the addition was reasonable and because the revised definition says "reasonable certainty" and "reasonably estimable," the Board was covering all the measurement attributes and saying that if one can get a reasonable measurement attribute of whatever type, then the item is measurable. It does not call for explicit consideration of probability, which was one of the things the alternative view members wanted—an explicit probability assessment required for recognition. This does not do that, but it introduces the notion that this is all part of the process. The various steps are presented as disconnected, but they are all part of the same system. The Board is trying to draw lines which in many people's eyes are not real lines.

Mr. Jackson asked why the phrase "the results of the measurement" in paragraph 57 is needed. Ms. Comes responded that if one got a zero measure from the selected measurement attribute, some would argue that is not recognition and she agrees with that. Others would say one has recognized a zero dollar liability. Mr. Allen said that in the discussion of uncertainty at the last meeting, he thought the Board was just acknowledging that uncertainty can affect any part of the process. One may consider that an item may not meet the definition of an element because of uncertainty or is not measurable because of uncertainty. But when one gets to materiality, it seems one is beyond the realm of uncertainty. He thinks one ought to end paragraph 57 before materiality is mentioned. The paragraph should say that uncertainty affects whether one recognizes an item and whether it is measurable, and uncertainty is also a consideration when an item is measured. Ms. Wardlow said one could do that but the paragraph is referring back to what is proposed in the "Recognition" section. The effort was to try to make clearer what was already in the ED but was not fully articulated, that this Concepts Statement does not address all aspects of recognition decisions. The Statement has a definition requirement and two basic recognition criteria—that an item meets a definition and can be quantified. At the January meeting, the Board wanted to clarify that whether something is measurable or not has some uncertainty to it, but is not a probability assessment in the sense of measuring the probability that the item is measurable. The Board also discussed that the two basic recognition criteria are not sufficient for recognition. An item that meets them is a candidate for recognition, but then one has to go through additional components of recognition decisions. They would include the attribute one chooses to measure, measurement, the result of measurement, and whether the measure is considered adequate to recognize the item on the face of the financial statements or whether the item should be disclosed, and then there are materiality issues and cost-benefit issues and probably some other things before one has completed the path of recognition. That is what the Board was trying to achieve in January, just to make clearer that this Statement covers only part of the process.

Mr. Allen said that paragraph 57, under the subheading "Effects of Uncertainty" begins by talking about uncertainty, but then the second sentence includes items that may not be recognized because of uncertainty and items that may not be recognized for some other reason. In his view, the last two items—materiality and cost-benefit—are very legitimate issues with respect to recognition decisions, but they do not belong in a paragraph on uncertainty. They could be put elsewhere. Mr. Reid pointed out that they are included in the "Recognition" section, which is appropriate because they can affect recognition. Mr. Allen added that uncertainty definitely clouds the first issues mentioned in paragraph 57: Does the item meet the definition of an element and is it measurable? Uncertainty is considered in how one measures something. Mr. Werfel asked for confirmation that uncertainty is relevant in the definition of an element. Mr. Allen said yes and that paragraph 57 has some very appropriate statements that uncertainty always exists. It exists at the definition stage and at the measurement stage. Mr. Werfel said he thinks that is what the last sentence in paragraph 59 is essentially saying. Mr. Allen agreed, although he found it hard to think of an example.

Ms. Comes asked whether the Board wished to edit paragraph 57. Mr. Allen said the Board was back to Mr. Jackson's original point: Does one need both "measurability" and "results of measurement" or is there a better word to use there? The Board is trying to capture that uncertainty is an issue at the definition stage, it is an issue in whether an item is measurable, and it is also a factor in the next phase of the project when the Board considers how one should measure an item. Uncertainty will play a key role there, perhaps an even more important role than in this Statement. Mr. Allen asked whether all members are comfortable with asking the staff to come up with better words to capture all three concepts, instead of the Board trying to wordsmith it. Mr. Reid said one should just delete the words "the results of measurement (including the probability of future flows)." He thinks that would leave what Mr. Allen was saying, that there is uncertainty in definition, measurability, materiality, and cost-benefit. He is unsure whether those statements should be in the "Recognition" section rather than under "Effects of Uncertainty." Mr. Allen agreed that they are true statements.

Ms. Comes said that paragraph 57 is a summary paragraph that leads to a more robust discussion of the different aspects of uncertainty. One concern is that when one starts to remove items from the list of things that could affect recognition, people start to wonder whether those items are gone forever, even though they are stated many times elsewhere in the document. She wondered whether one could delete the whole list of reasons because they are to a certain extent expanded on and explained in the following paragraphs or they have been covered earlier in the document. She suggested ending the paragraph after “uncertainty” in the second sentence, and then the other paragraphs would explain more fully what might lead one not to recognize something. Mr. Allen said he thought the Board’s attitude in January was that the majority of members were comfortable with the wording the way it was but were uncomfortable adding some words that made the discussion of uncertainty more robust at all of those levels. Ms. Wardlow responded that she was trying to make it clearer and more consistent with the “Recognition” section. She said there may be a way to clarify paragraph 57, but if one stops after “uncertainty” in the second sentence, the paragraph will talk only about definition.

Mr. Allen said the discussion was getting into a lot of detail based on Mr. Jackson’s original question about whether there is a difference between results of measurement and measurability. Ms. Wardlow pointed out that the Board has held since the beginning of the project that there is a difference and the two terms are defined in the text and in the glossary as being different. She would say there could be uncertainty in both. One may decide one can measure something, but when it comes to selecting an attribute and measurement method and looking at the result of measuring the item, including a probability assessment, one may decide that the amount is too uncertain to be recognized.

Mr. Allen suggested reducing the issue to a question, starting with himself because he had raised questions, particularly with the last sentence of paragraph 59. He did think the discussion led him to believe that the document would not do any harm. From that standpoint, he asked Mr. Jackson whether leaving paragraph 57 the way it is, making the distinction between measurement and measurability, would lead him to believe that the document is causing harm. Mr. Jackson said no. He thought that Ms. Wardlow and Ms. Comes had made a point that this is breaking the decision-making process into three distinct elements within a continuum. He does not view it that way, but he thinks the Board should state in Appendix B, Basis for Conclusions, that the Board has broken the decision-making process into three pieces. Mr. Allen said Ms. Wardlow has included that discussion in the Basis for Conclusions and she says that this document is only addressing the first piece and the Board will address the rest later. Ms. Wardlow referred the Board to paragraph 12 at the bottom of page 3 of the Basis for Conclusions and paragraph 13 on page 4. Mr. Jackson said he could “live with” that. He was not sure that assessing the probability of future cash flows should be limited to the results of measurement, but he is not proposing that the Board should change it at this time. He thinks the Board should move forward.

Ms. Wardlow suggested that paragraph 57 could refer to “uncertainty about whether they [items] meet the definition of an element, their measurability, and their measurement” and remove the reference to the probability of future flows and the rest of the paragraph. Mr. Jackson wondered whether other members are interested in ensuring that the probability notion is included. Ms. Wardlow said she thought that some members think that way, because what the Board has been saying in the project and discussed again in January is that the actual assessment of probability will occur at the measurement stage and not at the definition stage or in assessing measurability. Mr. Allen commented that the key thing Ms. Wardlow had added in the Basis for Conclusions is the acknowledgment that normally the three pieces are performed at the same time. But, when one has a concepts statement and does not have the part that tells one how to measure something, one has to make artificial distinctions between the parts. Once the Board addresses measurement, then it will indicate how probability should be measured. Mr. Jackson said he was fine with that, although he hoped there would be an additional opportunity for discussion after he had had time to digest today's discussion. Mr. Allen said that, from the standpoint of what he or Ms. Wardlow had said about what the Board was trying to do, to acknowledge uncertainty in each of the areas while maintaining a distinction among them, if any members believe that the document does not do it or does it incorrectly, then Ms. Wardlow needs to know that.

After a short break, Mr. Steinhoff referred the Board to paragraph 28 of the document and the sentence that reads "Nevertheless, as long as the government has the ability to exercise control of the economic benefits or services and to deny or regulate the access of other entities, the item is an asset of the government." He thinks that statement is very broad and the government has the ability to exercise any control. For example, conceptually it could nationalize the oil industry if a matter of national security arose. He thinks it would be better to say that the government "controls" access to the economic benefits or services. Mr. Jackson asked whether that would not be a problem for the other places in which reference is made to the ability to control.

Ms. Wardlow said the proposal is to change "can control" to "is able to control" in the definition of an asset and there is a discussion of it in the Basis for Conclusions. She said the issue is that when one says "controls," many people believe that the government has to be actively controlling the item at the balance sheet date in order for it to be an asset. There are occasions when that is not true. A government can have an asset but allow others to use the asset. The government has the ability to control the asset but is not actively controlling it. The Board has received comments on both sides of the issue—"controls" versus "can control" or "is able to control." Mr. Steinhoff said he understands what the staff is trying to correct, but he thinks that with the change there would be problems the other way. By saying "is able to control," some may believe that the government must record everything because the government can (has the ability to) exercise control. He suggested saying "the government controls access," because if the government gives active control to another entity, it is still controlling access. Ms. Wardlow responded that that view is one of two that have been expressed. The other view is that if one says "controls," the government has to be actively controlling access. Then, the government can say it is not actively controlling this item so the government does not have an asset.

Mr. Werfel said he likes the phrase "presently controls" in the GASB definition of an asset. Mr. Reid suggested "has the ability to control under current statutes or current circumstances." That would at least cut off the ability next year to change one's mind as to what will be controlled. Mr. Steinhoff said he would defer to Counsel, Mr. Jacobson, but in time of war the president has powers to take over industries and do all kinds of things. Mr. Allen asked what harm would be done by adopting Mr. Werfel's suggestion of "presently controls." Ms. Wardlow said that she would interpret that to mean the government has to be actively in control at the balance sheet date. She also thinks the phrase is redundant because the definition is in the present tense, so "controls" means the same thing as "presently controls," and the definition is addressing what is an asset at the reporting date. She does not think that people will interpret "controls" as future control, because the definition is talking about now. Mr. Jacobson suggested "present ability to control" to avoid a conclusion that "ability" incorporates the future. Mr. Reid said that Mr. Steinhoff is referring to the constitutional issue of what the government could do if it wanted to. Mr. Steinhoff repeated that "is able to" is too broad because the government is able to do many things. Ms. Wardlow said there clearly are potential problems with both "controls" and "is able to control." The discussion of the asset definition in both the FASAB and the GASB documents refers to the ability to control access. If the definition says "controls" and the government is not actively controlling access, does that mean that the government does not have an asset? Mr. Steinhoff asked for an example of when a government is not actively controlling its asset but has given control to someone else. Ms. Wardlow said that sometimes the federal government allows a state government to use certain equipment that belongs to the federal government. The federal government is not actively controlling the equipment, but it is still an asset of the federal government. Mr. Steinhoff responded that the federal government is controlling access by telling the state government that it can use the equipment. The federal government is controlling access to the economic benefits or services. Ms. Wardlow said if that is not clear she would add "access" to the asset definition, but it is referred to in the discussion of the essential characteristics of an asset.

Mr. Jackson asked how one would deal with a situation where the state government acquires assets with federal funds and the federal government has a reversionary interest in those assets. The state government receives the benefit of the assets and recognizes them on its financial statements. If the definition says the federal government "is able to" control access to the item, it would enable to government potentially to recognize the state highway system.

Mr. Schumacher asked Ms. Wardlow if there was an objection to the word "can" in the ED. She responded that some respondents to the ED objected because they thought it implied ability to control in the future, but not currently. Mr. Steinhoff said he thinks "can" and "is able to" mean the same thing. Mr. Werfel said he does not think that the GASB's phrase "presently controls" is redundant. He thinks the word "presently" is beneficial, because it would preclude someone reading "controls" on its own to include potential control. "Presently controls" removes that expansiveness. He would prefer "presently controls" but would accept "controls." He would not accept "is able to control." Mr. Steinhoff said that "controls access" includes allowing someone else to use the asset.

Mr. Allen suggested removing the proposed additions to paragraph 28 and leaving the text as it was in the ED, given that only two or three respondents objected. Ms.

Wardlow agreed that if “is able to” in the definition is changed back to “can” or changed to “controls,” then the additional proposed language in paragraph 28 would not be needed. Mr. Patton said that, emphasizing Mr. Steinhoff’s point about saying what “control” is, it might be useful to say in paragraph 28 that control may take the form of being able to deny access, rather than having current possession. Mr. Allen said he thought the concern being raised was saying that “Nevertheless, as long as the government has the ability”—the government is not doing it now, but as long as they have the ability to control, Mr. Steinhoff was saying that statement opens it up. Mr. Steinhoff said that in his view the government is controlling access when it gives someone else control over the asset. Mr. Jacobson said there is a middle ground. If one changes the definition to, say, “presently controls” instead of “is able to control,” then, in paragraph 28, instead of saying “it is possible the government does not currently exercise control,” if one is trying to present a contrast, one could say “the government does not actively exercise control.” That is, in order to meet the definition, one does not have to look to see whether the government is in possession of the item and managing it. Something other than active control would meet the definition. Mr. Allen asked whether Mr. Jacobson did not see a conflict between paragraph 17 (proposed definition) and the second sentence that was added in paragraph 28. Mr. Schumacher thought it was a conflict. Mr. Patton said one does not have to have possible control, and one does not want “nevertheless,” but one does want the concept that “control” can mean something other than physical possession. It could mean control of access. Mr. Schumacher said that Mr. Patton would remove the “nevertheless” sentence. Mr. Allen confirmed that he would not remove everything, just the “nevertheless” sentence. Mr. Patton said that the notion that the item need not be in the possession of the government in order for it to be an asset ought to be conveyed somewhere. Mr. Allen agreed that notion definitely needs to be included. Ms. Wardlow said that notion is already in the document; paragraph 30 states that “Possession or ownership of a resource normally entails control of access to the economic benefits or services embodied in it, but that is not always the case.” Mr. Patton agreed with that.

Mr. Allen asked whether Mr. Steinhoff’s proposal was to change the wording of the “nevertheless” sentence in paragraph 28 to “presently controls.” Mr. Steinhoff said that his proposal is that the government controls access to economic benefits or services. Mr. Werfel is saying “presently controls access to economic benefits or services.” One could just say “controls.” Mr. Werfel said that, before changing the explanatory language, there should be agreement on the asset definition in paragraph 17. His proposal is to delete the proposed phrase “is able to control” and replace that with “presently controls.” Responding to Mr. Allen’s question, Mr. Werfel said he would not object to simply “controls,” although he thinks “presently controls” is preferable.

Mr. Jackson said that what is good about “presently” is that it creates the construct of “under current law.” The phrase “is able to” draws in the notion of the government’s ability to change the law. The word “presently” is really under the current construct. Mr. Steinhoff said it denotes what the government is currently doing, but there are current laws that allow the government to do certain things in the future. Mr. Jackson responded that the government has not yet done those things. The government presently exercises control because it has chosen to exercise its authority, but the government does not presently control what it has not exercised its authority to do. Mr. Schumacher also likes “presently” because it balances the reference to “present obligation” in the liability definition. Mr. Allen said that if the Board uses the phrase “presently controls” the Board needs to define it. If the Board uses simply the word “controls,” the Board is not obligated to define another term. Mr. Jackson said that paragraph 30 is helpful and clarifies a lot.

Mr. Allen asked whether the Board is satisfied with the word “controls” or whether members wish to say “presently controls.” He added that if the word “presently” is included the Board should define it. Personally, he would delete “is able to” and replace it with “controls.” Mr. Jackson said that as Ms. Wardlow said earlier, the word “controls” would mean “presently controls.” Mr. Allen agreed but said the word “presently” is not used so it does not need to be defined. Mr. Allen asked for a quick vote: members who wish to include the word “presently,” members who wish to say “is able to” in the definition, and members who prefer simply “controls.” The majority of members preferred simply “controls.” With regard to paragraph 28, Mr. Allen said that the words added for consistency with “is able to” in the definition probably should be deleted. Ms. Wardlow said she would read paragraph 28 in conjunction with the change to the definition. She thought that the two sentences she had added to the ED language would not need to be included. Mr. Farrell asked about the inclusion of the word “ability” in the second line of paragraph 28. Ms. Wardlow responded that the word was in the ED in that place and elsewhere and the GASB also talks about “ability” in reference to control, even though the word “ability” is not in their definition.

Mr. Allen asked Mr. Steinhoff to present his next issue. Mr. Steinhoff referred to the staff ‘s questions on page 15 of the Board memo:

Does the Board agree that the definitions of Revenues and Expenses in the ED should be modified? If so, which of the four alternatives [that the staff presents in the memo] does the Board prefer? Or does the Board prefer a different alternative?

The staff proposed removing the reference to “borrowings” in the definitions of revenues and expenses, among other wording changes. Ms. Wardlow said the memo asked first whether the Board even wanted to change the definitions, given that very few respondents suggested changes. Then the memo reproduced the definitions of other standard setters and then it presented four possible alternatives for revising the FASAB’s definitions and asked whether the Board would prefer one of those alternatives or another alternative, including staying with the ED definitions. Mr. Steinhoff said that the GAO agrees with removing the examples from the definitions and thinks that it might be worthwhile to include the concept of inflows and outflows of resources.

Mr. Allen said that before discussing wording, the Board should vote on whether it wishes to consider modifications to the ED definitions. After that, the Board could consider Mr. Steinhoff’s suggestion. The first issue is whether members are comfortable with the ED wording, bearing in mind that the staff recommends changing the wording. Mr. Allen said he would stay with the ED definitions, even though they are redundant because net position embodies all of the things mentioned in the ED definitions and the staff's definitions are shorter. Ms. Wardlow said that the proposal to refer to net position was a way to remove the references to borrowings. The issue of removing or retaining examples was because of comments that did not favor the phrase "any other activities," which makes the definitions include everything. Definitions normally should be exclusive as well as inclusive, but the ED definitions seem to be all inclusive. Mr. Steinhoff referred to Mr. Synowiec for confirmation and said he thinks the GAO's concern is that capital contributions might be seen as revenue and capital distributions might be seen as expenses. The language the GAO is proposing would talk about inflows and outflows. Ms. Comes asked for an example of capital contributions. Mr. Synowiec said that revenues are an inflow of resources that result in an increase in the government's net position during the reporting period other than increases relating to contributions from owners or capital contributions from the federal government. Expenses would be the same (outflow of resources) but would refer to decreases in net position, other than decreases relating to distributions of capital to owners. Mr. Allen asked whether his assumption that "capital" does not refer to buildings is correct, because if someone donates a capital asset he would say it is a revenue. Mr. Synowiec said he was referring to appropriations.

Ms. Wardlow said that some of the definitions of other standard setters refer to capital contributions from owners and distributions to owners, but she does not believe that is relevant to the federal government. What would be contributions from owners? Ms. Comes said it is important to remember the context of the definitions. Elements are defined at the federal government level. Contributions from owners may have relevance to subcomponents in the sense of inflows from one of the government corporations.

Mr. Allen said he would call on Mr. Werfel to present his view and then he would ask members to present their views on the tentative direction they would like to take with this issue. Mr. Steinhoff had presented his view, so Mr. Allen would like to go quickly round the table. With respect to the classification of appropriations as revenue, Mr. Allen said that appropriations are revenues to a department when the department is preparing its financial statements. The Board is not saying that appropriations are revenues at the government-wide level, but they are revenues in the financial statements of a department. Mr. Jackson said that the consumption of an appropriation is a revenue, the way the literature states it.

In response to Mr. Allen's invitation, Mr. Werfel said he had the same question as for the liability discussion. He would feel more informed if he had a good understanding of what is broken with the current definition of revenue in FASAB Statement No. 7 and the current definition of liability in FASAB Statement No. 5. The only explanation he has read is that the Board is doing this because "questions have been raised" about the sufficiency of some of the Board's definitions. His preference would be to stay with the definition of revenue in FASAB Statement No. 7 until the Board has agreed where the gap is in that definition.

Mr. Patton offered two criticisms of the Statement 7 definition. First, it talks about resources and the Board has moved on to assets and has a specific definition of assets. Secondly, the current definition talks more about recognition than definition, because it states that the government “demands, earns, and receives by donations” and treats them as triggers for recognition. The definition the Board is now working on talks about assets and does not go on to talk about the recognition process.

Mr. Werfel said Mr. Patton’s comments were a good start, but he would like to flesh out a bit more and discuss the issue, although he was not suggesting a discussion at this meeting. He would feel better if the Elements document explained that the current definition of revenue has limits to it and here is why and here is how the Board’s new definition addresses those limits. Without that, he would not feel comfortable with the change in definitions. In addition, he would like the Board to be sensitive to other standard setters in this regard. He does not know who needs to be first or second, but he has a matrix showing “Assets,” “Liabilities,” and “Revenue;” FASAB, GASB, IPSASB, FASB. These standard setters are all over the map. It seems nonsensical that these standard setters are in the same process of developing definitions, but there is no concerted effort to make them consistent. Are things really that different between GASB and FASAB? Is there really a need to have different definitions? He thinks there is a missed opportunity and there should be some “globalization” of the definitions. That is part of the reason he advocates including “presently” in the asset definition. Even though one can argue that it is redundant, at least FASAB and GASB would have close to the same definitions.

Mr. Patton pointed out that the GASB started at a totally different point. The FASAB started with the fundamental building blocks of assets and liabilities and the GASB did not. He asked if Mr. Werfel was saying the FASAB should go back and restructure its approach. Mr. Werfel said no. He was just pointing out the direction that the effort is yielding when one looks at where the other standard setters are going. The result will be that each standard setter will be setting standards with a separate and unique definition of certain things that one would think are fundamental throughout the world: an asset, a liability, and revenue. Maybe internationally an asset is different from here in the United States, but he thinks there is an opportunity that the FASAB is missing. His preference would be to stay with the current definition of revenue (Statement No. 7) until the Board has a broader discussion of what the deficiencies are.

Mr. Schumacher said he has no problem with the original ED definitions, but he understands the issue with the references to borrowing. He accepts the staff recommendation.

Mr. Patton said he prefers Alternative #3. He likes deleting the examples, particularly the references to borrowing, but he thinks Alternative #1 is too terse in that it deemphasizes the link between the fundamental elements the Board has developed—

assets and liabilities—and the derived elements—revenues and expenses. Alternative #3 includes the flows of the fundamental elements as well as deleting the examples.

Mr. Jackson said for now he prefers Alternative #2, but listening to the discussion he may be leaning toward Alternative #3.

Mr. Farrell said he is fine with the ED definitions, but if the Board decides to change them, he would adopt Alternative #1. However, he is not sure about Alternative #1's reference to revenues and expenses increasing or decreasing the government's net position. Net position is an arithmetic calculation, so revenue is a change in an item, not an increase in net position because net position is defined as a sum or a difference. He said there is no account for net position. So, revenue is an increase in something that results in an increase in net position. Mr. Patton said that sounds like Alternative #3, which says a revenue is an increase in assets that results in an increase in net position. Mr. Farrell agreed and said if there is to be a change he would go with either Alternative #1 or Alternative #3.

Ms. Cohen said she had no problem with the ED definitions, but she would agree with Mr. Patton and Mr. Farrell and go with Alternative #3.

Mr. Marron said that if the Board stays with the ED definitions, he thinks the expense definition should be adjusted to deal with the borrowing issue, if the government is in a situation of repaying debt. Also, as Mr. Steinhoff said, there would need to be an adjustment for capital contributions, to the extent that the government is raising capital through means other than borrowing. He also wonders whether some flexibility is needed to address the issue of negative revenue, such as a tax refund. If one focuses too much on the net flow to the government, one may be missing some of the salient characteristics of the transaction. There is also the issue of negative expenses. For example, if one has accrued an environmental liability at the end of the year and something changes and the entry is reversed the next reporting period, it would be a reduction of an expense. Mr. Allen said that is the beauty of Ms. Wardlow's Alternative #1. It only talks about net position so there is no argument about whether something is a negative revenue. Mr. Marron responded that would make the environmental remediation a revenue, whereas one would want that to be an expense. Mr. Patton said there are contra-revenues and contra-expenses that one could invoke to solve that from a bookkeeping point of view. Mr. Schumacher wondered whether the definition being shorter would exclude some of these things. Does it take care of them by just saying a revenue or expense is an increase or decrease in net position? Mr. Marron said that none of the alternatives addresses that issue.

Mr. Werfel asked whether the choice of definition would trigger whether certain things are potentially significant classes of activities, like being a revenue or not, an expense or not, based on whether one goes with Alternative #2 or #3, for example. Is the Board talking about just trying to be clearer and have less ambiguity in the definitions when debating between Alternatives #1, #2, or #3, or does the choice of #1, #2, or #3 mean that transactions are classified differently? Mr. Reid said he thinks it is the latter, especially when talking about something like a tax refund. Under this definition, it probably would be classified as an expense, when in fact a better presentation probably would be to report it as a reduction of revenue. The same thing applies to the breakdown of the liability. One would want to record that as a reduction of an expense and it would be a fairer presentation to report it that way. But this definition might force one to do something other than that. Mr. Werfel said he did not know whether that was significant enough to be a concern, but he does have a concern about making changes once due process is done without going back out for comment when something has fundamental, substantive changes from the original proposal. Significance is a judgment call, but he thinks it is important to be clear whether the changes and decisions the Board is making when moving from the ED to the final Statement are for clarity purposes or whether they are going to change behavior and reporting in a significant way

Mr. Patton said that, in the spirit of being consistent with what others have done, he does not believe that FASB defined “contra-revenue” as one of their elements. They defined revenues and expenses and they dealt with the converses separately. In his view, the FASAB does not need to deal with them. Mr. Marron said that the beauty of the FASB’s definition is that it does not just reference net flows; it links them to some activity, such as from delivering or producing goods. That makes him hesitant about accepting Alternative #1, which does not draw a distinction between the taxing authority and other activities. Ms. Comes pointed out that an underlying reason for the difference is that the FASB defined gains and losses as separate elements. So, if one just had revenues and expenses, things that would be gains in FASB’s model would not be distinguished. The FASAB has chosen not to break out gains and losses from revenues and expenses, so it is not as important to mention the sources.

Mr. Reid said he would not choose Alternative #1 because he agrees with Mr. Patton that it is too terse. He also is a little concerned about Mr. Werfel’s concerns. He thinks the ED definitions are all right, although maybe some modifications, certainly in the capital area, might be helpful. He would not use any of the alternatives, although he probably would prefer Alternative #3. He would stay with the ED definitions, although some explanation might be appropriate either in the definitions or in the Basis for Conclusions about some of the other areas the Board has discussed, such as contra items, where one would apply judgment, or one would need to remove capital from the definition, where one is increasing or decreasing net position in a way, but one is not generating revenue or expense.

Mr. Jackson said he wanted to change his choice from Alternative #2 to Alternative #3. In the discussion, income tax refunds were mentioned, which are huge. One can put the refunds in Alternative #3 as a net amount, but they do not fit in Alternative #2. Revenue should be net of the tax refunds. Mr. Allen asked Mr. Jackson how he would address Mr. Steinhoff’s position with respect to capital contributions. Mr. Jackson said they would be an increase in assets. Mr. Farrell said there is no account in the federal government for capital contributions in. There is no stockholders’ equity. They have to go through the statement of changes in financial position in some fashion.

Mr. Allen said Mr. Steinhoff used the word "capital" but Mr. Allen thinks he does not mean capital assets. Mr. Synowiec responded that it is not like owners' equity in a commercial enterprise. He said they do not have an example at the moment but could work on providing one. Mr. Allen wondered what it would mean if Mr. Steinhoff said he was using Alternative #3. Mr. Steinhoff responded that they support Alternative #3 and in defining revenues and expense they want to use the terms "inflow" and "outflow." In response to Mr. Patton's question, he said that would be instead of "increase" and "decrease." Then they would want a qualification for capital contributions. They could be more specific later. Mr. Allen asked whether a capital contribution is a capital asset that someone gives to the federal government. Mr. Steinhoff said it could be. Mr. Allen said in that case, as Mr. Farrell mentioned, there is no statement where people go directly to changes in equity; the government has an all-inclusive operating statement. Mr. Farrell asked what the credit would be if someone gave a capital asset. Mr. Steinhoff said it would not be considered revenue. Ms. Comes said that donations are currently considered revenue and Mr. Synowiec's example or issue is probably better expressed at the subcomponent level, as capital contributions between component entities. Mr. Steinhoff agreed and said it could be a capital contribution from the federal government to a component. Mr. Allen asked whether he was referring to internal transfers of assets and Mr. Steinhoff agreed. It is an inflow or outflow within the government versus a contribution between governments. Mr. Allen said that is a challenge for the Board's entity project. When one has defined an entity, in this case the federal government, one can talk about assets and liabilities, but for component entities the assets are those that the federal government moves to them or assigns to them. It is hard to look at a component entity and say one can define its revenues and expenses, assets and liabilities. This project almost has to focus on the one entity that the Board has defined, which is the federal government as a whole. Mr. Steinhoff said he is talking about contributions from owners within the entity or contributions from the federal government. It would not be a citizen contributing; it would be within the entity. Mr. Farrell said it was more like an "other financing source." Mr. Steinhoff agreed and said if one refers to "increases" in assets, the assets increased but they were provided by one component to another or by the federal government to the component, so they would talk about "inflows" and "outflows." Mr. Jackson said that would be an implicit revenue.

Mr. Allen asked Ms. Wardlow to comment. She said the Board has discussed the issue several times. In this Concepts Statement the Board is defining elements in terms of the federal government as a whole and not in terms of component entities. That is, if an item is an asset of the federal government as a whole and it is being managed or operated by a component unit, then it is automatically an asset of that component unit for reporting purposes. Mr. Allen added that the Board has not said that as an asset is moved from one component entity to another that the component entity has to call it an asset. The component entity could call it a transfer or something else. Ms. Wardlow said the Board has made the point several times that it is trying to develop the Elements Statement without reference to a particular financial reporting model. Also, the fact that an item qualifies conceptually as a revenue, for example a gain, does not mean that for display purposes, which is a standards issue, a component could not separate it, call it something else, and display it where it wants. The Board discussed this issue for gains and losses, appropriations, and transfers and came to that conclusion. What Mr. Steinhoff is proposing would alter that conclusion. She added that the Board is trying not to engrave the current model in stone in this Concepts Statement. The concepts should be suitable for a variety of different reporting models because otherwise, if the Board in the future wishes to do something different with the reporting model, the Board would be faced with a Concepts Statement that would not accommodate that.

Mr. Allen said to Mr. Steinhoff that what Ms. Wardlow is saying would not do harm to the transactions that he is concerned about between different components. The Concepts Statement can call it a revenue or expense, which are defined for the government as a whole. Somewhere the asset has to be accounted for, if the component entity decides to call it an asset. Mr. Steinhoff responded that the key issue is does the government have to be the central focus here; is it an increase or decrease in net position. Ms. Wardlow agreed that was the substance of the four alternatives for defining revenues and expenses.

Mr. Allen said he thought he had five votes for Alternative #3. Mr. Schumacher said he would accept Alternative #3 also. Mr. Steinhoff said he voted for Alternative #3. Mr. Allen said he would prefer not to change the ED definitions, but he could probably support Alternative #3. He added that Mr. Werfel's question is legitimate: If the Board adopts Alternative #3 has it changed something significant from the ED? Mr. Werfel said that more important than the change between the ED definitions and Alternative #3 is the question of how Alternative #3 differs from what is currently in FASAB Statement No. 7. He said he understood a little of Mr. Steinhoff's point about focusing on assets being a better way to go. Mr. Werfel said the Board is about to issue an Elements document that will be lower on the GAAP hierarchy than existing standards. Potential incongruities between the Elements document and FASAB standards will invite confusion. Before issuing the document, he thinks the Board should know what incongruities exist. For example, the current definition of revenue and Alternative #3: Does the world change or does the Board just like the language better in Alternative #3? Can the Board anticipate that federal financial reporting will change with issuance of the Elements document because it is different from FASAB Statement 7? Without answering that question, he is not sure how to finalize the Board's vote on the definitions of revenue and expense. He feels the same way about the liability definition.

Mr. Allen said he thought there was a brief discussion at the January meeting. Maybe the Board has had a lot of discussion about it because the issue of what is the purpose of a concepts statement has been there since before Mr. Allen joined the Board. As Mr. Werfel pointed out, a concepts statement is very low on the hierarchy and that is on purpose, because it is not intended to change any existing standard. It is only intended to guide the Board as it considers those issues in the future. There would be a real problem—and maybe this is part of the problem the Board has—if somebody would read this concepts statement and say they were now going to ignore an existing standard. They would be in violation of GAAP. Mr. Werfel said he thinks the Board is operating in an ambiguous environment. During the discussion he asked whether classes of transactions would be treated differently if the Board went in this direction versus that direction and the answer was “yes.” The answer should be “no” if a concepts statement is not expected in any way to change the behavior of the preparer and auditor community, if the only purpose of a concepts statement is to guide the Board. Mr. Allen said that if the answer is “yes,” one is considering it in a theoretical future world and one may arrive at a different definition. But the answer is not “yes it will affect current behavior.” Mr. Steinhoff said he thinks people will read whatever is promulgated, no matter at what level, and they will take it in the context of other promulgations and use them together. He believes that in reality people will see this Concepts Statement as the most current thinking and they will apply this Statement in concert with standards. Mr. Allen said that he can only cite his experience. Six or seven years ago the FASB issued its Concepts Statement No. 7 on expected cash flows and everybody said that would be the end of FASB Statement No. 5, but that is not on their agenda or even on their radar screen. FASB Statement No. 5 may continue forever, even though it is in direct conflict with expected cash flows, which the FASB believes is a superior measure.

Mr. Werfel said that his office and OMB are struggling with the Elements Statement, specifically with the liability piece.   He had said to Mr. Allen before the meeting that it would be helpful for him to know exactly how the world is supposed to change with the new liability definition. What behavior is the Board trying to drive? As agencies approach the consideration of preparing their financial statements and they are thinking about liability recognition and liability measurement, is the Board asking them as a result of the Elements document to do things differently from the way they do things today and, if so, how? If the Board can clarify that, he thinks he will be better able to assess what the impact of the document is supposed to be. Mr. Allen had responded to him that the document is not supposed to change behavior. The way preparers and auditors approach the recognition of liabilities today should be essentially identical after this document is issued. Mr. Reid said it is required to be identical; it is not just supposed to be identical. Mr. Werfel asked then why is the Board issuing this document?

Mr. Allen responded that the document provides guidance for the Board for future consideration, but if preparers and auditors encounter something where there is no existing standard, then this document provides guidance that they would consider. However, he did not know of many major issues that were not already covered in standards. Mr. Werfel said that definitions of a liability and a revenue already exist and that is what preparers and auditors are compelled to follow. Mr. Reid said there is no definition of assets. So, this document might have an impact from that. Where the document is filling a vacuum, it has some stature because it is on the hierarchy, but it will not change an existing standard. Mr. Steinhoff said it will not change a standard, but if it is filling a vacuum or there is some ambiguity where people can interpret a standard a variety of ways, they will use this document to help them interpret the standard. It is part of the hierarchy. Mr. Werfel questioned whether it would help if there is an incongruity between the definition and the standard. Mr. Steinhoff said he was not commenting on the value of it, he was just saying that when people are doing something they will read all the available guidance, and to the extent that they believe this document is filling in some holes or they think it provides a better explanation of something, or if they like it better in some cases, they might be affected by it.

Mr. Werfel said that his point is that from a standard-setting standpoint he thinks the Board is creating a risk of non-homogeneous application of FASAB standards. Because, if there is a definition and then there is a second definition that has differences, and people are supposed to rely on that second definition to make sense out of the first definition . . . Mr. Steinhoff said they are not supposed to rely on it; they are supposed to rely on the first definition. They will be aware of the second definition like they are aware of questions and answers or any guidance that FASAB issues. Ms. Comes pointed out that the structure of FASAB Statement No. 5 is a very broad umbrella. Statement 5, which has the liability and the exchange-nonexchange classification is very different from a standard for environmental clean-up costs or a standard for public employee pensions. It creates a standard that is an umbrella. If there is a liability out there that people cannot fit into exchange or nonexchange and follow the diagram in Statement 5, she has not heard of one. Mr. Werfel suggested that there should be a single definition of a liability that guides preparers, auditors, and the Board, and to the extent the Board needs to flesh it out and add greater clarity in terms of its application, a lot of material in the Elements Statement could help the Board do that, but there is no need for a second definition, which he thinks invites ambiguity.

Mr. Farrell asked where definitions one and two are. Mr. Werfel said definition one is in Statement 5 and the definition in the Elements Statement will be definition two. Mr. Jackson said there also is a definition of a liability in Statement 1; Statement 2 also defines a liability in the context of credit reform, etc., etc. So the basic concept arguably should be somewhere else. Mr. Werfel said he is just trying to understand the role of a concepts statement. Mr. Jackson said Mr. Werfel is making a good point for the revenue definition and asked whether it would make sense to change the definition of revenue in Statement 7 so that there would not be a conflict, assuming the definition the Board adopts in the Elements Statement is better. Mr. Allen said at some future date the Board may reconsider every existing standard. This is only a concepts statement on Elements. The Board does not have a concepts statement on Elements where the Board has gone through due process and received feedback that is supposed to help the Board be consistent, because right now the Board is not consistent. In fact, the Board had some initial standards and almost every standard since then has been revisions to those initial standards. Those initial standards were issued very quickly at a 30,000 foot level. Mr. Jackson said the Board needs an omnibus standard.

Mr. Allen said that, given the time constraint, rather than asking Mr. Werfel to make a formal proposal now, he would ask Mr. Werfel to draft his proposal in memo form for the Board's consideration, and the Board will take a formal vote on it at the next meeting. There also will be a formal vote on the other issues in the staff's memo. On the revenue and expense question, there is a Board majority that favors Alternative #3. That does not preclude members considering Mr. Werfel's proposal. There are other questions in the staff's memo that the Board does not have time to answer now, but Mr. Allen does not want to lose the opportunity to provide answers for the revised draft. He asked members to send an email to Ms. Wardlow with their tentative responses to the questions that are framed in her Board memo for this meeting. That will help Ms. Wardlow to prepare for the next meeting. Ms. Wardlow said she would like to point out that the proposed changes to the revenue and expense definitions are not intended in any way to change the substance of the definitions that were in the ED; they are proposed as wording changes for simplification and clarity and to remove the references to borrowing. If any members believe the proposed changes do change the substance, she would appreciate it if they would let her know how the substance has changed. Mr. Jackson said that, if it has not already been done, some of the discussion should be included in the Basis for Conclusions so that the reader would fully understand that the language in the final document is not intended in any way to disturb the existing language in standards.

Mr. Marron said he would like to vote for Alternative #4 for the revenue and expense definitions. Alternative #3 would make the reduction of an environmental liability look like a revenue, and the Board may need another approach to address that. Mr. Allen said the Board probably needs to consider how to address contra accounts. If this document were setting a standard, the Board should definitely consider that issue, but he is unsure about the need for it in this concepts statement. The Board continued to discuss whether and how reductions and revenues and expenses might be addressed as well as the principal role of the concepts statement as guidance for the current and future Boards.

Mr. Patton said he had a due process question. Mr. Allen had asked members to send their votes on the questions raised in Ms. Wardlow's memo to Ms. Wardlow, but Mr. Patton suspected he would not be able to do so, for the revenue and expense questions, for example, until he had seen Mr. Werfel's arguments. Mr. Allen said that Ms. Wardlow has framed some initial questions in her memo, but most of them have not been discussed at this meeting. He is not asking for a ballot on a ballot draft. Ms. Comes said that the vote on the revenue and expense questions had been taken, and they were looking more for input on questions that had not yet been discussed. Mr. Allen said that, rather than have Ms. Wardlow start the next meeting where the discussion had ended at this one, he hoped she would be able to say that there was no disagreement on some of the minor wording changes she has proposed to accommodate respondents. Mr. Steinhoff suggested "yes" or "no" responses and Mr. Allen agreed. Mr. Allen said he did not intend to cut off deliberation. He sees Mr. Werfel's issue as the most fundamental question, but it is an issue of direction which he believes is separate from the questions in Ms. Wardlow's memo. Mr. Steinhoff said that comments also should be received on the issue of whether the document should include budgetary elements in its scope. Mr. Allen said that such a question from a Board member probably should go to Ms. Wardlow for her response in the next Board package. Mr. Werfel said it is a fundamental question that will fit into his proposal. He will prepare a series of three or four questions where members can respond whether they agree or disagree. For example, a question would be should there be a definition in this document or should the Board just work to explain the definition that is in a standard. Mr. Allen said that is a valid point, but he still would ask him to answer the questions in Ms. Wardlow's memo.

Mr. Jackson said he believes one of the key things the Board needs to consider as it goes forward is whether the existing standards conform to the definitions in the Elements concepts statement. Going back to Mr. Werfel's point and considering liability standards, for example, the Board has Statements 1, 2, 5 and so forth. Do they conflict in any way with what might be in this concepts statement? In other words, the Board would not want to have an existing standard that could be interpreted differently than the broad guidance in the concepts statement. Ms. Comes said that she probably could stack papers and defy an academic to argue that deferred taxes do not conform to the FASB's concepts statements. There are many assets that are not recognized in conformance with the FASB's concepts statements. One could find many examples. People still argue that OPEB is not a liability.

Mr. Allen said that if the world were perfect, the Board would issue a concepts statement before issuing any other statement, and this Board is actually closer with concepts statement than other boards that operated for a longer period of time before they issued concepts statements. If Mr. Jackson wants the Board to do that research, then that ought to be the driver. But a concepts statement is not a standard on purpose. If one steps back and conceptually analyzes what one believes is a proper framework for forward thinking, it likely always will have some conflict with existing standards. Mr. Jackson said he is not saying that the issue is a "killer" for him. But if one reads the accounting standard today and the Board adopts a concepts statement today that actually could turn the accounting standard on its head, there would be an absolute conflict. Revenue as defined in Statement 7 could potentially become non-revenue. It seems to him that the Board needs to be aware of that. That is the reason that it is important for the Basis for Conclusions to say that this is not intended in any way to reverse anything that has been promulgated previously. It might shape future thoughts. But the Board could find itself in the position that its definition in the concepts statement could be absolutely contrary to what is in a standard.

Mr. Allen gave an example of a standard on contingent liabilities (FASB Statement 5) that is commonly used by the FASB, the GASB, and the FASAB and that is absolutely in conflict with a concepts statement that was issued 10 to 20 years after FASB Statement 5 was issued. That does not mean that one is right or wrong. It just says that 15 years later when they looked at Statement 5 the FASB said expected cash flow is a superior measure, conceptually. That concepts statement does not go back and change anything. Mr. Werfel asked which one would people follow. Mr. Allen and other members said that they would follow the standard. And the FASAB follows FASB Statement 5. Mr. Werfel said that is a point of confusion. It is important to tell the story about how this can happen, but he is saying that the Board might want to avoid a situation where people look back and say "remember when the FASAB issued a concepts statement on liability that was very different from the definition of a liability, and the amount of debate and time that was spent talking about those differences."

Mr. Patton said that the alternative is to try to come up with a rationale for what exists now when it does not guide the Board into the future. If all the Board does is to rationalize what has been done, it probably would be a waste of time. Mr. Werfel responded that he is not proposing that. He is proposing the Board can move forward with an existing definition to a future definition by outlining guiding principles and concepts and issues that explain how the Board needs to move away from that current definition. But the Board would not issue another definition. Mr. Patton said he thinks the Board's problem is that it puts some definitions in standards. As for other bodies, the FASB has not put definitions in standards and nor has the GASB, to his knowledge. That is the hole the FASAB has dug. There is something wrong with the placement of those definitions. He agrees that the Board does not want conflicting definitions. He would be in favor of a fast track to remove the definitions from existing standards, let the rest of the standards stay and be applied as they are, and let the concepts definitions exist.

Mr. Allen said that if the Board wants to look at due process again, he is incredibly impressed with the initial group of standards that were issued together, but there was very limited discussion and very limited feedback. It was a very quick process to get at least a core set of standards under extreme pressure to produce them. This Concepts Statement on Elements is intended to be a more deliberative, due-process-oriented, broader discussion of what is theoretically the direction that the Board ought to go. Mr. Steinhoff said he sees Mr. Jackson's comments as being consistent with Mr. Patton's answers. Mr. Jackson is saying that it would be worthwhile to at least have a good idea of where things are different between the concepts statement and current standards, so the Board might elect to go on a fast track or some track to address the differences, if there are in fact differences and the Board knows where they are.

Mr. Allen said that is very legitimate and apologized that he had not looked at the situation as much in terms of the embedded definitions as in terms of the difference between concepts statements and existing standards. He thinks Mr. Patton is right. Mr. Allen did not know what was intended with the initial standards because he was not here for the original work. He wondered whether there was Board discussion as to whether something was a definition or part of the need for a quickly issued standard. Ms. Comes said she thinks it was a bit of both, but she would acknowledge that even within the standards there are inconsistencies where the more detailed standard governs the broad standard. For example, under FASAB standards, not all taxes receivable are accrued. Taxes are accrued on a modified cash basis. So, the Board created a standard that was very broad and put in the exceptions that the Board needed and, to a certain extent, would lead to measured or incremental change, because the standards are there and they are broad, and that insulates against shock. But, she said, staff members enjoy the analysis of the effects of different things and will give the Board an analysis of the differences between the proposed revenue definitions and the Statement 7 revenue definitions and what one could expect to be different over time.

Mr. Jackson said that Ms. Comes makes a good point about the taxes receivable issue, but in a way this is a broad definition of revenue. There are special stipulations where it is almost impossible to value revenue specifically in accordance with any one of the definitions presented, because one does not know what the receivable is at any point in time. So, the government has access but it is not measurable. Mr. Jackson does not have a problem when one looks at a particular Statement like Statement 7 and say "taxes will be recognized this way," generally in accordance with the standard, but there are some stipulations there that one cannot do it. One has not defined revenue in a macro sense.

Mr. Allen called for a break for lunch.

CONCLUSIONS: A majority of the Board voted in favor of Alternative #3 for definitions of revenues and expenses. Board members will email to Ms. Wardlow their responses to the questions in her memo to the Board of February 26, 2007. Ms. Wardlow will incorporate these proposals in her package for the May Board meeting, which will include a revised draft final Concepts Statement on Elements. Mr. Werfel will put his proposal in memo form for discussion by the Board and a Board vote at the May meeting.

- **Cost-Benefit and Smarter Accountability Discussion**

OMB has requested an explicit consideration of costs and benefits for each proposed issuance. (See attached letter.)

Mr. Allen suggested that an initial step might be to include an assertion in each document that (1) the Board has weighed expected benefits and perceived costs and (2) that it is impossible to assign a specific dollar amount to benefits and costs. Each exposure draft would include a general request that respondents raise any cost benefit concerns they have in addition to responding to the specific questions.

Members made the following observations regarding cost-benefit analysis:

- Cost-benefit analysis requiring specific estimates of the dollar costs and benefits and/or a specific threshold is unlikely to produce sound results because:
  - o Benefits are widespread (taxpayers, preparers and decision makers benefit and some of the beneficiaries may or may not be financial report users) but difficult to quantify. (Steinhoff, Reid, Allen, Jackson)[1]
  - o Benefits are not simply the benefits of annual financial reports – the quality of systems including controls and the resulting internal data improves. (Reid, Jackson)

[1]To streamline the minutes, members offering some input on a particular observation are listed. Each member expressed their views differently but the general observation is presented in summary fashion. Inclusion of the member's name is not an indication that he or she endorsed the observation as summarized.

    - Benefits include credibility which is very difficult to value but might result in lower interest rates or enhanced taxing ability. (Allen)
    - Cost estimates offered by preparers are likely to be inflated and may change over time since costs to implement are high but costs to maintain generally are lower. (Reid, Farrell)
    - In some cases, the cost may result from how the preparer elects to apply or implement a standard. (Jackson, Steinhoff)
- Cost-benefit analysis and outcomes through standard setting can be facilitated by:
    - Considering the relative burden of different methodologies. (Werfel)
    - Assessing benefits by considering the risk of mismanagement, fraud or waste that may be mitigated as a result of the standard. (Werfel, Steinhoff)
    - Assessing what is clearly the "right thing to do" and/or a routine practice that is widely accepted as beneficial (Steinhoff, Jackson, Werfel)
    - Considering whether the information needed is readily available (Allen, Farrell, Schumacher)
    - Ensuring that standards support macro approaches to data as well as micro so that the objectives can be obtained without excess precision (Jackson)
    - Classifying proposals with respect to the expected impact on systems and practices and for standards with extensive, wide-spread impact consider field testing and/or requesting cost estimates from IPAs for preparing the required information (Allen, Werfel, Steinhoff, Reid)
    - Considering how the implementation or transition could be adjusted to mitigate the cost- for example, alternatives for dealing with "legacy" assets or liabilities, phased implementation, or prospective implementation, or long implementation periods. (Allen, Reid, Jackson)
- Cost-benefit is a routine aspect of our current due process as evidenced by:
    - The extensive study that precedes a proposal including consideration of the availability of the data, how the data contributes to meeting reporting objectives, consultation with agency staff and development of an illustration of the application of the proposal (Farrell, Schumacher, Allen, Steinhoff)
    - Receipt of agency input on cost-benefit issues and past Board responsiveness (particularly to Treasury's request regarding the CFR) (Farrell, Allen)
    - Consideration of the uses of the data and that perhaps not all assets should be subject to the same valuation techniques. For example, Mr. Allen noted that GASB members were not particularly concerned with a dollar value being assigned to infrastructure. However, if a dollar value was not assigned, then debt issued to finance new infrastructure would have the same effect on the government's financial position as debt issued to finance ongoing operations. (Allen, Jackson)

Mr. Werfel noted that standard setting can be improved if informed by cost-benefit considerations that are explicit. He suggested that the Board consider what the risk exposure is and how a proposed change in financial reporting may help prevent mismanagement. He believes that even if the process of cost-benefit consideration doesn't satisfy everyone because there are subjective assumptions made -- the process you go through would enhance standard setting. It would make explicit the discussion of what benefit you are trying to attain. This Board may benefit from enhanced discussion of the cost and benefit of what we are trying to do. We have a lot of work to do in explaining to the community what behaviors we are trying to affect – there could be tremendous value added to our process.

Other members noted that a formal cost-benefit assessment is unlikely to produce defensible results or results that differ greatly from our current process. Some members noted the Board's current process of research, consideration of the availability of data and the magnitude of the impact on agencies, consultation with agencies, and assessment of how each standard would contribute to meeting reporting objectives—and expressed the opinion that this was appropriate. Some members noted that a formal cost-benefit assessment may strain the Board's resources—particularly in light of our budget constraints—without producing reliable evidence.

Smarter Accountability

Mr. Werfel provided a briefing on a new initiative – "Smarter Accountability." He indicated that the community is telling us to "stop." Both the inspectors general and the CFO's have asked that FASAB issue a moratorium on all new standards until a full cost benefit is conducted. This generated the letter from OMB but no request for a moratorium. The concern seen by OMB is that the community of federal CFOs, IGs and IPAs is at a boiling point and that this process is breaking down. OMB was approached by the chair of the PCIE and members of the CFO Community – all indicated that this audit season did not go well and that they cannot sustain this work environment. Concerns are that staff work 22 hours a day, there is a lack of clarity about what the auditors would be looking for, and non-responsiveness from the preparer side to the auditors. There is a strong message that we are on a non-sustainable path with federal financial reporting.

Mr. Werfel commented that if we were putting out these reports and the product was having an impact – that it was supporting decision making or influencing policy – then it would be worthwhile. But this process is not being utilized; global cost-benefit is not there. He noted that federal financial reporting has become a costly compliance effort to support internal controls. To relieve the increasing tension in the community, OMB has a working group to come up with ideas – strategic directions focused on relieving tension. Both David Walker and Linda Combs talk about looking at the financial reporting model for the federal government. They ask - Are the reports being used in a way that makes sense? Are we achieving the objectives of financial reporting? Mr. Werfel believes many have come to the conclusion that we are not meeting the objectives. He explains that's where the OMB concern is coming from and this letter is a way to deal with the debate without a moratorium.

Mr. Reid noted that there has been a substantial improvement in data. When agencies spend money – they don't write the check – Treasury writes the check – differences between what we show as FBWT and what the agency shows – these reconciling items would go back months – sometimes unclassified transactions for five months and hundreds of millions of dollars. This is down to days and smaller numbers. The hundreds of millions are spent for improved data, improved controls, and improved operations. He acknowledged that whether the hundreds of pages of reports are useful is debatable. A lot of the effort on reporting could be better channeled to something other than the report. He challenged the notion that we are not getting anything from the process since the data is demonstrably better.

Mr. Allen noted that we need to be sensitive – much of this stress is very challenging for us—at FASAB—to control. He commended the federal agencies for reporting in 45 days; noting that no other government entities can touch that accomplishment. He believes it makes a huge difference if you get financial reports out in 45 days and not 6 months – the reason you get them out in 45 days is so that more current info is more useful. But, he believes, when we talk about how to relieve the tension Mr. Werfel identified– we have to have sensitivity to the whole system. If the cost pie is $100 – the timing is $50, the audit is $35 and new standards are perhaps $5 of the $100. He states that we have to be aware of the role we have at FASAB and that may mean we delay standards – but his reaction is that these comments are valid but that it isn't a great percentage of the cost pie that FASAB has control over.

Mr. Steinhoff noted that we started this on the notion of individual standards, but what Mr. Werfel raises is a much broader issue – do we need to have a project to reevaluate the model? Do we want a traditional balance sheet? In looking at the CG's discussions – he has been talking about outside the box statements; different types of reports. Within GAO, he notes that they've been talking some about the real relevance of the balance sheet. GAO has never been enamored with having DOD go back and capture the cost of past assets. Maybe the bigger suggestion is both considering cost but also re-looking at the current set of standards – whether the current reports are the right ones. Are we requiring things that don't have much relevance? Maybe we should look at what should be. The Board should not be charged with the problem of whether the agency has the resources for financial management. Left to their own devises, agencies would still have a five month out of balance. OMB and Treasury have pushed hard for good business practices

Mr. Werfel noted that the guiding principle is not to reduce accountability – it is to strengthen it by focusing on the areas that matter most. Three main goals are to facilitate good internal control and process, alert the public about the nature of our finances, and support decision making. For agencies, we need to right size the footprint. We are spending resources on targeted initiatives and we need a cohesive framework so that everything we are doing in financial reporting supports meeting those three goals. This is about stronger more strategic accountability.

Mr. Jackson explained that he was a little surprised by the OMB letter because he didn't know what this Board has done that really increases the costs or puts a burden on the agencies. He has seen the overall burden on federal agencies increase dramatically – some of these things are good things but you have to take the stress the agencies are under and you have to look at the sources. He offered the following list of stressful initiatives stemming from OMB:

- quarterly reporting
- 45 day reporting deadline
- The PAR that results in an encyclopedia
- Circular A-123 provided an elaborate process – like a Sarbanes Oxley environment and that falls squarely on the back of the CFO

He explained that he was not suggesting that these initiatives are not useful or doubting that the reporting model may not be getting the right information out. The reporting model topic is a huge undertaking. He believes that when we talk about the federal community we need to ask if this layer is necessary at this time and what's the cost benefit – we need to look inward as well as outward to determine the stress factors on the community.

Mr. Steinhoff said that new financial systems, people retiring, and the budget conditions also contribute to the stress level. He said still it is a good time to reevaluate the current financial reporting model.

Mr. Werfel noted that he also gets complaints about OMB and that the moratorium call was just as much for OMB, GAO, and Treasury as it was for FASAB. OMB is putting down a marker that there is a cost benefit concern and we are asking FASAB to consider cost benefit. He expressed concern that there are standards—such as oil and gas—to be voted on soon and he can not go back to the community and say the Board has looked at the cost benefit issues.

Mr. Allen said that the Board has considered the costs and benefits of the oil and gas standards. He noted that the oil and gas information is available. While he cannot put a figure on the cost, he can say that the requirements build on information that is available in the agencies today. If you can say that, he believes that—with a clear conscience—you have answered the cost-benefit issue.

Mr. Werfel did not agree.

Mr. Farrell commented on the belief that the financial statement is not driving performance. He noted that Mr. Reid questions that conclusion by pointing to the improved data.

Mr. Werfel said the issue is right sizing the reporting model so that accountability is right sized. Agencies spend a lot of time, energy and resources on activities that do not have a return. The current model is not well tailored and there are inefficiencies. For example, DOD is about to spend a lot of resources to get a clean audit opinion – but if we reviewed their plan – we might say step 8 of 24 is good enough to accomplish goals and the remaining steps are not needed.

Mr. Steinhoff noted that GAO is having meetings with them to try to rationalize what they plan. For example, we don't think they should try for a clean audit opinion on fund balance with Treasury. A lot of the pressures DOD exist because they have never fixed the underlying systems. But that is not a standards issue and can probably be dealt with by OMB, GAO, and Treasury.

Mr. Werfel noted that we are after better cost of performance – these books say what the agency is trying to achieve, here's how they did and what it costs. He believes the goal is to say the data is reliable and the managers then have a good idea of what their costs are but we're far from being able to put out that kind of report. He believes PARs need to be clear and concise.

Mr. Allen asked what role FASAB plays? He believes Mr. Jackson's comments affirmed that we are a $10 player in a $100 cost arena. He noted that people have talked about the federal deficit and they say prior to standard setting they focused on one number - the cash deficit – now they are saying there are two numbers – the cash and accrual deficits. He believes FASAB ought to do whatever we can to add to the credibility of the accrual number. Further, much of the PARS reports we have no authority over – just the cost – when they link the cost to performance we influence that the cost they report is proper. It is essential that we capture all the accruals that we can. He affirmed the need to be sensitive to what Mr. Werfel is saying but we ought to consider how the agencies use the information inside the organization and we can't mandate that but we can advise.

Mr. Werfel indicated that the Smarter Accountability group will go ahead and define the new model. However, there is a need for FASAB acceptance of the guiding principle – assuming there is an acceptance of the framework. It may take 10 years to shift from the old to the new and he believes that if FASAB agrees the strategic framework is right then their work should align with it. OMB will provide the thought leadership and – if the Board is open to reform and can recognize that these are problems worth fixing – changes worth making – then if you can validate our reporting model – that will give us the credibility we need.

Mr. Allen said this board has already been open to that. He stressed that we have something no one else has – a Statement of Social Insurance. This demonstrates we can think outside the box. Further, he pointed out that the Board is thinking about a statement of fiscal sustainability. But, he cautioned, if you came to him and said I don't want a GAAP based number – I just want budget – then he would have a hard time with that message.

Mr. Werfel explained that he didn't mean to suggest that FASAB doesn't have a role to play. He believes the group would wrap this into the new framework and that FASAB elements are helpful. However, there are things that aren't on FASAB's agenda like the primacy of the balance sheet and the accuracy needed that should be addressed.

Mr. Patton noted that as an eight year member he feels indicted by the notion that the Board has not been sensitive to cost – benefits or perceives the need to develop the model. He explained that the Board is right in the middle of a conceptual framework – just completed a review of objectives – if people did not like the objectives they should have said so. He noted further that we are doing an elements concept statement and that you either have a balance sheet or you don't. He was not sure exactly what we're missing and would encourage participation in our projects rather than an outside project with an "either you guys get on board with this or not" approach.

Mr. Allen noted that there was not necessarily something for the Board to deliberate now but he would like to be kept abreast of the group's efforts. He asked staff to document the discussion and then later the Board can decide whether to add something to the basis for conclusions. He noted that there were no objections to inviting people to comment on cost-benefit issues but there was substantial concern about a full blown cost-benefit assessment.

Mr. Werfel, responding to Mr. Patton, apologized if the message comes across as an indictment. He views his role as bringing to the Board knowledge about what's going on in the community – whether that view is right or not. He doesn't think we see enough of what's going on in the community; we don't have enough of that dialogue or debate on the global issues. His role is to be a messenger for the community and sometimes the message will sit well and sometimes not. He has stated his objective – whatever role FASAB wants to play in this – whether you want to have your thought leadership here – he is bringing information to the table.

Mr. Jackson noted that there is a need to assess whether the current model is relevant. The current model was put together back in 1993. He noted that Credit Reform provided a very non-traditional way to account for direct loans and loan guarantees. We conformed the accounting for these programs to how they were accounted for in the budget. He noted the desire to have information in the audited financial statements to validate it. He commented that a second example of non-traditional approaches is the statement of social insurance. His 3rd example was the statement of financing—which may not be a service--but that did come about in SFFAS 7 and was non-traditional. The statement of budgetary resources is also non-traditional and it has improved the quality of information used in the decision making process significantly. He believes we need to get people together and see what kind of information people need to manage. That was done in the early 1990s. If we move farther away from the traditional model, he believes it should be informed by the community.

Mr. Allen noted that the community spoke in 2005 when we held meetings with a broad group of people and they reaffirmed the objectives. The strategic directions book is the result. He commented that the objectives have been confirmed but that confirmation does not address how the objectives ought to be met.

Mr. Steinhoff noted that at the end of the day if the parties do develop a model – they may find that the community does not like the new model any better. He commented that the Board has done a fine job of considering the communities' views over time.

CONCLUSIONS: The members agreed that each exposure draft should encourage input on the perceived costs and expected benefits of the proposal. In addition, some discussion of the Board's consideration of cost-benefit factors should be included in the basis for conclusions and the executive summary. Staff will prepare text to be added to the standard preamble to the request for comments section of each exposure draft to ensure a consistent approach is used in each document. Staff will review each in process exposure draft and strive to clarify discussions of the expected benefits and perceived costs as well as comparisons made between alternative methods regarding relative costs and benefits.

- **Financial Reporting**

Staff provided an update on the status of the project. The Financial Report project is the third phase of the five-phased conceptual framework acceleration plan. During the first phase, the Board decided to retain the four objectives of federal financial reporting (Budgetary Integrity, Operating Performance, Stewardship, and Systems and Control). The Financial Report phase involves reviewing the key components of financial reports that help achieve the financial reporting objectives and reviewing the financial statements used to present the elements critical to meeting them. The key components of financial reports include financial statements, disclosures, management's discussion and analysis (MD&A), required supplementary information (RSI) other than MD&A, and other accompanying information (OAI). The objective of the project is to develop a concepts statement that would:

1. Establish criteria for determining when financial statements, disclosures, MD&A, RSI other than MD&A, and OAI should be used in meeting the reporting objectives; and

2. Describe the financial statements used to present the elements critical to meeting financial reporting objectives and explain what constitutes a full set of financial statements.

Staff prepared an outline of planned topics to discuss in a proposed concepts statement and, at the January 2007 meeting, the Board decided to begin the project by reviewing concepts underlying the existing general purpose federal financial report (GPFFR), commonly known today as the Performance and Accountability Report (PAR). In reviewing the scope of the existing GPFFR, staff noted that the report includes non-financial performance information such as performance goals and levels of achievement. However, some standards-setters focus on financial information and do not necessarily consider non-financial performance as integral to financial reporting and constituents have raised concerns regarding the voluminous size and understandability of the PAR. In earlier standards[2], the Board stated that performance information was an integral part of the GPFFR, and staff asked whether the Board believed that performance information is an integral part of financial reporting and of GPFFRs, currently. In addition, because the area of performance reporting is still evolving and more time may be needed to allow on-going programs to accomplish their intended goals, staff suggested that the Board continue to monitor the progress in performance reporting rather than exploring the topic at this time.

While Board members agreed that the term “integral” does not indicate the audit status or the scope of audit work that should be conducted regarding performance information, members discussed agencies’ concerns about audits of performance information. Board members also agreed that performance information was integral to financial reporting and the GPFFR, but this does not preclude pursuing alternative PAR formats. In addition, Board members discussed that staff should participate in work groups engaged in reviewing PAR formats and developing strategic directions for a financial reporting model. This will permit the Board to continue monitoring the progress in performance reporting rather than exploring the topic at this time.

Staff also noted that the existing GPFFR includes financial statements, disclosures, MD&A, RSI, and OAI. FASAB literature discusses these components and the financial reporting community is familiar with them. Staff suggested that the Board limit the GPFFR components to the existing ones, rather than exploring other possibilities. Board members acknowledged that the components indicate audit status categories and agreed to limit the GPFFR components to those currently discussed in FASAB literature. Details of the Financial Report project discussion are as follows.

<u>Whether Performance Information is an Integral Part of Financial Reporting and the GPFFR</u>

Mr. Werfel discussed a current Office of Management and Budget (OMB) initiative related to the staff’s question and recommendation. Mr. Werfel noted that an OMB Circular A-136, *Financial Reporting Requirements*, working group is considering options for streamlining the PAR. One of the options is a pilot project for FY 2007 that would permit agencies to prepare a streamlined PAR rather than the traditional, detailed PAR prepared currently. Agencies would separate the MD&A and financial information from the performance information and focus on preparing a “highlights” document with links to the detailed financial and performance information. This approach would alleviate agency concerns about producing a voluminous document within 45 days after year-end. Also, users could review the highlights document and, should they desire more details, follow the links to detailed reports.

Mr. Werfel discussed agency concerns with financial audits of performance information. In one instance, an agency’s financial statement audit results included a reportable condition regarding performance information. Such results have led to discussions in

---

[2] For instance, Statement of Federal Financial Accounting Concepts 3, *Management’s Discussion and Analysis*, April 1999, par. 13.

the budget and performance integration community on what would be a good quality assurance strategy for performance information. Constituents desire to have performance information reviewed; however, they are concerned whether the traditional financial statement audit provides the proper vehicle for validating performance information quality. Some constituents also believe that the performance information should be separated from the financial statements and that they be permitted to prepare their financial report without performance information in the MD&A and without a performance section. This would allow them to focus strategically on preparing a highlights document that would integrate financial and performance information. Focusing FASAB requirements on financial information rather than on both financial and performance information could help the financial statement auditors focus their work on financial statements.

Mr. Steinhoff noted that performance information is important for managing the organization and it would appear that managers would want to know whether the information they are using is accurate. Mr. Jackson offered clarification on the auditor's responsibilities regarding performance information. He noted that the performance information is not subject to "audit." OMB guidance[3] requires auditors to assess internal controls over the completeness and existence assertions relevant to performance information. The guidance was not intended to require an "audit." The idea was that if the performance information was important enough to be included in the agency's annual report, there should be some procedure to validate whether the agency had controls to ensure the integrity of the information. Although the requirement for the review of internal controls over completeness and existence has been in existence for several years, Mr. Jackson expressed concern why it has now become an issue.

Mr. Werfel noted that the MD&A provides a link between the performance and financial information. The MD&A summarizes the performance information and provides an analysis of the financial information. Mr. Werfel also noted that Statement of Federal Financial Accounting Standard (SFFAS) 15, *Management's Discussion and Analysis*, appears to have permissive language that says that the MD&A "should" include performance information, and the working group on streamlining the PAR could consider whether, on a pilot basis, to pursue an MD&A without the performance information. Mr. Steinhoff noted that the decision ultimately depends on the objective for removing the information. One may consider whether the format improves financial reporting.

Mr. Reid noted that the performance information contributes to a voluminous document because some agencies have numerous programs they would need to discuss. Mr. Steinhoff stated that current FASAB standards envision that there would be certain top-level performance data that is important for judging the performance of the agency. Agencies with multiple components could role-up the top-level measures from the individual components.

[3] Currently, OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, August 23, 2006.

Mr. Allen noted that the issue is whether performance information is within the broader category of financial reporting. In the state and local government environment, including performance information with the financial statements enhanced the report. When considering FASAB standards, performance information is within the broader category of financial reporting. However, how the information should be presented and audited put forward other issues.

Monitoring the Progress in Reporting Performance Information

Rather than staff focusing on performance reporting at this time, staff plans to review the relationship among financial statements, disclosures, MD&A, RSI, and OAI, and describe financial statements critical to achieving the reporting objectives.

Ms. Comes noted that currently, FASAB literature discusses that performance information is an integral part of the GPFFR and financial reporting and the MD&A should include summarized performance information. If the Board would like to pursue the topic further in this concept statement, staff could expand the literature to discuss the areas such as the types of cost performance measures one is likely to find. Staff is recommending that that effort be deferred but efforts to improved reporting be monitored. Currently, staff is participating in the working group to streamline the PAR.

Mr. Werfel noted that there is a joint Chief Financial Officer's (CFO) Council and President's Council on Integrity and Efficiency (PCIE) working group that is developing strategic directions for a financial reporting model. Staff should participate directly in that group's efforts. Board members expressed the need to reassess the existing reporting model and agreed that staff should participate in working groups involved in reviewing the model.

Components of the GPFFR

While reviewing the reporting model, the Board considered whether to remain within the existing framework of components such as financial statements, disclosures, RSI, and other accompanying information. Board members noted that although these components are audit status categories, they are discussed in the FASAB literature and are used by preparers.

> **CONCLUSIONS:** The Board agreed that performance information is an integral part of financial reporting and the GPFFR. However, this does not preclude developing alternative formats. The Board also agreed to continue monitoring progress in performance reporting rather than exploring the topic at this time. Staff will participate in work groups engaged in reviewing PAR formats and developing strategic directions for a financial reporting model. In addition, the project will focus on the existing components of the GPFFR, such as financial statements, disclosures, MD&A, RSI, and OAI, rather than exploring other possibilities.

- **Fiscal Sustainability**

Time did not permit discussion of this topic.

- **Entity**

Staff explained the Federal Entity Project plan was approved at the January 2007 Meeting. Staff also explained the Federal Entity Project plan identified several issue areas that would be addressed in the project. The March 2007 briefing paper discusses the first issue area—Definition of entity / reporting entity. In assessing how entity / reporting entity should be defined for federal financial reporting purposes, staff considered the following questions:

- Does FASAB already define entity / reporting entity?
- Should there be a distinction between Entity and Reporting Entity?
- Is there a relationship between the reporting entity concept and the objectives of federal financial reporting? If so, should this be articulated?
- How do U.S. standard-setters and National and International standard-setters define Entity /Reporting Entity?
- Would a definition be best articulated in Concepts or Standards?

Staff explained the issue paper is a first in a series of papers to consider several different aspects of the federal entity concept. Staff plans to devote the next several Board meetings to issue papers that will address the following:

- Characteristics of a Reporting Entity
- Boundaries of a Reporting Entity
- Kinds of "things" that could be included in an entity—the types of transactions, events and entities that may be encompassed within a reporting entity, e.g., other entities, activities, guarantees, functions, etc.
- Overall scope of the Federal Government Reporting Entity

Staff explained that assessing the definition of entity / reporting entity at the beginning of the project would be beneficial. Staff explained the intent would be to finalize terms and definitions in the beginning stages of the project to avoid future misunderstandings and misconceptions. Staff also explained the current FASAB standards and concepts utilize several different terms—such as entity, reporting entity, federal reporting entity, component entity, component reporting entity, Federal Government entity when referring to entity.

Staff explained that most of the other standard setters have a current project on the Entity concept. Staff also explained that there has been a diverse approach to defining the term entity and reporting entity among other standard setters. For example, FASB and IASB do not define the terms, whereas GASB defines different levels for entity depending on the context, such as reporting unit, governmental unit, reporting entity and

Financial Reporting entity. Staff explained that an approach similar to GASB's may have merit in the federal environment as well.

Staff explained that it was not feasible to make a recommendation regarding a proposed definition for entity and reporting entity at this point because staff believed it would be helpful to assess the scope of the federal government as well as the characteristics of entities. Staff also explained that there is the potential of overlap between the definition of entity and the characteristics of an entity.

Staff requested the Board members initial thoughts on the definitional aspects of the entity issue as well as the staff observations included in the issue paper.

Mr. Allen explained that although it may be important to research areas on the definition and characteristics of a reporting entity, he believes the focus of Board discussions should be on the boundaries issue.

Mr. Allen explained GASB defined the different levels—primary government, component unit, etc, to ensure they captured everybody. Mr. Allen explained that he didn't believe the same issues exist in the federal environment. Mr. Allen explained that we know what the federal government is, it may be more important to focus on defining the boundaries of the all the entities that should be included in the consolidated financial statement for the federal government. Also, if an entity wants to issue their own financial statements, it is important to define the boundaries of what should be included in their financial statements.

Mr. Reid explained that this project could potentially solve some fundamental issues—such as the fact the Judicial Branch is not constitutionally compelled to provide the information for consolidation. Mr. Reid explained it would be helpful to determine if the appropriations and expenditures should be included and reported in the consolidation. As of now, Treasury does not receive all the information to enable them to be fully included.

Mr. Allen suggested that the exclusion of certain items such as the Judicial Branch could affect the audit opinion. Mr. Steinhoff explained this has been a long-standing issue--what should be included from the other branches of government in the consolidated financial statement. Mr. Steinhoff suggested the requirements may be different for entities of the other branches as there in no requirement compelling them to provide the information. Additionally, Mr. Steinhoff explained there are other laws and regulations that limit the boundaries of FASAB.

Mr. Allen explained that it is similar to the not-for-profit organizations that follow FASB reporting that were created by a University that follows GASB—GASB has stated that for the University to follow GAAP, they must include the not-for-profit as a component unit.

Mr. Jackson explained the statute establishes what is the federal government. He added he has difficulty assessing what there is outside of the 2 ½ trillion-dollar federal entity (other than perhaps GSEs) that is relevant and should be included in the federal entity.

Mr. Farrell suggested that it might be better to have staff continue working on the issue papers then present them at one meeting. He explained this would allow decisions to be made after all the areas have been researched. Staff explained that the project plan and the transmittal identified several issue areas that would be researched. Staff explained that it the Board preferred, staff could continue research, but delay further Board deliberation until alternatives for the proposed Concepts Statement could be presented. The Board explained that would be preferred.

Mr. Jacobsen explained from a legal sense, what is legally the United States Government is explained in law. In addition, who has to prepare financial statements and who is subject to FASAB rules can be explained as a matter of law. Mr. Jacobsen explained that as we move forward, the Board should look at this as separate from who prepares financial statements and for whom we issue standards because in defining the entity, the project will touch upon entities that don't prepare financial statements, are not required to prepare financial statements and may never plan to prepare financial statements. Further, the Board may have to consider entities over which FASAB has no jurisdiction. For example, there are commissions established by Congress that are clearly not federal entities in the statute, but perhaps should be included in the federal entity.

Mr. Allen explained that staff should move forward addressing the other areas and determine the best point to bring decision points to the Board. Mr. Allen suggested the Conceptual Projects contain a summary chart of what we have dealt with, what areas remain, and key decision points. Mr. Allen also explained that staff should feel free to provide updates and request Board feedback as needed, but if no decisions are necessary then perhaps it should not be included as an agenda item.

> **Conclusion:** Staff will move forward addressing the other issue areas identified in the project plan.

- **Natural Resources**

Staff presented a ballot draft of an Exposure Draft (ED) entitled *Accounting for Federal Oil and Gas Resources.* Staff explained revisions were made to the ballot draft ED based on comments received from Board members on the pre-ballot ED. Staff also explained that the Office of Management and Budget (OMB) provided the Department of the Interior (DOI) with a copy of the pre-ballot ED and asked for comments from the DOI. The DOI provided comments to the OMB and the OMB forwarded the comments to the FASAB staff.

Staff explained that the major concerns expressed by the DOI were:

1. DOI believes custodial collection and distribution accounting should continue and that the draft ED should really only focus on the treatment of the new 'estimated petroleum royalties.' DOI believes custodial provisions in SFFAS 7 would still apply.

2. The draft ED affirms that custodial collections and distributions will still occur; yet, includes conflicting provisions that royalty, rent and bonus collections will be recorded on the Statement of Net Cost rather than the Statement of Custodial Activity.

In regard to the DOI's first concern, staff noted that currently the Minerals Management Service's (MMS - a DOI component) accounting reflects custodial activity principles because of an exception in SFFAS 7, *Accounting for Revenue and Other Financing Sources* (as amended), which the ED proposes to rescind. Although the bonus bid, rent and royalties are classified as exchange revenue, the exception was granted because natural resources were not recognized as an asset and depletion was not recognized as a cost. However, under the proposed standards, the MMS accounting would be fundamentally different since estimated petroleum royalties and related rents and bonus bids would be accounted for consistent with existing exchange revenue principles. That is, an asset for estimated petroleum royalties would be recognized as an asset and depletion of the asset would be recognized as a cost. In addition, the bonus bid, rent, and royalty collections and distributions would be recognized on the statement of net cost. Staff added that it believes this is consistent with current revenue models as well as the Board's intent as the ED was developed. No Board members disagreed.

In regard to the DOI's second concern that "the draft ED affirms that custodial collections and distributions will still occur," staff referred Board members to the first and second paragraphs on page 50 of the ballot draft ED. Staff explained that the language presented in the two paragraphs was an attempt to explain that the proposed standards were not intended to change the MMS's procedures for its oil and gas revenue collection and distribution activities. However, because of the DOI's comment, that the draft ED affirms that custodial collections and distributions will still occur, the first and second paragraphs on page 50 were revised to eliminate any reference to custodial accounting and that the pro forma transactions and financial statements are not a complete model for departmental accounting.

Mr. Allen asked, in regard to earlier discussions during the meeting on cost benefits, what the DOI's desire was for wanting to continue to use the custodial accounting model as opposed to the revenues and expenses flowing through the statement of net cost. He asked if it was a cost benefit issue. Staff explained that the MMS wants to continue using the custodial accounting model because current GAAP in SFFAS 7 permits them to use it and they get a clean audit opinion using the model, so, they question why they can't continue to use it. Staff added that as the proposed ED was being developed, staff provided the ED to the DOI for review and comments. In all cases, the pro forma transactions and financial statements were presented and the text in the proposed standards indicated the revenues and expenses would flow through the statement of net cost and the DOI. Without any objections, the DOI said it was "doable." In addition, staff explained that when the initial methodology of calculating the value of estimated petroleum royalties was proposed, staff proposed that a nationwide quantity, a nationwide price, and a nationwide royalty rate be used in the calculation. It was the DOI who suggested using regional quantities, regional prices, and regional royalty rates to calculate the value of estimated petroleum royalties in order to get a more reliable estimated value.

Mr. Allen asked if it was staff's opinion that it does not appear to be a cost benefit decision by the MMS to still want to use the custodial accounting model. Staff replied that it was not a cost benefit decision. Staff added that it also asked the Treasury's Financial Management Service (FMS) to review the proposed pro forma accounting transactions and financial statements presented in the draft ED. The FMS reviewed the transactions and statements and provided only minor comments. Ms. Comes added that staff requested the review to verify that the illustration was consistent with current Standard General Ledger (SGL) illustrations regarding exchange revenue to be transferred to other entities.

Mr. Schumacher asked if the revisions to the first two paragraphs on page 50 changed any of the proposed reporting requirements. Staff responded the revisions did not change any of the proposed reporting requirements. Staff added that, besides the changes to the paragraphs on page 50, it also revised the transactions by disaggregating liabilities into an amount for the States and an amount for other Federal entities.

Mr. Werfel asked if staff's opinion that the MMS's desire to want to continue using the custodial accounting model was not a cost benefit decision was presented anywhere in the ED. Mr. Allen stated that it was not currently in the ED. However, a paragraph could be added to the basis for conclusions explaining the cost benefit of implementing the proposed standards as opposed to allowing the MMS to continue using the custodial accounting model was considered by the Board.

Staff asked if a request for comments question should be added to the document regarding the cost and benefits of implementing the proposed standards. Mr. Werfel responded that, in regard to discussions the Board had on the concept of a framework for cost and benefits, if it is known that information is being taken from existing sources and you are just leveraging existing processes there does not seem to be a need to do a cost estimate and no question is needed to ask respondents if they agree. However, if the proposed standards are asking that something more aggressive or more rigorous be done than was done in the past then a question should be asked if the respondents agree that a cost estimate need not be done. Mr. Werfel added that one of his concerns regarding the CBO's alternative methodologies is that the alternative methodologies might provide more precision or be a more trusted approach but it could be more burdensome to implement than the proposed standards. He said this concern raised a question in his mind as to whether there is any way of examining the marginal benefit of better precision in comparison to the baseline cost and what the marginal cost would be to implement the CBO's methodologies. Mr. Werfel added that he was not sure if the CBO was comfortable with the methodology in the proposed standards for calculating a value for estimated petroleum royalties.

Mr. Marron responded that there is a benefit to taking pre-existing numbers and repackaging them and doing something with them. He said the CBO's posture is that by eliminating the consideration of valuing possible reserves and focusing only on the valuation of proved reserves there is strong reason to believe that that simple process will give a number that is wrong, probably in a direction that 95 percent of the time the inaccuracy would be significant. However, to go the extra mile and consider valuing the possible reserves would take additional thinking and resources. He added that a framework is needed to determine if the possible reserves should be considered would be worth the additional resources which would be required. He said he hopes one of the benefits of the external review process by reviewers of the ED will be to get a sense of what the cost would be to use the CBO's methodologies and what the benefits would be.

Mr. Werfel stated that he believes there is a problem with the Board not being transparent in its issuances that it did discuss alternatives. He said it would be helpful and it would lend credibility to the Board's issuances if the issuances indicated that the Board had considered implementing other alternatives; however, implementing the other alternatives would have had a cost impact. Mr. Steinhoff noted that while the CBO concludes that there is a high probability that the value of estimated petroleum royalties would be materially misstated, the Board may say that it would rather have no valuation instead of having one that is wrong. He believes the Board would expect entities to spend more money to implement standards if it would provide more value. He said, theoretically, the Board would not adopt a standard just because it would be easy to implement and there would be little or no cost to implement it. Therefore, he believes by adding an explanation in the Board's issuances that alternatives were considered gives the Board the opportunity to document the fact that it was not the burden involved in implementing the alternative but it was the cost of doing so. Mr. Werfel explained that the oil and gas ED is the perfect example and opportunity to provide the transparency that alternatives and trade-offs were considered for implementing the alternatives.

Mr. Allen indicated that the term opportunity concerned him. He said what he would like to do would be to add a generic statement stating that the Board invites comments on the cost benefits for implementation of the proposed standards and also the alternative views. He added that the generic statement should be embedded in the Request for Comments section of the ED. Mr. Allen also said that, for future standards, the Board may want to create and define categories for a cost benefits framework. However, he would not want to spend several meetings discussing the framework.

Mr. Allen asked staff to present the next decision point. Staff replied that it wanted to present additional revisions requested by Board members since the ballot draft ED was distributed. Staff explained that the first revision was made to question Q.1a.ii. Staff stated that the words "probabilistic" and "as" were deleted and the word "method" was changed to methodology." There were no objections to this revision.

Staff said the second revision was the addition of a paragraph preceding the definitions on page 3. Staff explained the paragraph invites reviewers of the ED to examine the terms in the glossary before reading the proposed standards and basis for conclusions. Mr. Allen suggested a page reference for the glossary be added to the paragraph. Staff noted that it would add a page reference. There were no other comments or objections to this revision.

Staff stated that the third revision made was to footnote 8 on page 6. Staff explained it revised the footnote to reference the principle that the liability should be reduced when distributions are made as it is done in other FASAB standards. There were no objections to this revision.

Staff stated the fourth revision was made to paragraph A 118 on page 41. Staff explained the word "owned" was deleted and the phrase "that the Federal government is able to control" was added. Mr. Marron pointed out that, because of the discussions pertaining to the Elements project, the phrase "is able to control" should be changed to "controls." Staff noted the change would be made. Mr. Werfel stated that he did not object to this revision. However, he did have a concern with paragraph A57 on page 28. He said the proposed standards rely on and adopt the liability definition proposed in the Elements concept paper, which is still up for debate and has not been finalized. He said it is premature to put in the basis for conclusions a definition of an element that has not been finalized. Ms. Comes asked Mr. Werfel if he also objects to the asset definition presented in the basis for conclusions. Mr. Werfel stated he also objects to the asset definition.

Mr. Patton stated that he believes that presenting the definitions in the basis for conclusions is acceptable even though the definitions are not official yet, if a majority of the Board were to say the definitions were the foundation for its thinking. He also said he believes it is acceptable to have a citation of a working document in the basis for conclusions because it is not part of the accounting standard itself. He added that he believes it would be misleading to ignore recent conceptual developments and to rely on definitions that are very likely to be changed.

Mr. Werfel explained his concern was a due process concern. He said the Board has not yet completed the cycle of developing a conceptual statement. He added that he believes the Board would be signaling prematurely the outcome of something that has not been voted on. Ms. Comes explained that the challenge is running the Conceptual Framework project concurrent with the other projects. She added that staff has been tasked with keeping the projects synchronized. Therefore, the basis for conclusions presents information consistent with the stage of the Conceptual Framework. Ms. Comes stated that the basis for conclusions could be rewritten using commonly accepted definitions of asset and liability and recognition criteria. However, she said she believes it would be confusing to the community. She explained that by referencing a working document it may signal to the community that the Board has made a decision. On the other hand, she asked what would it signal to the community if the Board did not reference its own work.

Mr. Werfel replied that he knew there were trade-offs. He said before the Board starts to signal that a definition of a liability has been agreed upon, he believes the Board should complete the process of developing the elements concept statement and vote on it. He noted that the FASAB has a current definition for liability, but it is not being referenced. The definition of a liability being referenced is from a working document.

Mr. Allen, asked, prior to the current project on elements, were definitions such as asset and liability ever referred to or provided in the standards. Staff explained that FASAB had a definition for "assets," which is presented in SFFAS 6; however, it was commonly referred to as a working definition. Ms. Comes stated that in the past there was not a robust link to the conceptual framework because the framework had so many voids. However, she said staff was always tasked to link to the reporting objectives.

Mr. Jackson suggested that language be inserted into the basis for conclusions. He said, for example, that the language should make it clear that the elements concept statement is not a final pronouncement. However, the Board did use it to guide the Board and the Board's thinking. Mr. Allen suggested that the language be inserted as the first paragraph in the basis for conclusions. Mr. Werfel stated that retaining the current definition of a liability in the basis for conclusions would confuse the public, preparers, and auditors. He said they would be confused because there would be two definitions of what a liability is and the two definitions are very different. Ms. Comes asked if it would be helpful to provide a footnote to the definition of a liability. She explained the footnote would indicate that SFFAS 5 contains a different liability definition, which the Board has not amended, that still governs practice until such time as the Board amends the standard.

Mr. Werfel stated that selecting to reference a liability definition that is still being debated over a liability identified in the GAAP hierarchy sends the wrong signal. He said it sends the signal that the new definition is better or more up-to-date than the existing definition for driving decisions. Mr. Allen remarked the Board is not trying to hide or disguise the fact that when it issues a concept statement, which has a new definition, the Board, after due process, has concluded theoretically that the definition is better.

Mr. Allen asked the Board to vote on keeping or removing the definitions for asset and liability from the basis for conclusions. After the vote, Mr. Allen noted that, based on the majority vote of keeping the definitions, the definitions will remain in the basis for conclusions.

Mr. Allen asked staff if there were other issues to be discussed. Staff replied that it had added a sentence to the last paragraph on page 50. Staff explained that it had received comments that the paragraph did not follow up with the formulas preceding the paragraph, and thus, was confusing. For example, the formulas to be used to calculate the initial value of estimated petroleum royalties require regional information. However, the paragraph following the formulas states regional information was not available, so, information on a nation-wide level was used. Mr. Allen added that the methodology used to calculate the initial value of estimated petroleum royalties in the illustration was not consistent with the methodology in the formulas. He pointed out that in the formulas the quantities of proved reserves are to be used in the calculation. However, in the illustration, the quantities of technically recoverable resources were used. He added that by explaining that regional information was not available to develop the illustration could be confusing. In addition, reviewers may question the proposal to use regional information when it wasn't available to staff to develop the illustration. Mr. Allen noted that he would not describe how the initial value of estimated petroleum royalties was calculated. Mr. Steinhoff suggested that an explanation be inserted in the first transaction stating hypothetical numbers were used to develop the initial value of estimated petroleum royalties. Staff noted it would add an explanation indicating hypothetical numbers were used. In addition, staff proposed to delete the text beginning at the last paragraph on page 50 through the middle of the page on page 53. There were no objections from Board members.

Mr. Steinhoff stated he had one last question. He asked if there are any remaining concerns from the DOI. Staff replied there were no other major concerns besides the concerns identified and discussed during today's meeting. There were no other comments or questions from the Board members.

Ms. Comes stated that staff will make revisions to the ED based on decisions made during the meeting and distribute a pre-ballot draft ED. She indicated that Board members would have a five day window to return their comments. Once the comments are addressed, a ballot draft would be provided. She anticipates this occurring before the May meeting. She added that if any Board member had an alternative view to notify staff immediately.

CONCLUSION: Staff will make revisions to the ED based on decisions made during the meeting and distribute a pre-ballot draft ED to the Board members.

Adjournment

The meeting adjourned at 5 PM.

Thursday, March 22, 2007

Agenda Topics

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

The staff discussed comments received from agencies, its recommendations based on comments received, and other activity resulting from the January FASAB meeting. A key activity since the January meeting had been to vet the standards with the affected agencies, especially actuaries, although there were several other issues to develop as well. The staff explained that agency commentors did not object to any aspects of the display and valuation date standards, except for HHS representatives as noted below. Many comments focused on the discount rate standard. The objective of this session was to review the agencies comments and staff recommendations, make changes as the members might direct, and decide whether to proceed to a pre-ballot draft of the proposed standard.

Mr. Patton noted that the Board's consensus was for a stable rate and that a stable 5-year rate or a stable 10-year rate made sense to him; but not one rate for all maturities.

Mr. Reid said he was concerned about the change from year to year.

Mr. Allen said the goal should be to have a rate that is representative of the future payments, that convenience should not determine the rate.

Mr. Patton noted that the rationale for the discount rate standard is that it should reflect the cost of Treasury borrowing, not investments, and the timing of the borrowing will vary. He recommended that a single rate should be used only if it is not significantly different than a time-structured interest rate.

Regarding the display standard, the Board discussed the staff recommendation that would allow all actuarial gains and losses, i.e., those from changes in assumptions and those from differences between the assumption and experience, to be displayed as one line item on the statement of net cost and in the footnote if separating them was too costly or otherwise impractical. The recommendation was based on the probability that gains and losses from differences between assumptions and experience would be relatively insignificant, and on cost-benefit considerations.

Mr. Reid said that the value of the display would be lost unless gains and losses from changes in assumptions are displayed separately. He said he believed the information would be available and several other members agreed.

Mr. Jackson took issue with the notion that if in the preparer's judgment it is too costly versus the benefit to distinguish changes in assumptions from experience that they can be combined. He said he did not think that it should be discretionary.

The Chairman polled the members on the question of allowing the two types of actuarial gains and losses to be displayed as one line item under certain circumstances. The members decided to require changes in assumptions to be displayed separately. Staff said a question in this regard would be added to the ED.

Mr. Werfel asked that the questions for respondents be written both from a cost perspective and a substantive benefit perspective; the commenter should address both.

He said the respondents should address whether they think the information will provide useful insights for decision-making.

Ms. Cohen said the information about the volatility of assumptions would have to benefit managers. Extreme volatility would indicate that there is something wrong with the assumptions; it would reflect on their cost estimation methodology. She thought it would affect what the program's appropriation requests, and that, managerially, there would have to be a huge benefit in having this information. Mr. Jackson agreed.

Mr. Jackson encouraged the Board to reach out to program managers, including OMB's managers, with regard to whether they use this information separately in evaluating the program. He noted that an ED can be obscure to people who actually use the data for management purposes. He added that it would be very interesting to know, for example, how VA healthcare programs managers use the information, because if future funding plans are built around those assumptions, then you would expect the managers to find the information useful.

Mr. Steinhoff expanded on Mr. Jackson idea, saying that, if the program managers do not use this information, then they should be asked why not, and what information do they use; is there something else they use?

The Board discussed the staff proposal that the market rate for Treasury securities be disclosed. (The staff also proposed a specific question for respondents (#3) on that issue.)

Mr. Schumacher asked what the rationale was for the disclosure, noting that the preparer is not asked to discuss the differences.

The staff explained that the information would be a benchmark for comparison with the rate used. The market rate is often required in the private sector; the rate affects the liability and expense amounts reported; and having the market rate compared to the rate the federal entity is using would be useful. The staff added that the Board might consider requiring more discussion of the implications of the different rates.

Mr. Torregrosa responded to a question saying he did not see any harm in the display. First, he said the investment side is irrelevant to the display issue because the Board already agreed to discount liabilities and not look at the investments. Second, he said it is always reasonable to compare what is assumed with other rates; CBO does this all the time.

Mr. Jackson said he could not envision any decision being made based on that information but he did not object to the requirement.

Mr. Allen said he was comfortable with it.

Mr. Patton asked whether the standard required the disclosure of a single rate or multiple rates. The staff responded that either would be acceptable. Mr. Patton asked that the staff revisit that provision if the Board decided to require multiple rates.

Mr. Steinhoff asked whether the standard required consistency across the federal government with respect to discount rates. He said that was a bigger issue than displaying the market rate.

Mr. Werfel recommended that the Board move forward on this, but a question for respondents should explain why the Board thinks the benchmark is important to have, what value does the information have; for example, it allows the reader to distinguish between the program's assumptions versus the market. Then ask whether such information has value from a financial reporting transparency standpoint. He said clarification is needed, since Mr. Reid and some others were confused about the purpose of this information.

The Board then discussed the staff proposal that the discount rate standard allow either a single rate or multiple rates associated with the future years when payments are due.

Mr. Torregrosa objected to the staff proposal. He said that initially the Board was trying to solve two problems, the display issue of changes in assumptions and then VA's narrow problem. He preferred not to deal with changing actuarial practices; but if it was going to set a discount rate standard, the Board has not really discussed why it is going to allow people to use inconsistent rates for discounting. He said, in theory, every agency where the riskless rate is appropriate should be using the same rate to discount a cash flow in year 30. This standard does not require that. However, he did not think it was the Board's intent to change that when it took on this project. He asked if it were possible to address the VA issue in a single letter or interpretation. He said he did not want to write another alternative view.

Mr. Allen asked if Mr. Torregrosa's problem with the standard was that he does not like the variability that the standard allows, which is already in practice; or, it is that the Board ought to be to clearer that it expects the riskless rate to be the same for all agencies.

Mr. Torregrosa said CBO disagrees with a lot of actuarial practices, but he did not think that is the best use of the Board's time; and then there is the cost-benefit question. However, if the Board is going to set a standard, he did not think the Board has given enough thought to the question of consistency. He said CBO thinks using a single average or a single weighted average rate is the wrong answer, and that the correct approach is the "basket of zeros" approach, which is the same as the yield curve that OMB requires for credit reform. He said CBO disagreed with the statement in paragraph A32 of the basis for conclusions, which he characterized as saying that Treasury borrowing rates are relatively stable. He said the yield curve is presently flat but could change markedly. He said that, when it does estimates, CBO makes changes when they are needed. OMB updates its economic estimates every year and so does CBO.

Staff noted that the issue that the Board is addressing is broader in scope than a narrow VA issue, that SFFAS 5 had different instructions for the discount rate among pensions, other retirement benefits and OPEB; also, it is changing the focus for the discount rate from investments to the cost of borrowing.

Mr. Reid said the absolute value of the liability, especially the aggregate liability, is of lesser importance to him than the change in the liability during a reporting period. In other words, the discount rate itself is of lesser importance than a change in the discount rate or other assumptions during the reporting period. He said actuarial estimates by their nature are uncertain. What he is trying to do, particularly in the case of VA, is to control what happens during the current period because it is so significant to the operating statement. He said the issue is not that you cannot change the assumptions if you feel, intellectually, that you need to; it is segregating the effect. And, whether the discount rate is absolutely right or is a single rate or 30 different rates is of lesser importance than the change during the period. He noted that the immediate concern is the VA. Consistency across agencies, while valuable, may not be realistic. There are independent professionals in each of these programs whose judgment is respected. If you start dictating to them things they do not agree with you are going to have problems in terms of there professional certification.

Mr. Allen acknowledged that actuaries must follow actuarial standards, and said the Board does not want to deal with that; but he said it would be a different matter with respect to federal reporting. He did not have a problem dealing with differences of opinion, for example, if the Board believes that there is value in everybody applying the risk-free rate. He said that does not impinge on actuarial practice. He asked Mr. Torregrosa whether he was arguing there was no value in doing this standard.

Mr. Torregrosa said he was not arguing that there was no value in doing this standard but had numerous concerns. He would prefer not to address the discount rate issue. He asserted that there is going to be a lot of to-and-fro with the actuaries no matter what the standard says. He said he did not think the Board set out to change what the actuaries were doing.

Mr. Reid said he shared Mr. Torregrosa's concern about changing actuarial practice.

Staff said that the actuaries from OPM and DoD had been asked over the past six weeks whether the standard would change their practices and they said it would not.

Mr. Steinhoff said he thought he heard Mr. Torregrosa say that he had concerns about the way the actuaries are doing it, that it is not consistent, although perhaps not wrong.

Mr. Torregrosa said CBO would be against a weighted average rate, which is what OPM is using now.

Mr. Allen said CBO needed to submit its position to the Board in writing for consideration, if CBO believes there is a superior measure.

Mr. Torregrosa said CBO believes the yield curve is a superior discount rate wherever the riskless rate is appropriate.

Staff asked whether that would be the yield curve as of September 30.

Mr. Reid said the yield curve as of September 30 could not be used because is implies a market rate.

Mr. Torregrosa said CBO sees a big difference between multiple rates and a weighted average. CBO prefers multiple rates.

Mr. Patton noted that that is not the consistency issue; for example, you could still have consistent 5-, 10-, 15-year rates, etc., across the government.

Mr. Torregrosa said the credit reform approach requires each year the cash flows in any given year across all programs be discounted at the same rate based on the yield curve. CBO believes that is the correct approach. Additionally, CBO believes that, in general, assumptions change each year and should be updated. In CBO's view, VA is probably currently doing it right and if you display it separately that would be okay.

Mr. Reid said he would argue that VA is not doing it right. They are simply arbitrarily marking the entire flow to market without regard to what expectations are about long-term rates on average. For him, the expected future rates are critical rather than the rate today.

Mr. Torregrosa said CBO views the rate at or near the reporting date to be the best expectation of the future.

Mr. Reid disagreed with that view.

Mr. Steinhoff said there seems to be a huge difference in views and the Board might be served well by having Mr. Torregrosa write a brief paper distinguishing the trade off regarding discount rates. He suggested the Board may not be ready to decide on this.

Mr. Reid said he agreed with Mr. Torregrosa's original comment that the Board may not be ready to get into this issue. He said he is less concerned about how arbitrarily the assumption is set than about how often it is reset. He noted that these programs are very long-term. He said the preparer has an obligation to use his or her best judgment and then let time have a chance to work. The assumptions should be tested each year to see how close we are to something that is more appropriate, which requires a long period of time, and reset them if it looks like that is needed. Trustees are very, very conservative about changing assumptions. They take a very long view and certainly do not reset the assumptions very based on the market at September 30. He thinks the long view makes much more sense in multi-generational programs. He supported an “assumption verification” process and did not think 12 months was the appropriate time period for that. He said there is only one program that is doing it completely differently. He did not know whether the other programs have it absolute right or wrong, but he does know it is working reasonably well for financial statement purposes. He thought that was the point Mr. Farrell had made, i.e., that there are professionals working on the current estimates.

Mr. Allen responded that the proposal allows a change every year but tells VA to use a different rate than they are currently using.

Mr. Reid said he would argue that the Board is working on the wrong end of the rate problem. He repeated that he was not concerned so much about specifically which rates they use as long as in their professional judgment is appropriate; they are all using the borrowing rate from Treasury. He said realistically they are reasonably close together except for one program.

Mr. Allen said he was talking about the one program. He asked what in the proposed standard tells them that the rate they are using is inappropriate. He noted that the standard tells them they can reset every year; and it tells them that using today’s rate is not appropriate. He also noted that that may be the difference between the proposal and the CBO position as expressed by Mr. Torregrosa, which favors the current market rate.

Mr. Torregrosa said CBO also understands Mr. Reid’s problem. He said he did not have anything new to add but that he would see if CBO could write something.

Mr. Allen asked whether any Board member had fundamental differences with staff recommendation, subject to consideration of any CBO submission.

Mr. Patton said it seemed to him that the Board has been mixing together two points: (1) the frequency of change and (2) whether there ought to be different rates for different time horizons. He said he would like to keep them separate. He agreed with Mr. Reid that the Board ought not to be having changes every year, but he believed that the average long-term rate for 5-year money is not the same as the average long-term rate for 30-year money. The standard should require different discount rates for different projected periods of flows.

Regarding the first point, Mr. Allen said the proposal currently would allow the preparer to change the rate.

Mr. Patton noted paragraph 27 was permissive and thought Mr. Reid would object to it.

Mr. Reid said he was trying to solve the problem of the frequency of change and the rates they are applying when they change. One program apparently feels compelled to mark to market at the end of every year. If they simply chose a market rate and every 10 years chose a different market rate, that would not bother him as much as marking it to market every year. He did not object to using separate rates for different maturities as long as there is some stability.

Mr. Patton directed attention to paragraph 27, which says the standard does not require annual changes, which seemed to him more generous than Mr. Reid would prefer.

Mr. Reid agreed. He said he would prefer that paragraph 27 recommend that there be stability in the assumptions, and that they not be changed frequently.

Mr. Allen asked if the Board could agree on the ultimate outcome, however you word it, which is that the Board is not going to tell the agency to change every year.

Mr. Reid repeated that he did not object to different rates for different years as long as the actuaries agreed with it and it did not change current actuarial practice. What he objects to is the use of this year's market rate; he wants an average of expected future rates used.

Mr. Allen said the standard addresses that. Mr. Allen said Mr. Reid seemed to be saying that the standard needs to be modified to eliminate the option to change every year. It needs to say you assume a long-term rate that ought to be calculated in a manner consistent with applying a long-term rate.

Mr. Reid said he would prefer getting language directly from the actuaries.

Mr. Allen said the problem with that is that then the Board would be changing actuarial practice.

Mr. Reid agreed. He said he would rather not do that but he understood Messrs. Torregrosa'a and Patton's points that you probably have some greater precision, as long as the actuaries are not saying we are burning down the building. He said a change is needed and wanted at VA, but VA feels compelled to use market rates.

Mr. Allen said that that is exactly what the standard is doing the way it is worded now. It requires VA to make a change in their rate but it does not tell them how often they ought to calculate it. Mr. Allen said the objective is to get some valuable information doing the least amount of harm to what they are now doing.

Mr. Jackson agreed. He mentioned the objective of the best estimated costs and liability of the program.

Mr. Steinhoff said that if a 5-year number does that, then that would be fine; but if the 5-year number is arbitrary, then that would not be fine. Mr. Steinhoff said that at the end of the day the government would want to rationalize what it does as a government. You would not want 5 different entities doing 5 different things.

Staff agreed and said that was why the focus has been on the long-term average Treasury rate. Staff explained that the discount rate standard has been changed to accommodate the actuaries so that either a single or a multiple-year rate can be used. The original standard had required the multiple-year rate and had explained that is was more accurate and more representationally faithful. However, that would have changed OPM's practice.

Ms. Cohen noted that averaging is effectively a smoothing mechanism.

Mr. Werfel said that during this discussion he has had the feeling that the Board has had an over-simplified view of why we got into this in the first place. He understands that the Board was trying to solve a specific problem of fluctuations that were obscuring the financial reporting with respect to VA's actuarial estimate. He said the Board would not have undertaken the project without the VA problem. He asked whether the Board was fixing a bigger problem than it set out to fix, and is that necessarily the right thing to do. With respect to the VA problem in particular, is there a way to address the VA problem without doing a broad, comprehensive standard that is taking a lot of time and raising a lot of questions.

Staff explained that when addressing the VA problem inconsistent discount rate guidance was found in the SFFAS 5 between the pension and ORB on the one hand and OPEB on the other. The VA applies the OPEB standard. The objective became a consistency among those standards. The staff added with respect to Mr. Werfel's second question, that one could probably address VA's individual problem with a VA-specific vehicle, for example, an interpretation or a letter.

Mr. Reid said the VA auditors are insisting on their interpretation of the relevant SFFAS 5 paragraph. He said the only way to fix this is to change that part of the standard so that they are required to use the same approach as other agencies; or you use something like this that applies to everyone. He said that presumably a letter would not dissuade the auditors.

Mr. Allen said if the Board is aware that there is inconsistency this is a natural fix. This is not a major commitment of time and resources.

Staff noted that the display standard was already on the Board's agenda when the discount rate problems arose. The staff therefore used the display standard as a vehicle for addressing the discount rate issue. Addressing VA's problem might require an interpretation, which would require due process in any event. In short, there was no leap into standard-setting in order to address the discount rate standard.

The Board concluded its discussion of paragraph 27 and agreed to delete it. Mr. Jackson recommended putting it in the basis for conclusions.

Mr. Allen asked the members to respond to the other staff questions and make any other recommendations in writing over the next several weeks. Mr. Allen asked staff to communicate additional information regarding changes to the scope provisions over the next several weeks. He said he had a question about scope, too. He said he thought other concerns had been addressed previously because the Board had said last time that it did not have concerns unless the actuaries had concerns. He noted that the Board had gotten into a more robust discussion this meeting than last meeting.

> **CONCLUSIONS:** The Board approved the display standard. The requirement will continue to be that gains and losses from changes in assumptions are to be displayed as a separate line item and will not be combined with gains and losses from differences between assumptions and experience. There will be more explanation in the basis of conclusions regarding why the market rate benchmark is important information; for example, it allows the reader to distinguish between the program's assumptions versus the market. A question for respondents will ask whether the market rate benchmark has value from a financial reporting transparency standpoint and reference the appropriate basis for conclusions paragraphs. The staff will revisit the market rate disclosure standard regarding whether it should require the disclosure of a single rate or multiple rates.
>
> The members will respond to the staff questions in the March staff briefing memorandum (other that the first question on display which was addressed at the March meeting) and/or make any other recommendations in writing over the next several weeks.
>
> Regarding the scope question, staff will communicate additional information regarding changes to the scope provisions over the next several weeks.
>
> Paragraph 27 will be deleted.

- **Appropriate Source of GAAP**

Staff presented a proposed project plan and background information on the appropriate source(s) of generally accepted accounting principles (GAAP) for federal government corporations and other federal entities that currently follow accounting standards from a source of GAAP other than that recommended by FASAB (i.e., Financial Accounting Standards Board (FASB) GAAP).

Staff noted that this project was initiated in January 2006 after the topic was considered a priority as a result of (1) the Board's October 2004 agenda-setting session, and (2) subsequent consideration of comments on the July 2005 invitation to comment on the four projects selected by the Board for consideration.

The background information included entity profiles and excerpts from financial statements for the following ten federal entities that have historically followed FASB GAAP: Community Development Financial Institution, Corporation for National and Community Service, Federal Deposit Insurance Corporation, Federal Prison Industries (Unicor), Government National Mortgage Association (Ginnie Mae), Millennium Challenge Corporation, Office of Thrift Supervision, Pension Benefit Guaranty Corporation, Tennessee Valley Authority (TVA), and U.S. Mint (the Mint switched to FASAB GAAP beginning with its fiscal year 2005 financial statements).

Staff presented a number of possible outcomes of the project and the pros and cons of each option. Staff provided a draft timeline and requested Board approval to continue to the next phase in the project – "Analyze and document similarities and differences that might prove helpful in developing guidance on which source of GAAP is most appropriate."

Mr. Werfel indicated that OMB would rather not pursue the project at this time in light of resource constraints and other issues that are more pressing. However, Mr. Werfel also communicated that, if the board ultimately decided to go that route, OMB could issue a memorandum reminding government corporations to use FASAB GAAP unless they have a compelling reason not to, in which case the government corporations could come to OMB and explain what their reasoning is.

Mr. Jackson said he believes that staff should continue through at least the next phase to provide the Board with more decision-useful information and analysis upon which to base its decision.

Mr. Reid said he is getting to the point where he is unwilling to support projects that do not result in standards, stating that he would probably support the path of least resistance first, which might very well be having OMB issue some changes. However, he said that may not be effective for an organization such as TVA, which could argue that it is following FASAB GAAP because FASAB is silent in the area of utility accounting and TVA is following what appears to be generally accepted utility practices and the resulting difference is $10 billion. Mr. Reid said that one of the concerns he has is that he is consolidating numbers that are on different bases of accounting, but he acknowledged that it is possible that something more than a memorandum may have to be done before TVA and its auditors are comfortable issuing a report saying that the financial statements were prepared in accordance with FASAB, instead of in accordance with FASB.

Mr. Schumacher supported going to the next phase in the project to have enough information to decide how to proceed.

Mr. Steinhoff said he believes OMB's proposal is the way to go and staff could provide analysis to support OMB. He stated that he does not think the Board should make the ultimate decision of which corporations should follow FASAB GAAP and which can continue to follow FASB GAAP, but the Board may want to endorse or support the decision OMB makes.

Mr. Allen said he is not opposed to OMB saying who's in or who's out, but looking at the issue as a GAAP decision, he thinks staff should at least come back at the next meeting with further analysis and recommendations because the Board is the one that ultimately sets GAAP even though it does not have enforcement authority. Mr. Allen stated that, in addition to OMB's determination of which standard-setter government corporations should follow, the Board may wish to make additional recommendations, such as whether government corporations ought to also prepare a statement of budgetary resources or a statement of sustainability.

When asked to clarify whether OMB has authority to issue accounting standards for government corporations, Mr. Werfel responded that while OMB probably cannot issue accounting standards on its own volition and apply them to government corporations, OMB clearly has authority to apply financial management requirements to government corporations. Mr. Werfel stated that OMB's counsel is still reviewing the paper and he will reconfirm his understanding with them.

Mr. Jacobson said that if OMB can establish financial reporting requirements for government corporations to follow that look remarkably like a set of financial statements prepared in accordance with certain standards, then FASAB, as a derivative of GAO, OMB, and Treasury, can move ahead, and that then also answers the GAAP question.

Mr. Steinhoff said that if staff could provide a set of characteristics to be used as criteria for following one set of GAAP or another, that framework could be used to close the loop with the AICPA on determining who should be required to follow FASAB GAAP.

Mr. Jackson said all entities are one of three types (private sector entity, e.g., General Motors, which is subject to FASB; state or local entity, which is subject to GASB; or a federal entity, which is subject to FASAB). He said it seems clear that the federal government corporations ought to follow FASAB; they cannot pick their standards independent of what the standard-setter allows.

Mr. Werfel said the transition from FASB to FASAB standards would clearly be more difficult for some government corporations than others. He asked Mr. Reid if it would help him in the consolidation if OMB targeted only a handful of the government corporations that look like they would have a moderate to easy transition to FASAB while leaving the others alone.

Mr. Reid responded that one of the challenges they have is that if they are consolidating more than one type of GAAP, they need to demonstrate that the types of GAAP are not materially different. To do that, an entity would either need to (1) keep two sets of books to demonstrate that they are not materially different or (2) be faced with an exception that states “we don’t know if you are in accordance with GAAP or not.” Mr. Reid said he initially thought they could ask for a footnote disclosure to show the difference but that could be more burdensome on an agency that has to calculate it two different ways. However, if the agency transitioned to FASAB GAAP, you would know it is in accordance with GAAP and they only have one set of books.

Mr. Allen said that there are lots of options with display where you do not have to use a blended presentation. It is possible to have a discreet column that shows agencies that are prepared according to a different type of GAAP, similar to how universities display its not-for-profit foundations even though one is GASB and one is FASB. Mr. Reid responded that they would have to look to the standards for relief regarding whether or not it is sufficient to disclose that we have different bases of accounting for different entities. Mr. Reid said the only single significant, material difference he is aware of has to do with property reported by TVA.

Mr. Jackson said this should not be about the consolidation of the financial statements of the U.S. Government. Rather, it should be about providing decision-useful information to the users of the entity-level financial statements.

Mr. Werfel asked Mr. Reid if it was worth changing the status quo if we are not going to require any changes with TVA. Mr. Werfel said TVA seems to be the biggest problem we were trying to solve.

Mr. Reid responded that some clarification with respect to TVA could be sufficient to resolve the material issues. For example, if FASAB said that TVA could continue following FASB for utility accounting because there are no FASAB standards specific to the utility industry, than it solves the main problem with respect to the difference in property accounting.

The majority of the Board agreed that staff should continue through the next phase – “Analyze and document similarities and differences that might prove helpful in developing guidance on which source of GAAP is most appropriate.”

> **CONCLUSION / NEXT STEPS:** The Board has approved additional research on the project at this time. Staff will analyze and document similarities and differences among the ten selected entities and present FASAB staff observations and recommendations to the Board, as deemed appropriate.

Adjournment

The meeting adjourned at 12:10 PM.