FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 8-9, 2003
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, October 8, 2003

Administrative Matters

- **Attendance**

The following members were present: Chairman Mosso, Messrs. Anania, Calder, Farrell, Holtz-Eakin, Patton, Reid, Schumacher, and Ms. Cohen. Kimberly Geier attended for OMB.

JoAnne Boutelle was present as liaison from the Department of Defense.

The general counsel, Jeff Jacobson, and the executive director, Wendy Comes, were present.

- **Various Items**

The Chairman noted that the August minutes were approved electronically between meetings and a copy is in the binders.

Ms. Comes announced two recent contracting efforts.

> Volume II, a current text or topical volume of federal GAAP, has been produced under contract and is being formatted for electronic publication. The contractor remains available to update the volume during the year. In addition, Volume I, original pronouncements, is being updated. Members will received a CD with both documents by the end of the calendar year.
>
> Penny Wardlow , a former GASB staff member, is on contract to assist with the development of elements definitions.

Ms. Comes also acknowledged Ms. McKinney's success in completing the exposure draft on earmarked funds. Ms. McKinney will be retiring at the end of October and is particularly pleased to have completed an important phase of the project.

Agenda Topics

- **Public Hearing – Fiduciary Activities**

Ms. Nina Rose Hatfield, Deputy Assistant Secretary – Budget and Finance, U.S. Interior Department regarding the Exposure Draft "Accounting for Fiduciary Activities"

Ms. Hatfield thanked the Board and noted that it was a pleasure to be before the Board to discuss the Exposure Draft entitled "Accounting for Fiduciary Activities."

Ms. Hatfield's prepared statement: We appreciate the opportunity to highlight the concerns of the Department of the Interior regarding the presentation of "fiduciary" assets as assets of either the Department of the Interior or the Federal Government.

Overall, Interior oversees 507 million acres of land, which accounts for approximately 20 percent of the landmass of the United States. In addition, the Department manages over 900 dams and reservoirs that provide drinking water for 31 million people and protects threatened and endangered species and the habitat these species need to prosper.

In addition to managing a wide breadth of Federally owned assets, the Department has significant trust responsibilities related to assets owned by individual Indians and Indian Tribes. Specifically, Interior is responsible for the management of over $3 billion in Individual Indian and Tribal trust accounts. These amounts are maintained in approximately 252,000 Individual Indian Monies trust accounts and 1,400 Tribal trust and special accounts. The Department oversees trust funds for the specific benefit of the owners of those funds. We believe these are fiduciary assets with the characteristics that have been defined in paragraphs 12 –14 of the ED. The Department takes its fiduciary responsibility for the management and reporting of these trust funds very seriously. These funds are never combined or commingled with Federally owned assets or assets used in terms of our operations.

We have serious concerns with the proposal in this Exposure Draft to present Indian trust funds on the face of the Consolidated Financial Statements of the Department of the Interior. We believe that the proposed changes are not appropriate for the following reasons. The Department is concerned that the proposed changes in presentation would misstate the assets of the Department. This change would cause our total assets to appear to increase by over $3 billion, even though the trust assets do not belong to the Federal government and cannot be used for any of our operations. In Statement of Federal Financial Accounting Standards Number 1, assets are defined as “Tangible or intangible items owned by the federal government which would have probable economic benefits that can be obtained or controlled by a federal government entity.” It is clear that these Indian Trust Funds do not meet either the Federal or private sector definition of an asset since they are not “owned” by the Federal government, and cannot and will not provide any economic or operating benefits to any Federal entity.

We do not believe that the presentation of Indian Trust assets on the face of the Department’s consolidated financial statements will meet the Objectives of Federal Financial Reporting as documented in Statement of Federal Financial Accounting Concepts Number 1 and the ED. Presenting these Indian Trust assets as part of Total Assets on the Department’s balance sheet could confuse the reader into believing that these assets are available to the government to manage its operations. We believe that our current financial statements and disclosures, including extensive footnote presentation on the Indian Trust assets, meet both the letter and spirit of the objectives of this Board.

We do not concur with the Board’s suggestion (in paragraphs 16 through 30) that the name under which investments are held or even the institution in which the assets are held is the driving force in determining the treatment of fiduciary assets. Rather, the fiduciary relationship should be determined by the substance of the relationship, as described in the definitions and characteristics outlined in paragraphs 11 through 14. The “form” of the accounts, e.g. the account names that may be used for fiduciary assets invested and managed by the Federal government, do not change the underlying nature of a legally enforceable fiduciary relationship.

To summarize, we believe that the presentation of Trust Assets on the Balance Sheet of the Federal Government, or a component of the Federal Government, would be incorrect and misleading. The use of the “Non-Entity” assets section would not correct this inaccuracy since that presentation refers to assets owned by the Federal

Government as a whole. These assets are owned by individual Indians and tribes who have a very strong interest in the Department's management and reporting of these assets. We do not believe that these stakeholders would support this presentation, nor do we believe that other users of these reports would be led to the proper conclusion that these assets are not in any way, shape, or form assets of the Federal Government.

I would now like to turn the presentation over to Ross Swimmer, Special Trustee.

Mr. Ross Swimmer, Special Trustee, Office of the Special Trustee for American Indians, U.S. Interior Department regarding the Exposure Draft "Accounting for Fiduciary Activities"

Mr. Swimmer first talked about the uniqueness of the Interior Department's Office of the Special Trustee for American Indians as well as the Indian trusts. He stated he did not believe there was another entity within the Federal government that operates like these trusts. He also stated that the trust relationship between the American Indians and the Federal government does mirror private trust operations. Mr. Swimmer then mentioned to the Board recent court cases involving the Federal government and the Indian trust funds referred to as the "Cobell" Court Case". The "Cobell Court Case" is driving the Department of Interior operationally closer to the private trust model.

Mr. Swimmer noted that the Office of the Special Trustee was created in 1994 from an act of Congress and was intended to provide Indian account holders with an accounting of the funds earned by the account holder and held in trust by the U.S. Government. The Special Trustee was set up to oversee those operations and to perform the trust duties and to ensure that proper accounting was done. The trust began as early as 1887, the intent was originally to have land taken from the Indian tribes and divided to the individual Indians. The effort's objective was to "civilize" the Indians. In order to protect the title of that land it was to be held in trust by the U.S. Government, entitled "John Doe Indian held in trust with the U.S. Government" or often times "John Doe Indian in fee" but restricted against alienation without the consent of the U.S. Government. In all cases the assets belong to the individual Indians.

The original intent of the trust relationship was to help the individual Indians to become more self-supporting through the farming and ranching enterprise. The Indians were given between 80 and 160 acres each. There was originally a prohibition against the Indian leasing his land or allowing third-party use of the land because that would defeat the purpose of encouraging the Indian to use his own industry and farm the land. This prohibition was changed in the early 1900's when it became apparent that much of the land may not be suitable for farming but may be suitable for other uses, such as mineral production which was beyond the capacity of the individual Indian. As a result, Congress enacted legislation permitting, in some limited ways, opportunity for the individual Indians to allow third parties to use his property and to receive income. However, to ensure that actions would not jeopardized that income, Congress decided that the income would be taken into trust, held and then distributed to the individual but the Federal government would be responsible, as a trustee, for collecting the income for the benefit of and disbursement to the individual Indian. There is also a practice of "direct pay" for the individual Indian to sign an agreement and in essence receive payment directly from the third party land user. In every instance the individual Indian owns the property.

In some instances, approximately 1400 accounts, funds are held in the name of the Indian tribe. Most of those funds derive from judgments awarded by a district court against the U.S. Government in favor of the Indian tribes. The Indian tribes were given a sum of money. Those monies were supposed to be invested by the Government on behalf of the tribes. In more recent legislation, the tribe has been given the opportunity to invest the monies themselves. The trust is a "trust" in the true sense; meaning that any property we hold on behalf of individual Indians or the Indian tribes is their money and cannot be shown on the books of the U.S. Government. If we were to suggest that these monies be shown on the books of the U.S. Government as an asset with an offsetting liability we would be violating various common law trust standards, particularly commingling funds and duty of loyalty. Congress directed that these trust funds be invested in U.S. Government securities, however this does not make these assets the property of the U.S. Government.

Mr. Swimmer also stated that his concern is that the Indian trust funds are unique in that the Office of the Special Trustee is a trustee to a third-party and we invest those funds in accordance with the requirements of the trust statutes. In a recent ruling of the Cobell case the presiding judge made the following statement, "The fund (Indian trust funds) is <u>not</u> the Government's money, it belongs to the beneficiaries, the trust is supposed to be administered in their best interest and not simply in a manner that is most convenient to the Government." The judge is holding us to very high standards and he has also incorporated into the rulings all of the common law trust duties that we would have as a trustee to a third-party. This is the only situation throughout the Federal government where this type of trust relationship exists.

I also believe that footnoting this trust relationship in the financial statements is the most appropriate way to describe this trust fund. I do not believe that reporting the trust fund's assets on the Balance Sheet of the Federal government with a corresponding liability would be appropriate. A private sector trustee would never show the beneficiaries' assets as assets of the trustee. This is different from deposits into a bank where the funds are reported as assets of the bank along with a corresponding liability. In a trust relationship the assets of the beneficiary are never commingled with the assets of the trustee. Mr. Swimmer concluded his statements by offering to answer any of the Board's questions.

Mr. Mosso asked Mr. Swimmer to give the Board an update on the reform activities of the trusts. Mr. Swimmer noted that there are various steps being taken to reform the trust management activities being driven by the judge in the Cobell Court Case. The accounting for the funds is being addressed; the accounting for the trust funds themselves had been "haphazard". For instance, a farmer may come into the local Bureau of Indian Affairs (BIA) office to pay on his lease and the check may not be processed for weeks or maybe even not at all. We have now instituted procedures at BIA offices to be sure that does not happen. We have set up standards that would require deposit of those funds within 24-hours so that there is an immediate credit to the beneficiary's account. We have also addressed the issue of records with an entire records management program. Privacy issues are now being addressed. The entire trust management systems are under review. We are also required to maintain our own title plans and to do the probates for any Indian beneficiaries.

Mr. Anania thanked the Interior presenters for their letter and today's presentation. Mr. Anania asked Mr. Swimmer if the word "owned" in the working definition of an asset was changed to "controlled" would that change his notion about this proposed reporting. Ms. Hatfield noted that the current definition of an asset did seem to pose a problem for some respondents of the ED, but for us we do control the asset, but we control it on behalf of someone else. Mr. Anania asked if the word "control" better described Interior's role in the trust funds than the word "owned". Ms. Hatfield agreed. Ms. Carey, Department of Interior, followed up on Mr. Anania's question by stating that just because Interior controls these assets on the behalf of others that does not mean the assets should be reported on the Balance Sheet of Interior.

Mr. Anania posed his next question to Mr. Swimmer. Mr. Anania noted that Mr. Swimmer in his testimony relates the trust relationship between the Indians and the U.S. Government to a private trust relationship, but to his understanding it is not equivalent to a private trust situation and there are some definite distinguishing factors between the two. Mr. Anania then asked if Mr. Swimmer could tell the Board if he thinks they are identical, and if not, if he could point out where the differences might be.

Mr. Swimmer noted the main difference is the existence of a trust document in a private trust. The trust document sets forth the terms and conditions in which that trust is dealt with, it could be a blind trust, a self-administered trust, etc. In any event they are still trust funds that belong to individuals In our case the trust documents are the Federal statutes; the statutes describe how we are to administer the trust. Judge Lambert has moved us in the direction of a private sector model; he fully believes in his opinion that it is a private sector trust and should be administered as such. He has also determined that all of the common law trustee duties apply in this case. The "lord" of the trust is the Congress; Congress set this up in 1887. According to the statutes, BIA is the trustee; the Indians are the beneficiaries; and the Department of the Interior is the trustee delegate.

Mr. Anania asked if those differences mentioned by Mr. Swimmer added to the control that Interior has. Mr. Swimmer stated that the control is in the nature of a trustee. Another difference is the self-supporting aspect of a private trust, generally, in our case we do not collect fees for our administration of the trust – Congress appropriates money to support the administration of the trust. Mr. Swimmer noted that another difference between a private trust and the Indian trusts was the fact that a private trust trustee can resign as the trustee, in the case of the Indian trusts BIA cannot resign as the trustee delegate.

Mr. Anania asked the Interior representatives how the Indian trust funds were split between individual Indians and Indian tribes. Mr. Swimmer stated that there is approximately $2,250,000,000 of tribal money in 1,400 accounts and $750,000,000 in individual Indian trust. Mr. Anania asked if leasing was the primary source of income to the trust fund accounts. Mr. Swimmer noted that there are really three sources of income into the trust: surface leasing, mineral leasing, and timber leasing.

Mr. Schumacher asked the Interior representatives if the Government has a fiduciary liability to the Indian in these funds. Mr. Swimmer said outside of the accounting term of a liability, the Government has a legal liability for breach of trust. There are 21 cases pending against the Government brought by tribes alleging breach of trust in the form of failure to account for the taking of assets. Periodically the Government is also sued by individual Indians for failure to account properly. Ms. Carey did note that in cases when there are judgments against the Government for breach of trust they are recorded in accordance with SFFAS 5 on the Balance Sheet of the Department of Interior.

Mr. Fontenrose, FASAB staff, asked the Interior representatives how would they record any impairment to those assets held in trust. Ms. Carey stated that Interior would recognize a contingent liability in accordance with SFFAS 5. Mr. Swimmer followed up with a comparison to a private trust company. He stated that a private trust company would have to have adequate assets of its own to cover any losses to the trust assets that were due to the trust company's negligence. In the case of the Indian trusts, any loss of the trust assets that were due to the negligence of BIA would be funded by a Congressional appropriation.

Mr. Fontenrose then asked the Interior representatives if the Balance Sheet presentation of reporting the trust assets and a corresponding liability would be an appropriate presentation to highlight the fiduciary obligation BIA has as it relates to the Indian trusts versus the current footnote presentation. Ms. Carey stated that the presentation described by Mr. Fontenrose would imply that trust assets would be used to cover any liability incurred by BIA due to its negligence of the trust assets. Mr. Anania suggested that it would be clear to the reader if those assets were labeled "non-entity". Ms. Carey replied that "non-entity" still refers to another government entity, however these trust assets are not the property of the Federal government.

Mr. Jacobson noted one major difference between a "pure" private trust in the private sector and the Indian trust; that difference is the beneficiary's ability to initiate and dissolve the trust. In the case of a private trust the beneficiary is the initiator of the trust arrangement and retains the ability to dissolve the trust at their discretion. In the case of the Indian trust, the Indians do not have the ability to dissolve the trust and did not initiate the trust. Mr. Swimmer stated that the individual Indians as well as Indian tribes do have the ability to dissolve their own trust account with BIA. However, in order for a tribe to remove its land in trust the tribe must seek the permission of the Secretary of the Interior and then get the approval of the Congress. Mr. Jacobson questioned whether or not the beneficiaries actually had the "true" power to remove its assets from the trust. Mr. Swimmer asked the Board, with the current proposal, how would BIA report all of the land assets held in the Indian trusts. Mr. Jacobson asked the Interior representatives if the Balance Sheet heading was titled "Controlled but not owned " instead of "In the name of" would that be a better description. Mr. Swimmer said that if the assets are not owned but only controlled by the Government, they would not be appropriately shown on Interior's Balance Sheet. Mr. Mosso asked if the court case referred to earlier related to tribal accounts or individual Indian accounts. Mr. Swimmer noted that the current case relates to individual Indian accounts, but that cases involving tribes have also been filed.

Mr. Anania gave an example of someone receiving a deposit for future services; he noted that in that relationship the holder of the deposit has control over that deposit and should report it on its Balance Sheet as an asset and a liability. Ms. Carey stated that the example is more like a bank/depositor relationship as opposed to a trust relationship. In a bank/depositor relationship funds are commingled but in the case of the Indian trust those assets are "never" commingled. Mr. Swimmer stated that BIA can only invest the trust funds as directed by the Congress, it is not left to the discretion of BIA and therefore BIA has no control over those assets. Mr. Jacobson stressed the point that BIA the trustee delegate has no control over the assets but Congress ("the Government") does. Mr. Calder made the point that Congress has directed BIA to invest those trust funds in only Treasury securities, which is in a sense entering those funds into the Government as an asset. Mr. Swimmer disagreed and likened the investment to investing the funds through a banking institution or any other investment instrument. Mr. Schumacher asked if Interior would be amenable to labeling the assets as non-Federal assets. Ms. Carey stated that the labeling would simply be form over substance.

Mr. Mosso thanked the Interior representatives for coming to speak to the Board.

~Break~

Mr. Jay S. Miller, Financial Reports Officer, Office of the Chief Financial Officer, Library of Congress, regarding the Exposure Draft "Accounting for Fiduciary Activities"

Mr. Miller's statement: Mr. Chairman and Members of the Board:

I appreciate the opportunity to appear before the Board to discuss the Exposure Draft "Accounting for Fiduciary Activities."

As a legislative branch agency, the Library is not required to follow the executive agency accounting principles established by the Comptroller General under 31 U.S.C. 3511 or the standards developed by the Federal Accounting Standards Advisory Board (FASAB). However, the Library maintains its fund balances with the Department of the

Treasury and submits information required to incorporate its financial and budgetary data into the overall federal government structure. For purposes of financial management and reporting, the Library has issued a regulation, which adopts the federal standards for financial reporting and internal controls in a manner consistent with a legislative agency.

In general, the Library agrees with many of the issues addressed in this exposure draft. For example, disclosure on the face of the balance sheet of the segregation of entity and non-entity assets was a practice of the Library until the Office of Management and Budget “Form and Content” bulletins advised otherwise. The Library also agrees with the note disclosure requirement requiring the reporting of inflows, outflows, assets, liabilities, and net assets (beginning balance, change and ending balance). Finally, the Library agrees with the segregation of each major fiduciary activity into separate columns.

The Library does, however, take exception to one item in the exposure draft - the limitation on the use of the term "trust fund."

The Library of Congress Trust Fund Board Act of March 3, 1925, as amended (2 U.S.C. 154-163), created the Library of Congress Trust Fund Board (the Board), a quasi-corporation with perpetual succession. The Board has the usual powers of trustees, including the authority to

(1) "accept, receive, hold, and administer such gifts, bequests, or devises of property for the benefit of, or in connection with the Library, its collections, or its service, as may be approved by the Board and by the Joint Committee on the Library”;

(2) "invest, reinvest, or retain investments" after being received by the Secretary of the Treasury;

(3) deposit trust funds "with the Treasurer of the United States as a permanent loan to the United States Treasury, and the Treasurer shall thereafter credit such deposit with interest; and

(4) "adopt rules and regulations in regard to its procedure and the conduct of its business."

The Library has always referred to the funds accepted by the Board as “trust funds” in all financial documentation, including our consolidated financial statements. The President and Congress both make appointments specifically to the Library of Congress Trust Fund Board. Per our interpretation of the exposure draft, such reference to the Trust Fund Boards funds as “trust funds” would be in violation of the proposed standard, as the “trust funds” cited above are non-fiduciary and only fiduciary trust funds should be referred to as “trust funds” in financial statements. The Library cannot fathom referring to these funds as anything other than trust funds and believes there will be significant confusion to the on-going users of our financial statements, as well as appointed officials. In particular, the members of the Trust Fund Board itself receive both the Library's consolidated financial statements (prepared under FASAB standards) and a separate Trust Fund Board report (prepared under Financial Accounting Standards Board standards) and, based on this proposed FASAB guidance, will see no reference to the term "Trust Funds" in the Library's consolidated financials. A tremendous amount of explanation will be required for these particular readers.

As an alternative, the Library would cite our trust funds as "non-fiduciary" in the financial statements and provide necessary explanation of the distinction between "fiduciary" and "non-fiduciary" activity. As citation to the term "trust fund" is limited to the financial statement notes, such a presentation would provide the reader with an explanation of the distinction. It is the recommendation of the Library that this approach be permitted by FASAB and be reflected as such in the final document. We believe this approach will allow the Library to continue to use the term "trust fund" for its Trust Fund Board activity and accomplish FASAB's intention of segregating "Fiduciary" and "Non-Fiduciary" activity. The Library does not intend to report Trust Fund Board activities as fiduciary activities, so the reader will only observe true fiduciary balances on the face of the financial statements and the new financial statement notes. Our concern solely relates to terminology.

This concludes my statement. I would be happy to answer any questions that the Members of the Board may have.

Mr. Mosso thanked Mr. Miller for presenting the LOC's views on fiduciary activities and also for adopting FASAB standards.

Mr. Calder asked the LOC representative if they considered the term "non-fiduciary trust funds" an oxymoron; isn't the central characteristic of a trust fund a fiduciary relationship.

Mr. Miller noted that he views fiduciary activities as holding something on the behalf of others through a trust fund and I understand the Board's position that trust funds are fiduciary by nature. If I had the opportunity to go back to 1925 and call these funds something other than "trust funds" I would, but cannot. I do not quarrel with the Board's position on this point, however the fact remains that this fund is called the "Library of Congress Trust Fund Board (LCTFB)" and the assets associated with the LCTFB are considered trust fund assets. We also find it difficult to explain why a trust fund board cannot refer to its assets as trust fund assets.

Mr. Patton asked why the LOC does not plan on referring to the activities of the LCTFB as fiduciary activities. Mr. Miller replied by referring to other activities of the LOC that are fiduciary in nature (i.e., the LOC's copyright office and the licensing fees they retain for cable and satellite operators). The assets of the LCTFB belong to the LOC and there is no corresponding liability.

Mr. Schumacher noted that the LOC's concern is simply a terminology issue. He then asked if the LOC would be amenable to the use of the term "non-fiduciary funds". Mr. Miller noted that "trust funds" best describes the assets received by the LCTFB.

Mr. Anania commented that the Board had not discussed the use of the terminology "trust fund" when it is used outside of what is meant in the ED. He suggested allowing entities to fully explain the source and the basis of "trust fund" when it is used outside of what is meant in the proposed standard. Ms. Cohen asked if the activities of the LCTFB were unique within the Federal sector. Mr. Robert James, LOC, stated that possibly the Smithsonian had a similar trust fund operation.

Mr. Fontenrose noted that paragraph 15 of the ED states that non-fiduciary activities should not be characterized as "trust funds" in the financial statements. He then asked the LOC representatives if that were interpreted to mean "minimal use in the financial statements" and any nonconforming usage were explained, would that resolve the issues that LOC has with the proposed standard. Mr. Miller noted that "trust funds" is used 27 times in the notes to LOC's financial statements and does not believe that they could limit the use of the term any more in the notes.

Mr. Patton asked the LOC representatives to explain the activities involved in the collection of licensing fees received through LOC's copyright office. Mr. Miller explained that the copyright office maintains the funds collected from satellite and cable operators. He further explained that LOC has a fiduciary relationship with the National Baseball League associated with the collection of those funds and does not have a problem reporting the assets on LOC's Balance Sheet with a corresponding liability.

Mr. Mosso thanked the LOC representatives for coming to speak at the public hearing.

<u>Department of Defense--Summary of Mr. Gaddy's remarks regarding the Foreign Military Sales Program</u>

Mr. Gaddy began by thanking the Board for the opportunity to address the exposure draft, "Accounting for Fiduciary Activities." He noted that this has been a nebulous area of accounting in the Federal government and the Department welcomes the guidance to provide accurate and consistent accounting treatment of our fiduciary activities.

Mr. Gaddy explained that under the Department of Defense, the Defense Security Cooperation Agency has the responsibility of administering the Foreign Military Sales (FMS) program. The FMS program is a government-to-government method for selling U.S. defense equipment, services, and training to further national security and foreign policy objectives. These sales are conducted under the authority of the Arms Export

Control Act (AECA). The FMS program is not part of the Presidential budget and is mandated by law to operate at no cost to the Federal government. Foreign governments place funds into the FMS Trust Fund based on a forecast of future financial requirements to ensure funds are available when needed and the funds belong to the foreign country and are to be returned if the program is modified or cancelled.

Mr. Gaddy noted that DoD believes that the FMS Trust Fund meets the characteristics of the FASAB's definition of fiduciary activity and the current exposure draft provides very workable guidance. However, Mr. Gaddy explained that there are two FMS areas that he would like to see the FASAB provide more specific guidance:

1. Cash accounts held in the name of the non-Federal entity outside of Treasury. Specifically, the DoD would like affirmation of the proper treatment under the proposed guidance. Mr. Gaddy noted that there is an increasing trend in the FMS Program use of Tripartite or Quadripartite agreements. Under these agreements, foreign countries establish accounts in either the Federal Reserve Bank or in a private U.S. commercial bank. Although these accounts are established in the name of the foreign country, only a component of the Defense Department may withdraw these funds to be used in support of the country's FMS program. Mr. Gaddy stated that DoD's current interpretation of the FASAB draft guidance is only for disclosure of these amounts in the footnotes of the financial statements.

Mr. Gaddy also explained that another trend is that other countries are pursuing Standby Letters of Credit. These arrangements are established between the foreign country and a commercial bank in the name of the foreign entity and only a component of the Department of Defense can invoke the Standby Letter of Credit and withdraw funds to be used in support of the country's FMS program. Mr. Gaddy explained that it would be DoD's intent to only disclose this information in footnotes to the financial statements.

2. Expansion in the exposure draft on the discussion of exchange of assets. Mr. Gaddy explained that the exposure draft only addresses investments such as Treasury securities. The FMS Trust Fund makes cash advances to contractors for large end-items such as aircraft or weapon systems on behalf of the customer. In such transactions, however, the actual contract is not between the contractor and the foreign government, as title has not transferred to the foreign country. Mr. Gaddy further discussed that when advances to contractors occur, and while the foreign country anticipates receiving the item, it is still possible for the foreign country to cancel or be denied its request for that end item. Mr. Gaddy explained that DoD believes this type of transaction should be categorized as an "Advance to Others," and treated as an exchange of assets on the balance sheet. He explained that in this type of transaction, a reduction occurs in the Fund Balance with Treasury account while a fiduciary liability still exists for the foreign country and once the end-item is completed and the U.S.

concurs with delivering the asset, offsetting decreases in the “Advances to Others” asset account and the “Liability for Fiduciary Activity” account would be recorded.

Mr. Gaddy explained that although this type of activity may be unique to the FMS Program, DoD strongly believes that the definition of Exchange of Assets needs to be broadened to preclude future disagreements in interpretation.

DoD--Summary of Mr. Gaddy’s remarks regarding Seized Iraqi Assets

Mr. Gaddy explained that assets seized in Iraq during the recent war and during the current reconstruction period are held in custody by DoD personnel until such time the assets are used for the benefit the Iraqi people. He further explained that the Department of the Army is the Executive Agent for these accounts and is responsible for all financial management and accounting processes, internal controls, and accounting and reporting for these accounts.

Mr. Gaddy noted that Statement of Federal Financial Accounting Standards No. 3 provides accounting and reporting guidance for seized assets, but the DoD believes the seized monetary assets and their intended use and purpose in this situation are unique enough to warrant the Board’s consideration. Mr. Gaddy explained that seized currency is held by DoD custodians until such currency is authenticated as valid currency, and upon authentication, the currency is then deposited into the U.S. Treasury. Mr. Gaddy also explained that although these deposits are held at the U.S. Treasury, they are not treated as government funds nor do they impact budget receipts and outlays.

Mr. Gaddy explained that for the third quarter financial statements, the DoD reported the entity’s Fund Balance with Treasury (FBWT) representing these assets as non-entity assets on the face of DoD’s consolidated and the Department of the Army’s balance sheet. In addition, the DoD and Army financial statements included a “Statement of Custodial Activity” that presented separate lines for seized Iraqi assets and the Notes to the Financial Statements disclosed the source of the seized assets, applicable laws and regulations and how the assets were used.

Mr. Gaddy explained that DoD believes the Seized Iraqi Assets accounts meet the characteristics of the FASAB’s definition of Fiduciary Assets Held by a Component Entity of the Federal Government, outside the Treasury, in the Name of the Federal Component Entity.

Mr. Gaddy thanked the Board for the opportunity to address FASAB on the key issues and respectfully requested the Board to take the comments into consideration.

Army Corps of Engineers--Summary of Mr. Michael E. Walsh remarks regarding the Corps of Engineers Projects

Mr. Walsh also thanked the Board for the opportunity to present and explained that he would be discussing the proper accounting for the US Army Corps of Engineers (USACE) Civil Works Construction in Progress (CIP) and specifically to provide rationale for the inclusion of the USACE Cost Share Construction in Progress (CIP) work as a Fiduciary Activity.

Mr. Walsh discussed that currently the accounting and reporting for USACE CIP projects constructed for Non-Federal entities under the Water Resources Development Act (WRDA) is not covered by FASAB standards. The USACE CIP account is currently about $7.8B, of which about $3.6B represents construction work cost shared with Non-Federal entities (i.e. state or local governments). He explained that the USACE records on-going construction costs in its CIP account regardless of whether the asset would eventually become a Federally or Non-Federally owned asset. Mr. Walsh explained that the USACE acts as the construction agent for many Non-Federal entities who retain title to the land on which the project is constructed and USACE accepts legal liability for the project at a minimum until it is turned over to the local sponsor, leading to the assumption that the Federal government retains title to the project structure until completion. He added that upon completion, the Non-Federal entity assumes the responsibility for operation, maintenance, repair, replacement, and rehabilitation of the project (for example, the Structural Flood Control Model provides that "when the District Engineer determines that the entire Project is complete or that a portion of the Project has become a functional portion of the Project the Non-Federal Sponsor shall operate, maintain, repair, replace, and rehabilitate.")

Mr. Walsh explained that recent Department of Defense Inspector General (DODIG) findings have determined that CIP costs for cost shared projects should not be reported in the USACE financial statements under Property, Plant and & Equipment. The DODIG believe that since the constructed assets are turned over to a Non-Federal entity upon completion, the cost shared CIP costs don't meet the definition of PP&E described in Statement of Federal Financial Accounting Standards #6 Property, Plant and Equipment (PP&E) because the standard states PP&E must be constructed with the intention of being used or available for use by the entity. Mr. Walsh explained that all USACE projects perform Federal missions such as Flood Control or Navigation, which USACE is ultimately responsible for, regardless of which entity owns and operates the assets.

Mr. Walsh stated that the current FASAB exposure draft states, "Fiduciary activities relate to the collection or receipt, management, protection, accounting, investment and disposition by the Federal Government of cash or other assets in which non-federal individuals or entities have an ownership interest in." He explained that the USACE believes this definition should be expanded to include construction activity for Non-Federal entities, which serve Federal purposes because they believe USACE performs all functions listed in the Fiduciary Activity definition. Mr. Walsh further explained that for USACE cost shared projects, the Non-Federal entity shares in the project with either contributed funds, land or some other asset of value of which it retains title and likewise, USACE retains title to the construction features at least until project completion. Currently, USACE collects the asset value into its Funds Balance with Treasury and Unearned Revenue Liability account and has complete management and operational authority over the Federal and non-Federal funds during design and construction of the project.

Mr. Walsh concluded his presentation by also explaining that the expansion of this definition would also benefit the Department of Interior as they are also covered under WRDA and perform work under similar cost share agreements.

Board Questions/Discussion to DOD

Chairman Mosso thanked the DoD and USACE presenters and requested clarification that although there are areas that they are requesting specific guidance or clarification, that it would be accurate to state that DoD and USACE are in agreement with the exposure draft. The presenters explained that they are in agreement with the overall ED, but they are requesting specific guidance and clarification.

Mr. Anania asked if USACE had discussed the WRDA issue with DOI. Mr. Walsh explained that he is aware that DOI also struggles with these types of agreements (WRDA) but USACE had not discussed the specifics of the ED with DOI.

Mr. Reid asked that if during the construction of the project, there is a change and the asset would not be completed, what would happen in those instances. Mr. Walsh explained that those types of situations would probably end up in court, but the costs would most likely be shared.

Mr. Calder asked if an accurate example of one of the USACE cost shared projects would be a dam that the federal government may build but ultimately would be the property of the state or locality. Mr. Walsh explained that it would be an accurate example if the state also shared in the costs of building the dam. He further explained that USACE accumulates the costs in an in-progress asset account and then once it is finalized, the asset is removed.

Mr. Farrell requested clarification that the DODIG believes that these costs should be expensed during the construction versus being capitalized as USACE does. Mr. Walsh said that was correct and that USACE expenses the entire amount when they remove the asset when it is transferred. Mr. Farrell discussed that it is more of a timing issue of when to recognize the expense. Mr. Walsh explained that he believed it is more of a fiduciary relationship issue because USACE has complete management of the project. Mr. Walsh also clarified that USACE capitalizes the full amount (USACE share and state share) during construction. Mr. Anania stated that the DODIG issue appears to relate more with whether the USACE CIP meets the definition of PP&E. Mr. Anania asked Mr. Walsh if the DODIG had ever raised the liability issue with USACE. Mr. Walsh explained that the DODIG has approached the issue more from the asset side and there hasn't been much discussion regarding the liability aspects.

Mr. Mosso requested clarification on the control of the asset in the Military Sales Program. Mr. Gaddy explained that in both situations (Tripartite agreements and Standby Letters of Credit) it is in the name of the foreign country, but controlled by DoD in terms of making disbursements from those funds to pay for the services provided.

Mr. Calder requested clarification on the exchange of assets issue as it is different from the situation where there is Tripartite agreement or Standby Letter of Credit. Specifically, Mr. Calder asked if DoD in essence buys the asset in these exchange situations if a decision is made not to transfer an agreed upon asset. Mr. Walsh explained that there are two possible scenarios in this example—for instance, if it was agreed that DoD could not transfer a particular item at that time (for example, DoD needed the asset), DoD could deliver the next item or if DoD decided to not deliver the item at all, then they would in fact buy the asset and must pay termination/cancellation fees.

Mr. Mosso requested clarification on what DoD was looking for on the Iraqi Asset Seizure issue that they discussed. Mr. Walsh explained that DoD wanted to make sure that DoD's current treatment (reporting it as a Non-Entity Asset) is accurate. Mr. Walsh explained that this is a new issue so there has not been any question as to the accuracy of this presentation, but he did note that it is currently being audited. Mr. Calder noted that this was an interesting issue and that he viewed it in some ways as income redistribution or tax redistribution as the Government is taking Iraqi money and redistributing it to the Iraqi people or for the benefit of many, so it is not truly like the traditional fiduciary relationship. Mr. Walsh did point out that much of the money is actually found or seized, so it is different from tax redistribution and ultimately, once the Iraqi government is stable, the assets will be turned over to them.

Mr. Mosso thanked the DoD and USACE representatives for coming and noted that the Board would discuss the issues presented further to determine how it may impact the ED.

<u>Treasury Department --Summary of Mr. James Lingebach's remarks</u>

Mr. Lingebach thanked the Board for the opportunity to provide comments on the ED. Mr. Lingebach noted that he did want to make a distinction up front regarding he is representing (and providing comments from) the Department of Treasury, meaning the operating department (versus the Government-wide Treasury / FMS.)

Mr. Lingebach stated that Treasury does in general support the principles and standards in the ED, but there are a few specific comments that he would like to provide. He also did want to note that Treasury does not have any significant or material fiduciary activity as described in the ED, so he does defer to program agencies for the programmatic aspects that the standard might have.

Mr. Lingebach stated that the first area that may need clarification within the ED is in how the Department of Treasury is described. Specifically, he discussed the need for the ED to more clearly distinguish between the General Fund of the Treasury and Treasury, the operating department. Mr. Lingebach further explained that in the past it took a lot of time and effort to properly define the "Treasury" entity, so the ED should make this same distinction between Treasury, as an operating agency versus the "General Fund" of the Treasury. He also directed the Board to Appendix D: Pro Forma Transactions of the ED that illustrates the Department of the Treasury reporting a liability to other Federal component entities for Fund Balance with Treasury (FBWT). Mr. Lingebach explained that the Department, as an operating agency, does not report a FBWT liability to other Federal entities in its financial statements. Instead, the Department reports a liability for government-wide cash and a liability to the "General Fund" of the Treasury.

Mr. Lingebach explained the second area in the ED that Treasury believes there should be clarification relates to whether or not the component entity would actually recognize revenue (par. 58-60 in the ED). Mr. Lingebach suggested that the ED only alludes to increases in fiduciary assets and liabilities and therefore is unclear and clarification would be helpful.

Mr. Lingebach explained the third area that he wanted to address related to the elimination of investments in Treasury securities. He explained that if fiduciary assets are invested in Treasury securities, then they should be eliminated to avoid double counting and because they are not an asset at the Financial Report level. Mr. Lingebach further explained that the fiduciary assets and liabilities of the Federal Government shouldn't double because the Federal component invests in BPD securities. He also directed the Board to the pro-forma illustration 2.C on page 34 of the ED for a better understanding of the issue. Mr. Mosso explained that it would be similar to treating the Treasury securities similar to the FBWT which appears reasonable to eliminate.

Board Questions/Discussion to Treasury

Mr. Anania asked Mr. Lingebach if he believed that the language or the pro forma of the ED should show the income element. Mr. Lingebach explained that he believed it should be clarified because they were not sure. Mr. Fontenrose explained the ED (as written now) does not require recording the revenue—instead it requires recording the increase in assets and liabilities. Mr. Fontenrose further explained that no revenue would be recorded because it is not revenue and suggested that staff could make the point clearer in the ED and perhaps illustrate the point in the pro forma.

Mr. Reid explained that there has been some discussion at Treasury as to what to do with frozen bank accounts. Specifically, what constitutes control and how it is currently handled and whether this area should be addressed by the Board. Mr. Lingebach suggested that he does not believe that those types of situations would be described as a fiduciary relationship. He further explained that in these situations, the accounts are frozen until some action occurs that would normally lead to unfreezing the accounts or seizing the accounts. After discussing the issue further, the Board thought that perhaps this issue should be considered under SFFAS 3 Accounting for Inventory and Related Property, that addresses seized and forfeited assets. It was agreed that staff would review SFFAS 3 and determine if it would apply in these situations.

Mr. Mosso thanked Mr. Lingebach for his presentation and concluded by saying FASAB would try to incorporate his comments.

Following the hearing, the Board discussed the issues briefly before adjourning for lunch.

Staff noted that the fiduciary activities project has used the Thrift Savings Fund (TSF) as the key example of type of fiduciary activity that would be disclosed in the notes. The TSF beneficiaries and "owners" control TSF assets. If the Indians have similar control over the assets held in trust by the Interior Department, then the reporting of Indian trust funds could be the same as TSF. If not, then the only other possibility currently provided in the proposed standard is recognition on the face of the balance sheet. Staff noted that a third alternative could be developed for reporting Indian trust funds.

Mr. Patton said that the third alternative is what the Interior Department is asking for, and therefore the question is what is unique about the Indian trust funds, if anything. Mr. Reid said that one possible distinction there is that in the case of the TSF the plan itself maintains accounts for the participants. In the case of the Interior, the Interior Department maintains accounts but the funds are on deposit somewhere else. He said the funds are physically outside the Government, possibly in Bankers' Trust in New York. Thus, there is a complicated flow of funds with regard to those Interior accounts because the funds flow from the collection points, through the Government, and are then deposited with a trustee or with the bank in New York. As they are disbursed they are brought back into the Government and disbursed out of the Government. He said that flow might be significant. It may be the same as a bank would work their trust department.

Mr. Farrell asked whether Bankers' Trust then has direction of Interior investing in U.S. Government securities. Mr. Reid said that was his understanding.

In trying to distinguish private sector trust funds from what is going on at Interior, Mr. Anania noted that, in the case of the Indians, the Government in fact created the trust agreement through law and administrative action and is involved in place of the individual. Mr. Holtz-Eakin noted that the individual could terminate the trust, which is the ultimate control. Mr. Anania agreed. Mr. Farrell noted that the Government made the terms of the trust too beneficial for the Indians to terminate. Mr. Jacobson said no one knows exactly what one would get if one does terminate the trust because the value of the Indians claim hinges on the pending litigation. Mr. Holtz-Eakin said that was similar to the TSF: one does not know what one will ultimately get. He was struck by the similarity between the TSF and the Indian trust funds rather than the difference. Mr. Jacobson said that the current value of each TSF account is calculable whereas the current value Indian trust accounts are not due to the litigation. Mr. Holtz-Eakin said Interior made some very good points but expressed uncertainty regarding what reporting should be required.

Mr. Reid said that, considering the notion of fair presentation, the Indians – who are users of Interior's financial statements – probably would not believe that their assets would be fairly presented if shown on the face of Interior's financial statements. He said the Interior Department certainly seems to think the Indians would not. He said that, from a theoretical point of view, perhaps including Indian assets on the face of Interior's financial statements would not be a fair presentation. Mr. Mosso said on the other hand the Indians might be happy to know that their assets were under accounting control. Mr. Farrell said he was not persuaded by that argument, either, because it suggests no one can understand what you put in the financial statements. He said consider all the money the Government collects on behalf of state governments. The states do not understand why the Government puts that on its balance sheet because it is their money.

Mr. Schumacher said that the purpose of characterizing the trust assets on the balance sheet as non-entity assets was to make clear that they do not belong to the Government. He said that if that concept is hard to understand, what makes the Indians any different from other non-Federal parties with a fiduciary relationship who would not want the Government to claim their assets, either. He said that when you start carving out exceptions you could invite problems. Mr. Anania said he did not conceive of this effort as carving out an exception but rather of enhancing the information so the Interior can see whether they fit into the model or not. He said, in other words, that he would not want to explicitly except the Indians by name but rather to make it clear that what they are doing is closer to a private sector trust than what the Board considers fiduciary activity. Mr. Schumacher said that Indian situation meets the definition of fiduciary activity. Mr. Farrell said that that is exactly what the Interior representatives said. Mr. Reid said Interior agreed with the definition of fiduciary activity and that the Indian assets are fiduciary, but they disagreed with the required reporting.

Mr. Patton said he would like to see a comparison between their position, a private trust position, and the Library of Congress' copyright receipts. He said the Library of Congress situation was similar to the Indians.

Mr. Holtz-Eakin said one should distinguish between value and control. Control over the ability to take the ultimate economic benefits of a thing is a different issue than valuation. He said Interior may manage the assets but in the end the Indians control the use of those funds. The Indians are the only ones who can reap the economic benefit. He said that was an important control even if the Indians rarely if ever exercise it.

Ms. Cohen said that, the litigation – and the accompanying problem with accounting and reporting and valuation – changes ones' ability to control by exiting. One would not know what one is leaving behind since the record is so muddled. She did not think exiting under these circumstances would be an effective control, versus the TSF where one gets a monthly statement.

Mr. Holtz-Eakin said that the case would be the same for a private sector trust that was mismanaged or where the funds were stolen. One would not know what one was getting; but there would be no dispute over whose asset it was.

Mr. Mosso said there was no rule against two entities having the same item on their books. What they have is not a specific asset but a claim on the Treasury or whatever assets the Treasury has in its possession. The important consideration is not that the Indians own the Treasury securities but that they own a claim on the Treasury.

Mr. Anania said he agreed with Mr. Holtz-Eakin. The right of the individual Indian or tribe is an important element that the Board needs to understand, which is different from the valuation question.

Mr. Reid asked whether the Board contemplates Interior valuing all the Indian land holdings. He said Interior seems to think so. Messrs. Farrell and Anania said the Board hadn't contemplated and/or talked about the issue. Mr. Mosso disagreed. He noted that the proposed standard states that non-monetary assets are to be reported on the balance sheet in accordance with FASAB standards. However, the Board didn't say the preparer would have to value things that were not previously valued. Mr. Reid said the standard ought to make that clearer. Mr. Farrell said the Indian land would be no different than Interior's or BLM's land. The FASAB standards do not require them to value it. Mr. Calder said it was important to consider that the Indians' claim against the Government with respect to land is not for value but rather for specific parcels of land.

Mr. Mosso asked whether the members had problems with other issues raised during the hearing.

"Trust Funds"

Staff noted the issue raised by the Library of Congress about the use of "trust fund" and its proposal that "non-fiduciary trust fund" be allowed.

Mr. Anania said he would like the standard to allow preparers to call their funds "non-fiduciary trust funds" as along as they describe the basis, authority, etc., of such funds somewhere in the financial report.   He said the Board could not tell the preparer not to use the term “trust fund” if they have some basis for doing so.

Messrs. Farrell and Schumacher noted that clarifying the meaning of “trust fund” in general purpose financial statements was the purpose of the project. Messrs. Farrell and Patton noted prior Board support for allowing the use of “trust fund” if it occurs in proper names. Mr. Patton noted that allowing an exception like the one requested by the Library of Congress would render the provision meaningless. Mr. Reid said the Board is trying to separate out fiduciary activity from these things that are called “trusts” and that mislead most people to construe them as being fiduciary simply by reference to the name. Mr. Farrell said that the description of “trust fund” mentioned once in the basis of the presentation or elsewhere in the financial report would get lost.

Defense Department issues
Construction in Process

Mr. Farrell said he believed the Corps of Engineers would have a good basis for arguing that the construction in process (CIP) is not fiduciary activity. Mr. Anania said he thought that the non-Federal cash contributed for the CIP was fiduciary.

Ms. Cohen noted the Government controls all the construction, gets contributions, and then transfers the asset when complete. She said this frequently happens at the state and local level. She said contributions from non-Federal participants did not constitute fiduciary activity.

Mr. Farrell asked when the Government would recognize an expense for CIP. Mr. Reid said that this arrangement had more grant characteristics than anything else.

Mr. Farrell said CIP was not covered by the fiduciary standard.

Staff asked if the members wanted to see the relevant literature on this subject or have the staff press on with fiduciary activity and make it clear that CIP-type activity is excluded. Staff noted that GASB might have some literature and that the IFAC Public Sector Committee has a joint venture standard that may very well be relevant. Mr. Calder said he didn’t need to see anything else on this issue.

Ms. Boutelle said that the DoD Comptroller’s Office agreed with the DoD IG that the CIP is not general PP&E and DoD is seeking the Board’s guidance. She disagreed with the notion of putting contributed land on the balance sheet.

Mr. Anania said that the contributed assets he had in mind were mainly cash. Mr. Calder agreed that contributed cash would be an asset, but disagreed with the notion of capitalizing the Corps’ 90 percent as an asset during construction. Mr. Patton agreed that the other 10 percent would be an asset.

The members discussed work in process (WIP) accounting. The Corps is putting WIP/CIP on the balance sheet now. Mr. Reid said that he didn’t think the Corps was putting the contributed land on its balance sheet, but that construction costs incurred were being capitalized and expensed when title passed to the state or local government. The members discussed whether the Corps was recording the contributions as revenue, other financing source, or asset/liability, without drawing conclusions.

The staff said that it would provide an issue paper on the CIP process.

Iraqi Assets

With respect to seized Iraqi assets, Mr. Calder said the Iraqi assets come in just like tax receipts come in, and Congress, through the Army Department, authorizes its use for specified purposes. Ms. Boutelle said that some Iraqi assets were found and others were seized but all are referred to as "seized Iraqi assets". She said the Army disbursing officer (DO) is accountable for the seized Iraqi assets. The Army DO's Fund Balance with Treasury is increased when the funds are deposited with the Treasury. Mr. Reid affirmed that the funds are deposited in an account created at the Treasury that the Army DO can draw on. Ms. Boutelle said the funds are to be spent only for the good of the Iraqi people, for example, salaries of utility and construction workers. Mr. Farrell noted that these expenditures were similar to those paid for out of appropriated U.S. tax receipts. Ms. Boutelle said the rules for spending the Iraqi money were different than for appropriated money.

A member asked if the expenditures were showing up as a DoD expense. Ms. Boutelle said they show up on an Army financial statement. She said Army reported the money that was in the United States in the bank as entity assets, because it has come into the Army's accountability. Army reported what it has found in Iraq as non-entity seized assets. The Board discussed the flow of the assets, appropriated funds, and other subjects.

Mr. Mosso asked the staff for analysis of each of the issues discussed, with a staff recommendation and/or alternatives.

The Board adjourned for lunch from 12:15 to 1:00.

- **Concepts-Objectives**

The Board discussed question 1 in the project plan: ". . . are the objectives themselves clearly stated and complete?" Mr. Bramlett noted that he did not interpret the statement of objectives as limited to the boldface type in chapter 4 of SFFAC 1, but he acknowledged that probably many people do so. The boldface type reflects the input of the OMB-led taskforce, which Ms. Rodriquez had discussed with the Board. FASAB revised this input and greatly expanded it during its deliberations based on the Board members' views and the results of the "user needs" study.

Mr. Anania made some overall observations. He noted that paragraph 5 of SFFAS 1 states:

> . . . many information sources other than financial statements help to attain these objectives. The objectives relate to the management and financial reporting systems in the federal government in their entirety.

This raises a question about the proper scope of the objectives and of FASAB's standards. This question comes up in question 3 in the project plan:

> Are certain objectives currently met by means other than GAAP financial statements? If so, how reliable (stable) are the means currently in place?

What is different about our current concepts, and what do we want to be different going forward? First, we have an internal focus as well as external. Also, we have objectives that go beyond what we can do ourselves. So, do we want to keep it that way, or do we want to narrow it to something we can manage and control ourselves?

Ms. Cohen agreed that GASB is more externally oriented, but GASB GAAP reporting has been equally important to the internal working of state and local government, and in some ways more so than for the external user.

Mr. Mosso noted that the CFO Act focuses on internal management needs and objectives. FASAB has actually stressed external users more than the law does, though the law does not exclude concern with external users.

Mr. Anania mentioned that there is some belief now that, due to the Sarbanes-Oxley Act, the hierarchy of GAAP for the private sector may eventually include only two things: concepts and standards. FASAB does not have the problem of others being involved in setting federal GAAP, but there are a lot of other things going on, e.g. requirements from OMB that affect our overall mission and FASAB objectives as stated broadly in SFFAC 1 paragraph 5. There may be confusion about how this fits together with FASAB objectives.

He has no objection to keeping the statement of objectives broad, but if we do so, we will need to bring in the answer to question 3 (cited above), perhaps as stated on page 5 of Mr. Bramlett's staff memo.[1] Is that our job? If so, we need to think about it consciously, here and in setting standards.

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[1] This stated: "For me, consideration of role and mission of federal accounting and of FASAB must include consideration of congressional expectations, as defined in law, and other unique aspects of the federal domain such as the lack of net income as a performance measure and the lack of capital market demands for traditional accounting information. I have discussed some aspects of this previously, e.g., pages 39-44 of my August 3rd memo for our August meeting. For me, comparative advantage seems to include consideration of:

(1) Core data inherent in the financial transaction processing system,

Mr. Patton agreed, and suggested that AICPA's action in recognizing accounting standards published by FASAB as GAAP exacerbates the problem, making it a core issue. Asked to elaborate, he suggested that it either gives FASAB a new line of business (external financial reports that are audited) or tips the balance from the internal side to the external focus; particularly in light of all the other players on the internal side.

Mr. Bramlett asked whether Board members include elected officials among internal users? He noted that GASB lists elected officials among the users whose needs it attempts to address. Mr. Anania said he sees elected officials as internal. Mr. Patton noted that conceptually Congress can get whatever it wants whenever it wants, unlike external users.

Mr. Mosso noted that a federal manger in a different federal entity, an elected official, and even an appointed department head, may in some ways be like an external user.

Mr. Anania noted that there are many sources of requirements for internal reporting, some of which FASAB sometimes cites or relies on. An example is the guidance OMB issues for budgetary purposes, which is part of our perspective.

Mr. Farrell noted that OMB also publishes its bulletin governing "form and content" of federal financial statements, so it influences external financial reporting. Mr. Bramlett observed that different laws give authority to GAO and to OMB for defining federal accounting standards; this was one of the reasons FASAB was created.

Mr. Anania said that we need to have concepts to embrace all that the Government does regarding financial reporting, but we need to be a little cleaner and crisper about what we do versus what others do to meet those requirements. Right now it is unclear or murky in the areas of internal control and the budgetary perspective. It is unclear where what we do has a direct impact, versus being an indirect aid.

Mr. Mosso said the question runs to the essence of what FASAB has in the way of comparative advantage. One of the advantages we offer is the ability to set standards that subjects information to audit. That is one of the advantages we offer in connection with the budget. That is how we bring integrity to the budget; we don't tell anyone how to budget, but because we have some audited schedules that include budgetary data, and the budgetary data is reconciled to the accrual statements, we are bringing some integrity to the budgetary side.

Mr. Anania agreed. He recalled that FASB had reviewed some industry-specific guidance [e.g., in audit guides issued by AICPA] to see whether there were standards that needed to be elevated by FASB action. Perhaps FASAB needs to do the same

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(2) Mandated periodic public reporting (not necessarily limited to core data) that is potentially independent of the budget, and

(3) Potential for regular audit."

with regard to federal guidance issued by others. He doesn't know if that is necessary; perhaps the fact that the other guidance exists is enough.

Ms. Comes asked whether OMB's guidance regarding reporting on improper payments [pursuant to the Improper Payments Act] would be an example? Mr. Anania thought it was not a good example. He regards it as specialized information, unless the improper payments are creating some kind of hidden liability or something like that. Ms. Comes asked whether OMB's direction to look to FASB's guidance for lessor accounting would be an example? Mr. Anania agreed that would be a candidate.

Ms. Comes observed that even without specific direction, she would have used the GAAP hierarchy to get to that guidance. She views the Form and Content bulletin as internal management's accounting policy. In response to her question, Mr. Kilpatrick noted that there are some disclosure requirements in the Form and Content bulletin that are not found in FASAB's literature. For example, regarding credit reform accounting and the Statement of Budgetary Resources.

Mr. Anania suggested that if we think everything done regarding budgetary reporting outside FASAB is good, we could just identify that as an objective and cede all of that to what is being done by OMB and others. We would not continue to appear that we have some responsibility.

Mr. Mosso noted that the MOU says that FASAB shall not set standards for budgeting.[2] Mr. Anania said he does not think that is clear in SFFAC 1; we need to change something.

On the issue of where we have a comparative advantage, Mr. Patton suggested that managerial accounting is an area where we don't have such an advantage. Managerial accounting ought to be emerging from the managerial process; it seems like an internal process. Mr. Bramlett noted that during the user needs study, information about the composition and behavior of cost (marginal, variable, etc.) was one of the few areas where potential users who were interviewed identified an information deficiency that FASAB might address. This request came from congressional branch analysts.[3]

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[2][Excerpt from MOU: "The Board will consider accounting concepts and standards. The Board will not set or propose budget concepts, standards, and principles. In considering accounting concepts and standards, consideration will be given to the budgetary information needs of executive agencies and the needs of users of Federal financial information. . . ."

Excerpt from Mission Statement: "The mission of the FASAB is to recommend accounting standards . . . after considering the financial and budgetary information needs of congressional oversight groups, executive agencies, and the needs of other users of federal financial information."]

[3] [Subsequent staff note: Some executive branch managers interviewed also mentioned deficiencies in cost information, including (1) deficiencies in information available to them due to systems limitations and/or (2) inability to report to Congress information known to managers

Ms. Comes mentioned a letter from Jim Blum, CBO's first representative on FASAB, regarding cost information, and suggesting it was our biggest comparative advantage.

Mr. Mosso said one could look at FASAB as the one body that is concerned with accrual accounting for the federal government; without accrual accounting there is not much cost accounting. We have established a link through the statement of net cost, so the framework for cost accounting is there.

Mr. Reid said he was impressed with Mr. Patton's comment; certainly Congress can get things it needs. There are also issues regarding the way the budget is administered, unlike what one might see in the private sector. When one is making managerial decisions, all kinds of factors come into play: is the program getting larger or smaller, what does one do with fixed costs, is there some step function? The kinds of information requests that would be appropriate for management and congressional staff to look at would vary. Overarching accrual concepts, as Mr. Mosso points out, are more significant than how one would manipulate the numbers for specific decisions. We need to make sure there is a capability to do that, without getting too prescriptive about the specifics.

Mr. Mosso noted that even before listing objectives in chapter 4, SFFAC 1, asserts that "decision usefulness" and "accountability" are the two overriding objectives.

Regarding the budgetary integrity objective, Mr. Reid said this is one thing the Government does particularly well. The disbursement function is well controlled; all disbursements are matched with an appropriation; and there is a series of laws like the Antideficiency Act that govern the process. If we were going to have a functional array, he might think differently, but the budget is by program, e.g., for an aircraft carrier.

"Given the level of aggregation in financial reports that result from our rules, and their lack of timeliness," Mr. Patton suggested that it may not work to expect GAAP reports directly to serve the budgetary integrity objective. Producing GAAP reports may induce people to do some things that will help assure budgetary integrity, but not the report itself. On the other hand, one might include in the report itself some sort of management representation that, at some aggregate level, the budget was not violated in a significant way.

Mr. Farrell noted that this would certainly be within the scope of the auditor's testing and report on compliance with laws and regulations, although FASAB does not have any standard that deals with this *per se*.

In response to a question, Mr. Kilpatrick noted that when FASAB was set up, OMB wanted to have budget execution audited, that is, the "actual" column in the budget. Years ago GAO performed some of that function, but over time that fell away. The Statement of Budgetary Resources is an attempt to partially respond to OMB's desires.

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regarding asset impairment/depreciation because it would conflict with budget requests approved by OMB.]

It does not go as far as some would have liked, but to the extent it has been done, it has been useful. Problems have been discovered. The measurement of outlays, as Bob Reid said, is well controlled, but perhaps not some other parts of measuring obligations. The fact that the audit is once a year is fine; there is no need to do it more often. If there is a problem, it is because the information is so aggregated. Information about the major accounts is presented as RSI, but he does not know how much assurance one gets from that. Also, FASAB standards are not used by Government corporations, most of which are budgetary [i.e., in the budget]. Problems with budgetary accounting were recently discovered in one of these corporations. These were antideficiency problems that went undiscovered for a number of years. Budgetary integrity is also relevant to credit reform because accountants and budget people have an interest in working together and supporting one another to provide information that would otherwise not be available. The accounting standards are relevant for internal purposes of management control, and for decision making purposes for the estimation of subsidy costs for credit. What has been done in these areas is important, and could not be replaced by a management assertion.

Mr. Mosso noted that in addition to the Statement of Budgetary Resources and the Statement of Financing, Bob Reid has developed new reconciliation statements [for the government-wide report; see SFFAS 24, *Selected Standards For The Consolidated Report of the United States Government*]. That is another way of meeting this objective, but he does not know if one infers that from reading the objective. At a minimum it needs to be reworded.

Mr. Jacobson noted there are qualitative as well as quantitative issues regarding budgetary integrity. Some aspects are numerical, but in assessing whether expenditures are consistent with the purposes of an appropriation, the legal issues can be very subtle. Also, auditors of financial statements are usually concerned with big numbers, while qualitative violations often relate to amounts much smaller than what is material to the financial audit. For these reasons, violations of law are unlikely to be timely discovered and resolved during the audit. Evidence of that is found in the lack of significant findings compliance reports.

Mr. Anania asked whether there are other pieces of information about the budget that would be useful to bring into the basic financial statements.

Mr. Mosso noted that for the most part we are dealing with the same set of accounts, but the accrual accounts do not include obligations, while the budgetary accounts do not include the all the accruals and accrual accounts. Having that as a display in the agency financial statements would serve to emphasize the point. Mr. Anania agreed.

Mr. Mosso asked whether members had thoughts on how to revise the objective. Mr. Anania said we should try to articulate what others are doing overall that would have a bearing on this, rather than have it appear unclear what FASAB is supposed to do compared with other entities. If we have objectives that cover what everyone does, we need to cite what is being done more specifically to support the objective.

Ms. Comes noted that the discussion in the bolded text in chapter 4 of SFFAC 1 is general, so one does not always see a one-to-one correlation; sometimes more specific examples are provided in the unbolded text.

Mr. Schumacher asked, when OMB puts out directives, does it look to these objectives? Ms. Geier said no, not directly.

Mr. Reid said it might be helpful to look at what is being done in the compliance area, e.g., people in the budget office look to assess compliance with the Antideficiency Act. People in Treasury do the accounting for it. If we were to rewrite this, thinking of the budget more as a management tool, rather than how we complied with the law, then we might have something more substantial. There are a lot of people looking at things from a compliance perspective. He is less comfortable with FASAB's role as a way to assure compliance.

Mr. Anania asked if this could be related to the stewardship objective.

Mr. Patton said that, given the level of aggregation and delay in producing audited financial statements, providing a management tool did not seem to be a big role for FASAB. The output FASAB can produce is financial reporting standards.

Mr. Anania said that if there are pieces of information in the budget process that stand out as important to the management process and to stewardship, we should consider whether they should be part of our model.

Ms. Comes asked whether the Current Services Assessment would be an example? Mr. Anania said he did not want to get into forecasts, but rather would deal with what actually happened.

Ms. Boutelle said that for management purposes she would want information by program, not by appropriation.

Mr. Anania asked whether there were not parallels in state and local government, where GASB talks about programs and service efforts and accomplishments. Ms. Cohen said that is still controversial at GASB. She noted that there is a big difference in that GASB sets accounting standards for many different entities across the country, with different functions and responsibilities. Mr. Reid noted that there is great variety among federal entities at the bureau and program level.

Mr. Mosso summed up the discussion by saying we need to do work on the budgetary objective to reorient it around some things we have done and are doing. He asked staff for information on the antecedents, including the CFO Act, of our managerial accounting concepts and standards.

Mr. Reid asked for staff analysis of how legislation relates to the objectives: are there some objectives that could be deemphasized or eliminated due to legislation? Mr. Anania asked what information is being reported, to whom is it being reported, and is it useful?

Mr. Mosso directed the discussion to the operating performance objective.

Mr. Holtz-Eakin noted that GPRA is about performance, "how does that affect what we might do?" he asked. Mr. Bramlett first observed that to him the preceding discussion about the budgetary integrity objective seemed more like the basis for an agenda setting meeting, than a basis for revising objectives. The Board was requesting more information about what is being done as a basis for revising objectives. Yet to him, knowledge of what is and is not being done would seem to be a basis for knowing what remains to be done to meet the objectives, which are themselves influenced, among other things, by statements of Congressional intent inferred from various laws. With regard to GPRA, he would agree that assessing performance requires information at the program level. It follows that at some stage FASAB might want to mandate more disaggregated reporting than is required in the Statement of Net Cost; alternatively FASAB might reasonably conclude that the question of how much disaggregated information to present should be left to management, working in consultation with Congress. In either event, the issue GPRA raises for FASAB, as he understands it, has more to do with FASAB's future technical agenda than with the statement of objectives.

Another example of legislation with possible implications for FASAB's agenda might be the Reports Consolidation Act. When FASAB deliberated concepts and standards for management's discussion and analysis, the Board discussed whether it should set standards for the "Accountability Report," (now called the "Performance and Accountability Report"), or just for some subset of it called the basic financial statements. The Board included a very general schematic of the Accountability Report in SFFAC 3, but left open the question.

Mr. Anania said that he would not eliminate something from the objectives because it is being accomplished elsewhere, but he would make it clear where these things are being accomplished, to clarify what FASAB may need to do and may not need to do. If we compare the difficulty of FASAB setting standards under this approach compared with FASB's, ours is ten times more difficult. FASAB's objectives have a broad scope, with an internal as well as external focus. The FASB does basically one thing: external reporting, where the performance assessment is profit. There is no other management assessment. Obviously, EPS is not the measure of success for the government. He would not carve back the objectives, but would like to see a closer tie with what is being done, and where we are not currently accomplishing the objectives.

"And, to turn it around just a little bit, to show where we fit in," Mr. Mosso interjected. "And who else fits in, show how what we are doing and what they are doing creates harmony rather than disharmony," Mr. Anania added.

Mr. Patton said this raised the stakes of defining the broader objectives that could apply to accounting and financial reporting. He would guess that the "bold face" objectives are a subset of the objectives that could be served by accounting and financial reporting. If so, we should consider the possibility that these four are inadequate, add to them if necessary, then say we are going to take part of the game and others will take other parts.

Mr. Anania referred to the twin objectives of decision usefulness and accountability, which, as Mr. Mosso had pointed out, SFFAC 1 asserts. That might be the big umbrella. Mr. Patton said he liked that, and there might be other objectives in addition to the four listed under that umbrella. He noted that accountability and decision usefulness are traditionally competitors, [i.e.] alternatives, under FASB.

Mr. Mosso noted that GPRA did not exist when FASAB deliberated SFFAC 1; the Act probably put into law what the Board had in mind when it crafted the operating performance objective.

Mr. Patton observed that evaluating performance focuses on programs, while our standards focus on agencies. Mr. Reid noted that most agencies are amalgams of unrelated activities.

Ms. Comes said that our standards call for knowing the full cost by programs, and to some extent call for mapping that into the MD&A discussion of performance. In cases where components of departments are presenting audited financial statements, more detailed information is available. For example, the Mint's financial statements present detail not found in the Treasury Department's statements.

Mr. Reid said that agencies do a good job in the Statement of Net Cost of laying out what their programs are. Everything in the Statement of Net Cost, except the total, is unique to the agency.

Mr. Anania asked where the agencies get their guidance on what to present on programs. "SFFAS 4," Mr. Reid answered, "and also consideration of materiality, to come up with the line items, you have to break out the material activities."

Ms. Comes said that ideally the Statement of Net Cost should crosswalk to GPRA, which calls for strategic plans.

Mr. Mosso noted that the definition of program is a matter for management and OMB negotiation to some extent with congressional committees. That definition is taken as a given in the accounting standards, which call for reporting net cost.

Ms. Comes noted that SFFAS 4 provides for management to define responsibility segments and to have the ability to measure the cost of outputs. We don't have a specific requirement to report cost per output in basic information, but we do encourage cost per output information in MD&A. The implementation guide to SFFAS 7 illustrates ways agencies can report cost of programs. A lot of agencies accomplish that in notes and RSI. The full cost concept takes account of the fact that appropriations don't always align with programs; full cost means reporting the resources used by program regardless of the source of the funding.

In response to a question from Mr. Anania about other sources of guidance, Ms. Geier explained that the Form and Content Bulletin provides guidance for defining responsibility segments and on linking the Statement of Net Cost to MD&A. Ms. Comes observed that preparers elevate programs of interest by presenting information on them in the Statement of Net Cost and/or in MD&A.

Mr. Bramlett noted that the definition of program can change after every election; hence it is necessary to have flexible cost accounting information systems, if one is to have cost information by program.

Mr. Anania asked whether we intend to do more related to the objective? Mr. Mosso noted that when we last considered the technical agenda, the Board considered the possibility of adding a project on cost accounting or one on performance reporting; neither rose to the top. Ms. Comes said she could envision producing a glossary with definitions related to cost accounting, and/or standards to assure that, when appropriate, disaggregated data are presented and forecasts of cost are reported. Mr. Mosso noted that there has been some confusion or misinterpretation of SFFAS 4, which might be clarified.

Mr. Schumacher said the operating performance objective appeared comprehensive; Mr. Patton also expressed satisfaction with it.

> CONCLUSION: The Board will continue its discussion of the budgetary integrity objective, and will discuss the objectives dealing with stewardship and with systems and controls.

- **Rules of Procedure**

Ms. Comes opened the discussion after explaining that the rules were last discussed at the August meeting.

Mr. Schumacher inquired whether anything was added as a result of the ongoing American Institute of CPAs (AICPA) Rule 203 review of the Board. Ms. Comes responded that AICPA had requested clarification of (1) the effect of tied-votes and (2) the presence of non-voting members. In addition, it was agreed that further AICPA's input would be requested before the rules are finalized.

The following revisions were adopted:

1) Mr. Patton opined that we could increase our apparent independence by deleting two specific references to the sponsors. Since there is a general requirement that the chairperson confer with the sponsors the following specific requirements could be deleted:

    a) At page 8, appendix A describing the chairperson's responsibilities, language requiring that the chairperson confer with sponsors (page 8, line 29) before inviting liaisons to meetings

    b) At page 13, "Frequency of the meetings", indicating that meetings would be held at the request of any one of the sponsors

2) Mr. Patton suggested that a majority of the board should be able to request a meeting. Members agreed that this option should be added.

3) Mr. Patton asked that we clarify the means by which "FASAB decides" (page 14, line 36).

4) Mr. Anania asked that the Board's role in approving and the sponsors review procedures be specified in Appendix A. For example, Technical Releases at page 32.

5) Mr. Anania asked whether e-mails serve as written ballots. Mr. Jacobson indicated that they could be a substitute for the signed ballot. The rules will clarify this.

6) Mr. Schumacher asked for clarification on page 17 regarding approval of interpretations. It was agreed that the specific individuals would be listed instead of relying on terms such as "sponsors."

7) Mr. Patton, referring to page 6, line 26, asked whether we need to define "substantial change" to determine when re-exposure is required? The Board agreed to drop the pre-amble and simply note that the board may decide to re-expose.

There was extensive discussion regarding the timing of ballots and the meaning of quorum.

Ms. Comes explained that calling for ballots to be due at meetings may be difficult in practice as it precludes members missing a meeting from voting. She recommended that we simply drop the language that at page 7 at item 3c. This language indicates that ballots called for at a meeting are due at the meeting. The Chairperson's ability to call for a vote on a different schedule would cover the case where ballots were needed at a meeting to facilitate addressing an urgent issue.

Mr. Anania noted that quorum was another area of ambiguity. He asked whether someone could vote whether or not they were in attendance.

Mr. Farrell asked about the polling at the table – could that continue if someone wasn't here. Mr. Mosso noted that verbal polling is to gain a sense of the board and is not an official vote of the Board.

Mr. Farrell raised the issue of a member not physically able to vote. In that event, the board still needs to vote – so we need to specify what constitutes a quorum.

Mr. Anania expressed concern that we could have a meeting where six are present and four voted for something that the four absent members would object to. Could the vote be done without giving the absent four members a chance to vote?

Mr. Jacobson indicated that the board could decide on the minimum number of affirmative votes to pass something.

Members noted that:

1) We could require that all ten votes be cast before something is issued.

2) Eliminating the ballot at the meeting would enable absentee members to vote.

3) If you want to get the publication started and everyone agrees, then you would want to ballot at a meeting.

4) One option is six present for a meeting, six yes votes to publish and the ability to cast ballots at the meeting if needed.

5) It would not be not fair if new members could vote but the existing member who missed a single meeting could not vote.

6) Another option is a majority of all current members able to vote.

Mr. Reid explained that the idea that ballots are divorced from meetings seems contrary to public meeting/sunshine requirements. The formal ballot away from the table should follow public discussion of votes. We need to consider transparency. Our discussions and decisions should be public. We could then circulate ballots after that discussion.

Mr. Mosso noted that discussing the pre-ballot draft at the meeting and getting a sense of the board verbally gives observers access to the Board's decision making. Following that discussion and polishing of the document, members could submit ballots between meetings.

Mr. Reid indicated that would satisfy him. The public meetings would give a sense of the board subject to these conditions. Then members would get a final document consistent with the conditions and cast ballots.

Mr. Anania asked if conference calls are permitted. Mr. Jacobson responded that they are if the meeting is public. Ms. Comes explained that individual members have participated by phone when they were unable to attend but that it is not encouraged.

> CONCLUSION: Ms. Comes will revise the rules as indicated, confer with the AICPA review panel, and present revised rules at the December meeting.

- **Steering Committee Meeting**

Attendance: Chairman Mosso, Kimberly Geier, OMB; Robert Reid, Treasury; Philip Calder, GAO; and Wendy Comes, FASAB.

The Steering Committee briefly discussed the status of the budget. Ms. Comes noted that changes to the previously submitted budget were needed to provide for Ms. McKinney's retirement (note that no incentive award was made and the budget affected is for lump sum annual leave and the months during which the position will be vacant) as well as a potential new position in light of the JFMIP Principals recent meeting. She committed to providing the revised budget the following week.

The Steering Committee met in closed session regarding personnel matters.

Adjournment

The meeting adjourned at 4:00 PM.

Thursday, October 9, 2003

Agenda Topics

- **Social Insurance Project**

The staff presented a discussion paper regarding asset and liability definitions within the context of the social insurance project. Questions for the Board's consideration were inserted throughout the paper. The paper concluded with information tables about social insurance programs and an appendix containing facts about selected Federal programs.

Staff began the discussion by noting that the FASAB Members had indicated at the beginning of 2003 and at the conclusion of the SFFAS 25 project that they wanted to review the Social Security and other social insurance accounting provisions of SFFAS 17 and the liability concept as applied in SFFAS 17.

Staff noted that at the August meeting the Members directed that the analysis should begin with a review the FASAB liability definition, which was established in SFFAS 5. However, some members have stated that the project should start with basic questions regarding both assets and liabilities. The Board directed that an asset definition should be considered in conjunction with the review of the liability definition.

The Primacy of Assets

Staff noted some Board support for the primacy of assets in the FASAB accounting model, and for having the liability definition reflect the asset definition. **Staff Question #1** asked whether the members agreed that the asset is the fundamental element for the Government. Mr. Anania said that there seems to be a conflict between the idea of the primacy of assets and the sovereign right to tax. He favored moving on to the definition of assets and liabilities without spending time analyzing whether assets should be the primary element as in the private sector model. Mr. Schumacher agreed. He favored working on both definitions simultaneously without declaring the asset element primary. Mr. Holtz-Eakin said the definitions of assets and liabilities should be considered independently.

Mr. Anania said there probably should be a different focus for assets and liabilities in the Government than for the private sector, and the Board is currently in the process of determining what that focus might be. He said he would not like to start out with the focus being the same as the private sector if the Board thought it would end up being different. He said he would not want to be bound by the idea that you have to define a liability in terms of an asset.

Mr. Patton agreed that the Board should talk about assets and liabilities simultaneously without declaring one more fundamental than the other, but he was not sure how the symmetrical recognition idea would work, e.g., a federal liability and a private sector asset might end up being asymmetrical. If the definitions are different, then it may not be true that one entity's asset is another entity's liability. Mr. Mosso said that there might be a recognition issue rather than a definitional issue. One party could recognize a liability, for example, without an asset being recognized by the other party, but that would not affect the existence of the asset.

Mr. Reid said that his reaction to the paper's presentation regarding the primary element in the Government was that the liability element should be the primary element.

With respect to **Question #1**, the Board decided that the development of asset and liability definitions would proceed on parallel and equal tracks, and neither element would be declared more fundamental than the other.

The Working FASAB Asset Definition

Staff Question #2 asked whether the members concurred with setting aside the FASAB working definition. The staff said that the working definition was not subject to due process and the word "ownership" may be problematic.

Mr. Calder favored some terminology in the working definition and might argue for including it in the asset definition the Board ultimately develops.

With respect to **Question #2**, the Board agreed that the working definition would not be afforded status in the project that would have to be overcome. However, this decision would not preclude the use of a word or words from the working definition.

The Asset Definition

Linkage with FASB

Some members had stated that there is a compelling rationale for aligning FASAB closely with FASB where possible. The current FASB asset definition is as follows:

1. Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

2. An asset has three essential characteristics:

    a. It embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows,

    b. A particular entity can obtain the benefit and control others' access to it, and

    c. The transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

With respect to the FASB definition, staff noted that there may be fundamental differences between the Federal and private sectors. Also of concern is the current questioning and criticism of the FASB's model generally and assets in particular.

"Probable Future Economic Benefits"

The staff said that the phrase "probable future economic benefits" in the FASB definition and in the first FASB asset characteristic may suggest that a probable cash inflow or service potential is needed for something to qualify as an "asset". Public land legislatively restricted with respect to use may not qualify as an "asset". Thus, the definition may serve to disqualify an item for consideration as an asset. On the other hand, some would view the "benefits" issue broadly and not necessarily disqualify land or other asset candidates. **Staff Question #3A** asked whether the members believed that the phrase "probable future economic benefit" would disqualify an item that members might, intuitively, want to recognize as an Federal asset.

Noting several rationales for presenting fiduciary assets on the balance sheet, **Staff Question #3B** asked whether the phrase "probable future economic benefit" would preclude presenting fiduciary assets on the Federal balance sheet.

Mr. Patton said it would be hard to be against aligning with FASB where possible, depending on your interpretation of "where possible". He did not want to have to follow FASB unless there are totally compelling reasons to do something else. He did not mind having alignment with FASB as a goal as long as doing so would not be constraining.

Mr. Mosso said the essential point is the three FASB characteristics: future benefit, control, and past event or transaction. All of the other definitions involve variations on these three elements. Focusing on these three elements is better than focusing on the similarity with FASB's definition. Messrs. Patton and Calder agreed. Mr. Mosso said that if these are the three components then it becomes a matter of getting words that will express them in the Government environment.

Mr. Anania said the word "economic" is out of most of the other definitions. He said that word is troublesome and he would like to avoid using it in the Federal definition. Benefits can be of a nature that some people would perceive as economic. GASB talks a lot about service potential and about the ability to use things considered assets to provide services to the public. When we talk about some of those things where there might be a problem with recognition criteria or coming up with a value, we still believe they are assets. So, he said he would like to avoid the word “economic” because it can mean too many things to too many people, and it is more of a private sector notion.

With respect to **Question 3A**, the Board decided not to use the word “economic” to modify “benefit”.

Also, with respect to **Question 3B**, in addition to the answer for Question 3A, the Board decided that the phrase “future benefit” would not preclude presenting fiduciary assets on the Federal balance sheet

Other Definitions

Staff Questions #4 through 8 essentially asked what definitions the Board wanted to consider – FASB, Mosso, Patton, or other approach.

The staff noted that some FASAB members have offered other definitions or approaches for consideration. Mr. Mosso had offered the following:

> Assets are rights to ~~probable~~ potential future ~~economic~~ benefits obtained ~~or~~ and controlled by a particular entity as a result of past transactions or events.

Staff said that some might view the word “potential” in the definition of “asset” as a lower threshold than “probable”. Although many items that met this modified definition might not qualify for recognition due to “recognition criteria” or “measurability” issues, the concern is that “potential” benefits are easily imagined for all sorts of items that will have to be further evaluated by preparers and auditors. Since both “potential” and “probable” are probability statements, some members might prefer the higher barrier.

Mr. Anania noted the definition GASB has considered didn’t include the words “potential” or “probable”. He asked Ms. Wardlow, who was participating via a teleconferencing link, to comment on GASB’s approach.

Ms. Wardlow said that her recollection was that the GASB was not happy with any such term due to the problem of defining it. She said the GASB was not happy with “more likely than not” or other constructions. GASB concluded that such a term was not needed. The future orientation and uncertainty would be understood. GASB thought the word “probable” would be confusing if not defined. Staff noted that probability would be imbedded in the definition in any case and would have to be defined. Mr. Mosso said that probability is more a measurement issue than a definition issue. Ms. Wardlow said that whether probability was really an essential part of an asset was part of the GASB discussion. If one is trying to define an asset based on its essential characteristics, was probability necessary at that stage or did it have more to do with measurement and recognition.

Mr. Anania said that he supposed that having probable in the definition helps you if you are trying to set a high hurdle for recognition. If you want to set a lower level then you leave it out. He said the asset would have to be reliably measurable. And, if you do not have probability in the definition, it seemed to him you would have a little more wiggle room on meeting the recognition test.

Mr. Schumacher asked whether not having "probable" in the definition meant you have certainty. Mr. Reid responded that this would be true except it's understood that the future is not guaranteed, and that a probability notion was built into the Board's model. Mr. Mosso agreed.

Mr. Holtz-Eakin said that the issue is one of measurement. One's right to the asset would be unambiguous. What the right is worth as some point in time is a measurement issue.

Mr. Mosso noted the example of Czarist bonds: they represented an undisputable right if you had such a bond. So, by leaving out "probable" the bond would be an asset but whether you would book it or not depended on your assessment of the probability of getting something out of it.

Mr. Patton asked what would not be an asset under that approach. Everything would be an asset. Mr. Mosso said rights were assets. Mr. Anania agreed. For example, one would not have a right to a taxicab in front of the GAO building and therefore wouldn't book it as an asset. Staff noted Mr. Mosso's definition of rights provided in the issue paper [*rights* are claims or titles, whether legal, prescriptive, or moral]. Mr. Patton said he agreed with Mr. Schumacher: if there's a right, then that is certain, subject to the vagaries of the future. Mr. Patton asked whether the Board was saying that there would be a 100 percent right to an item. Mr. Mosso responded in the affirmative, although having a right would not mean you would recognize it.

Staff asked Mr. Jacobson to comment on the notion of a "right" in the context of Federal law. Mr. Jacobson noted that Mr. Mosso's definition of "right" could be read to include the concept of a "moral right". He said that the question of who has a moral right, to what, involves the eyes of the beholder.

Mr. Mosso mentioned the notion of a constructive asset or liability, but said that he offered his definitions to get the discussion going rather than as a final construction. He said he started with the FASB definition and modified it to address problems others have had with it. However, he said the notion of constructive assets and liabilities would be important for the Board for some things like environmental obligations.

Staff noted that Mr. Patton had also offered a definition of "asset" as follows:

> Federal entity "assets" are resources (rights to probable inflows of goods, services, or cash) controlled by the entity as the result of a past event where the resources will be used by the entity to achieve its goals in the future.

Staff noted that the terms “use” and “to achieve its goals” in this definition may be more difficult to operationalize than the FASB or Mosso definitions. For example, is protecting land a “use”? Can the asset be part of the goal? That is, the entity’s goal is to provide access to an historic site. If resources are “rights to probable inflows of goods, services or cash”, then we have all the same questions inherent in the FASB definition plus questions about the new aspects of “use” and “goal”.

Mr. Anania noted that, if Mr. Patton’s definition stopped at “past events”, i.e., delete “where the resources will be used by the entity to achieve its goals in the future”, which Mr. Anania thought was merely amplifying the prior statement rather than being a part of the definition, then it ends up being almost identical to GASB’s. Mr. Patton agreed, except that he included the word “probable”. Mr. Anania said including the word “probable” would be all right if the Board defined it in the asset definition. He wasn’t sure that the phrase “where the resources will be used by the entity to achieve its goals in the future” was needed. Mr. Patton agreed.

Mr. Holtz-Eakin asked what was meant by “control”. Mr. Anania said that there was a discussion of “control” in FASB Concepts Statement No. 6. Mr. Mosso agreed and said it essentially involved the ability to get the benefits from the asset and prevent someone else from getting the benefits.

Mr. Patton posed a question for discussion: Is it the Board’s intent that, for example, when the Government is suing someone, it would not recognize an asset unless a judgment had been rendered so that there would be a right established? Mr. Anania said there would be a right within the lawsuit that becomes a measurement question. Mr. Patton said he did not want to talk about the measurement question. Mr. Mosso said that, in the example of a lawsuit, the Government would have thought it had a right before suing.

The Staff noted that subsequent to the Board’s discussion in August, Mr. Patton had suggested an approach whereby a variety of possible models of Federal financial reporting would be considered. Mr. Patton had noted that the Board might have to come to some sort of agreement about the nature of a position statement in the Government before it can resolve the asset and liability issues. Mr. Patton had stated that the decision to include or exclude each of the above items would depend on: the definition of “asset”, the purpose of the position statement, and one’s tolerance of unreliable measures. Mr. Patton had suggested a similar approach for liabilities.

Mr. Mosso asked about how Mr. Patton would view “financial position” and “financial condition”. Mr. Patton said, as he recalled, condition was more forward-looking, broader than ”position”. Mr. Mosso said that perhaps position would be limited to the balance sheet. Mr. Patton said that that may be the Board’s model, and in that case certain conclusions would follow.

Mr. Anania said that, because he believes the word “owned” in the Board’s current working definition gets in the way, he would like to come up with another working definition that would at least for the time being supercede that former working definition for the purposes of the Board's forward work. He would be willing to take Mr. Patton's suggested definition, without the final phrase, and leaving in the word "probable".

Mr. Calder said he was uneasy with striking "owned" and relying on the word "control". By way of example, he discussed the problem with the word "control" in relation to military actions that would control territory, for example, the District of Columbia. There would be control but should an asset be recognized? He said ownership is an essential element of assets. One has certain rights of ownership in, for example, land depending on whether one holds title to it or is merely leases it. He said ownership is important, although it changes based on our relationship with the object or thing in question. He said another example would be a case where the Government could control an entity's oil wells for the next five years or indefinitely without "owning" it; which is different than a lease where there are certain ownership rights for a fixed period of time.

Mr. Patton said that in the case of the oil wells the Government presumably has seized the asset and therefore <u>would</u> recognize an asset. Mr. Mosso agreed. Mr. Jacobson asked about the case of Japan in 1946. Ms. Cohen asked how this discussion would affect Iraq. Ms. Boutelle noted that the revenue from Iraqi oil would be a benefit to the Government because it would substitute for the need for supplemental or other appropriation of tax receipts.

Mr. Anania asked whether this discussion suggested the Board can not define an asset for the Government. Mr. Calder said it suggested that "own" is a better word than "control". Mr. Anania said one reason he is uncomfortable with "own" goes back to one of the Board's discussions during new Board members orientation. One of the overall concerns was that some believe that there is an issue regarding the Federal model not giving equal consideration of unrecognized assets as the Board is focusing on certain liability issues. He added, there are also issues related to assets: unrecognized assets, assets that may be more difficult to measure and to identify, etc. He said he was trying to remove some obstacle in the definition, to make it a broader-thinking exercise in terms of what the assets might be, and that is why the term "own" seemed to be getting in the way.

Mr. Mosso noted that in the prior day's discussion of fiduciary activities the issue came up several times. Mr. Anania said that if eliminating the term "own" opened up other new unexplored doors, he was not sure what to do about that. Mr. Mosso said the issue goes back to the discussion of control, and using it for military actions is not within the context of accounting. The Board decided to direct staff to development and explain the "control" starting with the FASB Concept statement.

Staff asked Mr. Calder whether having the word "own" in the definition would affect the placement of fiduciary assets on the Federal balance sheet. Mr. Calder said they might put it on the balance sheet for other reasons but fiduciary assets are not "owned" by the Government. Mr. Schumacher said that leases would be similar: the lease would be an asset but the lessee does not own them. Mr. Calder said the lessee would have legal rights to the property. Mr. Schumacher asked if that represented legal ownership. Mr. Calder answered that he thought it was. Mr. Mosso noted that someone other than the lessee has legal title, and that's why the word "own" is problematic. He noted that, in writing up the definition, ownership is certainly present with the vast majority of assets. For those fringe elements where "own" does not fit or is not tight enough as in the case of a lease, you could say you "own" a certain segment of the thing but someone else has ownership. Mr. Calder said he thought it was agreed that lease rights are property rights. Mr. Mosso surmised that that is probably why some standard setters have shifted to "rights" rather than absolute ownership.

Staff noted that some members had favored as an initial working definition an amended version of the Mr. Patton's suggested definition as follows:

> Federal entity "assets" are resources (rights to probable inflows of goods, services, or cash) controlled by the entity as the result of a past event.

Staff asked where the Board wanted to insert the word "own" into the sentence. The Board decided not to add that word at this time.

Mr. Jacobson asked whether the asset definition had to contain either "controlled" or "owned". He noticed Mr. Mosso's definition did not, and that Mr. Patton's definition included a parenthetical explanation of what is meant by "resources", which was very nearly the same thing as Mr. Mosso's. Thus, he suggested that the following definition:

> Assets are an entity's rights to probable inflow of goods, services, or cash as a result of a past event.

He said this definition would eliminate the problem of defining "owned" versus "controlled" and focus on the definition of "rights", and in some cases those rights would be ownership rights and in other cases those rights would be other legal rights. Mr. Anania noted that Mr. Jacobson's definition was essentially GASB's definition. [GASB: Assets are an entity's rights to goods, services, or cash flows as a result of past transactions or other events.]

Mr. Calder said that the GASB construction may get the Board past the immediate problem, but the issue is not "rights" but entity's rights. At some point the Board will have to determine what are the entity's rights: are they the things that they control or the things that they own. He said the GASB construction is a good solution to the immediate problem.

Mr. Jacobson asked whether there are not things currently on the balance sheet and that everyone would agree belong on the balance sheet as an asset that the entity does not "own" but to which it has a unquestionable legal right. Mr. Calder suggested accounts receivable for example. Mr. Calder said the same problem of control versus ownership would exist for receivables. Mr. Jacobson said the entity might characterize the right that triggers the recognition of the receivable asset as a legal right but not an ownership right. Mr. Calder said the entity would own the legal right to collect the receivable, nobody else could collect that receivable.

Mr. Anania said the idea of rights is embedded in ownership, and the question is whether the Board needs to use the term “ownership” -- which may imply something beyond certain imbedded rights -- or a less inclusive term. He said ownership might not include all rights of ownership, but if you have some rights of ownershipthat is good enough for asset recognition. Mr. Calder said he agreed, in those terms. He said he didn’t think “control” has the same imbedded rights.

With respect to **Staff Questions #4 through 8**, the Board decided to focus on the following definition and elements for further consideration:

> Definition: Federal entity “assets” are resources (rights to probable inflows of goods, services, or cash) controlled by the entity as the result of a past event.
>
> And, the three asset characteristics from FASB:

1. It embodies a probable future benefit~~.~~,
2. A particular entity can obtain the benefit and control others' access to it, and
3. The transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

Mr. Mosso said the staff would come back with more analysis of the two terms “control” and “own”. He said some of the analysis would be found in the accounting literature.

The Liability Element

Staff noted that phase one of the social insurance liability project would consider the definition of liability. A subsequent phase(s) will consider measurement and recognition criteria.

Staff noted the current liability definition from SFFAS 5, paragraph 19, first sentence:

> A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.

An item could meet this definition without being “recognized” because it is not measurable. Paragraph 19 goes on to state that general purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from past transactions (exchange and nonexchange) and events (Government-related and Government-acknowledged).

Staff explained that SFFAS 5, paragraph 33, defines “probable” as “more likely than not” and explains how Federal liabilities are not necessarily dependent on budget authority.

For the social insurance programs FASAB's liability definition says that expense is recognized for the benefits paid during the reporting period plus any increase (or less any decrease) in the liability from the end of the prior period to the end of the current period. The liability should be social insurance benefits due and payable to or on behalf of beneficiaries at the end of the reporting period, including claims incurred but not reported (IBNR). SFFAS 25 categorized the SOSI as basic information and the other SFFAS 17-required information as RSI.

Staff noted the current FASB liability definition:

> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. A liability has three essential characteristics:
>
> 1. It embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand,
>
> 2. The duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and
>
> 3. The transaction or other event obligating the entity has already happened.

Members have suggested other alternatives. Mr. Mosso (July 2003) suggested:

> Liabilities are ~~probable future sacrifices of economic benefits arising from~~ present obligations ~~of~~ incurred by a particular entity to transfer assets, issue equity interests, or provide services to other entities in the future as a result of past transactions or events.

Mr. Patton has noted that, based on the "equal and opposite" meanings approach, the Board may be asking the reader to infer the presence of "potential" future sacrifices in the definition of "liability". Or "obligation" might imply "probable" outflows. Mr. Patton believes that an explicit probability concept is an important feature of the definition of "asset" and "liability".

Mr. Patton offered the following definition (August 2003):

> Obligations (duty to transfer resources) of the entity that exist as a result of a past event where it is probable that the obligation will lead to outflows of resources from the entity to other entities in the future.

Mr. Jacobson said that if the Board used the word 'obligation' in defining 'liabilities,' they should explain that it differs from the budget usage of the same term. Mr. Kilpatrick agreed and added that he did not think that the accounting usage, accompanied by an explanation, would be a problem from the standpoint of the budget. FASAB concepts and standards are written for specialized internal audiences, not the general public.

Mr. Patton has noted that "legal enforceability" has not been required to record private enterprise and some non-profit liabilities. Extending that reasoning to the Government, Mr. Patton has said it will be difficult to figure out where the boundary would be drawn for liabilities, e.g., for entitlement programs. He has stated that the consequences of canceling certain social or defense programs would certainly seem adverse enough to ensure their continuation. His main concern has been is that a conceptually defensible boundary is drawn between "liability" and other probable future outflows.

OMB states[4] that the Government 's fiscal condition can only be properly evaluated using a broad range of data and several complementary perspectives. The GAO has noted[5] that the Government undertakes a wide range or spectrum of responsibilities, programs, and activities that may either obligate the government to future spending or simply create an expectation for spending. For GAO, "fiscal exposures" include not only liabilities, contingencies, and financial commitments that are identified on the Government's balance sheet or in the accompanying notes, but also responsibilities and expectations for Government spending.

Mr. Anania has said that the FASB concept of constructive liabilities should be explored. FASB notes in SFAC No. 6 [par. 40] that the line between recognition on the balance sheet and disclosure or other forms of financial reporting is not always easy to draw using the private sector model. Some liabilities rest on equitable or constructive obligations that may be binding primarily because of social or moral sanctions or custom.

Staff Questions #9 through 13 asked whether the Members want to use, revise, further analyze the current FASAB liability definition, adapt the FASB definition, create a new liability definition, or favor another approach.

The staff noted that the current FASAB definition might be a starting point for the discussion since is contains terminology and concepts closely related to the FASB definition. The staff explained that prior Boards had emphasized elements of the definition such as probability and transactions and that the present Board may want to re-examine the prior emphasis while retaining the current SFFAS 5 construction.

Mr. Patton said that the notion of an existing obligation that is in the FASB and other definitions seemed to be absent from the current definition, and he asked whether that was intentional. Staff explained that SFFAS 5, paragraph 19, explained how and when the liability definition would arise and the notion of an existing obligation was implicit there. Mr. Anania said he noted that absence of the word obligation as well.

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[4] OMB, *Analytical Perspectives*, FY 2004, Chapter 3, "Stewardship".
[5] GAO *Fiscal Exposures: Improving the Budgetary Focus on Long-term Costs and Uncertainites*, January 2003, GAO-03-213.

Mr. Anania said the definition without the word “obligation” was too loose. He said there are many probable future outflow of resources without an existing obligation.

Staff noted that unlike the working asset definition, the liability definition is in a standard, SFFAS 5, paragraph 19. Staff noted that the agencies have been applying it, along with the accompanying recognition criteria from paragraph 19.

Mr. Patton said that in the interest of harmonization with FASB mentioned earlier, the notion of present obligation is in FASB, so that would support adding “obligation”. Mr. Anania said he would favor adding that word to the definition. He said he wasn’t sure how GASB came up with duty and asked Ms. Wardlow for background. [GASB: Liabilities are an entity’s duty to transfer assets or provide services to other entities as a result of past transactions or other events.]

Ms. Wardlow said one or possibly two GASB members were opposed to the word “obligation” because they felt that was merely a synonym for liability. She said GASB ended up with duty, which wasn’t favored by some GASB members; but, GASB’s definition is a working definition and GASB will probably get back to it.

Mr. Holtz-Eakin asked Mr. Mosso for background on the changes he made to the FASB definition. Mr. Mosso said he felt “obligation” was a counterpart to “rights” in the asset definition, and used it to get a parallel construction. He said he struck out “probable future sacrifices of economic benefits arising from” because it seemed to be redundant in the sense that the obligation is to transfer assets. Mr. Mosso included “present obligations” because it was embedded in the FASB definition. “Obligation” is broader than “liability”. The latter goes on the balance sheet. “Obligation” is broader than legal obligations. It would include moral obligations.

Mr. Mosso said the problem he sees with the current FASAB definition in SFFAS 5, paragraph 19, is that it includes recognition criteria. He said he thought the purpose of this was to keep Social Security off the balance sheet.

Mr. Calder asked how FASB squares its definition with its treatment of pension liabilities. He said he didn’t know if there is a definition or a recognition problem, but the fact of the matter is that when an employee comes on – assuming a defined pension plan -- there will be a pension. At the time the employee comes on board the entity does not owe anything to the individual. Assume that at the end of five years they have certain vested rights, at which point the entity owes them something. But the entity’s accounts would recognize a liability that does not relate to the settlement value if the employee leaves in five years, but rather the entity is recognizing a liability for some portion of the total amount the entity is going to owe at the end of the employee’s career, although the entity does not have an obligation to the employee for that amount. Mr. Schumacher said the obligation is in the future.

Mr. Anania said the real question of obligation comes in the form of, one, the entity may have a union plan, which the entity is bound to by contract and may be a part of ERISA; and, two, the entity may have a management plan that can be terminated any time the entity's management so desires. The latter is where the constructive obligation comes into effect. The FASB position was that that kind of a plan should get recognition on the basis that the consequences of terminating that plan would be so onerous that no one is going to accept the idea that it is going to be terminated. Mr. Schumacher added that the constructive liability is even more pronounced in the case of retirement health care benefits, which are explicitly cancelable.

With respect to **Staff Questions #9 through 13**, for the next FASAB meeting, Mr. Mosso asked the staff for background on some of the words that the Board had discussed. The Board wants to give further consideration to adding "present obligation" to the current FASAB definition. Mr. Mosso asked staff to provide some alternative words for the definitions.

Mr. Holtz-Eakin asked whether the Board was going to draft just an asset definition, or re-visiting the liability definition standard only. Mr. Mosso said he would like to do both because the two definitions are essentially parallel. The staff noted that the scope of the social insurance project included the liability definition, and if the definition needed re-working, then once it is amended or re-developed, it would be applied to the five social insurance programs. The social insurance project would move concurrently with the asset/liability portion of the element project.

Mr. Patton asked whether there would be an elements concepts statement and a standard applying those or re-do the definition within a statement.

The staff said its vision was one or more concept statements on elements. Staff said it is important to move forward faster on some of the concepts than others. There are standards that have asset and liability issues in them, so it is possible to have a concepts statement on assets and liabilities and then build into a larger concepts statement on elements. Much will depend on how the work moves forward. With social insurance it would be very difficult to issue an exposure draft altering the statement of social insurance without concurrently having a change in the liability definition. However, there are scenarios where the emphasis in the liability standard might be changed, e.g., non-exchange versus exchange transaction, without a change in the liability definition.

> CONCLUSION: Staff will provide an analysis of the terms "own" and "control", the need for a term such as "probable" or "potential", and alternatives with respect to the asset definition. Staff will provide further material on the liability definition including the nature of "present obligations" and "constructive obligations."

- **Leases**

The session began with a presentation given by Ms. Lee on: (1) the significant differences between FASAB guidance and the guidance of other standard setters on the topic of leases, (2) lease issues raised by the Department of Justice, Office of the Inspector General, and (3) accounting and reporting issues arising from lease arrangements being used by Federal agencies.

During the presentation, Mr. Anania sought clarification of IFAC, IASC, and IASB, and whether IASC's standard on leases was incorporated into the IFAC standard. Mr. Mosso and Mr. Kilpatrick clarified that IASC standards were incorporated into IASB's standards, and IFAC decided that for the first few years it would adopt IASC standards almost word for word, adapting it to the government environment. [6]

Mr. Schumacher asked if lease arrangements wherein the Government is the lessor, like the TVA example given, are becoming more and more prevalent. The answer was that there are many, many examples where the Government is the lessor. These arrangements are called "outleases" and there is legislation pending that would expand further the use of outleases by authorizing GSA and other landholding agencies to enter into lease arrangements as the lessor. Generally, since there is not FASAB guidance on accounting for the lessor, agencies seem to be falling back on FASB guidance. Of course, TVA, as a government corporation, follows FASB guidance in preparing its financial statements. Also, the National Historic Preservation Act authorizes agencies to lease historic properties and to use lease proceeds to offset the costs of operating other historic properties.

Mr. Anania asked if the issue of a lease between related parties was applicable to the Federal Government, and whether it is addressed in government literature. Mr. Calder said that there are many, many transactions between entities of the Federal Government, for example, GSA leases buildings to other agencies. Other than guidance on inter-entity eliminations, Board members were not aware of any overall guidance provided by GAO, OMB or others on transactions between related parties. According to Mr. Reid, usually rules are established by a formal agreement between the two agencies. If FASAB decides to provide guidance, Mr. Calder suggested that the guidance should simply state there should be recognition of the service provided, if substantial.

Ms. Lee discussed that leases are attractive to the private sector as well. Lease financing can provide tax benefits to a lessee that is not available to a lessor. For example, owned land is not usually deductible for tax purposes, but it can be fully deducted by the lessee as a lease payment. Operating leases are also attractive because of the "off-balance" effect. Since assets and liabilities are not recognized by the lessee in operating leases, debt ratios and the accounting rate of return are improved when compared with other financing alternatives. Thus, the factors leading to the result may be different, but the result for the private sector and the public sector are the same: often times lease terms are negotiated to favor operating leases rather than capital leases.

Following the discussion of issues raised by the Department of Justice's Office of Inspector General on GSA occupancy agreements, leasehold improvements, cancellation clauses and fiscal funding clauses, Mr. Reid asked about the situation where a building may have been equipped or built based on the special requirements of an agency and if that lease were to be terminated early, would there typically be a penalty clause. Ms. Lee responded that there would

[6] [The Acknowledgement in IFAC Public Sector Committee's IPSAS on Leases states,"This International Public Sector Accounting Standard is drawn primarily from International Accounting Standard 17 (revised 1997), *Leases* published by the International Accounting Standards Committee (IASC). The International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace IASC. The International Accounting Standards (IASs) issued by the IASC remain in force until they are amended or withdrawn by the IASB. Extracts from IAS 17 are reproduced in this publication of the Public Sector Committee of the International Federation of Accountants with the permission of IASB."]

be a penalty clause. For example, the Drug Enforcement Agency within Justice, had some laboratories built to its specification; their occupancy agreement with GSA contains a penalty clause if the lease is terminated early. Mr. Calder noted that IRS has GSA agreements without termination penalties, even though it would seem that some of the buildings rented from GSA would surely have some unique characteristics for IRS.

Mr. Anania raised the question that since GSA has so many transactions with other Federal entities, should GSA be following FASAB rules, the same as if it were dealing with outside entities? Does GSA have any special license or privilege to do something other than what would be done by an outside normal commercial entity? Is there an option to use an entity other than GSA? Based on her experience at Commerce, Ms. Geier said that agencies must consider leasing with GSA first. If there is not property that meets an agency's needs, then the agency may opt to lease from an outside party.

Mr. Anania added that normally in a lease arrangement, it can be assumed that it is subject to the normal, competitive environment, with GSA occupancy agreements, this cannot be assumed. Mr. Reid stated that you might be able to assume a competitive environment because the process by which GSA acquires space is competitive, and presumably the space that has been acquired has been done so in an arm's length way, and in an as economical situation as possible. Generally speaking, said Ms. Cohen, the government provider, whether GSA or a state agency or authority, is cheaper than the commercial side. Mr. Anania stated that he would like to have a better understanding of what GSA does and the ramifications of their leasing arrangements with other governmental entities to be sure there are not any special requirements that must be considered. [7]

During the presentation, Ms. Lee discussed the growing use of operating leases to meet long-term commitments. More and more, there is concern that existing standards do not require the recognition of material assets and liabilities arising from operating leases in lessees' balance sheets, and that the standards have prompted the structuring of financial arrangements to meet the criteria for operating leases. GAO has long advocated that many GSA operating leases used for long-term needs should be scored and treated on the same basis as purchases. Mr. Anania asked if GAO's advocacy is written. Ms. Lee responded that GAO's position is documented in many, many of their reports, some of which are noted in the footnotes to tab F.[8] This past summer, OMB issued revised Circular A-11 requiring an agency's lease in a public/private partnership be treated as a capital lease. Mr. Kilpatrick elaborated that this treatment was applicable when there is substantial private interest. When there is not substantial private interest, the partnership itself should be considered governmental. Mr. Phaup sought clarification of whether accounting standards or budget treatment was driving the structuring of leases. Ms. Lee responded that for the government, the budget has been a key

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[7] [In a follow-up conversation with a GSA representative, GSA confirmed that generally agencies are required to seek space through GSA, but are allowed to proceed with a third party with the approval of the Administrator or Associate Administrator of GSA. GSA staff was to confirm this and provide the authorizing citation. This was still pending as the minutes of the meeting were being completed.]

[8] [For example, GAO, GAO/T-AIMD-94-189, Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings, Statement of Paul L. Posner, Director, Budget Issues, Accounting and Information Management Division, September 20, 1994; GAO/GGD-97-148R "Comparison of GSA Cost Estimates," Letter to Representative James A. Traficant, Jr. August 6, 1997. GAO, GAO/T-AIMD-GGD-94-43, Public Buildings: Budget Scorekeeping Prompts Difficult Decisions, Statement of L. Nye Stevens, Director of Planning and Reporting, General Government Division, October 28, 1993.0]

factor. Mr. Calder added that the accounting implications are also a factor, for example, in the TVA case, long-term leases were used in an effort to avoid bumping into their debt ceiling.

Next, Ms. Lee discussed the “new approach” [9] which was proposed by a “working group” consisting of Board members and senior staff members of the standard-setting bodies of Australia, Canada, New Zealand, the United Kingdom, and the United States of America, and staff of the International Accounting Standards Committee. The approach would eliminate the “arbitrary” determinants of whether a lease is a financial (capital) or operating lease. Instead, all non-cancelable leases of more than one year would be recognized at their present value. Material assets and liabilities arising from operating leases would be recognized at the beginning of the lease term, and reported in lessees’ balance sheets.

Presently, the fundamental premise in lease accounting is the transfer to the lessee of substantially all the risks and rewards of ownership. If substantially all the risks and rewards of ownership are not transferred to the lessee, the lease is classified as an operating lease and no asset or liability is recognized by the lessee. The new approach suggests that regardless of whether a lease transfers the risks and rewards of ownership to a lessee, the lease gives rise to the acquisition of an asset (the right to use an asset for the lease term) and the incurrence of a liability (the obligation to make the payments required by the lease). While the lessee usually cannot dispose of the asset, “nonetheless, the right granted by the lease to use the property is a source of economic benefits controlled by the lessee and, as such, is an asset.” [10] Mr. Anania asked when the working group study took place. Ms. Lee responded July 1996, with a follow-up document dated February 2000. Ms. Comes offered to provide copies of the two documents to Board members. Mr. Anania stated that the new approach represents the only hope that he knows for simplifying the existing codification on leases. FASAB can wrap? a lease standard on the existing codification or do something that is simpler, easier, and more direct along the lines of the new approach. The International Accounting Standards Board (IASB) plans to undertake a leasing project to develop a single method of accounting for leases that would not be dependent on the distinction between an operating and finance (capital) lease. Based on a conversation with IASB staff, they are considering the aforementioned new approach. A review of the issues will be compiled towards the end of this year and an exposure draft is anticipated in 2006.

Ms. Lee closed the presentation by discussing the issue of whether a special-purpose entity that is essentially established and controlled by a Federal agency, should be consolidated into an agency’s financial statements. In many public/private ventures, a special entity, essentially under the control of the public partner, is established to obtain financing for, and/or design, construct, and operate, a Federal asset. Yet, there is no recognition or disclosure of the special entity in the agency’s financial statements. An argument could be made that as the primary beneficiary of the special entity, its assets, liabilities, and results of activities should be

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[9] McGregor, Warren, Accounting for Leases: A New Approach (Recognition by Lessees of Assets and Liabilities Arising Under Lease Contracts), Financial Accounting Standards Board, 1996.

[10] Nailor, Hans and Lennard, Andrew, Leases: Implementation of a New Approach, Financial Accounting Standards Board, 2000, page 4.

consolidated in the financial statements of the Federal agency. This would provide readers of financial statements with a more complete picture of the agency's resources, obligations, risks, and opportunities.

The next steps to be considered would be whether FASAB should evaluate the applicability of the new approach to the Federal sector? If so, what interim FASAB guidance is needed? If not, what additional FASAB guidance is needed? Should FASAB evaluate the consolidation of special-purpose entities in a Federal entity's financial statements?

The Chairman asked for the Board's thoughts. He felt the new approach would be worth undertaking and that providing comprehensive guidance on leases would not be worth the time. FASAB could instruct agencies to follow FASB and take care of internal issues, such as those raised by Justice. Mr. Farrell asked if Justice's issues could be addressed by referring to FASB guidance, and Ms. Lee responded yes for the most part. Ms. Cohen mentioned that at the state and local level the lease concept, capital leasing by another governmental agency, has been expanding and is an extremely common form of capital financing, considered by the analyst to be long-term debt of the parent government.

Mr. Mosso added that the existence of special-purpose entities concerned him the most, and he viewed this issue as even more important than the new approach issue.

Mr. Reid asked how soon a standard might be issued by IASB based on their project, and whether FASAB should wait for their results. Given that IASB is in the early stage of their work, the Board decided to proceed and not wait. Ms. Comes stated that provisions of SFFAS 5 and SFFAS 6 would have to be revised . The Chairman asked that the documents on the new approach be given to Board members. This will familiarize the Board with implementation issues and give members a better idea of whether the new approach is possible.

> CONCLUSION: The Board decided to: (1) maintain the two key issues (new approach and special purpose entities) on the list of items to be considered for future projects, and (2) to add to the list the possibility of providing interim guidance, addressing Justice's concerns and using existing FASB guidance to the extent FASB guidance is applicable. Staff will distribute the two publications on the "new approach" to Board members.

- **Natural Resources**

Staff, Rick Wascak and Monica Valentine, led the discussion. Staff indicated that the binder materials included a summary of staff findings and Board discussions, and proposed disclosure requirements. Staff explained the next steps of the project would involve the custodial statement, specifically addressing collections, disbursements, and revenue recognition. In addition, staff would begin addressing other natural resources using the oil and gas standard as a model.

Staff noted, based on previous discussions, there had been general agreement that information about natural resources would be disclosed. Staff presented the summary of findings for the general stages of the oil and gas production cycle, followed by staff proposed disclosure requirements. Discussions, which followed, focused on balance sheet recognition and disclosures.

Balance Sheet Recognition

Mr. Anania noted that, in the Assessment stage of the oil and gas production cycle, there are assets that cannot be reasonably measured. Staff concurred. Mr. Patton responded that if there is an associated cost, for example the assessment cost, it is better to recognize that cost than to recognize no cost even if it is not very relevant. Mr. Mosso observed that oil and gas at this stage could not be capitalized under private sector standards. However, that doesn't mean that FASAB couldn't do it. Mr. Reid noted that it would be helpful to have some order of magnitude for the cost of the assessment, even some type of range for the cost. Mr. Patton indicated that he was agreeable with not capitalizing the cost based on immateriality. Conceptually, however, he believes there is a potential measure for oil and gas at the assessment stage. Mr. Anania indicated that a line item on the balance sheet referring to a note would call attention to the assets if the cost is not capitalized. Mr. Mosso asked staff to get assessment cost information from the Mineral Management Service (MMS) and to provide it to the Board. In relation to the assessment cost, Mr. Mosso asked that staff review the FASB Concepts Statement 7 for its "expected present value" concept and the SEC's "full cost" method of accounting which is used in the extractive industries. He also asked that staff provide to the Board relevant information from the reviews.

Mr. Reid asked about the possibility of capitalizing based on a statistical probability model. That is, to impute an estimated net present value for anticipated revenue by correlating historical information. (e.g., for oil and gas, the basis for arriving at the imputed value could be the assessed information for oil and gas, the expected number of leases to be sold based on the MMS' 5 year program, the average estimated year when production would begin for the leases sold, the average estimated production period for the leases, and the average estimated production volume per production year for the leases. (**Staff perception**) Mr. Reid noted that he didn't believe the assessment cost would be representative. Mr. Anania noted that Mr. Reid was introducing a mathematical approach to book future revenues. Mr. Calder noted that the number based on the Mr. Reid's approach would be a small number because much of the royalty income is not retained by the federal government. Mr. Reid replied that his approach might work better for some natural resources than for others. Mr. Anania noted that it is not the convention to book contingent assets or a mathematical probability. Mr. Mosso replied that that convention is based on the old conservatism notion and is dying out. He suggested that it would not be useful to spend a lot of time trying to do something so complicated, noting that the private sector only discloses proven reserves. However, he asked staff to talk with experts at MMS about the possibility of imputing a value for anticipated revenue and to provide the Board with the information.

Disclosures

Staff noted that the proposed disclosures were modeled on the disclosures approved by the Board for the heritage assets and stewardship land exposure draft (ED). Staff indicated that some of the proposed disclosure information is currently presented in the Management Discussion and Analysis section of the MMS's financial statements. However, all of the proposed information is available.

Mr. Calder observed that he wasn't enthusiastic about the staff's suggested disclosures. He noted that it is not informative to report that the federal government has a certain number of leases, a certain number that are producing, and a certain number that are not producing. Mr. Calder added it should be reported that the federal government has significant wealth in natural resources, but it is not known how this wealth will be obtained or when it will be obtained. Mr. Mosso asked Mr. Calder if he was suggesting a descriptive note with no data. Mr. Calder responded that it would be more informative. Mr. Farrell suggested that the statistical data suggested by Mr. Reid could be in a footnote.

Staff noted that there are some projections in the assessment report for undiscovered resources. Mr. Mosso asked if it would be possible to get copies of the assessment for the Board to review. Staff responded that they would e-mail a copy to the Board members. Mr. Mosso noted that the assessment report could give the Board some ideas.

Mr. Mosso asked if the collection and disbursement exhibits in the materials were helpful? There were no comments about the exhibits. Mr. Mosso asked that item (b) in the proposed disclosures be augmented to include illustrative information pertaining to the assessment, the 5-year program, lease sales and leases, and the collection and disbursement of revenue.

Mr. Farrell asked if the lease information in item (c) of the proposed disclosures could be augmented to address the number of acres associated with the lease sales and the estimated number of acres withdrawn from the lease sales. He noted this information could possibly be used in conjunction with the proposed disclosures to estimate a volume of resources that were withdrawn. Staff noted that item (c) would be removed based on the Board's discussion that the proposed material was not meaningful. Staff added that projections of quantifiable assessment information would be proposed as a replacement. Mr. Patton asked if the projections would be audited. Mr. Calder replied that they would not be audited. He added that something would have to be added to the standard to indicate the projections were not to be audited. Mr. Mosso asked that work be done on the disclosures and to gather information on the measurement issues.

> CONCLUSION: Staff will: 1) revise the proposed disclosures based on the Board meeting discussions; 2) prepare information papers addressing: a) the assessment cost, b) the "expected present value" concept in FASB Concepts Statement 7, and c) the SEC's "full cost" method of accounting which is used in the extractive industries; 3) meet with representatives from MMS to discuss the possibility of imputing a value for anticipated revenue; and, 4) e-mail a copy of the *MMS National Assessment 2000* to the Board members.

- **Inter-entity Costs**

Ms. Comes opened the discussion by noting that the Board last saw a draft on this topic in June. She noted that changes were provided to include a stronger rationale for the action in the document and more extensive questions for respondents. She then opened the floor for comment.

Mr. Anania noted that the words material and significant were confusing. Some of the confusion is unavoidable because it stems from SFFAS 4. He asked that care be taken in paraphrasing the task force report. He finds the material/significant phrase particularly difficult. He referenced 2.i and page 11 as examples. He acknowledged the difficulty but asked that we use care.

Ms. Comes stated that she plans to work with the task force to ensure that the task force report is published with appropriate wording and summarized clearly in the ED.

Mr. Schumacher referenced page 12, item b – which suggests that before the barrier to full implementation of inter-entity cost is removed implementation guidance is needed. Ms. Comes believes the task force would like case studies. She noted that there will be greater experience on which to base guidance due to the implementation of Interpretation 6 as well as entities' efforts to implement this proposed standard by FY 2008. She believes FASAB staff could provide implementation guidance. It is not the objection to foreclose guidance but simply to focus the community on cases where guidance really is needed.

Mr. Mosso believes the exposure draft will reveal the need for guidance.

Mr. Anania asked if the basis for conclusions would change as a result of the task force consultation. Ms. Comes indicated that she expected the task force to focus on the appendix summarizing their report and minimal changes to the basis for conclusions.

Mr. Anania asked whether the basis for conclusions covers the TF call for guidance. Ms. Comes indicated that the questions for respondents address the need for guidance and that she would cross-reference that to the task force report to alert readers to the task force's views.

Mr. Reid noted that he believes this proposal is a bad idea. He expects it to result in circular reasoning. Some members noted that hearing the responses to the exposure draft could help them weigh the outcome and whether the proposal would affect decision-making. Ms. Boutelle noted that DoD is doing this type of thing in the working capital accounts. While painful, the outcome has been positive. It has grown to be a business thought process. The components receiving services are now very much aware of the cost of the service.

Mr. Reid agrees that in a rate setting area it could be productive. The exercise may simply affect reporting and not decision-making. He asked how many iterations of charging do you go through as you refine these charges.

Mr. Calder noted that he heard of proposed legislation that would charge settlement costs to agencies in EEOC cases. He brings it up because it is exactly what we are discussing – the cost would have to be reflected in the causing agency's statements. There is interest in getting the cost to the correct agency.

Mr. Reid acknowledges that this works—where through reimbursable agreements agencies actually pay for goods and services.

Ms. Comes noted that Mr. Reid might wish to provide an alternative view. Mr. Anania noted that an alternative is to add a separate question. Mr. Reid indicated that he would offer either a question or an alternative view.

With the exception of Mr. Reid (and Mr. Holtz-Eakin who was not present), members did not object to proceeding with the document.

> CONCLUSION: Ms. Comes indicated that she would work with the task force following the November reporting deadlines. She anticipates returning a revised draft to members for action in early December.

- **New Project Proposals by Mr. Calder**

Mr. Calder provided a memo on disclosure of social insurance assumptions and recognition of liabilities for veterans' health care for the members' consideration at a future meeting.

Adjournment

The meeting adjourned at 2:30 PM