FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
Final Minutes
June 18-19, 2003
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, June 18, 2003

Administrative Matters

- **Attendance**

The following members were present: Chairman Mosso, Messrs. Anania, Calder, Farrell, Kull, Patton, Reid, Schumacher, and Ms. Cohen

The following ex-officio members were present: JoAnne Boutelle, the Department of Defense

- **Approval of Minutes**

It was noted that the minutes of April 23-24, 2003 had been approved via e-mail and that a final copy was provided in the binders.

- **Introduction of Susan Lee**

Ms. Comes introduced Susan K. Lee. Ms. Lee is on detail to FASAB from FAA for six months to research lease accounting issues and options. Ms. Lee has had an extensive career in Federal accounting and budget, having also worked at the National Archives and Records Administration, the Office of Management and Budget, and the Financial Management Service, Department of the Treasury.

At the National Archives, she was the Director of Accounting and the Director of Budget, in charge of accounting operations, systems, and policy; financial management; grant payments; budget formulation and execution. At the FAA she chaired an intra-agency task group to identify possible user fees, co-authored a report to Congress on FAA's existing billings and collections system, and wrote a report on Government Corporations that was cited by the National Performance Review. More recently, she established and coordinated the FAA's Audit Advisory Committee and served as FAA's audit liaison for the FY 2002 financial statements audit, and was responsible for preparing the agency's FY 2002 Performance and Accountability Report.

In her last position at Treasury, Ms. Lee was the Director of the Federal Agency Financial Systems Program and served as Treasury's Fiscal Service representative on the Chief Financial Officers' Council and the Systems Committee of the President's Council on Management Improvement. While at OMB, she worked on financial systems, implementation of the Federal Managers' Financial Integrity Act, and debt collection. She has been active in the Association of Government Accountants, American Association of Budget and Program Analysis, the Brookings Institution Accountants' Roundtable, and the Comptrollers' Roundtable. She is a Certified Public Accountant and a graduate of the University of Maryland School of Business.

- **New Memorandum of Understanding**

Ms. Comes announced that there is a new Memorandum of Understanding (MOU) governing FASAB. She reminded members that the Treasury had previously given up its veto authority over standards and concepts. That change was intended to increase the Board's independence. The latest MOU change brings CBO back as a voting member.

Mr. Farrell noted that the Board would then have ten members. Mr. Anania asked if the voting provisions had been modified given the even number of members. The Chairman indicated that it had not and a simple majority of voting members would be required to approve documents. Ms. Comes explained that draft rules of procedure would be provided for review at the August meeting. The draft rules would clarify all voting issues.

- **American Institute of Certified Public Accountants Rule 203 Review**

Mr. Mosso noted that the American Institute of Certified Public Accountants (AICPA) has begun its five-year review. He asked Ms. Comes to provide background.

Ms. Comes explained that in 1999 the AICPA recognized FASAB as the generally accepted accounting principles (GAAP) standard setter for federal entities but that a five-year sunset provision was provided. The AICPA committed to conducting a review of FASAB before the conclusion of the five-year period. The AICPA has five criteria for a GAAP standard setter with “independence” being the criterion most at issue for FASAB.

Ms. Comes explained that some procedural changes were made in 1999 that enhanced independence. However, the AICPA indicated that additional changes were expected. Chairman Mosso commented that the change that brought the number of non-federal members to six went beyond the independence changes proposed by the AICPA.

The five members of the review panel are:

> Gary Previts, Professor of Accountancy at Case Western Reserve University, will chair it. He chaired the 1999 task force and was instrumental in the effective review in 1999. The fact that he already knows a great deal about FASAB should facilitate the current review.
>
> Judy O’Dell, President of O’Dell Valuation Consulting, LLC, also serves on our Appointments Panel.
>
> Marilyn Pendergaust, Managing Director at Urbach Kahn & Werlin, LLC (Albany, NY) served on the 1999 task force.
>
> Sharon Russell, Director, Research & Professional Development at Alabama Department of Examiners of Public Accounts, represents the Association of Government Accountants.
>
> Pete Smith, President and CEO of the Private Sector Council, is familiar with FASAB and has been involved in financial management improvement throughout the federal government.
>
> Ian MacKay, Director of Professional Standards and Services, serves as the AICPA staff liaison to the task force.

Chairman Mosso noted that the timeline for the review is tight and that the review should be completed by spring 2004.

Mr. Farrell asked if we would be reviewed every five years. Chairman Mosso indicated that he wasn’t certain. He believes the AICPA objective is a periodic review of each GAAP standard setting body.

Chairman Mosso closed by indicating that the review panel wishes to meet with the Board at its August meeting. The objective would be to ensure that the members understand the review plan and to solicit members' views on any issues related to the criteria.

Agenda Topics

- **Performance Survey Results and Issues**

Ms. Comes explained that the survey was taken in December 2002. The objective of the survey was to develop performance measures for federal advisory committees. Since the universe of federal advisory committees is broad and the survey was not tailored for FASAB, she commented that the questions could have been interpreted differently by different members. She noted that FASAB is unusual because FASAB products influence all federal agencies whereas many advisory committees influence a single agency's policies.

Ms. Comes noted that FASAB scored very well relative to the government average as well as on the 5-point scale. Nonetheless, she emphasized that the survey could be used as a tool to support continuous improvement. Mr. Patton asked about the sample. Ms. Comes noted that the sample included Board members and the Executive Director.

Ms. Comes indicated that the Gallup report showed:

1. that all members would work with FASAB again
2. separate indices for people, process and outcome
3. FASAB's process index was slightly above average but that the most room for improvement lies in process

Ms. Comes explained that Gallup encouraged organizations to focus on moving "fours" to "fives." While she saw value in that recommendation, she felt that FASAB's few "threes" warranted some attention.

The members briefly discussed how to read the detailed survey results and the chart classifying specific areas as "major/minor strengths" or "priorities for improvement." Then Ms. Comes explained that she had provided some suggestions for addressing each identified priority for improvement. She qualified this by noting that it was possible that members interpreted the questions differently – making her suggestions possibly off-target.

Chairman Mosso suggested that the survey questions be sharpened for the next survey. Ms. Comes agreed to communicate that suggestion to Gallup.

Mr. Anania asked if FASAB has a formal responsibility to follow-up to anyone on our next-steps. Ms. Comes indicated that no follow-up has been requested.

The Board discussed the survey results and identified the following enhancements to current practice:

1. Having minutes sooner following each meeting.

2. Highlighting action items at the conclusion of each section of the minutes is helpful.

3. Increasing between meetings staff contact with the members (e.g., through staff requests for comment on re-drafts or issue analysis) helps the members stay engaged in the projects and facilitates resolution of issues.

4. Ensuring that staff identifies which issues are most significant so that members focus on providing input on those issues first.

5. Active solicitation of responses from groups identified as likely to be interested in exposure drafts.

6. Member participation in conferences – as speakers and attendees – would benefit the members and establish connections between members and the federal community. The staff will explore holding the June 2004 meeting in conjunction with the Association of Government Accountants Professional Development Conference in Washington, DC.

7. Access to reference material (preferably electronic) was requested by some members.

Conclusion: Staff will take action on all suggestions subject to resource constraints.

- **Earmarked Funds**

Ms. McKinney began the meeting by noting that the Board had requested revisions to the first draft ED and illustrations showing flow information for earmarked funds. She also noted that two issues of primary interest to Board members appeared to be clarifying the note on investments and deciding whether to require flow information.

The Board first addressed the note on investments. Mr. Kull distributed copies of his revision to the note. The resulting discussion centered on the need to be technically correct in describing the process of redeeming securities and financing expenditures versus the need to convey to users of the financial statements that investments in Treasury securities do not represent actual cash assets. OMB's suggested revision emphasized that cash is not needed to redeem securities, cash is needed to finance expenditures. The revision also noted that these expenditures are financed in the same manner as any other expenditure.

Mr. Anania noted that the members wanted the reader to understand that although a fund holds a Treasury security, the government does not have an equal fund of cash available to be spent. Mr. Mosso agreed that this is one of the most misunderstood aspects in the public's mind regarding earmarked funds. He suggested that the Board members provide staff with the wording that they prefer and that staff use the different versions to develop one acceptable to all Board members.

Following this discussion staff pointed out to the Board that a major revision to the ED was in the definition, which now requires that an earmarked fund meet three criteria. Board members asked that wording be revised to clarify that all three criteria must be met. Mr. Calder observed that the first few paragraphs in the introduction to the standard (and the corresponding ones in the executive summary) are not clear on whether an earmarked fund is the revenues or the accounting mechanism. Several board members agreed and suggested language to make the distinction clearer. Mr. Calder emphasized that he wanted the ED to clearly show that the Board is interested in the money that is being collected with a promise attached to it, more so than in the accounting mechanism.

The Board then discussed the disclosure requirements of the ED. Mr. Farrell observed that paragraph 18, which requires any change in legislation that significantly changes the purpose of the fund to be disclosed, should also address situations where funds are not being appropriated. Ms. McKinney responded that par. 46 in the Basis for Conclusions included a broader requirement and that staff had intended for the broader requirement to be included in the standard. She repeated the language from par. 46, which is "or redirects a significant portion of the accumulated balance to another purpose", and asked the Board members if that would be satisfactory. Board members agreed that the revision was appropriate.

Mr. Patton asked whether the standard was clear regarding amounts that should be recognized on the statements and amounts that would be disclosed in a note. He observed that the term disclosure refers to a note, whereas on the face of the statements meant recognition. Mr. Schumacher questioned whether the standard was clear on when information had to be disclosed for an individual fund and when it could be aggregated for immaterial funds. Mr. Anania pointed out that the standard needed to be clear that even if funds were immaterial in the aggregate they had to be shown. Staff suggested that the standard could require even less information for immaterial funds that were aggregated. Ms. Comes suggested that subparagraphs 4 and 5 of par. 17 would be the only ones applied; the requirements for explanations of changes in legislation, etc. would only apply to the material funds.

Mr. Schumacher said that he did not think the standard clearly resolved the difficulty of what would occur with comparative statements if a reporting entity changed the funds it was reporting from one year to the next. Board members agreed that no restatement would be required, just a note. They also agreed that early implementation would not be allowed, and decided to try for a fiscal year 2005 implementation date (after September 30, 2004).

Mr. Patton raised the question of whether the standard should require flows to be shown on the statement of changes in net position. The Board members discussed the examples on statements of net cost and statements of changes in net position provided by staff. Mr. Farrell suggested that a more simplified format be used with a line that reported aggregate amounts for earmarked funds. Board members agreed with that approach and suggested that the ED ask specifically whether it would cause any difficulty in implementation. Mr. Mosso also suggested staff might want to include a question on statement of net cost.

Mr. Anania suggested that the Board might want information on funds that were significant instead of material, and that might require the Board to define significant. The Board members discussed at length what earmarked funds might be “significant.”. Mr. Patton observed that the standard as written required that all funds be listed and questioned whether that would be too onerous for the CFR. After discussion Board members agreed that the CFR would not list all the earmarked activities because Treasury did not have management responsibility for all funds.

At the request of the Board, staff provided examples of the use of the word “significant” in various occupations, including the definition used by the SEC. The SEC definition was deemed too vague to be of any use. Another staff person noted that GASB 34 used the definitions of major and non-major based on percentages. After some discussion a majority of Board members decided that they preferred the word “significant” without any further definition. Mr. Patton preferred that the Board stay with the term “material” since it has a history of usage in accounting. He also noted that having one person interested in a fund should not make it significant.

Mr. Kull preferred to require a preset number of funds based on criteria such as three top funds. Other Board members, however, raised objections to this approach, including the difficulty of establishing a measure, disparities at different reporting levels and others. Mr. Kull responded that the Board could address exceptions as preparers raised them but that it was better to have a concrete requirement than to have preparers and auditors argue about it. Mr. Calder stated that he thought the standard was overkill, that after the top eight or ten funds the ones remaining are not significant. Mr. Reid noted that below agency level some of the funds would be material. Mr. Mosso observed that the funds were significant to beneficiaries.

Mr. Anania reminded the other Board members that it may have treated materiality differently in earlier standards and would have to address any inconsistency.

CONCLUSION: Staff will:

1. include a question in the ED asking responders if they believe the guidance is adequate and, if not, to provide some suggestions for alternatives.

2. provide Board members with alternatives on the note on investments and then to proceed to a pre-ballot draft of the ED incorporating the changes discussed by the Board.

[NOTE: Some of the points covered in the minutes above actually occurred during a follow-on discussion the morning of June 19th . For ease of reference, the entire discussion on earmarked funds is presented above.]

The Board adjourned for lunch.

- DoD Update on Implementation of SFFAS 23

Mr. Stephen Tabone, Deputy Director for PP&E Policy, OUSD (AT&L), Department of Defense (DoD) presented a DoD status briefing to the Board on implementing the new accounting and reporting requirements for military equipment.

<u>Background—The Amendment to SFFAS No. 6</u>

Mr. Tabone stated that DoD refers to SFFAS 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, as an amendment to SFFAS 6, *Accounting for Property, Plant, and Equipment*. Mr. Tabone explained what effects the amending standards would have on SFFAS 6. He noted:

- prior to the new accounting and reporting requirements for military equipment, DoD expensed the costs of acquiring and modifying/upgrading military equipment (e.g., ships aircraft, combat vehicles, weapons);

- the new requirements designate military equipment as general property, plant, and equipment (PP&E),

- existing military equipment and future acquisitions would be capitalized and depreciated; and,

- the effective date for the amending standards is effective for fiscal year (FY) 2003.

He added that the SFFAS 23 provides implementation guidance recognizing the imprecision in developing historical costs for existing assets and permitting various means to estimate initial capitalization amounts (e.g., budget, appropriation, and other reports reflecting amounts expended).

<u>Background--The Department of Defense</u>

Mr. Tabone provided a brief overview of the organizational entities reporting to the DoD, it's FY 2004 budget, quantities of military equipment, and feeder business information management systems. He noted:

- There are three Military Departments, 15 Defense Agencies, 7 Field Activities, and 9 Unified Combatant Commands

- The FY 2004 DoD Budget is$379.9 Billion--$72.78 for Procurement, $61.88 for RDT&E, $117.08 for Operations and Maintenance, and $128. 4 for other appropriations

- The quantities of military equipment, which include:

  -1,355 Combat and Support Ships (does not include over 2,000 small boats)

  -15,706 Combat, Airlift and Other Aircraft

  -194,953 Combat Vehicles

- The number of financial and non-financial feeder business information management systems exceeds 2,300

<u>USD(C) and USD(AT&L) Directed Implementation Requirements</u>

Mr. Tabone explained that the Under Secretary of Defense (Acquisition, Technology & Logistics) and the Under Secretary of Defense (Comptroller) directed the PP&E Policy, OUSD(AT&L), to lead the Department's implementation to ensure:

- Standard and consistent approach and methodologies
- Policies are modified, coordinated and promulgated
- Historical costs (baseline) pass the test of the audit community
- Implementation must focus on information required by DoD decision makers

Mr. Tabone noted that both Under Secretaries are in general agreement on how the implementation process is proceeding. The Under Secretary of Defense (Comptroller) also directed that a parametric estimate be developed and reported in the June 30, 2003, quarterly financial statements.

Mr. Tabone proceeded to present and discuss the following major implementation tasks.

<u>Develop and report a parametric estimate</u>

Mr. Tabone explained that, per GAO, the DoD could move from a disclaimer of opinion to an adverse opinion in FY 2003 with the new requirement for military equipment because "the DoD Balance Sheet would be materially understated". To avoid an adverse opinion, the DoD agreed to either report the amount removed from the Balance Sheet in 1998, with appropriate modifications, or to develop an estimate. The DoD decided to report an estimate, a parametric estimate, using information from the Bureau of Economic Analysis (BEA), Department of Commerce. The BEA captures DoD investments in PP&E from budget information submitted to the Congress and calculates depreciation on such investments. The DoD obtained the BEA database, removed non-military equipment investments, sorted the data by DoD Component, and established an estimate to be reported beginning June 30, 2003.

Mr. Tabone noted the amounts to be reported in the June 30, 2003, DoD Consolidated Financial Statements:

- Investment in Military Equipment $1,116 Billion
- Accumulated Depreciation $794 Billion
- Net Book Value $322 Billion

He added, for purposes of the estimate, investments in equipment prior to 1970 are considered fully depreciated.

Development of the Historic Cost Baseline

Mr. Tabone described the efforts made in developing the historic cost baseline:

- Involving the Office of the Secretary of Defense and Military Department Acquisition, Logistics and Financial communities
- "Working" the DoD budget to obtain implementation funds and have hired contractor support
- Identifying over 600 military equipment programs and/or major end items to be valued to date (many more may need to be valued),
- Presently, have 54 military equipment programs and/or major end items in various valuation stages (includes documenting cost; determining asset useful lives; documenting quantity of items acquired, when delivered and when disposed; and calculating accumulated depreciation)
- Identifying and beginning to assess 34 logistics systems for quantity data
- Developing a historic cost archive and data repository system

Mr. Tabone added that the following policy decisions used in developing the historic cost baseline are currently under review:

- Capitalization of individual ships versus ship program
- Capitalization of aircraft and combat vehicle blocks (models) versus programs
- Componentization of ships by major acquisition programs

- Capitalization of modifications and upgrades by asset, block or separately
- Capitalization of bulk purchases of assets below the DoD capitalization threshold of $100,000
- Depreciation based on useful lives determined by experience versus engineering estimates.

Incorporating the Accounting and Reporting Requirements in the Business Enterprise Architecture

Mr. Tabone continued by discussing the incorporation of the accounting and reporting requirements in the DoD-wide business enterprise architecture. He noted that the Department completed Version 1.0 of the Business Enterprise Architecture in April 2003. He also noted that the Acquisition Domain submitted a Business Enterprise Architecture Pilot Project Proposal to validate and further define the architecture for the military equipment accounting and reporting requirements. He added:

- Approval for the Business Enterprise Architecture Pilot Project is expected to be obtained by July 31, 2003.
- It is expected that the funds ($3.5 million) will be obtained and the project begun in August 2003.
- It is planned to complete the project within 270 days.

He also stated that a contractor has been hired and a project plan drafted to identify the financial information requirements of military equipment program managers.

Challenges

In closing, Mr. Tabone presented the DoD's challenges in implementing the new requirements. They include:

- Minimizing the cost of developing the historic cost baseline (current estimate is $12.5 million)
- Modifying and coordinating numerous policies and regulations:
    - DoD Financial Management Regulation
    - Federal Acquisition Regulation and Defense Acquisition Regulation Supplement
- Capturing reliable quantity information for quarterly reporting
- Capturing and reporting classified program information

- Modifying business practices of the Acquisition, Logistics and Financial communities
- Replacing or modifying over one hundred acquisition, procurement, logistics and financial systems

- Concepts

Mr. Mosso explained that the objective for the day's discussion was to identify issues the Board would like to study in phase 1 on objectives, not to debate them.

Question 1: is more background information needed on some topic?

Mr. Bramlett noted that at the April meeting Justine Rodriquez provided background information about SFFAC 1, with particular emphasis on the "stewardship" concept and stewardship reporting in the Budget of the United States Government. He asked whether the Board needed more background information on other aspects of SFFAC 1, and whether the implications of specific provisions of SFFAC 1 were unclear.

Mr. Anania said it would be helpful to have a better or common basis of understanding of what is implied by the "systems and controls" objective: Is it a GAO audit standards-based concept, an AICPA-based concept, or something else? Is thinking about systems and controls today different from then? Mr. Schumacher noted that he had not often seen standards refer to the objective, leading to the question: has the Board just not gotten into that area, or does the objective need to be revised?

Mr. Anania said someone has commented that the effect on systems and controls can be indirect rather than direct. If that is true, perhaps we should elaborate on that. One might say the same thing about the budgetary integrity objective. Mr. Patton noted that the shorthand label for some of the objectives might lead one astray. One might infer from the phrase "systems and controls" that the goal is to make systems and controls better. But when one reads the text under that heading, it is about providing information about the nature of systems and controls and whether they are adequate. Mr. Anania suggested that one might infer from the objective that the Board needs to deal with the effectiveness of controls in any area where it writes a standard. Mr. Mosso observed that the objective as written reminds one of the recent SEC release on controls pursuant to the Sarbanes-Oxley Act. [Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports. See http://www.sec.gov/rules/final/33-8238.htm]

Mr. Patton noted that SFFAC 1 cites management's assertions as an example of the kind of information that would address this objective. He didn't know whether every standard would need to address the objective, but he could imagine a single standard that called for management's assertions about control effectiveness.

Mr. Calder said GAO agrees that systems and controls are important and management should report on them and improve them if that is needed. He did not know what the authors of SFFAC 1 had in mind. In response to a question about what FASAB could do to address that, Mr. Calder said he supposed FASAB could require management's assertions about controls as an integral part of the financial statements. Several people said this kind of reporting is already required elsewhere by statute. Mr. Calder agreed, noting that it was in a different context. In response to a question, he explained that Government Audit Standards have long called for the auditor to report on controls. Eventually auditors may express an opinion on controls.

Mr. Kull asked whether the question was how systems and controls are reported, or how users understand that? He noted that OMB tracks controls and this is reported in the "Performance and Accountability Report."

In response to a question about private sector practice, Mr. Anania explained that FASB does not deal with controls directly. The community of users there relies on the SEC and AICPA to deal with internal control and reporting on it. Mr. Anania noted that SFFAC 1 paragraph 46 expands on the budgetary objective and what the Board might do in that regard, but he did not see a similar expanding paragraph regarding the internal control objective.

Mr. Calder noted the evolution of accounting standards and the expanded scope of financial reporting. GASB has added MD&A. FASAB has issued SFFAS 4 on Managerial Cost Accounting to provide better information for management purposes, and SFFAC 1 talks about performance reporting and internal control. Mr. Kull said the purpose of the Board is to set standards for reporting information that the public needs to assess the Government's accountability to its citizens. Mr. Mosso noted that was not the way the Board was originally structured. Mr. Kull agreed, saying that the change in structure may indicate a need to review the objectives. Mr. Mosso noted that systems and controls was also part of the Board's mission statement.

Mr. Patton said that SFFAC 1 notes there are other sources of information that contribute to the objectives. He would like analysis of the extent to which the objectives we end up with are FASAB objectives or are objectives that go beyond FASAB.

<u>Question 2: does the Board want a new users' needs study of some sort?</u>

Staff recalled that in the past Mr. Kull had urged a new study of users' needs. Mr. Kull said that he would rather have a discussion about some of the other issues that have been raised than have another user needs study. His question about users is "who are we really trying to serve?" Are we trying to serve the citizens, or to prescribe how the executive branch manages? There are many ways of cutting this.

Mr. Anania noted that SFFAC 1 asserts that the objectives encompass internal as well as external users. More interaction with groups like the CFO Council or some advisory groups and at conferences might be helpful. In addition there might be one or two roundtables.

Mr. Kull said that people say they don't understand what of value they get from having audited financial statements. Federal managers say, "so what, I got a clean opinion." Some aspects of this process, especially the controls, are important to getting quality information to managers.

In response to a question, Ms. Boutelle agreed, saying she is constantly asked why her department is spending millions to put the weapons systems on the books. She sees value in reporting control deficiencies and improving the underlying data.

Mr. Schumacher noted that we are spending the taxpayers' money; we need to be accountable to the stakeholders. Mr. Reid said that there is an assumption that there is a continuum that starts with good accounting practice and ends with clean opinions. It is possible to get a clean opinion in other ways, but that is not preferable. Better systems and management are evolving. The standard-setting process is probably less relevant to this improvement than is management.

Question 3: What changes may affect objectives?

Members have suggested that changes in the environment since SFFAC 1 was published may imply a need for revised objectives. What changes, apart from the change in the Board's structure mentioned earlier, do members have in mind?

Mr. Reid suggested that staff look at laws that have come into play since SFFAC 1.

Question 4. Do members have other concerns or questions about parts of SFFAC 1?

Mr. Anania noted that the way the internal/external focus is stated differs from FASB's objectives. Paragraph 10 can be read broadly. Some review, elaboration and discussion of this would be desirable. Are we meeting that objective or not? Perhaps the Board should consider whether that objective should be modified. . Mr. Kull noted that the "budget" and "accounting" communities are two different worlds. Mr. Anania asked if that implied we should not address the budget in our objectives. Mr. Kull said that could be studied. Alternatively, the budget community might want appropriations audited. Mr. Anania said he had heard some people say that accrual accounting can help in the budgetary world. Mr. Kilpatrick said that credit reform was an example of accrual concepts being useful in budgeting, though it was a limited application. Mr. Kull said that one can't truly manage for results only with budgetary concepts and information.

CONCLUSION: Staff will provide background information on the evolution of the "systems and controls" objective and internal control reporting practices in the federal government and in the private sector. Staff will provide information on laws passed since SFFAC 1 was published that may have implications for the objectives of federal financial reporting. The Board will consider further the implications of (1) the dual "internal/external" focus asserted in SFFAC 1 (2) the budgetary integrity objective, and (3) the idea, also asserted in SFFAC 1, that there are multiple sources of information, including many outside FASAB's purview, that contribute to achieving the objectives described in SFFAC 1.

- **Natural Resources**

Staff noted that the objective of the meeting was to review the questions and issues from the April meeting and to discuss further how to proceed with an oil and gas resources ED. Staff also noted that the focus of the discussions should be on (1) what, if anything, can be recognized; and, (2) what would constitute good disclosure.

The first issue was quantifiable information that could possibly be disclosed in the footnotes. Staff indicated that Attachments A and B of the materials contain quantifiable information that could be presented as disclosures. That information included the number of acres and the number of producing and non-producing Federal onshore, Federal offshore, and American Indian leases included in the number of acres. Staff also reviewed projected revenue and projected volumes of sale information. Mr. Schumacher asked if any audit work was done on the acres and lease information. Staff responded that that no audit was done on it. Mr. Kull asked what agencies would be affected by this ED. Staff indicated that, while the Mineral Management Service (MMS) within the Department of the Interior gets information from the Energy Information Agency (EIA) within the Department of Energy, only MMS and the Bureau of Land Management (BLM) would be affected.

Mr. Anania indicated that the pertinent questions were (1) what should be recognized as an asset, if anything, now or before leases are signed and revenue is generated; and, (2) what is the source and what is the reliability level of unit information that would allow for it to be a note disclosure. He also noted that the source and the reliability of the information would have some bearing on where information should be reported and if it is worthy to go into the basic statements.

Mr. Kull noted that in past Board meetings the Board had talked about the priority of projects. He added that at each of the last 2 or 3 Principals meetings, all the Principals wanted FASAB to focus on the liability issues. Yet, FASAB is working on natural resources, heritage assets and stewardship land projects. Projects, which he believes, are of very limited value to the government. He said he believes what constitutes a liability is a far more important issue than these projects. Mr. Kull indicated that 0MB will be sending FASAB a letter urging FASAB to be responsive to the request of the Principals. He added that the Board should be looking at available resources to work on projects that would have a maximum impact on the government.

Mr. Reid indicated he had access to a number of people who are anxious to work on the liability issues and who could work with FASAB staff. Mr. Patton noted that he agrees that the liability issues are important. However, he believes the nature of the concepts project and the nature of what an asset is are also important issues. Mr. Patton noted that when a project or vehicle is found that would address the asset issue, addressing that issue would cover all government assets. Mr. Patton added that defining what is and is not an asset may be a small component of that project, however, the conceptual underpinning for the resolution of the asset issue would be enormous and as important as the liability issues. Mr. Mosso noted that staff work has started on the liability issues.

Staff led a discussion on the national assessment of oil and gas resources and agencies' 5-year plans. Staff explained that information obtained from these 2 tasks was not consistent, timely, or reliable. Mr. Mosso noted that there was not much interest in disclosing information about the assessment and 5-year plan. Mr. Anania stated that, based on information presented by the staff and Board discussions, nothing major has surfaced in regard to asset recognition or the timing of revenue recognition. Mr. Mosso said that natural resources would likely be disclosed and asked about items that are attractive for disclosure and the quality of the data. Mr. Calder noted that the questions here are do we have contingent assets and should we say something about them.

Staff noted that capitalizing the value of leases or recognizing a future royalty stream is problematic because there are many uncertainties and variables involved. Mr. Mosso indicated that these questions came up at the last meeting and staff is saying that the numbers would be soft.

Staff explained that collections made one month are distributed the following month using statutory distribution formulas. Mr. Anania asked how big the collections were in regard to the big picture of things. Ms. Debra Carey, a representative from the Department of the Interior, responded that last year's collections amounted to approximately $10 billion. Mr. Kull noted that, in comparison, the current year budget is $2.2 trillion. Staff added that the entire $10 billion would not be recognized by the Treasury General Fund. Staff indicated that royalties are allocated to various entities including the Treasury General Fund, special funds, the states, and American Indians using the distribution formulas. Staff also indicated that royalty-in-kind (RIK), (i.e., oil), may be provided in place of paying cash value for royalties in certain specific situations. Mr. Schumacher asked if the RIK would be recognized as an asset. Mr. Mosso responded that they would be recognized in the strategic petroleum reserve as stockpile material.

Staff informed the Board that the annual value presented in the Analytical Perspectives of the Budget, Government Assets and Liabilities, for Mineral Rights is determined in the same manner that the value for Land is determined. That is, there are no official estimates of the market value of these holdings. The estimates in the Budget are based on a study published in 1987. Researchers in the private sector estimated what oil and gas resources were worth through 1985. The estimates presented in the study have been extrapolated over the years. Each year the estimated value is adjusted based on the crude energy price from the Producer Price Index without taking into account any depletion of oil and gas resources or any new discoveries.

Staff described how natural resources are recognized in the countries of Norway, Saudi Arabia, Denmark, Pakistan, United Kingdom, Canada and Russia and in the state of Alaska. Staff noted from its research that a majority of these countries either lease/sell the rights to private companies to explore, develop, and extract oil and gas resources or the countries establish their own "state-owned" oil company(s) to provide those services. In either case royalties or sale proceeds are remitted back to the government as a revenue source. Staff also noted that the only assets reported on the statements related to oil and gas operations were fixed assets and other FAS 19 related assets. In other cases only statistical information was available on the oil and gas activities Revenues are normally recognized when products are delivered to customer.

Staff noted that the Alaska consolidated annual financial report (CAFR) did not report any oil and gas resources on its Balance Sheet nor were they're any statistical disclosures pertaining to the oil and gas resources under the control of the State. The CAFR did disclose minimal information about the revenues collected from these activities and what those funds are used for.

Staff stated they attempted to clarify the definitions to be used in the oil and gas resources ED with the proposed revisions on page 10 of the materials. With the revisions, staff explained they were identifying specific lands that would be subject to the oil and gas resources accounting standards. Mr. Calder asked if the focus of the ED would be on land or oil and gas resources. Staff responded the focus would be on oil and gas resources. Staff added that, depending on where the oil and gas resources are located (offshore, onshore, on Indian land), the administration of the resources and the collection and distribution of revenues are different based on statutory regulations. Thus, definitions for the types of lands are needed.

Staff explained that they had provided excerpts from the FASAB Natural Resources Task Force Discussion paper in response to the suggestion that some sort of cost basis be measured as opposed to not recognizing a resource. Staff also noted that questions 8 and 9 on page 14 of the material had been deferred to the August meeting.

Mr. Mosso asked about the quality of the information in Attachments A and B of the materials? Mr. Anania, Mr. Calder, and Mr. Farrell all indicated that the information in Attachments A and B was of little value. Mr. Anania mentioned the possibility of capitalizing the cost of oil and gas survey/assessments.

CONCLUSION: For the August meeting, Mr. Mosso asked that staff also look at how the proposed recognition of oil and gas resource collections and disbursements would affect an entity's Statement of Custodial Activities; and, to bring back to the Board pro forma disclosures that could be included in entity financial reports. Mr. Mosso asked staff to research and come back with pros and cons for capitalizing oil and gas assessments.

Adjournment

The meeting adjourned at 4:00 PM.

Thursday, June 19, 2003

Agenda Topics

- Earmarked Funds

The Board resumed discussion of earmarked funds. The discussion occurring June 19th was incorporated in the June 18th section of these minutes.

- Inter-Entity Costs

Ms. Comes introduced the topic by explaining that a number of groups have worked towards guidance to fully implement par. 110 of SFFAS 4. She noted that the most recent effort did not result in guidance that would move implementation along. She proposes that a date certain for full implementation of inter-entity costing be established and that any implementation guidance would be provided as entities identified specific problems.

Mr. Reid indicated his opposition to the proposal. He described a “daisy-chain” result where agencies simply keep reallocating costs. He believes that could keep going indefinitely with agencies passing costs between each other. Mr. Reid noted that the group failed to identify any truly government-wide issues of significance. Thus, he is inclined to simply leave this alone.

Ms. Comes noted that cost accounting improvements drove up costs charged without regard to whether the inter-entity cost provisions were in place. In addition, she noted that the proposal would remove a barrier to full costing of future inter-entity arrangements even if there are no significant issues today.

Mr. Anania described private sector practice for subsidiaries. He indicated that entities have costs allocated from related organizations. When that occurs there are disclosures covering the related party transactions and allocations. From a management perspective, there are inter-unit pricing issues. Disclosures deal with the fact that these are not market driven costs.

Chairman Mosso asked whether the private sector allocates all inter-entity costs. Mr. Anania indicated that his experience was that some costs are allocated and some are not. Mr. Schumacher agreed.

Members asked for clarification on the current OMB guidance. It was noted that four costs are allocated at this time.

Mr. Reid indicated Treasury would be impacted by this change. Treasury would be exporting costs but that the biggest costs are being reimbursed now. In theory, Financial Management Services (FMS) provides support services to all agencies. Bureau of

Public Debt (BPD) services intra-governmental debt which is about half of the debt. Most of the cost at BPD is servicing savings bonds which are not intra-governmental.

Mr. Farrell asked what is reimbursed and what is not? Mr. Reid indicated that some are reimbursed and that a large portion of FMS operations is covered by reimbursable agreements.

Mr. Kull noted that agencies are currently unable to eliminate their business with each other. Some of the interagency activity is program related – enhancing each others programs because all benefit. In other cases, it's business related. New business rules are being developed that will assist with the elimination problem. He believes that forcing the business rules will reduce these types of problems. Agencies will need to identify the activities between agencies.

Mr. Kull noted that all inter-entity activities require an agreement of some sort. Mr. Reid noted an increase in reimbursable agreements. He wondered whether budgetary problems were driving this increase. Mr. Kull agreed that it may be the recent and continuing budget constraints and that more reimbursable arrangements would be expected.

Mr. Kull indicated FMS and Justice legal services were government-wide activities. He did not know if they were material activities. He wasn't sure that this is worth pursuing.

Chairman Mosso said that he liked the proposed solution because it takes away the prohibition. It would remove the barrier and allow agencies to work out agreements if there are material amounts.

Mr. Patton asked if it was imminent that OMB would remove the barrier without FASAB action? Mr. Kull responded that with his current staffing it was not imminent. Mr. Patton indicated that means we would need a standard to fix it.

Mr. Schumacher asked Mr. Reid if he believed that this would unleash a lot of new reimbursements or transactions. Would people start charging for single days of detailed staff? Mr. Kull indicated that there were un-reimbursed staff details but that they were training events for the home agency. Thus, the cost to the home agency is a training activity. The cost belongs to the home agency because they expect to get the person back with enhanced skills.

Mr. Jacobson noted that some reimbursements would not be legal and so there would not be new reimbursable agreements from, for example, Justice's legal support.

Mr. Calder noted that FASAB currently has a detailed staff member from FAA and should there be a cost for FASAB? He suggests that there is a benefit to FASAB and that the cost of those staff services should be in FASAB's cost for the year. FASAB should debit expense and credit imputed financing source. At the consolidated level, the FASAB entry would simply reverse the entry to impute costs and imputed financing source.

Members debated how FAA should report the cost – some suggested that leaving the cost on FAA's books was double counting. Mr. Kull noted that the reduction of cost at FAA should be noted. Ms. Comes noted that there was a provision permitting FAA to show cost of services provided to other agencies without reimbursement.

Mr. Reid noted that the Economies Act allows agencies to charge and that has driven the increase in these agreements. Especially given the budget pressures, there have been more and more agreements. Maybe the actual reimbursable agreements have captured all the big ticket items.

Mr. Kull does not believe these inter-entity costs are relevant or significant.

Mr. Calder noted that the equivalent of 14% of payroll is not picked up through a reimbursable agreement by employing agencies since OPM bears 21% of the cost but only charges agencies 7% of payroll cost. Mr. Kull stated that the 14% cost was being picked up at the employing agency under current standards. Ms. Comes indicated that SFFAS 5 requires the recognition of this cost by the employing agencies. Mr. Kull noted that the rates have been refined over time and that cost matching with the employee mix at each agency is improved. [Clarifying note: Because there are different retirement plans agencies' costs vary depending on the mix of employees covered by different the plans.]

Ms. Comes indicated that the proposal would remove the barrier to full cost and that a large implementation window was to be provided for any needed guidance.

Chairman Mosso noted the basic underlying principle of SFFAS 4 was full cost. Par 110 is the only exception. Removing the barrier conceptually may have very little effect. But where there was a significant item, full costing would be attainable.

Mr. Kull asked about veterans' benefits – are they defense costs or Veterans Affairs (VA) costs? If you look at the cost of running VA, you treat it separately. But you can't have a VA cost without first having a defense cost. The entire cost of the VA would be added to the cost of a defense budget if you really want full cost. When you get to the consolidated financial statement, if you listed costs by functions of the government instead of by agency then VA would disappear.

Mr. Calder noted that if the recommendation were accepted then the implementation would be within 10 years of the effective date of SFFAS 4. He believes this is an unacceptably long time for implementation.

Mr. Farrell asked if GSA and OPM disappear? Mr. Calder indicated they are central support service that charge for services.

Mr. Kull indicated that virtually all of GSA is currently distributed to agencies. Only the headquarters costs are not currently distributed. OPM costs – other than pension and other post-employment benefits - are immaterial.

Mr. Anania indicated that the federal model generally looks at pieces of the government and tries to get the cost associated with the pieces. If we have 24 or so reports for subsidiaries – how important is it that we have the full cost there? He noted that the task force described par 110 as an impediment to getting full cost. He wondered if managers are impaired in carrying out there duties by this impediment? Mr. Kull indicated no. Mr. Anania asked if it's not going to help in the management, what is the point of doing it?

Mr. Farrell noted that you needed to know the cost of the program so that you know if the program is efficient and effective. Mr. Anania asked who is looking at it if not the managers?

Mr. Anania expressed surprise that it would not help the manager to know the full cost. Ms. Cohen assumes defense does not make the decisions about VA. Thus, defense does not control the benefits.

Mr. Farrell describes this as a long-term change in behavior not an immediate fix.

Mr. Kull does believe that managerial accounting is needed to manage an agency. But, you can't control some of the costs. Often they are dictated to you. The value it brings to the equation is that if you were empowered to change things that impact cost then real cost savings could occur. But you can't do that in the government. He related the debate over the printing of the budget by GPO. OMB could not get authority to print the budget cheaper somewhere else.

Mr. Anania asked if people know that some costs are "musts" – the same thing happens in the private sector and the entity is required to disclose the non-market activity. People reviewing the information know that it's other than a market rate.

Mr. Anania stated his overall view – he would like to remove par 110. But, he wants to solicit a response from all agencies on what the impact on behavior would be. He wants to be able to judge whether we are opening Pandora's Box. He asked for expanded requests for comment.

Chairman Mosso polled the members on whether to pursue the draft exposure draft by revising the very rough draft provided for this meeting. Messrs. Kull, Reid, and Farrell opposed pursuing the issue. Messrs. Patton, Schumacher, Calder, and Anania and Ms. Cohen wished to pursue the issue.

Mr. Farrell again indicated that he believed this would be a Pandora's Box. Some members indicated that it might result in (1) a swamp of phone calls requesting cost information and (2) un-ending debates between auditors and preparers.

Mr. Anania suggested placing the SFFAS 4 limiting language (e.g., broad and general support excluded from recognition) in the body of the introductory section. Also, he requested a question such as "Would the removal of paragraph 110 cause your entity to impute additional costs?"

Mr. Jacobson noted that the "authority to seek reimbursement" must be present before entities may collect for these inter-entity goods and services. Thus, there is a barrier to too much circular costing.

CONCLUSION: Staff will revise the exposure draft for the August meeting. Changes will include:

1. An enhanced explanation of the objective of and need for the proposal

2. Additional requests for comment relating to the potential managerial impact of the change and specific information on inter-entity costs that might be recognized if the change is made

3. Presentation of the SFFAS 4 material limiting inter-entity cost recognition in the introductory material

4. Enhanced presentation of the task force findings

- Stewardship Land and Heritage Assets

Melissa Loughan opened the discussion on the Heritage Assets and Stewardship Land Reclassification project by explaining that the Board had decided at the April Board meeting to move forward on the project, but did limit the scope to reclassification issues. [This project is part of the Board's overall review and re-categorization of the stewardship elements in the Federal financial model. (If this effort leads to reclassification of all items in the RSSI category, the Board will ultimately eliminate the category.) This particular project addresses appropriate categorization of two of the stewardship elements: heritage assets and stewardship land.]

Staff explained that since the last Board meeting, staff had updated the working Exposure Draft (ED) *Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information* based on input received during the April Board meeting. Staff explained that an updated version was shared with the Board members during May for additional comments. Staff explained that comments received from Board members were incorporated into the ED presented in the June Board binders.

The ED proposes that heritage assets and stewardship land information be reported as basic information, except for condition reporting, which should be reported as Required Supplementary Information. The ED provides for a line item to be shown on the balance sheet for significant heritage assets and stewardship land, but no financial amount should be shown. Instead, the line item would reference a note disclosure that would provide the current minimum reporting requirements consistent with those in SFFAS No. 8. The ED also incorporates the revised multi-use heritage asset standards of SFFAS 16 and the deferred maintenance reporting requirements related to heritage assets and stewardship land from SFFAS 14. Accordingly, the ED proposes rescissions to those standards. As a result, the ED will provide all current standards for heritage assets and stewardship land. The Board believes by fully incorporating all requirements for heritage assets (which includes multi-use heritage assets) and stewardship land readers will better understand the current proposed standard

Staff requested the Board members comments on the revised ED and identification of issues that may need to be resolved to issue a ballot version of the ED. The Board provided the following comments:

- Mr. Calder suggested that the reference to the Systems and Control Objective within the Executive Summary be removed as it is not a clear relation, especially considering some of the Board's discussion in the Concepts Project.

- Mr. Patton suggested that the sentence in par. 6 that discusses heritage assets and stewardship land be removed. Mr. Patton explained that the scope of the project is limited to reclassification of the heritage assets and stewardship land. He stated that it was not appropriate to address whether the Board believes they are assets or not, especially considering there is a current project specific to the definition of an asset that will allow for that type of determination once completed. The Executive Director, Ms. Comes did identify that although the Board does not explicitly state that heritage assets and stewardship land are assets, we are requiring a line item on the financial statements and classifying the information as basic, which conveys they meet the definition of an element of a financial statement. The Board agreed to remove language that specifically addresses whether heritage assets and stewardship land are assets from the ED.

- Mr. Patton also suggested that the ED should be segmented into two parts—1.) Reclassification and 2.) Carry forward information. He explained that this would be a clear way of identifying the things that already exist. The Chairman suggested that staff could explore the use of shading to distinguish the reclassification or new language from areas that were simply brought forward. Staff explained that the use of shading in conjunction with the language in the introduction that describes the scope of the project and the specific issues deliberated by the Board (versus those that were carried forward), it should be clear to the readers.

- The Board discussed whether it was necessary to carry forward the Implementation Guidance that was previously included in SFFAS 16. Specifically, the guidance related to heritage assets that were previously recognized as assets for balance sheet reporting. The Board agreed that this did not need to be included as this was no longer an issue since the implementation period has past and it may confuse the readers to have it included.

- Mr. Anania suggested that staff should review the overall structure of the ED and the information that is currently under the Measurement and Disclosure sections. Specifically, he noted that there may be some language under the Measurement section that relates to Disclosure. Mr. Anania explained that Measurement should be more specific to recognition. Staff agreed to restructure the heading and flow of the information included in the ED.

- The Board agreed that for first year of implementation, it would be reasonable for entities to show the line item and related disclosures in the footnotes for the current year without requiring it for the prior year. No additional language would have to be added as it is the Board's policy to remain silent on comparative statements in this type of situation.

- Mr. Patton also suggested that par. 59 of the Basis for Conclusions be removed as it may prejudge the outcome of a project that has not been completed. The Board agreed to delete, as it may be too predictive.

- Mr. Calder stated that par. 2 in the Introduction explains that the Board originally believed that RSSI should receive more audit scrutiny than RSI. He explained that this was not an official vote of the Board and it may be more appropriate to state that some members of the Board believed this. He also explained that the paragraph contradicts or is inconsistent with par. 56 in the Basis for Conclusion. Par. 56 states the Board believed that some of the RSSI data may not withstand the same type of review as basic information. Mr. Calder suggested that both paragraphs should be removed. Staff explained that both paragraphs were paraphrased from the original standards to explain the background of RSSI, so both issues were addressed in SFFAS 8. The Board agreed to remove the paragraphs.

- Mr. Anania asked if the discussion of the land and land rights may cause some confusion with the work being done in the natural resources project. Staff explained that there was a footnote explaining that there is a current project related to natural resources. Mr. Anania suggested that the footnote be expanded to include more information about the project scope.

- Mr. Anania also discussed the concern over the source of the information that we are now proposing to classify as basic information. Mr. Anania acknowledged that staff had provided a listing and description of various public laws and federal regulations specific to heritage assets that relate to controls because they deal with identifying, preserving, recovering, inventorying, etc. However, he had not had a chance to review it and he did want to pose the question to other Board members for discussion. Mr. Calder explained that there are a number of sources of information and that the Board has heard presentations about the source of the information in the past. Based on the information presented in the past, Mr. Calder explained that he did not have great concerns. Mr. Anania suggested that perhaps the Board could set up a question to respondents about the source of the information that would be reported as basic information. Other members suggested that it would be best to rely on the respondents to identify any potential implementation issues or concerns.

- Mr. Calder requested that staff ensure that the Basis for Conclusion includes specific language that no information currently required is eliminated. The Board also discussed the fact that the reclassification should not reduce or limit the information presented as preparers continue to have the option of voluntarily presenting information above the minimum reporting requirements as other accompanying information.

Staff directed the Board to new language included in the ED specific to the requirements of the consolidated financial report (CFR) for the government. The additional language addresses the fact that some of the information required at the agency level may not necessarily aggregate well for the CFR. Specifically, the disclosure requirement for the entity stewardship policies and the description of major methods of acquisition and withdrawal for heritage assets and stewardship land are not required in the CFR.

CONCLUSION: Staff will incorporate the suggestions for revisions made during the meeting and work toward finalizing the exposure draft for issuance.

Adjournment

The meeting adjourned at 12:00 PM