

Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording

**Statement of Federal Financial Accounting Standards
Exposure Draft**

Federal Accounting Standards Advisory Board
13-September-2010

Response from the Department of Housing and Urban Development

Questions for Respondents

Measurement of the Elements of Accrual-Basis Financial Statements in Periods After Initial Recording

(Issued September 13, 2010 with responses requested by November 30, 2010)

Responses Provided by: *The Department of Housing and Urban Development*

Q1. This Statement discusses whether and under what circumstances it might be more useful to report an asset or liability in periods after its acquisition or incurrence (a) at the amount initially recorded (i.e., "historical cost," subject to appropriate adjustments for amortization, depreciation, or depletion) or (b) at an amount measured at each financial statement date. These two amounts are referred to in this Statement as, respectively, "initial amounts" and "re-measured amounts."

a. Is the distinction between initial and re-measured amounts understandable and useful to you? If not, please suggest improvements.

Yes, the distinction is understandable and useful.

The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realizable value, marketable securities may be carried at market value, and pension liabilities are carried at their net present value. Furthermore, some entities use re-measured amounts (realizable costs) basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

- **Historical cost (Initial amount):** Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.
- **Realizable cost (Re-measured amounts):** Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

HUD's Federal Housing Administration (FHA) records its Direct Loans and Loan Guarantees in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) SFFAS No. 19, Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantee. This method is similar to re-measured basis discussed above. The cost of loan guarantee programs is the net present value of the estimated future cash flows from payments (for claims, interest rate subsidies, and other payments) and collections (for loan origination and other fees, penalties, and recoveries) by credit agencies.

- b. Are the benefits and drawbacks of using each approach clear and complete? (See paragraphs 17–33.) If not, please suggest improvements or additions.**

Yes, each approach is clear and complete.

- c. Do you agree with the decision to exclude any discussion of the advantages and disadvantages of inflation-adjusted amounts from this Statement? (See paragraphs 14–15.) Please provide the rationale for your answer.**

Yes, HUD agrees. Particularly with the Office of Chief Financial Officer's Accounting Division, inflation has not been a factor in recent years.

Only entities that report in the currency of a hyperinflationary economy will benefit from discussion of the advantages and disadvantages of inflation-adjusted amounts. Inflation accounting is a term that describes a range of accounting systems designed to correct problems arising from historical cost accounting in the presence of inflation. Inflation accounting is used in countries experiencing high inflation or hyperinflation. For example, in countries experiencing hyperinflation the International Accounting Standards Board requires corporate financial statements to be adjusted for changes in purchasing power using a price index.

Since we are not operating under hyperinflationary economy like during the 1929 depression, there is no need to include the discussion of the advantages and disadvantages of inflation-adjusted amounts in the financial statements.

- Q2. This Statement distinguishes among “measurement approach,” “measurement attribute,” and “measurement method.” (See paragraph 7.)**

Are the distinctions clear? If not, please suggest improvements.

Yes, the distinctions are clear.

- Q3. The Statement asserts that:**

[W]hen the goal is to help ensure that reported information meets several financial reporting objectives in response to the various decision-making needs of a range of users, it is necessary to accept that different measurement approaches,

measurement attributes, and measurement methods may be appropriate to convey useful information about different transactions and underlying events. (See paragraph 33.)

Do you believe that it is appropriate to measure items presented in accrual-basis financial statements using different measurement approaches, attributes, and/or methods? Please provide the rationale for your answer.

Yes.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement. As discussed in Q1(a) above, the selection of a particular basis of measurement depends on the existence of stable measuring unit assumption and the reliability of the resource measured. Inventories are usually carried at the lower of cost and net realizable value, marketable securities may be carried at market value, and pension liabilities are carried at their present value. The cost of loan guarantee programs is the net present value of the estimated future cash flows from payments (for claims, interest rate subsidies, and other payments) and collections (for loan origination and other fees, penalties, and recoveries) by credit agencies.

Historical cost basis records the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation. Current cost basis records assets at the amount of cash or cash equivalents that would have been paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently. Realizable (settlement) value basis records assets at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

In addition, the nature of assets and liabilities can vary significantly and the impact of external economic factors can affect some more than others. For example, economic factors would have little impact on the value of PP&E (Property, Plant, and Equipment) and accounts payable versus loan guarantees and loan guarantee liabilities.

Q4. Beginning in paragraph 34, this Statement presents the definitions of measurement attributes and discusses each attribute in relation to the qualitative characteristics that information in financial reports should demonstrate. These attributes will be relied on in establishing accounting standards in the future.

- a. **Is the definition of each attribute clear and understandable? If not, please identify the attribute(s) for which you found the definition lacking, explain why, and suggest improvements.**

Yes, HUD agrees. The definitions are clear and the explanations are helpful.

- b. **Is the list of attributes complete? If not, please identify and define the attribute(s) that you would add to this Concepts Statement and explain why you would add it (them).**

Yes, HUD agrees. The list of attributes is complete and comprehensive.

- c. **Are there any attributes in the list that you believe are inappropriate for accrual-basis federal government entity financial statements? If so, please identify the attribute(s) that you would exclude and explain why.**

No, the attributes seem appropriate.

- d. **Do you agree with the discussion of the extent to which the measurement attributes and methods fulfill the individual qualitative characteristics? If not, please identify which aspects you view differently and explain why.**

Yes, HUD agrees.