FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
March 3-4, 2004
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, March 3, 2004

Administrative Matters

- **Attendance**

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

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

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

- **Update and Discussion**

The Chairman introduced new FASAB member Elizabeth Robinson, Deputy Director of CBO. She will be representing the Congressional Budget Office. The Executive Director introduced two new FASAB staff members: Eileen Parlow and Julia Ranagan.

Mr. Reid briefly discussed the recently issued FY 2003 Financial Report of the United States Government. This year's report was published a month earlier than last year's; next year it is scheduled to be published on December 15th. They have learned that the secret to acceleration has more to do with the procedures and processes that are used than with information systems, though systems can help. Next year's deadline for agencies will be November 15th. The schedule will be very tight for everyone.

Mr. Reid noted that the deficit is somewhat higher this year. The actuarially-based accrual added to the budget deficit is about 10% each year. The audit opinion is the same as last year [disclaimer]. For the last three years the "plug" or "harmonizing entry" as it is known in Canada has been positive. It is an addition to revenue or a reduction of cost, in the neighborhood of $17-$25 billion. It shows up when we do the elimination, from which he infers that it is not affecting assets and liabilities in a significant way. The problem may be procedural, e.g., arising from out-dated instructions. The appropriation transfers appear to be substantially out of balance, for reasons not yet determined.

Ms. Comes announced that she had received affirmative votes from more than six members to issue an exposure draft of an amendment to SFFAS 25, to require disclosure of social insurance assumptions. She also had received seven affirmative votes to issue the exposure draft on inter-entity cost. Accordingly, no discussion of these exposure drafts was necessary, and the agenda for the meeting would be changed. The Board would discuss natural resources on Wednesday afternoon instead of on Thursday. She discussed plans for the June Board meeting, scheduled in conjunction with AGA Professional Development Conference. She also discussed plans for Board members' participation at AICPA's Government Accounting and Auditing Update Conference.

Discussion of recent developments

Mr. Mosso noted several informational items about recent developments relevant to FASAB's projects and concerns. Mr. Anania observed that the lead time for changes to social insurance programs seemed to be shrinking, thus adding pressure for a plan to deal with the projected fiscal imbalance. He asked about the historical pattern of debate on social insurance. Mr. Mosso observed that in the 1960s, there was pressure to increase benefits, with resistance to recognizing an associated liability. Later there was concern about solvency [leading to changes in law in the 1980s].

Mr. Schumacher noted Mr. Walker's statement about the balance sheet being potentially misleading. Mr. Patton suggested that the problem is so well known that putting it on the balance sheet won't make a difference: success or failure in solving the problem won't hinge on FASAB's decision. In a capital market setting, there would little question that this information would be impounded in pricing the related securities. Mr. Zavada agreed with Mr. Patton. Ms. Robinson agreed; she noted that the Budget's presentation shows the timing of the problem. The projections swing dramatically from year to year, raising questions about the best policy approach for dealing with the issue.

Mr. Reid noted that Social Security and Medicare are very different. Experience with putting information about social insurance in the Financial Report shows an increased understanding of what it means. He has to discuss issues such as the meaning or implication of a $20 trillion item. It does not mean that one needs to raise $20 trillion; he is not sure what the Government would do with $20 trillion if it had the money. The number does help focus people on issues of what needs to be done and when. Paradoxically, young people are not concerned about retirement, yet they are the ones who should be concerned. Concern is greater among those near retirement age, yet they are not the ones who most need to be concerned.

Mr. Patton noted that some Government sponsored enterprises (GSEs) had been in the news. He was not clear why Government corporations, such as the Pension Benefit Guarantee Corporation, are included in the federal financial reporting entity but not the GSEs such as "Fannie Mae" and "Freddie Mac." Mr. Reid agreed it was a good question: generally those entities that are included are federally owned, while those excluded are privately owned. Ms. Cohen noted that capital markets attribute higher creditworthiness to GSEs, based on the perception that there is a moral obligation, albeit not a legal obligation, for the Government to back up the debt of the GSEs. Mr. Jacobson added that employees of Government corporations are government employees, Congress appropriates the amount the corporations can spend on administrative activities, the corporations' accounts are kept in the Treasury, and by law the corporations are agencies of the executive branch, while GSEs like Freddie Mac by law are not government agencies.

Mr. Mosso observed that tanker acquisition was still an issue for the Air Force, reminding us of the potential lease accounting and related issues discussed at an earlier meeting. Mr. Schumacher asked how much of the budget is discretionary. Ms. Robinson said about $850 billion, or about one third of the budget. Of that $850, over half is for defense.

Agenda Topics

- **Concepts – Objectives**

Mr. Bramlett opened the discussion. He noted that an additional issue should have been listed, pertaining to the proposed discussion of comparative advantage (page 29 of the staff memo). That concept pervades the other six issues listed for discussion. The Board had expressed a need for additional tools to help move from the objectives to specific standards. He did not mean to assert that the proposed language is the optimal way to accomplish this; it was merely offered as a prompt to further discussion by the Board. As the listed issues were addressed, members might consider whether the Board would be better able to make such a decision by thinking about what would be implied by the proposed addition to paragraph 108. He read the first sentence of the proposed addition:

> The FASAB's primary mission is to deliberate and publish the accounting standards that guide preparation of the financial statements most federal agencies are required to publish by the Chief Financial Officers Act, as amended by the Government Management Reform Act, and by the Accountability of Tax Dollars Act.

He explained that this sentence was intended to be responsive to comments Mr. Patton made at the last meeting. However, he inferred from subsequent communication with Mr. Patton that he might have misunderstood Mr. Patton's intent. An alternative might be for FASAB to publish a variety of products, in addition to GAAP accounting standards. Mr. Patton explained that he was not sure of the right answer; we just need to make a choice whether to have a single product line or multiple product lines.

Mr. Bramlett then asked the Board to focus on issue 1: should the language in SFFAC 1 that pertains to systems and controls be amended? Mr. Patton has suggested that the "indirect" explanation for our standards' impact on systems and controls is not consistent with the language of the objective, particularly paragraph 150, which could be seen to imply some form of direct reporting. Mr. Patton suggested that we should either (1) amend the language of the objective to eliminate the implication that FASAB would call for management's assertions about controls as an integral part of the basic financial statements, or (2) require direct reporting by management regarding systems and controls.

Mr. Bramlett asked whether the Board agreed with that analysis, and if so, which alternative it preferred. He did not envision the Board making a decision today on whether to embark on a project that could lead to a standard mandating management's assertions. Rather, he was asking the Board to focus on the conceptual issue of how the Objectives of Federal Financial Reporting should address the topic. Is the current language appropriate, in terms of how the Board sees its role? If not, how should the language be changed? He noted that he personally did not think a change was essential. Even with the existing statement of the systems and control objective, the Board could (if it wanted) justify a decision not to mandate managements' assertions with a statement of accounting standards by pointing to existing federal reporting requirements and cost/benefit considerations.

Mr. Mosso observed that, for SEC registrants, the Sarbanes-Oxley Act requires the auditor to attest to management's assertions regarding internal control over financial reporting. Mr. Anania said that he found the objectives regarding Stewardship and Systems and Control to be worded very broadly. He thinks the language needs to be revised. It was written years ago before new mechanisms were put in place regarding stewardship and regarding internal control. The Board could issue consolidated standards in that area, but that would not be his preference. He would prefer to revise the language of the objective, perhaps to incorporate what is being done by others, and to carve out a narrow path for FASAB.

Mr. Patton asked whether that would imply that we should not consider mandating SOX-style rules? Mr. Anania said, “yes, others should consider SOX and we should be aware of what they are doing, but I don’t think we should have a direct role, unless we want to be the body for all promulgation with regard to internal controls, stewardship, and all the other elements in our concepts now.” He does not think that the nonfederal members of FASAB have the knowledge or the time to get into the audit standards business.

Mr. Zavada said he strongly agrees with that. The language of the objective should focus on the indirect effect. Acceleration of the reporting schedule will increase the indirect effect, because agencies will need systems in place to produce financial statements within 45 days after year- end. The CFO Council is looking at the costs and benefits of doing what it takes to have an opinion on internal control. Also, there is some draft legislation relating to the Department of Homeland Security that would direct the CFO Council and President’s Council on Integrity and Efficiency (PCIE) [the Inspectors General] to make such a study and for GAO to comment. Mr. Mosso noted that Sarbanes-Oxley (SOX) requires the auditor to express an opinion on management’s assertions about controls over financial reporting.

Mr. Calder suggested that FASAB’s responsibility is to determine what kind of report a federal entity should issue to its constitutes, the citizens; i.e., what should that entity tell them? For a corporate entity, the report to its constituents should tell them about its financial position and something about the extent to which it has been successful. The focus is on net income and net assets, with some information about the future. But in government we have something different.

There is a feeling, he continued, that we have to give citizens more information than just the financial statements to give them a fair indication about the status of the government and its ability to continue. These are things that go beyond the corporate-world disclosures; things that tell citizens something meaningful about performance, stewardship, systems and controls. We don’t have to tell agencies how they might put the information together, or how an auditor might be associated with the information. But it might be useful to say that we need to disclose something about the conditions that exist. SOX is moving in that direction. It says in general terms that corporate management should do this. In the private sector, the PCAOB will tell auditors what to do regarding corporate managements’ statements. In the governmental sector, the GAO sets Government Audit Standards to do that.

In response to questions from Messrs. Mosso and Schumacher, Mr. Calder confirmed that he would propose that FASAB could decide whether the financial report should include a report from management on internal control, leaving to others the rules for auditing that report, if an opinion on it were required.

Ms. Boutelle noted that DoD’s report has 20 pages devoted to this kind of information now, in response to FMFIA and other requirements. Mr. Anania said that he could envision FASAB deciding that that information should be an integral part of the report, but did not envision FASAB deciding what that information should be. Thus, his view is quite different from the language about “systems and control” now in SFFAC 1. He said that, if we are to retain the discussion of the “indirect effect,” it needs to be better explained.

Mr. Zavada said he thought that some of the language staff had proposed constituted steps in that direction. He said that he agreed with much of what Mr. Calder had said, “that is precisely why we have a more robust reporting model for the federal government.” Information on performance, stewardship, and internal controls is important to get a full picture of the government’s performance. Those things are already incorporated in the reporting model. Management and auditors do report on internal control; OMB’s guidance on Form and Content does require performance information to be included.

Mr. Patton said that relying on the indirect effect of setting accounting standards seemed likely to be an inefficient and ineffective way to improve systems and controls. Something like SOX or FMFIA seemed more direct and effective ways to affect behavior. Therefore, if we were to retain the systems and control objective, he would be in favor of something more direct, like Mr. Calder had described.

Mr. Zavada said that in his experience preparing financial statements, it was essential to have reliable controls, particularly in light in the accelerated reporting schedule. Therefore, he sees a strong relationship between financial reporting and control over financial operations. In response to a question, he said that the financial audit is a good barometer of the financial reporting controls. Mr. Mosso observed that in passing SOX, Congress evidently concluded that the financial statement audit had not been sufficient. Messrs. Zavada and Farrell noted that prior to SOX, reporting on internal control for corporations had not been as visible to the public as is the case in government. Ms. Boutelle observed that under the Integrity Act federal managers must identify internal control problems and report on the plan for corrective action.

Mr. Anania agreed that there is a lot of information available. He said it would be interesting to know how much of the money being spent on new information systems was caused by accounting standards. He recalled that DoD had reported on its extensive efforts to account for property, in part stimulated by FASAB’s accounting requirements. Perhaps FASAB should be more explicit about the expected system impact and benefits when doing exposure drafts and final documents, if it wants to retain the idea of “indirect effect.” We may want to drop the idea, and allow other mechanisms to deal with it.

Mr. Patton said that new systems have a cost. When he thinks of a benefits of a financial reporting standard he thinks about the information; any systems improvement is second order at best, especially since there are so many other tools in government for dealing with systems and controls. Mr. Anania said we could ask about effect on systems and controls when we issue exposure drafts.

Mr. Jacobson agreed with those who said that federal agencies have done more reporting on systems and controls than have nonfederal entities in the past. Federal practice is based on a variety of requirements going back 22 years. These different and overlapping requirements have not been integrated into a crisp, easy-to-understand package.

Mr. Mosso noted that Board members had used the terms “direct” [management’s assertions] and “indirect” to describe two ways in which FASAB might relate to the systems and control objective. He asked for members’ views as to which approach they would prefer to emphasize in the statement of objectives.

Mr. Bramlett observed that the original FASAB members had emphasized the idea of “users information needs” but left open to some extent the question of how much of those needs accounting in general, and FASAB in particular, might usefully address. The current language regarding systems and controls describes both a perceived need and an existing practice in the federal government. It did not, in his view, commit the Board itself to mandate managements’ assertions about control as an integral part of the basic financial statements, but left open that possibility. If the Board wished to indicate that it regarded such a requirement as outside its domain, this could be done either by an explicit statement that such a requirement might be imposed by others but not by FASAB, or by eliminating references to the idea of management’s assertions entirely.

Mr. Anania said he was opposed to FASAB taking a SOX-type approach. He would refer to the broad range of needs and what is being done to achieve them in a general preamble, then scope down to what we see our role to be, both for stewardship and for systems and control. This also applies to financial condition and position as well, where we would clarify what we are dealing with.

Mr. Mosso agreed with that general approach, but not necessarily regarding whether FASAB should take a “direct report” or SOX-type approach to dealing with the systems and control objective. He asked staff to come back with language to accomplish this. That still left a question as to whether the Board favored taking a direct [SOX-style] approach to reporting on internal control. He noted that federal mangers are doing this now, so the question for FASAB is whether to say that such reports should be part of the financial statements.

Mr. Patton said this posed a fundamental question about the scope of FASAB’s activities. To keep the umbrella wide, we would need to come up with products or deliverables in addition to standards, such as “best practices.” Having said that, he thinks the indirect approach to defining FASAB’s role regarding systems and control is unlikely to be productive if we stay with this objective.

Mr. Schumacher said he would prefer the direct approach, similar to that described by Mr. Calder.

Mr. Zavada would focus on the indirect approach.

Mr. Reid agreed, saying that dealing with systems and control requires great expertise. He would not necessarily take out the objective, but he sees it as a by-product of the standards: systems and controls improve as our requests for information are expanded. He liked the approach illustrated by staff on page 29, perhaps adding other bullets to deal with other issues.

Ms. Cohen said positive assurance would be a big step; she was not sure FASAB should take that step. There could be alternatives that would fall shy of that. She leans toward the “indirect” approach.

Ms. Robinson preferred the direct approach.

Mr. Farrell said he would prefer the indirect approach, but he would like to see someone rationalize all existing requirements. Mr. Zavada said this is what the CFO Council and PCIE are developing. Mr. Anania asked if Board members could sit in on that; Mr. Zavada said that a briefing for the Board could be arranged at the appropriate time.

Mr. Anania said that if the Board is to have the objective, he would prefer a direct approach to dealing with it. If we are not going to say something about it, then we should not have the objective.

Mr. Mosso agreed; if we keep the objective, we should address it directly.

Ms. Comes said that she believed SFFAC 1 was intended to include a broad description of federal users’ needs, and thus included references to all federal financial reporting, not only financial statements prepared on conformance with FASAB’s standards. She interpreted Mr. Mosso’s comment to mean that if the systems and controls objective also relates to FASAB’s objectives, he prefers the direct approach. Mr. Mosso indicated that he thought it was directed to FASAB.

Mr. Anania said he thought that if the objectives are to relate only to FASAB, we could delete the systems and control objective.

Mr. Jacobson asked whether that meant that we could not have this as an objective without committing the Board to address it. Mr. Anania agreed. Mr. Zavada suggested that would be true only if one did not believe there was an indirect effect.

In response to a question about the intended scope of SFFAC 1 – whether it describes objectives for FASAB or something broader – Ms. Comes said that she had always read it more broadly. Mr. Bramlett agreed that parts of SFFAC 1 could be read that way. He noted that, for example, paragraph 108 says: “The Board expects that its recommendations will be applied to improve information for program management and executive and legislative branch decision making. The Department of the Treasury, OMB, and the GAO expect that, to the extent possible, their reporting requirements will be aligned with the Board’s objectives and standards.” [This language had been marked for deletion in the revised version provided to the Board to stimulate discussion.] He noted that the “hierarchy” of guidance for federal accounting was different then.

At the same time, he said, there also is some attempt in SFFAC 1 to define a narrower focus for FASAB within the broader spectrum of federal financial reports. For example, the solid arrows in figure 1 in SFFAC 1 seem to indicate a primary focus on budget execution reports and on general-purpose financial statements, but does not define what comprises those statements. At that stage, it seemed difficult to go beyond generalities such as the need to consider "cost/benefit."

Mr. Bramlett agreed that parts of SFFAC 1 clearly describe aspects of federal financial reporting outside FASAB's domain (e.g., the budget). On the other hand, he acknowledged, a reader might infer that the boldface type in chapter 4 describes objectives to guide FASAB itself. Given the language of paragraph 146 and 150, such a reader might infer that FASAB might mandate some kind of report or information about internal control. He noted that FASAB has done so in SFFAS 15, Management's Discussion and Analysis, which calls for certain required supplementary information to accompany the basic financial statements.

> CONCLUSION: Mr. Mosso concluded that at the next meeting staff should further describe the alternatives for the Board, with examples of language to implement the alternatives. Mr. Anania referred to his earlier comment that Objectives should refer to the broad range of needs and what is being done to achieve them in a general preamble, then scope down to what we see our role to be, both for stewardship and for systems and control. Mr. Reid asked for more discussion of the purpose of Objectives: are they to guide the Board or to describe something broader? Ms. Robinson said that when we consider stewardship, she would like more discussion about the relationship and difference between financial reporting and the budget.

- **Concepts – Elements**

Ms. Wardlow led the discussion. She indicated that today's discussion would involve essential characteristics of assets. Notions of "ownership" and "control" would be discussed. The objective of the discussion was to decide on essential characteristics at a conceptual level. At the next meeting, precise wording of the essential characteristics and of a definition and the related implications would be discussed. She reviewed how FASB and other standards setters had dealt with the concepts of ownership, control, and essential characteristics of assets. Most other authorities have built on FASB's work. Mr. Mosso noted that three essential characteristics were summarized on page 12 of the staff memo, with recommendations and alternatives for the Board to consider.

Mr. Patton asked about the potential implications of the recommended characteristics for fiduciary items? Without something else being added, it seems that fiduciary resources would not be assets of the federal government. He noted that in governmental accounting there is foundation of accountability, which might add another characteristic to be considered, such as special accountability.

Ms. Wardlow agreed that accountability is very important in governmental accounting. She suggested, however, that a distinction could be made between being accountable for something and saying that it is an asset. To her mind, reporting something on an entity's balance sheet implies that the entity not only has control over the resources, but also that the benefit of the asset inures to that entity. In contrast, trust benefits do not inure to the managers or trustees of the trust, even though they are accountable for trust assets. There are ways to report resources for which an entity is accountable without reporting them on the entity's balance sheet.

Ms. Robinson said that part of the issue relates to the word "control." One kind of control is the power to determine the disposition of the economic benefits, which she associates with having an asset. There is also managerial control that a fiduciary exercises, which we can say something about but not in the context of an asset, because that kind of control does not include the power to determine the disposition of the economic benefits.

Mr. Mosso suggested it that may be a question of whether to consolidate them in reporting. He noted that the Board's previous decision was that fiduciary assets appear on the balance sheet.

Mr. Anania suggested that the proposed words might be a bit narrow. One benefit might be the ability to carry out the mission. Is that a derived benefit that could be considered when deciding whether something is an asset? Perhaps that could fit into "service potential." Possibly you could then argue that a fiduciary item is an asset because it is essential to management to carry out its mission.

Ms. Wardlow suggested that it was a question of what you are trying to report and whether you can achieve different kinds of reporting in the same statement or whether it is better to present different statements. ." You can't use fiduciary assets for the reporting entity's programs. In accounting terms, it may come down to what you think the balance sheet is reporting. If it is the financial position of the reporting entity, then she thinks fiduciary assets should not be included, or should be clearly labeled in some way.

Mr. Schumacher asked whether these are now called "nonentity assets"? He asked how that nomenclature relates to the definition of assets? Mr. Anania said he didn't like that title.

Mr. Mosso directed discussion to the idea of "ownership." Mr. Anania said that control is a better notion than ownership because assets can be unbundled—like derivatives, for example, and many financial instruments. Ownership is an unnecessary collar or restraint. Mr. Schumacher said that leases are a good example of bundled assets. Mr. Calder noted that ownership can be broken into pieces e.g., ownership of the bond, and ownership of the interest on the bond. In his view, the way the Board is addressing control equates to a concept of ownership.

Mr. Jacobson asked how Ms. Wardlow defines control. Control of what? And what is the entity? Congress creates nongovernmental entities with the power to receive nongovernmental resources to accomplish certain objectives. It also gives them appropriated resources that must be spent in a certain way. Is the nonfederal entity controlled by the federal government? Mr. Anania responded that control of an entity is different from control of an asset.

Ms. Wardlow indicated that the key point about control in the FASB's concept was the right of access to a resource and the ability to limit other entities' access to it. In Mr. Jacobson's example, the government has relinquished the right of access unless it takes another step to get the money back. It's more like a restriction on the use of the resources.

Mr. Reid said that the Government often makes grants, but the grant money is not a federal asset, unless the entity does not comply with the rules. In that case, it is possible to try to get the money back. Mr. Jacobson said that differed from his example, where the entity would not exist but for the Government's action.

Mr. Mosso said that the important point in Ms. Wardlow's paper was that ownership was incorporated by control.and he suggested that control of an entity was something different from control over a set of economic resources.

Ms. Robinson suggested that there seemed to be consensus about not relying on a narrow concept of ownership, but the concern was over the need to define the implications of "control." The federal government exerts control in a number of ways. Management control alone, as in control of a fiduciary resource, is not a sufficient criterion to define an asset.

It's who gets the economic benefit, Mr. Reid suggested, and Ms. Robinson agreed. She felt that control was too broad a word because it has many usages. Mr. Patton asked who gets the economic benefit of a program. Some group of citizens probably.

Mr. Mosso said that control is limited to access to the benefits, so the word is limited to that extent. But that needs to be spelled out to take account of the thoughts being expressed today.

Mr. Anania asked Ms. Wardlow what is different about the federal government that might make GASB's [working] definition not fit as well? Noting that she does not have the depth of background in federal matters that she does for state and local governmental accounting, she said that she did not see a difference. She pointed out that neither ownership nor control appears in GASB's working definition. There was some discussion by the GASB about whether to use economic benefit or service potential in the definition of an asset, and there was some concern about referring to cash flow. State and local governments also have fiduciary responsibilities. In a fiduciary relationship, the benefit inures to the beneficiaries of the trust. The purpose of the balance sheet [in GASB's model] is to report on the entity's financial position. GASB therefore has something in its model to report on fiduciary accountabilities separate from reporting on the entity's assets and liabilities. She doesn't know whether that would fit the federal government, but that is not the key issue. How you design your model follows what you are trying to convey to people.

Messrs. Anania and Calder noted that the federal model is similar to GASB's for the Thrift Savings Plan, but not for pension plans.

In response to a question, Ms. Wardlow said that GASB's discussion of asset definition might have been influenced to some extent by the fact that state and local governmental entities may use and derive benefit from capital assets and infrastructure that is technically owned by another level of government, but that factor was not fully articulated. However, that factor may be considered more when GASB revisits the working definition of elements. Now that GASB's new reporting model has been settled, it is clearer what entities are trying to report. That clarifies what GASB is trying to convey in a balance sheet.

Mr. Schumacher observed that GASB does not use the word "control" in its working definition, but does use it in the characteristics. Ms. Wardlow noted that the definitions were working definitions and the wording was not final for either the definition or the characteristics. She also said that it is difficult to avoid the concept of control, and difficult to define what kind of control is meant. FASB pointed to having access and denying or controlling others' access to the economic benefits embodied in an asset.

In response to a question from Mr. Patton about the characteristics listed at point 3 on page 12 of the staff memo, Ms. Wardlow indicated that she expected we would discuss them further at the next meeting, in the context of discussing alternative specific wording. Mr. Reid asked whether different definitions used by different Boards made a difference? That is, do they lead to recognition of similar items, or do they lead to differences in practice?

Mr. Wardlow said that any definition, without a discussion of characteristics, was susceptible to many interpretations. Different standard setting bodies have chosen different words for various reasons, and the substance may or may not be the same. We need to consider the meaning they attach to the words they selected and their environments.

Mr. Patton expressed a desire to discuss "probable." He thinks it is part of the substance of the definition. Messrs. Anania and Schumacher agreed. Mr. Reid sees probable as related to recognition and measurement. Mr. Mosso referred to the list of contingencies disclosed in the Financial Report.

Ms. Wardlow suggested that the probability notion is incorporated in the notion of economic benefit. She thought that whether the word probable should be included might depend on whether the Board defined an asset as an economic benefit or service potential or cash flow, or, alternatively, as the right to one or more of those things. She did not think one would use the word "probable" in conjunction with the word "right," but it might be appropriately associated with economic benefits, service potential, or cash flow. In response to a question from Mr. Anania, Mr. Jacobson said he would not associate the word probable with the word right. In other words, one might have a right, but the probability of obtaining a benefit from it might be low.

Mr. Anania observed that, by incorporating the probability notion in the notion of economic benefit, you have jumped over the probability hurdle. Mr. Patton said we should acknowledge the probability hurdle, and he would prefer to avoid relying on an implicit statement about probability. Mr. Calder said that he likes the term "right." He thinks that the notion of probability belongs with measurement and not with the definition of an asset.

Mr. Reid opined that the applicability of the word "probable" to the definition of assets relates to measurability, so "probable" should not be part of the definition. Mr. Patton responded that if this position were espoused, something with a 1% probability would be regarded as an asset. He would like to eliminate the potential for recognition of something with a 1% probability. Mr. Reid said that measurability would come into play. Mr. Anania said that he thought the notion of probability should come into the definition of a liability, and that he thought that the asset definition and the liability definition should be parallel with respect to how they use the word "probable." Messrs. Mosso and Reid suggested that contingent liabilities can be remote (not recognized or disclosed) but they still are liabilities.

Mr. Zavada indicated that he liked Ms. Wardlow's recommendations but didn't understand what was meant by service potential. Ms. Wardlow responded that the GASB staff had used the terms economic benefits and service potential to mean the same thing. However, others believe they mean different things, so a discussion of different interpretations in a future paper will be important. Ms. Robinson expressed a desire to discuss "service potential." She noted that it also is relevant to defining "liability." Mr. Anania expressed a desire to include the idea of service potential in the definition of an asset. Heritage assets and stewardship land have service potential. FASB has said that economic benefit encompasses service potential. He would like to ensure that assets are given equal weight with liabilities in federal reporting. Service potential is more direct. Mr. Schumacher agreed that there should be some reference to mission or service potential that is not conveyed by "economic benefit."

Mr. Farrell suggested not specifying "balance sheet date" in the third essential characteristic, instead of the more general "in the past." There was a concern about subsequent events being excluded by the reference to balance sheet date. Ms. Wardlow agreed that it might be wiser to say in the past. Mr. Patton, however, noted that FASB recently issued a standard that specifies occurrence of the transaction by the balance sheet date, so that the mention of balance sheet date in the third characteristic might be appropriate.

> CONCLUSION: Mr. Mosso concluded that the Board agreed on the substance of the three essential characteristics of an asset. Specific wording would be the subject of the next meeting.

- **Fiduciary Activities**

Staff introduced guests from the Department of the Interior: Mr. Ross Swimmer, Special Trustee for American Indians and Mr. Robert Winter, Director of the Office of Trust Reporting and Reconciliation.

Mr. Swimmer noted that the purpose of the session was to answer the Board's questions concerning control and ownership. Mr. Swimmer introduced additional guest speakers: Mr. Michael Bentzen, contract legal counsel to the Office of Historical Trust Accounting, Mr. Bert Edwards, Executive Director of the Office of Historical Trust Accounting; and Mr. Fred Winter, Jr., Partner, KPMG Albuquerque, the auditor of the Indian Trust Funds.

Mr. Swimmer distributed copies of a letter from Mr. Bentzen that, in legal counsel's opinion, the Fiduciary Activities ED would improperly, and potentially unlawfully, cause assets that do not belong to the United States to be presented as assets of the United States.

Mr. Swimmer also distributed a paper outlining the issues of degree of control, ownership of monetary assets, type of accounts and consistency with private sector trust accounting.

- <u>Control</u> In all cases of the Individual Indian and Tribal Trust Funds, the account holder (beneficiary) or authorized representative has control over the flow of funds in accordance with established trust documents. The Federal government has duties in accordance with the trust agreement, but does not control the funds. Investments are made (with a reasonableness test) at the discretion of the tribe. Funds held for individual Indians are pooled for greater purchasing power and better overall return than could be achieved if accounts were invested individually. Individual accounts are either "unrestricted" or "restricted" meaning an account holder can withdraw funds at any time for any purpose, or, due to incompetency and/or not yet reaching the age of majority, are supervised by an authorized representative who requests that funds be distributed in the best interest of the account holder.

- <u>Trust Agreements</u> The Board asked about the nature of the trust documents. Mr. Swimmer replied that the trust agreements are governed by 25 CFR 115. Mr. Anania asked how many trust provisions or regulations there were, and Mr. Swimmer replied that there were over a thousand provisions or regulations. For example, one regulation provides that if a beneficiary requests disbursement of funds, the disbursement must be made within 24 hours. Mr. Anania asked if there was anything in the trust documents that referred to a benefit to the Department of the Interior. Mr. Swimmer replied that there were no benefits provided to the Department of the Interior, only duties and responsibilities. Mr. Swimmer noted that one difference from private sector trust funds is that appropriated funds pay for the expenses of managing the Indian trust funds, while in the private sector expenses are paid out of the assets of the trust.

- Ownership of Monetary Assets Monetary assets held for individual Indians and Tribes are held by a private custodian for security purposes. In order for the custodian to properly account for the assets, they are held in the name of the entity purchasing the asset as trustee. Although the assets are held "in the name of" the "Office of the Special Trustee for American Indians, Trustee," the subsidiary ledger of accounts, their respective asset holdings list, and the associated balances are the true record of ownership of the assets. All monetary assets are accounted for and attributable to individual Indians or Tribes.

- Type of Accounts The share or form of an Individual Indian Monies or Tribal account is irrelevant to the issue of ownership and control. Whether the account be unrestricted, restricted, minor, estate, judgment, whereabouts unknown, etc., the Federal government has no rights to the funds and must follow established rules and regulations related to the overall administration of the two Indian trust funds and with respect to the governing trust documents.

- Consistency with Private Sector Trust Accounting The trustee/beneficiary relationship in the Indian trust operations is very similar to the private sector trust relationship. Assets are being held in trust to eventually be distributed to the rightful beneficiary(ies) in accordance with the governing trust documents. Likewise, financial statement presentation should be similar. The Office of Special Trustee already produces an annual set of audited financial statements for all funds held in trust for American Indians and Tribes for proper disclosure of funds held, and as a deterrent to fraud, waste and abuse. The audit reports are publicly available upon request or on the Department of the Interior Inspector General web site.

Mr. Swimmer then distributed an excerpt from the AICPA Audit and Accounting Guide for Banks and Savings Institutions, paragraph 17.12, which states:

> While a trust department or trust company may have responsibility for the custody of trust assets, they are not assets of the institution and, therefore, should not be included in the institution's financial statements.

Questions and Answers

The Board asked about the basis of the Cobell vs. Norton litigation (a class-action lawsuit brought by a group of individual Indians against the Federal government alleging breach of trust with respect to the Federal government's handling of Individual Indian Monies and various other claims). Mr. Swimmer replied that part of the basis is an assumption that $13 billion flowed into the individual Indian trust fund over a period of about one hundred years, and that Treasury, after a certain period of time, disposed of the canceled checks that were sent in payment. The lawsuit assumes that no payments were made to beneficiaries, and also claims that not enough money was collected in the beginning. However, the Court has limited the case to the money that actually was collected.

The Board asked for details about who makes the determination of how funds are invested. Mr. Swimmer replied that, within the scope of investments available (Treasury Securities and Securities of Government Sponsored Entities and Federal Agencies), the tribes determine the investment strategy. In accordance with the 1994 Reform Act, a tribe also has the right to withdraw 100% of its funds and invest them as the tribe sees fit. Individual Indian accounts generally are paid out as the revenues come in, but the individual Indian or guardian has the option of having the funds invested.

The Board asked if any of the guardians were Federal employees. The DOI replied that this varies, but the court-appointed legal guardian was generally a relative of the beneficiary.

The Board asked about the source of the revenues coming into the two trust funds. The DOI replied that the revenues came from a variety of sources, including oil and gas royalties, leases of land, timber sales and other sources.

The Board asked about the management activities related to the non-financial assets such as land. The DOI replied that typical duties executed by the Bureau of Indian Affairs include leasing the land, maintaining the land, and ensuring that it is put to the highest and best productive use for the beneficiary. Appropriated funds cover the costs these non-financial management activities, as well as the costs of financial management of the Indian trust assets. One exception is that there is a ten percent fee charged for timber sales, which is used to reinvest into the timber product; for example, to reseed, grade the land, and other forestry procedures to maintain the productivity of the land. There is a provision in 25 USC 413 to allow the Secretary of the Interior to charge fees for work done on behalf of the trust, as is usual for private trusts. The authority to do so has generally not been utilized, with the exception of the ten percent timber fee and a $10 flat leasing fee charged directly to the lessee (not the landowner). The normal practice for private trusts is also to charge management expenses to the trust. The cost of managing the Indian trust funds is about $400 million a year, and the income is about $380 million. All of the income is distributed to the beneficiaries.

The Board asked if the beneficiaries have the right to remove their land from the trust. The DOI replied that they do have that right, in which case the DOI would have no further responsibilities for it.

The Board asked about the disposition of unclaimed property in cases where the beneficiaries could not be located. The DOI said that Treasury is prohibited from accepting unclaimed property from the individual Indian trust fund, so the unclaimed property remains within the Indian trust fund in perpetuity. The DOI said that those funds would never revert to the DOI or to the Treasury.

The DOI noted that there were 260,000 individual accounts for the $413 million in individual Indian trust fund assets. The DOI is working with Congress to try to resolve the unclaimed property issue, but only proposes that the property would revert to the tribe, and not to the DOI.

The Board asked if the $2 billion in tribal trust fund assets were invested in the same way as the $413 million in individual Indian trust fund. The DOI replied that the tribal accounts are generally large and are managed individually in accordance with the directions received from the tribes. In contrast, the individual Indian accounts are pooled. Due to the fragmentation of assets as they pass to succeeding generations of Indians, there are a large number of individual Indian accounts with very small balances. Every quarter, individual Indians receive a statement of their account and receive a check when their account reaches $15 for grazing and agriculture, or $5 for mineral and oil revenue. For the 20,000 accounts with assets under $1, Congress has provided that only an annual statement is sent.

The Board summarized the DOI position: that the DOI does not control or benefit from the assets. The DOI agreed, and said that it would border on illegality to combine the funds of the two Indian trusts with DOI funds on the financial statements. This would violate the duty of a trustee not to commingle accounts. Two separate sets of financial statements are prepared and audited; separate financial statements for the tribal trust fund, and for the individual Indian trust fund.

The DOI summarized by noting the AICPA citation, the opinion of the DOI's legal counsel, and private sector accounting practice all supporting the DOI position that trust fund assets may not be reported on the face of the trustee's financial statements. The DOI noted that the relevance of the common law of trusts to the Individual Indian Monies and Tribal Trust Funds has been established by the U.S. Supreme Court.

Mr. Mosso thanked the DOI representatives for providing the Board with the information requested, so that the Board can now re-examine the issues that were in the ED.

> CONCLUSION: At the June meeting, the Board will consider possible revisions to the ED based upon information received from the DOI.

- **Social Insurance**

The staff explained that the scope of the work on this project was limited to the social insurance (SI) liability and related issues, and that the liability element would be considered fully in the elements project. Staff explained that in order to proceed with the SI liability project a working definition of liability was necessary. Staff recommended that the project proceed under the presumption that the current FASAB liability definition in SFFAS 5, paragraph 19 – "a probable future outflow or other sacrifice of resources as a result of past transactions or events" – is workable, at least in concept, either as currently worded or with minor modifications. Staff noted the need to discuss the SI liability recognition and measurement sooner rather than later, and that the SI liability project would be coordinated with the elements project.

Staff discussed the liability definition in SFFAS 5, paragraph 19, which defines "probable" as "more likely than not", "measurable" as "reasonably estimable", and "past transaction" as either an exchange or a non-exchange. Staff noted its view that these characteristics are fundamental for Federal liabilities, and that they appeared to be, essentially, generally accepted in the private and other sectors. The staff also compared these characteristics with those in FASB, GASB, and other standard-setters' definitions. The staff explained how the current FASAB definition was applied in SFFAS 5 to categories of Federal liabilities, and to the social insurance (SI) programs in SFFAS 17.

The staff mentioned the concept of constructive liability relative to SI programs. During the analysis that resulted in SFFAS 17 the Board considered the many characteristics of the SI programs. Some argued that the Social Security and other programs taken as a whole constituted constructive liabilities (see SFFAS 17, par. 76). However, the fact that Congress can change the SI programs by changing the law played a decisive role in the final outcome of those deliberations. The staff recommended that the concept of constructive liabilities be explored in greater depth than was the case for SFFAS 17.

Ms. Robinson asked how broadly the constructive liability concept would be applied. The staff replied that the scope is reflected in the FASB conceptual discussion in SFAC 6, which is included in the staff paper. Mr. Anania said the concept of constructive liabilities was imbedded in the FASB concepts but in his experience it was difficult to implement. He said he thought its use by FASB was limited but that it is an important concept. He said its possible application to social insurance programs was an important issue. It is a way to explore the idea of a liability that he did not think existed in any other way.

Staff noted that during the development of SFFAS 17 the Board cited Congress' ability to change the SI programs as a basis for not accruing a long-range actuarial liability. Mr. Schumacher said that even written OPEB plans reserve the right to change. Ms. Cohen mentioned that state and local governments have similar plans.

Ms. Wardlow mentioned that the GASB's draft OPEB accounting standard[1] basically tries to take care of the issue of substantive plans by asking if there is a common understanding by the employees, retirees, and other users and the management of the government itself as to what the plan consists of based on passed history, whether it is written down precisely or not. She said that since a government is a going concern, continuation would be assumed unless there is some specific action to make a change.

Mr. Anania asked Ms. Wardlow whether from her experience she saw the terms "substantive plan" or "de facto plan" as other ways to say "constructive obligation". She

[1] Two GASB exposure drafts dealing with OPEB for state and local governments were issued in 2003. The one dealing with OPEB plan itself, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, is substantially complete. The one for employers, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, was re-exposed in January 2004, with the comment period ending April 30.

said she did not think that was the intent. She said FASB's and GASB's approach to OPEB has been that the liability is based on an exchange. She said the difference between FASB and GASB is in measuring the liability.

Mr. Mosso added that both approaches – substantive plan or constructive liability – are ways to get around the lack of strict legal enforceability. He said the plans involve a promise and it is the promise that matters.

Mr. Zavada said that the issue of constructive liabilities seemed to be one more appropriately dealt with in the liability definition project where the concept would be considered across all programs rather than just SI programs. The staff said that the SI programs could be used as an example of how the concept would be applied. Mr. Zavada said examples would be helpful but they should be considered within the context of defining "liability".

Ms. Comes mentioned that a new staff member, Julia Ranagan, would be taking up a companion liability project that would apply some of the concepts from other projects to Federal programs other than SI, e.g., some of the general assistance programs. Thus, there will be three liability programs going at the same time.

Mr. Mosso said he thought the three essential characteristics of a liability listed on page 10 of the staff paper – present obligation, future outflow of resources, and past transaction or event – are the key to moving forward. If the concept of constructive liability were developed it would be within the context of these three characteristics. As for the asset element, there are words in the liability characteristics that would be troublesome but basically these are the reverse of the asset characteristics.

Ms. Robinson said she did not like the concept of constructive liability for two reasons: (1) it is a way to get around the essential idea of a "liability": that there is a legal obligation; and (2) it is a very difficult concept to apply. There is a severe "slippery slope" here. For example, why stop with Social Security. The idea could apply to a large number of activities of government that we do not consider to be liabilities.

Mr. Mosso said that the concept of constructive liability would not necessarily be an over-riding concept. The focus should be the triggering point for liability recognition. Mr. Zavada said that he did not think that introducing the concept of constructive liability into the discussion of whether SI programs are a liability or not is a particularly useful way of looking at the programs. He said the Board's current SI standard where you have the statement of social insurance giving a full view of the inflows and outflows in net present value terms is probably a more useful way of assessing the program, rather than taking just a piece of it and saying for whatever reason that that it is a liability.

Mr. Calder said that he thought that the statement of social insurance was a good way to assess the SI programs but not a good way to assess the nation's financial condition. The latter ought to reflect the Social Security deficit over time. Also, he said that the focus on the balance sheet obscures the need to consider the operating statement effect of the alternatives. For example, if OPEB cost is recognized only when incurred, then the annual program cost will not reflect the incremental cost of a year's service.

Ms. Robinson said that the annual costs are recognized in the budget, even if not on an accrual basis. She said the budget itself is based on a baseline and changes from that baseline, so it is not like the information is not out there and people do not know it. She said she was not sure what objective is served by reporting a liability on the balance sheet. She questioned whether reporting information on the financial condition of the nation should be a FASAB objective, considering the tools FASAB had at its disposal. Mr. Calder responded that he meant to say the Government's financial condition rather than the nation's.

Mr. Anania stated that it is too early in the project to talk about what the final conclusion will be. The current discussion is about yardsticks and measurements and concepts that will help the Board get to a conclusion. He said that Board members have a right to be suspicious about how the notion of constructive liability would be applied. He had serious doubts about the usefulness of constructive liability concept. The Board should reserve judgment until it had examples of how the concept was applied in practice. He said he did not think it had been used very broadly.

Mr. Reid said he would argue that Congress could adjust almost everything on the balance sheet; nothing is sacrosanct. This is one of the unique things about the Federal Government. Even Federal pensions could be eliminated if Congress so desired. He said liabilities are being recorded now because there is a statutory basis for doing so, and also because that is the way they are operated. And this approach can be applied to a lot of other situations. He said the Board's objective is to try to present the situation on the financial statements as it exists now, as impartially as possible. He said he looks at the balance sheet as something that simply reflects Congressional intent as of the reporting date. The concept of constructive liability is inherent in everything on the balance sheet.

Mr. Mosso said that the Board was arguing about something that does not make any difference. He reiterated that the three essential characteristics of a liability listed on page 10 of the staff paper are the key to moving forward to explore recognition points. He said it was not necessary to consider the concept of constructive liabilities in the SI liability project, although it had been discussed in the literature and it might be useful to consider it later in the elements project.

The Board discussed the elements project timeframe. Ms. Comes said that developing background for the project and exploring issues would require significant time, and issuing an exposure draft was not on this year's work plan. Mr. Reid added that, before issuing definitions the Board would need to think about the consequences of those definitions. If the definition makes a difference, then the Board needs to be very clear on what those differences are.

> CONCLUSION: Mr. Mosso noted that page 25 of the staff paper contained a proposal for work for the April meeting whereby the staff would analyze the

Social Security program, e.g., how are OASI and DI programs similar or different? How is OASDI different from general assistance programs on the one hand and employee compensation on the other hand? What are the alternative liability and expense recognition points? Mr. Mosso asked the Board assent to this plan and there were no objections.

- **Natural Resources**

Staff, Rick Wascak, led the discussion. Staff provided Board members with the names of experts that would be participating in the discussion by speakerphone. The experts who participated by speakerphone were:

1. Mr. John Wood, Director of Reserves and Production Division, Office of Oil and Gas, Energy Information Administration (EIA), Department of Energy, in Dallas, Texas; and,
2. Mr. Tom Farndon, Petroleum Engineer, Economics Division, Minerals Management Service, Department of Interior, in Herndon, Virginia.

Staff indicated that the objectives for the March meeting were to:

1. Discuss staff's proposal to capitalize estimated proved reserves for oil and gas;
2. Obtain general agreement on the proposal from the Board; and,
3. Discuss staff's "next steps" to develop an accounting methodology for asset and revenue recognition. In regard to this last objective, staff indicated it had provided some initial issues; however, it was not intended for the issues to be addressed at this meeting.

Staff explained that currently, the EIA does not distinguish between the quantity of proved reserves from lands under Federal jurisdiction and the quantity of proved reserves from other lands. However, the EIA has now been tasked with the requirement to provide this information in its September 2004 reports. Therefore, because this information will be available, staff proposed that an estimated value for proved oil and gas reserves from lands under Federal jurisdiction might be capitalized.

Mr. Patton asked how confident Mr. Wood was that the EIA could provide proved reserves information with great reliability, given what has been presented in the newspaper about Shell Oil reassessing the amount of its proved reserves. Mr. Wood indicated that the estimates are very reliable. He explained Shell reassessed the part of their world resource base, as opposed to its U.S. resource base, regarding what should be called proved reserves. He added there are many criteria applied to the proved reserves category that are not so stringently applied to things like economically recoverable or technically recoverable resources. He said, in effect, Shell now has its world estimate base using the exact same standards that the U.S. programs are using for proved reserves.

Mr. Wood stated that it was a technical question about those reserves reported in its world base. He explained the oil and gas, which Shell wrote down, is economically recoverable and technically recoverable. The reason Shell wrote it down is because to be a reserve under the International Society of Petroleum Engineers definition or the World Petroleum Council definition or the Minerals Management Service definition of the U.S. or the U.S. Security and Exchange Commission, you have to had made the financial commitment to develop the reserves before they are usually considered to be proved reserves. The financial commitment was the thing that was missing and, subsequently, the reason for the Shell Oil write-down. Mr. Wood added the EIA has been reviewing the domestic numbers of proved reserves estimates independently for more than 25 years. EIA finds that, if you look at an individual field, you almost always find it to be within professional competence; and, if you look at an aggregate of a number of fields those numbers are even more reliable. Mr. Wood stated all of the proved reserves reported by the EIA will be recovered with a probability rate of 99.999%.

Mr. Schumacher asked if the data, which is obtained by the EIA to prepare its proved reserves reports, is verifiable by auditors. He also asked if auditors have reviewed the combined data that the EIA is currently publishing on proved reserves; and, if so, what the audit status was on the review. Mr. Wood responded that a CPA would have very little to offer in regard to reviewing the quality of proved reserve estimates for oil and gas. He stated you must take a great deal of indirect scientific and engineering evidence and make an estimate of what that proved reserve number means; and, there is a large professional corps of people who perform this type of work. He added that the quality of the proved reserve estimate depends on the professional competence and integrity of the individual who makes the estimate. He noted the proved reserves are not things that can be counted; nor, are they direct measurements. They are estimates.

Mr. Anania asked if the EIA estimating was performed entirely by EIA experts or if outside experts were involved. Mr. Wood replied that the fundamental numbers are submitted by operators from private companies. Periodically, the EIA points out significant errors or misinterpretation of the private companies' data. He said the EIA would always need to rely on the raw data from the operating companies. Mr. Wood noted there are roughly 44,000 active oil and gas fields in the U.S. and roughly 22,000 operators. Of the top 600 operators, the EIA requires them to submit a direct report of the proved reserves they carry for each field. The EIA checks and edits all of the reports at the field level and that number would exceed 20,000 operator field reports. On all the checks and edit steps, Mr. Wood stated the EIA relies on its own engineering staff, which is very competent. In addition, the EIA staff independently checks about 20 fields a year. This can be described as an audit procedure performed by the EIA staff. The fields are selected either because they are new or there is something that might attract attention to the EIA about the field. Mr. Wood added that most of the numbers compiled by the EIA are submitted by the operators of the fields. If the operator is a public company, the numbers submitted to the EIA are the same kinds of numbers the company submits to the Security and Exchange Commission (SEC).

Ms. Robinson asked if there is a material difference between the reports or the interaction that the EIA has with operators on Federal lands versus operators on private lands. Mr. Wood responded that he assumes there is no difference. However, he has never a run a test. He explained that inside a given operating company, such as ExxonMobil, there is a single proved reserves manager. He added that the larger the company the more likely it imposed the same standards across all of its U.S. operations.

Mr. Farrell asked if there is a time phasing as to when the proved reserves will be extracted. Mr. Wood responded there are ways to estimate it. He explained that the EIA names a field by geographic location. He said the field may have many reservoirs at various depths. Each reservoir is an isolated pressure system. After the oil and gas is extracted from one reservoir, the company moves on to the next reservoir. So, while the EIA requires operators to submit a report about proved reserve on a field by field basis, the operators almost always do their estimates at the reservoir level and, for the EIA's convenience, summarize them to a field level.

He added that if there is a brand new field, which is especially common in the Gulf of Mexico, a company may book proved reserves, and a great deal of them, 3 years before they start production; and, sometimes it is longer than that. He continued by saying the typical time estimates would come from discussions the EIA would have with engineers in the company or from an independent analysis the EIA would make of the likely projected life of the wells that are drilled into a specific reservoir. He said the EIA has an internal edit that if it ever sees a projected life for more than 60 years, it examines to make sure there are no mistakes in the data.

Mr. Wood offered a rule of thumb for estimating the crude net present value of proved reserves. That is, the net present value of proved reserves is roughly one third (1/3) of the nominal value of the proved reserves. For example, if the quantity of estimated proved reserves were 9 million barrels and the price per barrel was $20, the net present value of the reserves would be $60 million (9,000,000 X $20 per barrel X 1/3 = $60 million). However, the actual calculations for net present value are very complex. As an editorial, he added that the SEC and the EIA were in disagreement over what price should be used to value proved reserves. He indicated that professional organizations, such as the Society of Petroleum Engineers, and the EIA believe an average price for the year should be used to value the proved reserves. However, the SEC currently suggests the price on the last day of the year be used to value proved reserves. He noted that with a roughly 50% price variation throughout the year, with the high side being in December, using the price on the last day of the year gives a distorted view of the value for proved reserves regardless of how good the volumetric estimate is.

Mr. Mosso asked if there is an active market for selling proved reserves? If so, is this done very often during the year? Mr. Wood responded that it was done thousands and thousands of times a year. He said there is a publicly available data that can be viewed regarding this. He added that for all of these transactions there is a continuum between those quantities that are very well known, like proved reserves for oil and gas and the probalistic estimate, which is that 9 times out of 10 you will recover at least the amount of the estimated proved reserves. He noted that there are also other categories for classifying oil and gas resources. Mr. Mosso asked if the EIA had data on probable resources. Mr. Wood replied that the EIA has numbers on the oil and gas resource base.

Ms. Robinson asked how complete Mr. Wood thought EIA's oil and gas resource base was for the U.S. Mr. Wood replied that it is a solid estimate. He noted that the U.S., with exception to some of the ocean fronts and Alaska, is relatively well explored. Ms. Robinson asked how often did the EIA revise its estimates for technological developments. Mr. Wood answered that he would say continuously. He added that whenever a proved reserve is estimated, it is to be estimated using the definition of proved reserves. That is, proved reserves are estimated using current economic assumptions and technology. Ms. Robinson asked how often did a technological development occur to cause the EIA to significantly revise its estimates. Mr. Wood responded that he would almost rather call it a lumpy continuum. He said in the 90s, the U.S. tripled the efficiency of finding small oil and gas fields. He explained that was a striking improvement over the previous 20 years and was due purely to technological development.

Mr. Wood noted that the EIA 2002 proved oil and gas reserve report and its mid-term model, with the documentation for the model, can be found on the EIA's website. Mr. Mosso asked staff to get the website addresses for the Board members. In closing, Mr. Wood commented that there are a large number of companies, such as the Ryder Scott Co., who serve as proved reserve estimating consultants.

Ms. Robinson asked, if in developing the staff proposal, whether the gray areas of resources were considered; or, if the proposal stopped with proved reserves. Staff replied that the proposal addressed only proved reserves, similar to the commercial accounting model. Mr. Mosso and various other members of the Board indicated that the Board should at least consider disclosing information relating to the other classifications of oil and gas resources. Staff responded that it would provide proposals for disclosure of other oil and gas resources information.

Staff noted that issues relating to the valuation of the proved reserves will be addressed at the June meeting. In regard to pricing, Mr. Reid suggested using something independently verifiable for transparency purposes. Mr. Mosso acknowledged that there are obviously a number of unknown details; however, did the Board agree with the basis of what staff is proposing. Mr. Anania indicated that many things on the balance sheet are not perfect so there is no need to get hung up on precision. He added that he basically agrees with staff's notion that the Board should make an attempt to see if these assets can be recorded. Mr. Mosso added that his preference is to keep it as simple as possible. Mr. Calder asked how the asset will come off the books? Staff indicated that this issue will be addressed at the next discussion of proved oil and gas reserves.

CONCLUSION: At the June Board meeting, staff will provide: 1) proposed methods for pricing and valuing estimates of proved oil and gas reserves; 2) proposed disclosures of other oil and gas resources; and, 3) an accounting methodology for asset and revenue recognition, as noted in the March 2004 Board meeting objectives.

- **Steering Committee Meeting**

Ms. Comes reported on recruitment efforts for the existing entry-level staff vacancy as well as the two college interns joining staff for brief periods.

Ms. Comes requested input on finalizing the revised rules of procedure. The committee decided that the draft rules should be approved by the full Board and then by the Steering Committee.

Ms. Comes requested and received approval of the process for issuing Staff Implementation Guidance.

Adjournment

The meeting adjourned at 4:30 PM.

Thursday, March 4, 2004

Agenda Topics

- **Public Hearing on Stewardship Land/Heritage Assets**

Summary of Testimony Provided by John Webster, Library of Congress

Mr. Webster began his testimony by thanking the Chairman and Members of the Board for the opportunity to discuss the exposure draft on "Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information (RSSI)." He identified that Nancy Davenport, Director of Acquisitions for the Library of Congress (LC) was accompanying him.

Mr. Webster explained that the LC considers the reclassification of non-monetary heritage asset information (except for condition information) as basic, to be a major change in financial reporting that would increase the cost of financial reporting and decrease the amount of useful information available in LC's financial statements. Mr. Webster explained that the main message he would like to present is that the LC does not believe the proposed change is cost beneficial. He further explained that the FASAB proposal should not be considered a minor reclassification change, but a major change that would increase agency cost without a worthwhile payback in better financial reporting.

Mr. Webster discussed that if heritage asset information must be reported in a note to LC's basic financial statements, LC would significantly reduce the amount of information communicated to the reader of the financial statements. He explained that this would be done because the benefit of including any non-monetary information above the minimum required information would not be worth the additional audit and preparation costs.

Mr. Webster explained that the LC provides useful, detailed information for its one heritage asset category—Library Collections—of some 128 million items. For example, the estimated number of manuscripts is 57 million, music items is 5 million, photographs is12 million, films, television, and video items are 925,000, maps is 4.8 million, books and other printed materials are 29 million. He added that this useful, detailed breakdown of the LC's collections is not required reporting and would not be presented if the current proposal is adopted. The cost for LC's staff to explain and verify this estimated count for audit purposes and the cost for auditors to perform audit procedures for this subset of LC's total collection would simply not be a good allocation of LC's resources.

Mr. Webster explained that the LC would limit its audit exposure to one descriptive total number (i.e., approximately 128 million items), and LC might also include the estimated number of items added and withdrawn during the year. Mr. Webster noted that even by limiting the information to this level of detail in the basic financial statements, he estimated that the LC would still expend hundreds of thousands of dollars in staff costs to document the size of the LC collections because LC's collections are permanently assigned to one of more than a dozen separate custodial divisions, and may be temporarily located in many others while being processed, circulated, exhibited, preserved or subject to other related activities.

Mr. Webster noted that the benefit of expending LC's limited resources for FASAB's new financial reporting requirement is in his view, NOT MUCH! He added that at best, LC would improve its estimate by several million items.

Mr. Webster explained that the proposed FASAB change would not improve, in any way, LC's plan for collections security. He further explained that the LC has a very detailed collections security plan, which has been reviewed by many groups of auditors and approved by congressional oversight committees. Mr. Webster explained that he is concerned that the cost of implementing the proposed FASAB standard would be funded by reducing resources currently used to implement the collections security plan.

Mr. Webster explained that he does not believe that FASAB has demonstrated that the benefit of having LC's one essential number subject to additional audit scrutiny is worth the extra costs or the reduction in usefulness of information about LC's collections. In fact, Mr. Webster asked the Board--What are the benefits of the proposed change, Has audit scrutiny been increased in a measurable way, and Has including the reduced information about LC's collection in a note to the basic financial statements improved "fair" presentation. Mr. Webster stated that he believes the answer is NO.

Mr. Webster explained that from his standpoint, LC's financial reporting took a major step forward when a separate heritage assets section was added and LC does not want to take a step back to the traditional model. He explained that the heritage asset section is prepared jointly by program and financial staff, and it effectively communicates information to a reader of LC's financial report.

Mr. Webster explained that presenting non-monetary heritage asset information in potentially three separate locations in the financial statements would be confusing, not measurably improve audit scrutiny, and definitely is a step backward in Federal financial reporting. He strongly urged the FASAB to reconsider its proposed standard. Mr. Webster noted that when SFFAS No. 8 was adopted, FASAB stated "…these stewardship items warrant specialized reporting to highlight their importance and to portray them in additional ways than provided by financial accounting." Mr. Webster explained that he believes that non-monetary heritage asset information should not be mixed with monetary basic financial statement information because the mix will hurt not help "fair" presentation.

Mr. Webster added that all agencies are facing tough financial times as the next few budget years are going to be real tight. He explained that to put this on agencies—extra costs—when the preparers believe it is not cost beneficial, he believes it is not the right thing to do.

Mr. Webster concluded his remarks and stated that he welcomed any questions that the Board may have.

Board Discussion/Questions to LC

Mr. Mosso noted that the original FASAB Board set up the category RSSI with the intention that they would be primary statements and would be subject to full audit, so what the Board is trying to do now is not really new, but more of just trying to carry out what the original Board intended. Mr. Mosso noted that the delay had been because of difficulties with getting auditing standards for non-financial information, but the AICPA is in the process of addressing that issue.

Mr. Farrell commented that Mr. Webster might want to mention the management assertion on the controls over the collections and that the auditors used to opine on that at one time. Mr. Webster explained that there is a separate Report of the Independent Auditor's that opines on LC's Statement of Controls over their collections. Mr. Webster added that he believes that should be the focus of the report—the focus of reporting and efforts should be on whether LC is properly controlling them and that is not the same as financial reporting. Mr. Webster explained that the LC has a mixed assertion on their collections controls. He further explained that this means the LC can assert that they do have control on their collections as they receive current collections, but they cannot assert that they have control over some of the older collections because there is a lot of work that needs to be done on inventorying the older items and other security procedures that is included in their security plan. The plan is currently being carried out and is partially funded by Congress. One example is that Congress funded an eight-year inventory plan for classified book collections.

Mr. Mosso commented that based on the plan that is in place, the LC will eventually be in a position to provide total assurance on the controls over their collections. Mr. Webster stated that the LC's Strategic Plan includes that goal for LC by 2008, but this depends on funding.

Mr. Farrell asked if the Management Assertion over Controls was done in response to a law or regulation. Mr. Webster explained that it is part of the annual audit. Mr. Webster noted that as a legislative branch agency, the LC is not required to follow standards issued by FASAB or prepare annual audited financial statements, but LC has chosen to adopt FASAB standards and prepare annual audited financial statements because it is a good business practice. Mr. Webster said that he was happy to say that this was the eighth consecutive year that the LC has received a clean opinion. Mr. Webster said that the LC has never had a positive assurance on its controls over its collections.

Mr. Patton commented that Mr. Webster had testified about presenting information in three places in the financial statements. Mr. Webster explained that it was a possibility. Mr. Webster referred the Board to LC's current footnotes, which are 33 pages. He explained that the LC would add an additional footnote page for the basic note about the collection, then in RSI the LC would have to include information about the condition of the collections and then the LC could include additional information in the Other Accompanying Information (OAI). Mr. Webster explained that the LC would probably opt not to include the other information because the LC prepares another report—the Annual Report on the Library to Congress, which already contains some of the information. He further explained that the Annual Report on the Library to Congress also includes condensed financial statements.

Mr. Patton clarified that under the current proposed standard, the LC could still provide the same information as supplementary information that is unaudited. Mr. Webster responded that the LC could provide it, but they would probably opt not to do so in the financial statements. Mr. Patton questioned why the LC would no longer present it based on the change in the current proposal. Mr. Webster explained that it would be duplicative of what he could report in the Annual Report on the Library to Congress plus it would be broken up in three places if included in the financial statements.

Mr. Patton asked for further explanation as to why it would have to be reported in three places in the financial statements as his understanding is that the LC would retain what it is doing now plus a fairly short footnote that it is audited. Mr. Webster said that his understanding of the proposed standard is that certain information would be RSI and certain information would be OAI. Mr. Webster explained that perhaps all could be included in RSI, but it still doesn't get around the additional audit costs. Mr. Mosso asked how would there be additional audit costs if the summary level information were included in the footnote. Mr. Webster explained that the 128 million collections number is a number that is derived from many collections and the auditors would have to look at the detail of that number. Mr. Webster explained that the staff would have to document the methodologies used in determining that number and that much of that is historical knowledge and not written in a way that can be audited.

Ms. Davenport suggested two examples to illustrate the point—one example is that LC's security procedures calls for inserting theft detection targets in each book and the way they count how many they have done is to count the number of books on their book truck at the end of the day and document that, then the supervisor reviews that workload to determine if it's reasonable. These individual workloads then get accumulated with other individual totals to determine daily and weekly totals. LC does not keep track of the individual totals and the support for those are not maintained. The auditors would want to see the individual tally sheets to support those numbers and LC does not see the value of such an exercise. Another example is one that is actually on the front page of the New York Times today, LC opened Justice Blackman's papers and when LC acquired Justice Blackman's papers, there was an initial record of how many items were in that collection. As LC began putting the collection into service (it could not be for 5 years after death), LC discovered there were thousands of pieces of hate mail included because he was the author of Roe vs Wade decision. LC does not need to retain thousands of pieces of examples of hate mail, so LC chose a representative sample for research purposes and returned the rest to his heirs. Ms. Davenport noted that there now is a disconnect (from an audit perspective) from what was the initial estimate of papers in the collection to what is now in the collection. There is not a count page by page, instead there is a finding aide for looking at the papers, but in a collection like this where there is not item level control, the LC uses the physical security method to secure the collection—meaning it will be only be viewed by patrons at a table with a camera overhead. Ms. Davenport explained that the intent of LC is to protect the collection, not count the collections.

Mr. Webster explained that the LC does have a goal to have an item level inventory of the book collection, but LC will never have an item level inventory of the special collections, which are the large bulk of LC's collections. Mr. Webster added that this is the common practice of museums and that type of activity as it is not cost beneficial.

Mr. Schumacher asked why the LC would provide less information if the proposed standard was approved and why LC would not report the information as RSI. Mr. Webster explained that if the standard would permit that LC would consider that alternative further, but his understanding of the proposed standard would call for additional information to be included in OAI. Mr. Schumacher explained that there is not a restriction that would prevent additional information from being presented in areas of the financial statements. Mr. Anania agreed that there are never restrictions from presenting additional information.

Mr. Webster explained that he believes the Board has not made their case that it is cost beneficial to subject the counts to audit scrutiny. He added that preparers will present the least amount of information possible in an effort to minimize costs.

Mr. Anania asked if there have been discussions with LC's current auditor about the potential audit implications. Mr. Webster explained that their auditors participated in the Roundtable discussion that FASAB staff held the previous month. Mr. Webster also explained that he presented them a Draft footnote and Draft RSI for LC under the proposed standard.

Mr. Anania explained that in this area, the maintenance of good and valid unit records are important for a report on internal accounting controls related to collections, yet testimony provided indicated that this is not always done and may not be important. Ms. Davenport explained that item level counts are not performed or are not important for particular kinds of collections. Mr. Anania suggested that to be a bit confusing as it would be difficult to have control over a collection if you don't have control over the units themselves. Ms. Davenport explained that the LC collections exist to be searched, so items are put at risk, but LC chooses the level of risk. Ms. Davenport explained that there are four controls over the collections that LC established with the assistance of a major accounting firm. She explained the controls are—(1) Bibliographic-what it is (2) Inventory-where it is (3) Physical security-are you protecting it and (4) Preservation-are you keeping it for the future. In addition, Ms. Davenport explained that there is a fifth control that heritage assets presents and this is are you acquiring what you should in order to be a heritage asset.

Mr. Anania suggested that the bibliography control is a type of unit control. Ms. Davenport explained that the paper of Justice Blackman is a unit control, but not each individual sheet. Mr. Anania explained that it is still a unit control, it is a particular kind of unit, and in this case that is the lowest level of unit control concept. Mr. Webster explained that it could vary depending on factors. For example, for George Washington's papers, the unit of control is every single paper. Ms. Davenport explained that it is a level of discretion used based on the level of the collection. Mr. Anania confirmed that there is no standard unit used for collections.

Ms. Davenport explained that the controls discussed above, when considered together are the LC's control mechanism. Mr. Webster added that there is also another dimension to consider. The LC categorizes their collections by value, there is platinum, gold, silver, bronze and copper. The controls that LC applies to collections are based on a matrix, based on the different levels of collections. The process of determining that and the security plan approved by Congress was based on a cost and benefit analysis.

Mr. Reid agreed with Mr. Anania's point about the difficulty in controlling an item that you don't have an actual count for. Mr. Reid suggested that it would be valuable to readers for LC to describe the different levels and then include them as LC currently has them, whether levels of collections or whatever the unit may be based on the bibliography. He added that it appears this would be in existence and auditable. Mr. Webster responded that it increases the audit costs and the LC does not want that. Mr. Reid suggested that the initial costs would be more costly, but the changes in the following years would not be as significant. Mr. Webster explained the LC's collection security controls and LC's assertion on the controls is audited every year and LC agrees that this should be audited.

Mr. Mosso asked if LC would have an issue if the Board just required an assertion about internal controls over the collections. Mr. Webster explained that it would be different issue from LC's standpoint.

Ms. Davenport explained that the LC is beginning to collect in digital format, which will make things even more difficult and there are a different set of controls over items such as this.

Mr. Webster welcomed Board members for a visit of the LC and collections so they may have a better idea of the magnitude of the issue.

Summary of Testimony Provided by Jesse King, US Department of Agriculture, Office of the Chief Financial Officer

Mr. King thanked the Chairman and Members of the Board for the opportunity to speak and represent USDA and specifically the Forest Service, who has a preponderance of stewardship land and heritage assets.

Mr. King began by asking what is gained by changing the classification and is having stewardship land and heritage assets as basic information going to change the decision of rational users of the financial statements. Mr. King explained that the proposed standard would require a balance sheet presentation with no financial data because it is not financially oriented. Mr. King further explained that the footnote reference that is required in the proposal would be subject to audit.

Mr. King explained that the proposed change would require additional reporting requirements, software enhancements, and other procedures and significant costs to USDA. The Forest Service has over 300,000 heritage assets and 192 million acres of stewardship land. Mr. King noted that there were only nominal changes in the balances in the past year.

Mr. King explained that he believes it is the condition of these assets that should be considered the more important element. The proposed standard continues to require that the condition be reported in RSI. Mr. King noted that many of the heritage assets are programmatic in nature.

Mr. King explained that he agrees that there should be sufficient controls in place to ensure that the assets are safeguarded and they are not inconsistent with other information presented. Mr. King discussed that the Department is in the process of implementing a Real Property Management System and that system does not incorporate a heritage asset or stewardship land component. Mr. King explained that the Forest Service has had significant enough problems with over $4 billion net value of real property that auditors have had to opine on. He explained that trying to identify the heritage assets and stewardship land from a wide variety of forms of information and then put this in an automated system would be a monumental effort that would be very costly. Mr. King explained that this would have to be done before the auditors could even attempt to audit the information.

Mr. King explained that he believes the benefits obtained from heritage assets and stewardship land being basic information is relatively small in relation to the costs that would be involved to improve the quality of the data so that it may be audited and the associated audit costs. Mr. King explained that this information has never been audited and most assets date back 100 years. Mr. King explained that he can relate to what type of endeavor that might be because in 2002, USDA received its first clean audit opinion, however; USDA's major weaknesses and hurdles that they had to overcome related to the existence and valuation of real property assets. He further explained that it took an enormous amount of work by USDA, auditors and outside contractors to accomplish it.

Mr. King that the heritage assets are located all across the United States. He also discussed the fact that the Forest Service is a very decentralized organization with 153 accounting centers. He explained that the Forest Service has had internal control problems for a long time and these problems have been cited by the IG and GAO.

Board Discussion/Questions to USDA

Mr. Mosso asked if Mr. King believed the intense effort for USDA's clean opinion was worth the effort and costs involved. Mr. King said he did believe the effort was justified as he appreciates the value of financial audits to the public.

Mr. Mosso asked if Mr. King was confident that they have good controls over the heritage assets and public lands, especially considering the weaknesses that exist in the real property area. Mr. King said he was not there to say that USDA has satisfactory controls over the stewardship land and heritage assets. Instead, he would like to convey that agencies are under accelerated reporting deadlines and quarterly reporting requirements that should be considered. He also explained that the Forest Service has launched a project to address long-standing issues related to its weak financial management practices. Specifically, they are centralizing the financial operations from 153 accounting centers to one. Mr. King explained that all of these factors combined present a tremendous challenge to USDA and specifically to the Forest Service relative to meeting the accelerated timelines with quality information and adequate internal controls over the financial information. He further explained that if the Board adds the additional requirement of reclassifying heritage assets and stewardship land as basic, it may put at risk USDA's solutions to the other long-standing issues.

Ms. Robinson asked Mr. King if he believed that the proposal was actually a good idea, but it may be that the time is not right because USDA is trying to satisfy the other requirements. Mr. King explained that he believed once USDA addressed some of the other issues that they would be in a better position to attempt implementation of the proposed standard, but he does not necessarily believe the proposed standard is a good idea. Mr. King explained that he does not believe that the benefits exceed the costs.

Ms. Robinson asked if USDA provides a management assertion (similar to what the Library of Congress does) regarding the controls over the heritage assets and stewardship land. Mr. King explained that the USDA prepares a management representation letter that covers many aspects as required that is signed by management and provided to the auditors. Ms. Robinson asked if the letter specifically addresses heritage assets and stewardship land. Mr. King explained that he could not recall if that was specifically included. Along those same lines, Mr. Zavada suggested that USDA must have internal controls that safeguard the heritage assets. Mr. King explained that there are controls, however, one must keep in mind that the heritage assets are located throughout the country. Mr. King explained that there are different types of physical security controls based on the type of heritage asset.

Mr. Patton discussed that the proposed standard talks about reporting quantities of major collections, so what would be considered the major collection or category for USDA. Mr. King explained that USDA's heritage assets include buildings, administrative facilities, ranger cabins and ranger towers.

Mr. King suggested that if the Board does approve the proposed standard, at a minimum the effective date should be moved out to FY 2006 because it will take time to address issues, especially considering the accelerated timelines. Mr. Anania asked if USDA has a timeline or target date for resolving the identified weaknesses in their internal controls to the point where USDA could at least be in a position to report clean information in the heritage assets area. Mr. King explained that it would take 2 to 3 years as there are many financial management related issues on the core financial system that needs to be addressed first before USDA could focus on improving the internal controls and accuracy of the heritage assets and stewardship land information.

Mr. Mosso thanked Mr. King for coming. Mr. King thanked the Board for the opportunity to testify and stated that he would be available for any other questions that the Board may have as they proceed on the issue.

Summary of Testimony Provided by Debra Carey, Department of Interior, Office of the Chief Financial Officer

Ms. Carey explained that both Sky Lesher and Nina Hatfield sent their apologies for not making the meeting and both had sincerely wanted to be present.

Ms. Carey began her testimony by thanking the Board for the opportunity to testify on the Exposure Draft. Ms. Carey explained that the DOI manages a vast array of federal lands, including one out of every five acres of land in the United States. Ms. Carey explained that in addition to the land, DOI manages heritage assets on behalf of the nation. She explained that most of the heritage assets came to DOI as they found them, such as archeological items on public land, or they were donated to DOI. Ms. Carey explained that most of the heritage assets were not acquired in arms length financial transactions. Ms. Carey explained that the management of these stewardship assets is a critical part of the mission of the Department.

Ms. Carey explained that the issue before the Board is twofold--first, what information is necessary to the proper management of these assets and proper reporting of stewardship over those assets to the public and secondly, what information is necessary to support an audit of that information under 21st century Financial auditing standards. Ms. Carey then explained that these are not the same question and that the

DOI's proper management and reporting of the assets are not dependant upon the existence of the types of physical records which would be necessary to support a financial audit. In fact, Ms. Carey explained that in some ways these would be mutually exclusive because in order to compile the documentation, you would have to actually step back from managing the asset because there is a very limited workforce.

Ms. Carey explained that the vast majority of the Stewardship Land was acquired by the nation as a result of major treaties and as a result of wars and for very small cash payments, but a lot of the costs associated with the war and treaties could not be valued. Ms. Carey explained that over the first 200 years of the nations history, we acquired approximately 80% of land mass of the United States through agreements such as the Louisiana Purchase and the purchase of Alaska. Ms. Carey explained that over time, large portions of this land were removed from Federal ownership as a result of sales, grants to railroads and homesteaders, became military bases and other such transactions. She further detailed that the land currently under DOI is that which is "left over" and there is not a purchase document to support ownership of what was "left-over". Ms. Carey explained that there are millions of pieces of paper or documentation that supports the acres sold or given away, not the acres retained. She added that for example, we know that the acre of land in Yellowstone National Park underneath Old Faithful is owned and managed by the DOI, however; DOI does not have a purchase document for this acre other than the Treaty supporting the Louisiana Purchase. Ms. Carey explained that the ability for Park managers to manage Yellowstone National Park is not dependent on the existence of 19th century records. Ms. Cary explained that in very rare cases there are disputes over land and in those rare cases the DOI can come up with proof. She added that it is very expensive and time-consuming process that is done on a case-by-case-basis.

Ms. Carey explained to prove ownership for all of the land would be a monumental task for DOI and the fact is that this is not the information that our managers need, nor is it the information that our public needs. Ms. Carey explained that Yellowstone National Park, for example, includes approximately 3,400 square miles of public land and the State of Rhode Island covers only 1,214 square miles. Ms. Carey discussed the fact that surveys of Federal land during the 19th and early 20th centuries were dependant upon the technological and transportation limitations of the time and the surveyors simply did not have the technological accuracy available today, nor the physical ability to reach wild and remote lands. As a result, original land acreage estimates often differ from newer surveys using modern technology. Ms. Carey explained that there is no benefit to Park management or the public to perform new surveys to confirm the exact number of acres. She reiterated again, the manager does not need this information and that managers have the information necessary to proper management.

Ms. Carey explained that parallel issues exist regarding Heritage Assets and what matters is that the assets are safeguarded. Ms. Carey explained that most of the heritage assets have been found or donated and there is no purchase documentation to support it. For example, over the last 200 years, archeological artifacts have been discovered on public lands. Ms. Carey explained that DOI does have a duty to report on the stewardship of these assets to the public, which would include how they are safeguarded and cared for.

Ms. Carey noted that there is concern over referring to the information as Required Supplementary Stewardship Information and she agrees that it is in fact an odd term and hard to explain. Ms. Carey suggested renaming it “Federal Stewardship Information” which may better capture the essence of the information. She also suggested that this information be placed in the Management’s Discussion and Analysis Section of the Report, a more prominent position in the report.

Ms. Carey explained that there is a clear distinction between (1) the information that managers need in order to properly manage the assets and report on the stewardship over these assets to the nation and (2) documentation which would meet 21st century financial auditing standards. Ms. Carey explained that the issue DOI has is that 21st century financial auditing standards should not apply to something that is a management issue. Ms. Carey also discussed the fact that the DOI resources are scarce and are devoted to managing what they have and should not be directed to creating documentation.

<u>Summary of Testimony Provided by Curtis Crider, Department of Interior, Office of Inspector General</u>

Mr. Crider began by expressing an apology on behalf of Mr. La Rouche who could not be there today and also stating that he was pleased to have the opportunity to comment on the Exposure Draft.

Mr. Crider explained that the Board does have a copy of their written comments, so he will summarize some of the key points. Mr. Crider explained that the DOI OIG agrees that improving the accountability for stewardship assets is very important, however, they do not support moving heritage assets and stewardship land information to the basic financial information at this time.

Mr. Crider discussed that they believe that further development of the accounting and auditing standards that would be used for preparing and auditing this stewardship information is needed so that everyone will have a clear understanding as to what is expected and how the audit would be conducted to support opinion level work.

Mr. Crider referred to the fact that most of DOI’s land was acquired over a significant period of time and DOI may not have ownership documents, so from an auditor’s perspective, how would one establish ownership and how would one establish boundaries without surveys to show where the boundaries are. Mr. Crider explained that there is a great concern about the cost of trying to do that type of work and what level of documentation would be required.

Mr. Crider explained that there are unique problems with their museum property. He discussed that much of the museum property are non-federal facilities and they are responsible for the safeguarding and controlling of the properties. Mr. Crider explained that he does believe they need to have control and there are procedures in place, but going out to audit 145 million items at over 1100 repositories would be extremely difficult and very costly.

Mr. Crider explained that he believes that DOI has very good disclosures and the DOI continues to focus on providing basic financial information to the readers about what assets the DOI does have and how they manage those assets. Mr. Crider explained that he believed presenting the information in a footnote would actually lessen the importance perceived by the reader because DOI would probably limit the information presented in the footnote and the information would be fragmented because it would not be presented in one place.

Mr. Crider explained that he believed the most important information to the readers is what resources/assets the DOI is managing and how well they are being managed and safeguarded. Mr. Crider further explained that he believed auditing the information would give an over-reliability on that number, condition, and use.

Mr. Crider discussed how there have been numerous discussions regarding what is a defined unit. Mr. Crider explained that there are qualitative factors that need to be considered in determining these type of unit and quantity issues. Mr. Crider further explained that these type of issues need to be addressed in the standard before agencies are required to move forward so there is a clear understanding of what is expected.

Summary of Testimony Provided by Jeff Norris, KPMG (IPA currently performing audit of DOI)

Mr. Norris explained that the Board has a copy of their statement, so he would just hi-light a few of the major points from the auditors' perspective. Mr. Norris added that he wanted to emphasize a few points regarding the fact that the heritage assets and stewardship land has never been audited before. He explained that the auditors have performed limited procedures. He further explained that in their FY 2003 audit of DOI, the audit identified that DOI needs to improve the controls over the stewardship assets. In addition, he noted that if this information were to be audited as basic information, it would not pass the audit test.

Mr. Norris explained that the key challenge the auditors would face in auditing stewardship assets is the ownership assertion. Mr. Norris explained that DOI does not have historic records readily available to demonstrate ownership of certain land and heritage assets or to demonstrate the number of acres owned because a majority of the records date back hundreds of years.

Mr. Norris explained that the accuracy of the number well also be an issue because the auditors will perform tests such as surveys and there is a strong possibility that the auditors will determine a very different number due to new and different techniques available. He further explained that the auditors would select a sample and if that sample contains errors (based on their survey) that error would be extrapolated over the entire population.

Mr. Norris explained that it will also be a challenge for the auditors to validate the completion of the reported stewardship asset quantities. Mr. Norris referred to the chart distributed by DOI that details the DOI originally acquired 1.8 billion acres of land and now they report approximately 437 million acres of land. Mr. Norris explained that it will be difficult to ensure that the reported acres amount is actually complete and that it in fact shouldn't be higher.

Mr. Norris explained that the DOI has only catalogued 40 percent of their estimated museum collections. Mr. Norris discussed that the collections are spread over 1100 non-federal facilities and 600 federal facilities. He explained that compiling the information for audit will be a huge undertaking for DOI, let alone the associated audit costs to validate that information, especially considering DOI is still trying to confirm all the collections that it has.

Mr. Norris reiterated that to audit the stewardship it would be a huge effort for auditors and they have estimated that it would be in excess of $5 million for a first year audit, assuming that DOI would be addressing all the control findings previously identified, performing surveys, obtaining the necessary historical records to prove ownership, and other procedures to ensure the accuracy of their reported numbers. Mr. Norris added that the costs to DOI in preparing the information for audit will also be significantly higher than the audit costs of $5 million.

<u>Board Discussion/Questions to DOI</u>

Mr. Mosso noted that based on much of the discussion, one might gather that the individuals testifying may not believe that an audit is actually worth the money. Mr. Mosso asked Mr. Norris if he believed that the auditing process provides value to the financial reporting process. Mr. Norris explained that he does believe the audit is a valuable process as it does validate the information and provide assurances to the readers of the financial statements. He further explained that for the stewardship assets, he does not believe the readers of the financial statements actually care if DOI reports 437 million acres versus 430 million acres. Mr. Norris explained that most readers would care about the ability to go to the parks and whether the land is secure and protected.

Ms. Carey explained that she wanted to point out that DOI believes the audit is very valuable and well worth the money. She added that there have been a number of management benefits come out of the audit process and that DOI has historically tried to implement FASAB standards early and that DOI takes financial management very seriously. However, she believes there is not significant benefit obtained by auditing stewardship assets based on financial auditing standards. She believes it is important to assess if DOI is safeguarding the assets and following prescribed procedures. Ms. Carey explained that there are efforts underway by DOI to ensure accurate reporting—for example, DOI is in the process of the major undertaking of cataloguing all of the collections. She explained that she believes a management control audit (instead of a financial audit) of the stewardship assets is more appropriate.

Mr. Mosso commented that DOI has put forth much effort in the stewardship reporting area and their disclosures are very well too. Mr. Mosso asked if the Board members had any questions.

Mr. Anania asked if it would be fair to say that the weaknesses identified at DOI with the limited audit procedures performed over the information indicates that DOI is not in a position to accurately report the stewardship asset information. Ms. Carey explained that would be a correct statement. Ms. Carey explained that the management controls over the stewardship assets are not currently to DOI's satisfaction and if the auditors were to issue a report, DOI would fail. Mr. Anania confirmed that there are control weaknesses over the stewardship assets, but DOI is currently working on addressing the. He asked if DOI has a target completion date for addressing the weaknesses. Ms. Carey explained that DOI is very diversified and that one component bureau has stated it would take until 2030, however; the Department management does not agree with that assessment. Ms. Carey explained that it is a long-term and very expensive process. Ms. Carey reiterated that DOI would fully support an opinion on the controls over stewardship reporting, DOI does not agree with an opinion on the quantity or unit information. Ms. Carey explained that it is the management and safeguarding of the assets that is important to the public and therefore, that should be the focus.

Mr. Schumacher asked Mr. Norris if the estimated $5 million for audit costs was incremental, meaning in addition to the current audit costs. Mr. Norris confirmed that was true.

Mr. Patton explained that he was still concerned about the physical unit issue. He noted that as he recalled the Board's discussion, units would be based on collections or museums and not a matter of an individual pottery shard being considered a unit. Ms. Comes commented that there have been a few phone calls regarding the definition of a collection and that SFFAS 8 provided illustrations that led one to conclude it should be numbers of museums versus numbers of shards in the museum. Ms. Comes explained that staff chose not to include those types of illustrations because illustrations have often created boiler-plates that preparers are compelled to use. Ms. Comes noted that discussions with informal contacts have identified that based on the language in the proposed standard (item c.1.), a majority of readers interpret it to mean to actually count the individual unit items within a collection versus collections or museums. Mr. Patton suggested the issue should be clarified in some way if the illustration is not included. Ms. Comes explained that the proposed standard does need to be clarified to indicate the Board's intent because the community is viewing this as something much more.

Mr. Zavada noted that he believed the problematic issue discussed by DOI was actually the unit of acres for stewardship land. Ms. Carey responded that this was in fact an issue for DOI. Ms. Carey explained that the exact number of acres of land is something that DOI does not know and does not feel that they need to know or report to the public. Mr. Zavada confirmed that DOI does not see the marginal benefit of a more accurate number for management or accountability purposes. Ms. Carey explained that the benefit obtained does not exceed the cost.

Mr. Anania asked Ms. Carey what unit is currently considered by DOI in its management control functions and for accountability purposes. Ms. Carey explained that it varies with each bureau—for example, the National Park Service manages by parks and there are estimated acres for each park. Mr. Anania commented that audit challenges would vary depending on what unit is reported. Mr. Anania also suggested that it would be difficult to come up with a boiler-plate reporting example that would actually fit all situations. Ms. Carey added that what matters is that each park superintendent and each wildlife refuge manager and state director know what is under their care and what the needs are for the land under their care. Mr. Anania confirmed that they know the boundaries although they might not know the exact number of acres. Ms. Carey explained that it was true and added that not knowing the exact acres does not limit their management ability.

Mr. Reid asked if it would impact the work if DOI increased the unit size to square miles versus acres. Ms. Carey responded that it would not impact because there would still be the issue of what is a material misstatement and DOI is still not sure how many there are, especially considering the original surveys were conducted by a man on a mule. Mr. Reid explained that he thought perhaps it might affect DOI thinking in terms of decisions because an acre is something that is a lot more precise than a square mile.

Ms. Robinson asked if DOI has physical control policies in their inventory controls that would provide for certain physical boundaries, such as a fence, for national parks. Ms. Carey explained that the National Park Service is very precise about what is part of a national park. She explained that there are no fences around the parks, but the Park Service knows which acres within the parks, are owned by the Federal Government and which are not. Ms. Robinson confirmed that there was no consistent physical control type policy in place at DOI, meaning any particular control that management could actually provide a management assertion in terms of physical control. Ms. Carey responded although there is not a consistent boundary control (as discussed) at DOI and she is not sure what that could be, she does believe that DOI could provide a management assertion.

Mr. Zavada commented that DOI had mentioned that park rangers, managers, and others know what they own and control. He asked if there were alternate controls in place that identifies ownership, such as park rangers patrolling the land. Ms. Carey explained that the DOI has approximately 426 million acres of land and 70,000 employees. Mr. Crider commented that park rangers do participate in law enforcement activities to protect the Federal land, so they do in fact patrol the parks, but there is not policy to patrol every acre or visit every acre.

Mr. Patton asked if DOI solved all the measurement issues and then the auditors audited the information and found a discrepancy—how would the auditors report the discrepancy in terms of materiality and how would that affect the audit opinion on the financial statements as a whole. Mr. Norris explained that the auditors have thought about that and it will come down to what level of detail DOI puts in the footnote as the level of precision will depend on the level of detail and categorization that DOI reports. Mr. Norris explained that the easiest unit to audit by would be the number of park units, versus acres. Mr. Patton asked if using that example, DOI reported 320 parks, but the audit determined there to be 360 parks—would that be considered a material difference to the financial statement as a whole. Mr. Norris explained that he would not view just the number by itself, materiality isn't just a number or a difference, one must consider all the qualitative factors and this is an area that the auditors struggle with.

Mr. Anania commented that the Board has talked about heritage assets and stewardship land together and the Board has more or less required the same information. However, he explained that he believes there might be a difference that would in fact affect what should be reported for each. Ms. Carey explained that different requirements are needed, but in both cases what needs to be reported to the public is the stewardship of the assets. Ms. Carey explained DOI's issues for heritage assets and stewardship land are different—for stewardship land DOI knows where it is, although they may not have an accurate count; however, with heritage assets there are more issues with what DOI actually has and where it is located.

Mr. Anania commented that it appears that the heritage assets at DOI face many problems and asked if DOI has considered addressing the issues with the stewardship land as their first priority. Ms. Carey explained that DOI does have different priorities. She further explained that DOI divides their policies between stewardship land and heritage assets, and within heritage assets, they divide their priorities between structures, buildings and museum property. Ms. Carey added that they take all of them very seriously but there are more definitional issues within museum property. She explained that with buildings there is a huge deferred maintenance problem that exceeds billions of dollars.

Ms. Carey reiterated that DOI does not oppose an audit review of their controls over stewardship assets (although this may be painful for many bureaus) because it is very important to the public. She noted that this type of audit is different from an audit that would review documents for proof ownership. Mr. Mosso asked if the ownership issue relates to Indian lands. Ms. Carey explained that DOI knows the boundaries and knows what are Federal lands. Mr. Mosso asked who would dispute DOI on ownership. Ms. Carey explained that occasionally a farmer might come forward and claim that property, for example, between that river and that tree is his because ancient boundaries were in fact rivers and over the course of over 100 years, that river may shift.

Mr. Patton asked if DOI could provide an estimate for the approximate amount of change in heritage assets or stewardship land from year to year. Ms. Carey explained that the change for land is small—between 2002 and 2003, it went from 436.6 million acres to 437.1 million acres.

<u>Summary of Board Discussion/ Questions with David Cotton</u>

(NOTE: Mr. Cotton provided testimony on the Earmarked Funds ED, but offered to provide his views on auditing heritage assets and stewardship land.)

Mr. Mosso explained that he would like to hear Mr. Cotton's views on auditing heritage assets and stewardship land. Mr. Cotton suggested that the first thing he would like to put on the record is that he would like the opportunity to bid on the DOI audit of heritage assets and stewardship land.

Mr. Cotton explained that a very wise auditor, with much more experience than himself, told him that he could audit just about anything and Mr. Cotton said he would have to agree. Mr. Cotton suggested that the first question that has to be asked is what are people going to use the information for. He explained that in the case of stewardship land and heritage assets, the information has not been out there before, so no one has ever relied upon it and maybe no one will ever rely on it. He added that materiality can't be defined until you determine what people will use the information for.

He suggested that if you are looking at a billion acres of stewardship land and nobody is going to use that information, then he would probably default to some order of magnitude level for materiality. He suggested that it would then be an iterative process, meaning once you put that information out there and people start relying on that information to make economic decisions, then you will have to reassess how accurate that number needs to be.

Mr. Cotton explained that he believes that the quality of the systems that produce the information is more important than the accuracy of the numbers. He further discussed that the question people should ask when considering if the information should be classified as basic is—are the assets important enough to require that they be maintained and accounted for, if yes then it should be basic, if not then it should not be basic information. Mr. Cotton explained that he believed that stewardship assets, especially those discussed during the public hearing, are important enough. He added that the value in auditing those numbers is not so much in the accuracy of the numbers, but it is more in the discipline that it places on safeguarding the assets and on the maintenance systems that ensure the assets operate at an effective level of condition.

Mr. Cotton compared the issue and current discussions of auditing the stewardship assets with those discussions in the early '90s regarding the cost-benefit of the CFO Act. Specifically, he discussed that many people did not believe the cost of the financial statement audits were worth it, but since then, people have seen the benefits obtained and no longer argue that point. Mr. Cotton explained that, for example, the work in the reduction of improper payments alone has produced savings that more than cover the audit costs and related costs to improve financial systems. Mr. Cotton suggested that the same would be true for the stewardship assets area—the benefit to making it basic information and subjecting it to audit will result in improved safeguarding of assets and ensuring that they are maintained.

Mr. Cotton explained that he does not believe the audit costs should be as much as some have suggested in earlier testimony. For example, he referred to the fact the Library of Congress noted earlier that they have a system of controls in place that is currently being tested. Mr. Cotton explained that once an entity's systems of controls have been tested, it is then a small or marginal cost to perform a statistical sampling of the population and confirm the reported numbers; however this does tie back to the concept of materiality.

Mr. Cotton explained that many make the mistake of bringing a commercial financial audit mindset when considering the concept of materiality in this situation, where the question of what the users are going to use the information for is very different. When considering non-monetary value information such as the stewardship information, one really must consider how the information will be used in determining materiality. Mr. Cotton reiterated that the most important focus should be on safeguarding the assets and ensuring that they are properly maintained.

Mr. Anania suggested that along those lines, there appears to be a number of mechanisms in place now, in terms of acts that require reporting of maintenance and deferred systems, that force a better result with regard to the record keeping and the controls over those types of items. He added that it appears because the Board is considering the proposed standard that would require a change in reporting, it has brought more focus on the area; however it would seem that the acts or requirements that are currently in place should already be driving a focus on this area or mission. Mr. Cotton explained that he agreed with Mr. Anania's comments.

Mr. Anania further explained that the Board had discussed the systems and control objective during the previous day Board meeting and he believed that this area is actually an example of where there is enough requirements in place to deal with the systems and controls aspects, which actually appear to be the primary consideration for stewardship assets in most people's minds and financial reporting might be considered secondary. Mr. Cotton explained that he believed if the systems and controls over the stewardship assets are in place and operating effectively, then the audit costs to substantiate the quantity information would be minimal. He added that he believes it is the focus on the numbers that will force agencies to maintain those systems of controls.

Mr. Anania explained that based on testimony provided during the hearing, it appears that agencies are not where they need to be in the systems and controls mechanisms over stewardship assets, so the question is—if the Board puts a requirement to report the information as basic, will that force the issue and make it happen faster and is that a proper role for the Board to do that. Mr. Cotton explained that he believed it was absolutely the proper role of the Board. Mr. Cotton referred to a statement by Dr. Linda Blessing on a similar discussion in which she said that even if it takes ten more years to get to a clean opinion, let's go ahead and invest those ten years of qualified opinions if that's what it takes to have the best standards possible once we get to a clean opinion.

Mr. Mosso thanked Mr. Cotton for his participation in the public hearing.

-Lunch Break-

Afternoon--Board Discussion Regarding Testimony

Executive Director Ms. Comes led the afternoon discussion by requesting the Board's input on staff direction after considering the testimony provided during the morning. Ms. Comes also directed the Board to staff issue papers provided in the Board Binders. Ms. Comes explained that the issue paper summarized discussion held at a Roundtable meeting held with auditors in February and it also included staff recommendations that may be responsive to some of the issues discussed today.

Ms. Comes requested that the Board share their thoughts of areas that they may wish to have staff follow-up on by resolving or performing additional research on in light of the morning's testimony.

Mr. Anania suggested that perhaps the Board should consider heritage assets and stewardship land separately because they may not actually require the same information. Mr. Anania explained that he believed stewardship land to be quite different from the category of heritage assets in terms of where agencies are in identification, control aspects, and the concepts of units. Mr. Anania added that there are different challenges. Mr. Mosso explained that there is essentially the same language or requirements for each in the proposed standard, but the language is flexible so there could be different approaches. Mr. Anania suggested that perhaps the proposed standard should have information about the unitization aspects and how that can be approached and more flexibility for units in the heritage assets. Mr. Mosso said that perhaps the Board could address the unit aspect to make it clearer.

Mr. Anania referred to FASB's approach on this issue for museum inventories. Mr. Anania explained that FASB used a phasing in approach for recording those types of assets. He also explained that FASB's standard has been in place about six or seven years and that there was a study performed on the type of reporting and results after implementation. Mr. Anania suggested that the report may be helpful because some of the issues discussed regarding heritage assets appeared to be quite similar to those discussed by FASB with museum collections.

Mr. Mosso suggested that FASAB staff get in touch with or visit some of the major museums (such as the Museum of Art, the Museum of Natural History) as they have a huge variety of collections. He explained that FASAB could learn how they unitize and how the auditors test. Mr. Farrell suggested looking at the Smithsonian Institute, although it is part of the Federal Government, they follow FASB standards. Mr. Mosso suggested that perhaps the Board needs to make a comparison as to what is in the FASB standard, GASB standard and FASAB's proposed standard.

Mr. Anania explained that there was an AICPA implementation guide or study of some sort that dealt with reporting for not-for-profits. Although it was not completely specific to museums, it did contain a lot of discussion about museums.

Mr. Reid explained that he was surprised about the notion of proving ownership of the properties. Mr. Reid suggested that FASAB could issue some sort of implementation guidance (similar to what the Board did with military assets) to make it clear that it is not necessary to go back to the Louisiana Purchase. Mr. Reid suggested that there could be some type of disclosure that explains there may not be a deed as one might expect in the private sector. He added that there must be a way to explain certain things that would somewhat limit the audit procedures in those types of situations. Mr. Reid explained that the physical inspection of thousands of documents to demonstrate that it is fact a clear title to the property doesn't appear to be productive. Another possibility would be to authorize satellite surveys as some relief.

Mr. Farrell explained that offering relief such as that, in essence may be saying that an actual audit of the numbers is not important and that he tends to agree with that. Mr. Farrell proposed that the Board should reconsider if the information should instead be classified as RSI (versus basic audited information). Mr. Farrell explained that he was persuaded by the arguments of the agencies and his previous involvement with the audit of the Library of Congress. Mr. Farrell explained that he believed the users of the financial statements are more interested in the controls and maintenance of the assets versus the number of assets.

Mr. Reid asked if there was a way to link the numbers or units of collections with the types of controls in place for those particular collections. Mr. Reid further explained that he believes that both are important—he would want to know the type of control as well as the number of collections to ensure that none are falling through the cracks. He further explained that he does not believe that each individual item needs to be counted, but the collection or unit by which the agency accounts for them and this should be disclosed or defined by the agency. Mr. Reid explained that he believes it may be difficult the first time, but maintaining it after the first year should not pose a big problem.

Mr. Farrell suggested that the Board should consider the value of the information as they continue through the process.

Mr. Zavada suggested that if the Board does go forward with the proposal, detailed implementation guidance would be appropriate and necessary. However, Mr. Zavada explained that he was very sensitive to the cost-benefit issues that were raised and the Board should consider those very seriously. Mr. Zavada noted that the agencies consistently explained that due to the nature of the assets, there are alternative controls in place to safeguard and manage the assets. He explained that because of these controls, the benefit obtained from driving some type of improvement through the financial reporting process is probably not worth the cost associated with it. Mr. Zavada further explained that considering the information is non-financial, perhaps FASAB should not be involved in it. Mr. Mosso explained that it may not be fair to say the information is non-financial information just because there are not dollar values currently associated with the assets.

Mr. Reid explained that he was concerned about the fact that these items are the core of the agencies that testified. It is great to say that they have a clean opinion on their administrative costs, but that is not the most important aspect of these agencies, instead it is these assets that they have been entrusted with. Mr. Reid believed there must be some step in that direction because these assets are one of the main reasons for the existence of those particular agencies.

Ms. Boutelle explained that there are some agencies, like DOD, that have heritage assets and they are not related to their mission. For example, DOD has cemeteries, collections and museums. Mr. Reid suggested that DOD would define the unit as a cemetery and report the number of cemeteries.

Mr. Calder explained that he did not want to put it on the auditor to determine if the unit is reasonable as it may lead to auditor/preparer conflict. He prefers to leave it the Department to determine what is important about its stewardship of assets, it is the agency's obligation to report the assets that have been entrusted to it and to tell the public about it.

Ms. Boutelle explained that their heritage assets, pales in comparison to the agencies that testified today. She added that their estimated audit costs for their heritage assets is approximately $1.3 million. However, these costs will lead telling the readers the exact number of cemeteries, but DOD already discloses the cemeteries, so what is being gained. Will the taxpayer be happy that we are spending money to validate this type of information?

Mr. Patton noted that the agencies mentioned individual items such as shards of pottery as an argument, when in fact they can report aggregated levels and disclosures. Mr. Patton also noted that the agencies testified about their controls over the heritage assets, yet at the Roundtable meeting with the auditors, the firm responsible for DOI's audit mentioned significant deficiencies in internal controls over heritage assets and stewardship land. Mr. Patton explained that making the information subject to audit would lead to more accurate information, that would in fact then be more useful for managing. He added that not auditing it would make it less useful. Mr. Reid mentioned that presumably all the "fixes" to those deficiencies are on the agencies list of things to do and if the Board implemented the proposed standard it would make agencies reprioritize their lists and accomplish it sooner. Mr. Anania suggested that it would in fact give them a time certain of addressing the issues.

Mr. Anania asked how many agencies would the proposed standard actually impact. Mr. Reid explained that there are only two or three major agencies impacted by the stewardship land. Mr. Reid explained that he could come back with what was submitted for the CFR. Mr. Anania explained that he does not like to write entity-specific standards, but if there is only a few affected agencies, perhaps there are some alternative ways to address. For example, perhaps the standard could be written with enough examples to address all the issues so preparers could deal with it or we could look at it as it only affects a few agencies and it may not be appropriate to address this now by imposing a deadline or perhaps a staggered deadline. Mr. Mosso explained that he preferred a transition tool as it would not require immediate results, but would make it move toward a desired end.

Mr. Jacobsen asked if it would be helpful for the Board to see GAO's recent audit report on the American Battle Monument's Commission as its nature of its activities are very similar to heritage asset type activity. The Board noted that it is a much smaller scale type entity. Mr. Jacobsen explained that it is small, but some of the disclosures may be useful to consider due to the similarity.

Mr. Anania asked the federal Board members if there is a date established in law or a timeline when all material weaknesses must be addressed by agencies. Mr. Zavada explained that under the President's Management Agenda (PMA) and related scorecard, there are two issues that should be considered—the first being the accelerated financial reporting deadlines, with agencies required to issue financial statements within 45 days of the fiscal year end. Mr. Zavada explained that the Board should be sensitive to that when imposing new requirements. Secondly, one of the items that OMB monitors under the PMA scorecard is resolution of material internal control weaknesses. He discussed that OMB is putting a lot of pressure on agencies and OMB holds quarterly meeting with agencies to monitor progress. The scorecard is very visible and very much an administration priority and through this mechanism, there has been success in resolving material weaknesses. However, there is no date certain when all material weaknesses must be resolved. Ms. Boutelle explained that a certain date would be very difficult because each material weakness and its magnitude is different and varies by agency. Ms. Boutelle explained that DOD has a plan in place to get a clean opinion by 2007 and 100s of millions of dollars to finance that effort.

Mr. Patton explained that he still believes that the materiality issue of non-dollar items may still need to be addressed. He added that he is not certain and perhaps it is more an audit issue to be resolved. Mr. Farrell explained that there are not guidelines for auditors to do this at this point. Mr. Reid discussed that in some ways the issues relate to measurement—for example, we know the land exists, but is it fair presentation to say 4.5 million acres versus 5 million acres and does it matter. Mr. Farrrell explained that the bigger challenge is the fact that things may be understated, and there actually may be unrecorded items and how does an auditor test for that. Mr. Mosso asked if the AICPA was working on auditing standards in the non-financial area. Ms. Comes explained that the AICPA is working on some guidance on the Social Insurance Statement. She added that the only guidance prepared in this area was drafted by the AAPC and it attempted to tie materiality to the mission of the agency.

Mr. Schumacher asked if the Board was discussing the materiality of what needs to be disclosed or the materiality of what is counted versus what is really there, or both. Mr. Farrell commented that the materiality is in terms of what level it is audited, meaning when is the auditor satisfied that he has done enough. Mr. Schumacher explained that the individuals that testified the information that they are now presenting is the same information that would have to be audited and they would not necessarily exclude any of that based on materiality. Mr. Anaia commented that they actually testified that they would scale back the information because it was subject to audit. Ms. Boutelle commented that is a logical thought process for them to reduce the information being reported, meaning why would they subject themselves to audit scrutiny and the additional costs. Mr. Reid suggested that it would make sense for agencies to first look at what are the minimum requirements and after you get beyond the minimum requirements, what falls into fair presentation versus nice to have information and how doable is that. He agrees that every agency must first look at meeting the proposed standard's minimum requirements. Mr. Schumacher asked if that would be meeting the Board's objective if in the end the agencies eliminate the detailed information that it is currently reporting. Will the agencies still be reporting information that is useful to the financial statement reader and is it cost effective to do that. Mr. Reid commented that it was not the Board's objective to turn the reports into telephone books, so limiting the detail is not a bad thing. He further added that there is tremendous detail in the reports and when it comes to consolidating for the CFR it is very difficult with that level of detail in the agency reports.

Mr. Anania explained that he gathered that there is a huge difference when there is a material weakness related to information that is reported in RSI or RSSI versus a material weakness reported on information that is in the basic financial statements as that may lead to a qualification of the opinion. He commented that he believes this is one of the main concerns of the agencies, especially those that testified today. Mr. Mosso added that the motivation is that the agencies do not want to lose their unqualified opinions because of this. Mr. Anania also commented that it is not just the cost issue, there is an issue with the agencies ability to get there as well. He added that if the agencies are not there with having the systems and controls and procedures in place, it would be difficult to audit until then. Mr. Patton explained that it is very important information and should be audited so readers can believe the numbers. Mr. Calder added that just because the controls may not be in place as of now, that is not a reason to delay the proposed standard.

> CONCLUSION: Mr. Mosso suggested that staff research some of the issues discussed and come back with options for the Board. Mr. Farrell suggested that staff develop different levels of unit reporting for consideration. Ms. Comes explained that staff will develop different approaches to solve some of the problems discussed while accomplishing the Board's objective. Staff will also consult with museums to determine the outcome of what is done in the private sector and especially the results of auditing based on the FASB standards. Staff will also attempt to develop some sort of transition or staggered approach to implementation (versus the FY06 date that had been discussed in the previous Board meeting). For example, GASB 34 did a staggered implementation based on size and perhaps something similar based on primary missions is at least something that should be considered by the Board.

- **Public Hearing on Earmarked Funds**

U.S. Department of the Interior (DOI)

Ms. Debra Carey presented testimony for the DOI on behalf of Mr. Sky Lesher and Ms. Nina Hatfield, who were unable to attend.

Thank you for the opportunity to comment on the Exposure Draft, "Identifying and Reporting Earmarked Funds."

For reference, I have brought copies of the Department's Fiscal Year 2003 Dedicated Collections footnote disclosure. For your information, I have also distributed a list of Treasury Fund Symbols within the Department of the Interior that potentially meet either the budgetary or financial definition of a dedicated collection or earmarked fund.

On the whole, we agree with this proposed standard, and believe that it will enhance the Dedicated Collections requirements currently provided in SFFAS #7. In particular, we concur with the requirements of paragraph 17 regarding the presentation of earmarked funds by the entity clearly responsible for managing each portion of the fund. This will resolve a current issue with the Aquatic Resources Trust Fund and lead to better information.

While we agree with the proposed Standard in principle, there are a number of issues that are likely to cause confusion and detract from meeting the Board's objectives.

First and foremost, the term "earmarked fund" is commonly used and well-defined in the Federal budget community. This budget definition appears to be very close to, but not exactly the same as, the definition of "earmarked fund" in the exposure draft. The term "earmarked" is a great term. However, having two very similar but not quite identical definitions of the same term will only create confusion. This confusion will greatly increase the difficultly in gathering accurate and complete information and decrease the meaningfulness of the disclosures to at least a portion of the target audience. In gathering information for the Financial Report and reporting this information, finance personnel will continually need to differentiate between earmarked funds, definition one, and earmarked funds, definition 2. As great as the term "earmarked" is in capturing the essence of the Board's intent, it is not worth the confusion it will generate.

Generally, from a budget standpoint, 5000 series Treasury Fund Symbols are considered to be earmarked funds. In Fiscal Year 2003, Interior disclosed a little over a dozen 5000 series and 8000 series funds as dedicated collections, while a large number of Interior's 5000 series and 8000 series funds were not considered to be dedicated collections for 2003 reporting.

Second, the proposed presentation on revenue in Earmarked Funds on the Statement of Changes in Net Position is problematic. Earmarked Funds may generate either exchange or non-exchange revenue. Further, the non-exchange revenue may consist donations, interest or one of several types of taxes. Exchange revenue is currently presented on the Statement of Net Cost, by program and responsibility segment and included in the "Net Cost of Operations" line on the Statement of Changes in Net Position. Non-exchange revenue is presented as a financing source on one of several lines on the Statement of Changes. We feel that the current exchange and non-exchange disclosure are correct and meaningful. Therefore, while we concur with the disclosure of revenue earned in earmarked funds, we believe that footnote disclosure would provide the most clear and complete disclosure to the reader. Otherwise, the earmarked fund revenue reporting will be split onto multiple lines on the Statement of Changes in Net Position, reducing the overall clarity of the disclosure.

Third, we do not concur that Cumulative Results of Operations should be separately disclosed for earmarked funds. This disclosure would be misleading. Interior has dozens of funds that meet the definition of "earmarked" funds. These funds are often closely linked to an agency operation or program where several Treasury Fund Symbols are used to carry out the program. Most earmarked funds are best understood in the context of the whole program. Reporting the equity in these funds separate from the other Fund Symbols that make up an activity would not be appropriate. Footnote disclosures of equity in the context of full financial information of the earmarked fund would provide the reader with a better understanding of the information.

Fourth, the disclosure of financial information about large and unique "earmarked" funds is meaningful and appropriate. As noted earlier, Interior has dozens of funds that meet the definition of "earmarked" funds. A limited number of these funds warrant disclosure of "full" financial information, such as a summarized balance sheet, a summarized Net Cost statement, etc. However, many of these earmarked funds are quite small. Reporting "full" financial information and program descriptions for the dozens of smaller funds is not appropriate. Regarding disclosure of information about the nature of investments in Federal securities by earmarked funds, the requirements should make it clear that to be accurate, these disclosures may need to be tailored to the situation of the specific fund.

Department of the Treasury

James Lingebach presented testimony on behalf of the Department of the Treasury.

Mr. Lingebach noted that detailed comments had previously been sent to the Board. He said that Treasury supports the idea, but has questions about implementation, which could be problematic.

One problem is with the definition of earmarked fund. There are some funds in Treasury that would not meet the literal definition in the ED but should probably be included in the earmarked fund category. Mr. Lingebach said that there was also a materiality issue, because it would be problematic to gather compile information for many immaterial funds and have that information audited.

Mr. Lingebach noted that the GAO report, "Federal Trust and Other Earmarked Funds" listed a number of funds that the ED definition would exclude, and it omitted some funds, such as the Bureau of Engraving and Printing, that would be included in the ED definition. The Mint is included in the GAO report, and the Mint is an enterprise fund, but most of the Mint's revenues are turned over to the general fund. All revenues beyond what the Mint needs to run its operations are turned over to the general fund.

Mr. Lingebach said that he anticipated lengthy discussions with the Treasury's auditors regarding what is and is not an earmarked fund. He noted that due to the proposed effective date of FY 2006, Treasury has ample time to conduct those discussions.

Mr. Lingebach noted that most of Treasury's revenue for earmarked funds is exchange revenue, so it would flow through the Statement of Net Cost. He noted that additional guidance was needed for this Statement. He also pointed out that Treasury supported disclosure in the Notes, and not on the face of the statements, to keep the presentation cleaner. He noted that the Notes are also becoming voluminous. He asked for a little more guidance for the Statement of Net Cost, such as examples of what the reporting would look like, and also examples of the types of activities that would fall under the definition of earmarked funds.

Mr. Lingebach notes that although it would be impractical for the ED to list the funds it wants included, but that without this, different interpretations might result in something other that what the Board wants to see.

Mr. Lingebach stressed that it is Treasury's view that this information should be presented in the Notes, and not on the face of the statements. He noted that with comparative financial statements, the addition of additional lines would only add confusion rather than clarity for the readers. Mr. Lingebach noted that Changes in Net Position is detailed by sub-entities already, and this would add an additional layer of complexity.

Mr. Lingebach also asked that the wording of the ED clearly differentiate between the general fund of the Treasury and the operating entity. He said that he represented the Treasury operating entity, and that referring to the general fund as "Treasury" also causes problems in reconciling with Treasury's partners for intragovernmental transactions.

Mr. Lingebach noted that when earmarked funds earn interest from Treasury, the interest would appear on the component's financial statements, but would be eliminated in the government-wide financial statements. He noted that this would cause a discrepancy, perhaps sizeable, between the federal component reporting of earmarked funds and the government-wide reporting.

Mr. Mosso asked if Treasury has given any thought to what might be done about eliminations. He noted that Treasury's written comments identified the Comptroller of the Currency as having no statutory authority to retain and use fees collected from banks, and that the Comptroller of the Currency was one that the Board specifically intended to be included in the definition of earmarked funds.

Mr. Lingebach said that when the Comptroller of the Currency originally reviewed the ED, they noted that historically, the Comptroller of the Currency levied fees on banks and retained the fees within Comptroller of the Currency to use in regulating the banks. He noted that this had not been researched fully, but that it did not appear to be based on a statute.

FASAB staff asked if it would be helpful to delete the word “explicit” if the authority were more implicit in the legislation. Mr. Lingebach said that the word “statutory” appeared to be the problem, but that, on the other hand, deleting “statutory” might expand the category to include other things that do not belong in the category. Mr. Mosso agreed.

Mr. Jacobson (FASAB Counsel) said that he would take a look at it, but that he was wondering if it was the combination of “statutory” and “explicit” that was a problem, because sometimes what people do not think is “explicit” is there because you look at the totality.

Mr. Mosso asked if the Comptroller of the Currency was the only one that had this characteristic. Mr. Lingebach replied that the Mint was an example of where some of the revenue was retained and could be considered earmarked, but that most of the revenue was turned over to the general fund, where it was not earmarked. Mr. Mosso asked if the Mint picked up the seigniorage revenues, and Mr. Lingebach replied that it did. He said that the seigniorage was turned over to the general fund for general government purposes after the Mint deducted what it needed to maintain its operations and capital equipment needs.

Mr. Mosso asked about the Bureau of Engraving, and said that he thought that was an intragovernmental fund. Mr. Lingebach said that it is established as a revolving fund, and that it would be considered an earmarked fund under the ED.

Mr. Lingebach said that Treasury has the D.C. Pension fund, which was included in the GAO listing. He said that Treasury took it over some 6 or 7 years ago from the D.C. government. He said that Treasury took over its actuarial liability and also its investments, which it converted to Treasury securities. He said that the investments were insufficient to cover the liabilities, and that the D.C. Pension fund also received appropriated funding to help cover its obligations. He said that looking at it further, it might meet the definition of an earmarked fund, but that they had “struggled with it a little bit” because the fund does not get “revenues”, other than from the investments in Treasury securities.

Ms. Cohen asked, “Wouldn’t the D.C. Pension fund be more of a fiduciary fund than an earmarked fund?” Mr. Lingebach said that it might be. Ms. Cohen said that on the state and local level, once funds were put into a pension fund, they were considered as held in fiduciary trust for the beneficiaries. Ms. Cohen noted that the Federal government is responsible, under the agreement with the D.C. government, to pay out benefits as they come due over time, using appropriated funds as necessary.

Mr. Mosso noted that the Board would probably have to work with Treasury individually on those funds to make sure that they get classified properly.

Mr. Patton noted that Treasury's written response asked for more guidance on the term "significant." He asked what sort of problems Treasury might run into. Mr. Lingebach said that different people interpreted "significant" differently, and that it might be applied unevenly throughout the government. He said that some sort of percentage might help with the "eye of the beholder" issue. He said that he did not want to see a lot of disclosure for immaterial things, and that it relates to what the users want to see. Mr. Patton asked if he considered "significant" to be "material." Mr. Lingebach said that he did, but did not know if everyone did.

Mr. Schumacher noted that Treasury supports disclosure in the footnotes rather than on the face of the statements. He asked if that was because of systems issues, or because the statements would be cluttered. Mr. Lingebach replied that it was the "clutter factor," because the systems issues would be the same regardless of placement of the disclosure. Mr. Lingebach said that footnote disclosure would keep the format of the financial statements cleaner. Mr. Schumacher asked if the relative placement of the disclosure would not be a cost issue for Treasury, and Mr. Lingebach replied that it would not.

Mr. Anania said that he had a similar question. He noted that Treasury's letter stated that it would cause confusion and misinterpretation. Mr. Lingebach replied that there is already enough complexity on the face of the statements. Mr. Lingebach said that there should be a reference to the note disclosure in the Net Position section and any other line items that are impacted. Mr. Anania said that the reader should see "as soon as possible" that there was limited discretion for some of the incoming resources. Mr. Anania asked if Treasury agreed with the concept, but not with the presentation. Mr. Lingebach confirmed that this was Treasury's position on the ED.

Mr. Patton said that if the earmarked flows were fundamentally different, that this should be made clear to the reader. He said, "We often hear that things get buried in these footnotes." Mr. Lingebach said that a lot of the flows would be eliminated on the consolidated government-wide financial statements. He said that the only disclosure possible would be to refer the reader to the component financial statements or to provide capsule information.

Mr. Anania asked if this would provide additional breakdown of information to assist in reducing unreconciled intragovernmental balances. Mr. Lingebach said that Treasury already has a more detailed breakdown than the ED requires, and that it would have no impact.

Mr. Lingebach repeated that much of the revenue flows, such as interest on Treasury securities, would be eliminated even within Treasury's agency-wide financial statements. Mr. Patton asked if in Treasury's case, the appropriate treatment would be to omit the revenue flows and only disclose the earmarked net position. Mr. Lingebach repeated that most of the revenue flows would be eliminated in the agency-wide consolidation process.

Mr. Anania brought up the issue of management discretion, and asked the Board if this would be useful information from the perspective of management discretion in terms of how the funds were used. There was no immediate response from the Board, and after a pause Mr. Mosso thanked Mr. Lingebach for his testimony.

Institute for Truth in Accounting

Mr. David Cotton presented testimony on behalf of the Institute for Truth in Accounting.

Chairman Mosso, members of the Board, Executive Director Comes, FASAB staff, it is a pleasure to be here today to discuss two important exposure drafts. My colleague Mr. Phil Peters is unable to be here due to illness. Phil and I are both members of the advisory board of the Institute for Truth in Accounting. The Institute's founder and CEO, Sheila Weinberg, regrets that prior commitments precluded her being here today; but she sends her best wishes to you all.

The mission of the Institute for Truth in Accounting is to promote, through education, a federal accounting and budgeting system that provides citizens and policy makers the information needed to make knowledgeable financial decisions.

In preparing these remarks, I revisited FASAB's own mission statement: to promulgate federal accounting standards after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information.

The missions of our two organizations could not be more compatible, in my view. Sheila wants you to know that the Institute for Truth in Accounting supports your efforts and will welcome opportunities to establish a closer relationship that will further the missions of both organizations.

The two exposure drafts we would like to comment on are the one on earmarked funds and the one on fiduciary activities. We recognize that this latter one is not on your agenda, but we think that these two need to be considered as companions of one another. (I will be happy to give you my personal views from an audit perspective of the other exposure draft on heritage assets and stewardship land if you would like.)

Regarding the bifurcation of dedicated collections into two separate treatments, we generally agree with the Board's intent, reasoning, and planned changes. Our concern with these two EDs is a narrow one, but very significant. We disagree with the Board's proposed classification of social insurance as an earmarked fund. We are not saying that social insurance does not have some earmarked funds characteristics. It clearly does. But, in our view, social insurance also has some fiduciary activity characteristics.

I struggled to find a good analogy to explain my reaction to reading the earmarked funds ED. Imagine that you have just purchased a small appliance that is used to turn ice cubes into crushed ice, the FASAB EF Model 2004. You take it home and start reading the operating instructions. Looks pretty straightforward. Then you come upon a paragraph that says "the uses for the EF 2004 range from home refrigerator sized ice cubes, to North Atlantic icebergs.

We think few would disagree that the looming social security crisis is the most significant fiscal dilemma the nation faces. It was shocking to us to see it slotted into the earmarked funds category in that "for example" fashion.

We agree with your 1999 statement: "Social insurance programs have complex characteristics and thus require specialized accounting standards. These programs blend elements of exchange and nonexchange transactions and therefore do not completely fit traditional accounting notions of either annual governmental assistance programs (nonexchange transactions) or long-term pension programs (exchange transactions)."

The declaration in these two EDs that social insurance has no fiduciary component seems counter to the reasoned and balanced position you took in SFFAS 17. That standard—SFFAS 17—did a wonderful job of articulating the sincere views on both sides of the "what is social security" question.

Our recommendation is that you leave social insurance out of both of these EDs. You are re-visiting the accounting for social insurance. Why not wait until that work is complete and cover social insurance accounting in a revised SFFAS 17? This would be consistent with the position the board took in SFFAS 17 that social insurance programs have complex characteristics and thus require specialized accounting standards. In fact, we recommend that FASAB follow that logic-stream a few steps further and consider the feasibility of separating social insurance assets and revenues into those two competing, component parts: non-exchange, or earmarked, and exchange, or fiduciary.

We would also like to address the recommendations in Ms. Weinberg's letter to you. We know that FASAB would like greater public and congressional participation in the standard-setting process. Not a single member of Congress commented on either of these EDs. That is disappointing. My letter, Sheila's letter, and perhaps Hal Steinberg's letter are the closest that you got to getting input from "ordinary" citizens. You might have gotten a much larger response to the fiduciary activities ED if you had instead titled it "The Federal Government has No Fiduciary Responsibility to Pay Social Security Benefits." You could have titled the earmarked funds ED " Social Security is Just Earmarked, Not Fiduciary."

As you continue your study of social insurance, we know that those deliberations will be of great interest to most Americans. We recommend that you consider holding future meetings in selected cities around the country and invite John Q. and Jane R. Public to come and share their views. The Institute for Truth in Accounting will welcome the opportunity to help set up and conduct educational meetings for that purpose.

Let me close my remarks by returning to my iceberg metaphor. Imagine, if you will, that we are all passengers on a giant ocean liner. The skies are bright and we are making good speed towards our destination, the Port of Prosperity. Passengers are busy planning what they will do when they get to Prosperity. Two particularly intelligent and well-respected passengers, one is an economist (Alan), the other is an auditor (Dave) are standing in the bow, looking forward. They spot a huge iceberg off in the distance—directly in the ship's path. Alan and Dave immediately recognize the danger. They report the problem to the group responsible for communications between and with the passengers and the captain and his crew, a group called FASAB. Alan and Dave find FASAB busily rearranging the deck chairs and warn them of the looming danger that could cause serious damage to the ship and ruin the well-thought-out plans of the passengers. FASAB is nonplussed: "Yes, we are aware of what you call an iceberg. But, our research indicates that it contains some other elements besides hydrogen and oxygen, so technically, it 's not really an iceberg."

"Well, don't you think you should tell the captain?" Alan and Dave ask.

"Oh, the captain and crew know about it." FASAB says.

"Why don't they do something about it then?" Alan and Dave say.

"Because," FASAB observes "they want the passengers to be happy, and changing course would delay the planned arrival, the passengers might get upset and want to replace the captain and crew."

Alan and Dave become even more concerned and say to FASAB "Well then, <u>you</u> need to alert the passengers to the danger ahead and its implications so that they can compel the captain to take appropriate action before it's too late, or at least, enable the passengers to change their plans in anticipation of the collision. The longer we delay taking corrective actions, the greater the damage will be."

"But, we have already told the passengers." FASAB says, "See right here, on page 198 of the cruise handbook. See right down here in the small print. We even have several graphs that show exactly where and when we will hit the object, based on our current course and speed. By the way, do you think the earmarked and fiduciary deckchairs look better facing toward the sun or away from the sun?"

Thank you for indulging my sense of humor about what I think is a very serious topic.

Let's step out of the twilight zone. The initial impact is just a short 14 years away. When it happens, you can bet that there will be politicians and critics looking for someone to blame. I predict that many will blame FASAB. "FASAB established GAAP," they will declare, "and FASAB consistently told us that this was, in fact, not a liability. They should have warned us years ago."

Thank you for giving me, on behalf of the Institute, the time to speak. We will be happy try to respond to your questions.

Mr. Anania noted that the Board is looking at social insurance as a separate project. He said that Mr. Cotton seems to be chiding the Board on the fact that the Board identifies it as an earmarked fund. Mr. Cotton said that this was correct. Mr. Anania asked what was the harm in identifying it as an earmarked fund, if in fact the Board has a full-scale project looking at social insurance separately. Mr. Cotton said the harm was not so much in the accounting for it as an earmarked fund but rather in the description of it as non-fiduciary. In Mr. Cotton's personal opinion, there is a fiduciary component to social insurance, and he believes that is the position that the Board took in 1999.

Mr. Anania asked if the objection was to the fact that the fiduciary activities ED was silent on social insurance. Mr. Cotton replied that the fiduciary ED was not silent on social insurance but that it cites social insurance as an example of something that is non-fiduciary in nature. Mr. Anania agreed, and asked Mr. Cotton if he thought that identifying social insurance as non-fiduciary, but rather earmarked was sending a bad signal at this point. Mr. Cotton said that he thought that that position was taking the Board away from the position it took in SFFAS No. 17, that social insurance was a hybrid type of program. Mr. Anania replied that at the current time, since the Board was looking at social insurance separately, that the best answer is to remain silent in both of those documents, and simply say that social insurance is a separate project and would be dealt with accordingly. Mr. Cotton agreed with this suggestion.

Mr. Anania said he was trying to understand Mr. Cotton's position in why he was so concerned about the signals in the fiduciary activities and earmarked funds EDs, since at least in his view, the Board thought it was not important in those documents, because social insurance is being studied in a separate project. Mr. Cotton replied that the fiduciary activities and earmarked funds EDs should not put any boundaries on what the results of the social insurance project might be.

Ms. Cohen said that she was not familiar with the Institute for Truth in Accounting and asked Mr. Cotton to tell her about some of its activities. Mr. Cotton said that he had read the organization's mission statement, and that it was a relatively new organization founded by Sheila Weinberger. Ms. Weinberger is a legislative assistant to Congressman Mark Kirk from Illinois. The basic mission is focused on what the financial statements of the Federal government should contain, particularly on issues such as social insurance. The activities have been rather limited, until now. Ms. Cohen acknowledged Mr. Cotton's statement that Ms. Weinberger is a Congressional staffer, but Mr. Cotton clarified that Ms. Weinberger was not on the payroll of Congressman Kirk. Ms. Weinberger is an unpaid legislative assistant, a CPA from northern Illinois who focuses on Federal financial accounting.

Ms. Cohen noted that Mr. Cotton expressed disappointment that no one from Congress responded to the EDs. Ms. Cohen said that since Ms. Weinberger would appear to have a connection with Congress, did she encourage Congressman Kirk to respond? Mr. Cotton replied that although Ms. Weinberger has discussed the issue with

Congressman Kirk, the Institute did not decide to respond to the ED until recently, and in fact missed the deadline.

Mr. Mosso said that as the Board goes forward with the social insurance project, particularly in deciding whether a liability should be booked, the Board hoped that the Institute would provide some input. Mr. Cotton replied that the Institute was very interested in that project, and would like to become as involved as the Board will permit. He asked if Ms. Comes had talked to the Board about the new Federal committee that had been formed. Ms. Comes said that Mr. Cotton had recently become aware of the fact that the AICPA would no longer be able to allocate resources to sponsor comment letters on each and has arranged for the Greater Washington Society of CPAs to sponsor a group to provide comment letters to the Board. The group is going to be chaired by Dan Kovlak from KPMG. Ms. Comes believes that Mr. Kovlak has begun to populate the group with members, and that the approach will be to provide the comments of the group, but not a majority view. He said that the group's first meeting is scheduled for March 18, 2004.

Mr. Farrell asked if Mr. Cotton thought that FASAB weighing in on whether Social Security is a liability would have a significant impact on decision-makers. Mr. Farrell said that he wants to do what's right from an accounting perspective, but doesn't know if there are a lot of people out there listening.

Mr. Cotton replied that no one is looking at the financial statements yet, because they don't have a clean opinion. He said that in his opinion, the clean opinion is not far off. He that it's very important that we get this promised commitment, which David Walker calls "implicit exposure" into the accounting equation: make it assets less liabilities, less implicit exposure under current law equals net position." It's in the footnote. SFFAS 17 did a pretty good job of defining whatever information needs to be in the footnote. But until it gets into the accounting equation, we don't know whether we've gone backward of forward from one year to the next. Mr. Cotton said that he hoped that it would reach a point where the financial statements would have an impact on decision-making, and that budgetary information would be in the background. When we get there, he wants the financial statements to be complete. This is why he is pushing the issue to the Board.

Board Discussion after Testimony

Mr. Mosso asked the Board what follow-up they want regarding the testimony on earmarked funds.

Ms. Comes said that it was clear that Board needed to follow up on some of the definitional issues that had been identified. Ms. Comes said that the DOI's letter was not explicit about the lack of alignment. She said that the table was intended to show the how the definition generally relates to other OMB categories.

Ms. Comes asked if OMB formally defines "earmarked funds." Mr. Kilpatrick (staff support for the Office of Management and Budget) said that he doesn't know what difference Ms. Carey was referring to. He said that it might be worthwhile to ask her. Staff said that OMB Circular A-11 does not define “earmarked” in the Glossary. However, the word “earmarked” does occur it A-11’s definition of “trust fund” which is “a type of account, designated by law as a trust fund, for receipts or offsetting receipts earmarked for specific purposes and the expenditure of these receipts.” Ms. Cohen said that it is her understanding that when appropriations go to agencies, Congressional members can put an “earmark” for certain projects. She assumed that this was the term “earmarked” that Ms. Carey was referring to. Staff said that the House of Representatives website defined “earmarked” as mandatory spending for specific items. Ms. Cohen said that that was what she was referring to. Staff said that groups like “Citizens Against Government Waste” referred to earmarked spending as “pork.” Mr. Kilpatrick said that “earmarked” is used in that very different sense, but that Ms. Carey seemed to be referring to the other (Circular A-11) use of the term, in a more generic sense. Mr. Kilpatrick said that the latter use of the term was such a big difference that there would probably not be confusion.

Mr. Patton said that the survey on the guidance for the word “significant” seemed to indicate that there was a need for further guidance. He said that some people think it’s identical to “material” and some think otherwise. He said that if we were going to use a different word, we should provide guidance on what it means. Mr. Anania said that the Board just used the word “significant” in the latest ballot regarding the SSI statement and significant assumptions.

Staff said that paragraph 19 of the Earmarked Funds ED said that every penny of earmarked funds had to be accounted for. She quoted, “Information for immaterial funds may be aggregated, but must be provided even if the aggregate total is immaterial.” Ms. Comes said that this is because the lines must add to the total.

Ms. Boutelle (DoD DCFO) referred to the list of earmarked and possible earmarked funds that DOI had presented, and asked if all of those must have separate lines. Mr. Patton said that there would be a separate column rather than separate lines, and referred the Board to page 29 of the ED. Staff noted that after the first year, comparative statements would show four columns, and that the Statement of Net Cost would also be impacted. Mr. Patton said that the information could also be stacked. Ms. Comes agreed that there would be time for the staff to put together mock-ups of how the information would look.

Mr. Anania said that the Board agrees to consider either better defining the term “earmarked” or changing it.

Mr. Mosso asked about the Balance Sheet and the Statement of Operations. Mr. Patton said that the essential nature of the split is important, and that research shows that readers put more weight on what is shown on the face of the statements than in the notes. Mr. Farrell said that the statement disclosure could show the “reserved” balance in the Statement of Net Position, and refer the reader to the notes for explanation and detail. Mr. Patton said that the end of the period might not be typical of during the period.

Staff said that the notes would need to explain what the information is and what it means. Mr. Farrell said that currently the readers have nothing at all. For example, it would say, "We've been collecting Highway Trust Fund" money from you. Here's the balance that we have available to spend fixing your highways." He said that it probably would take some explanation initially, but that right now it's just lumped in with the general fund of the Department of Transportation.

Ms. Cohen said that the Board did spend significant time talking about the appropriate term for earmarked funds. Mr. Mosso said that he is reluctant to re-open that discussion unless the discrepancy Ms. Carey described is confirmed to exist.

Mr. Anania asked if it was a question of explaining the various uses of the term "earmarked," in addition to the definition in the ED.

Ms. Comes said that later in the ED the Board explains how it typically should relate to the budget use. Mr. Kilpatrick said that OMB uses it in both ways (designated spending of appropriations, and restricted resources from collections). Ms. Comes said that the FASAB definition would typically align with the latter, but that there would be some exceptions to that alignment. Mr. Kilpatrick said that FASAB's definition was a third definition, according to his understanding of Ms. Carey's statement. Mr. Mosso agreed. Mr. Kilpatrick said that it appeared to be an overlapping category with OMB's use of the term.

Mr. Patton asked if there was any response to Mr. Cotton's recommendation to separate Social Security out of the Earmarked Funds project. Mr. Anania said that Mr. Cotton stated that Social Security was fiduciary in addition to earmarked in nature.

Mr. Jacobson said that Mr. Cotton indicated that although Congress could at any time change the law, at the date of the financial statements there was a law on the books, and a liability based upon that law to pay a stream of benefits to a class of people. The difference between this and the Highway Trust Fund is that with the Highway Trust Fund, there is no predefined allocation of those funds to future highway projects.

Mr. Mosso said that he thinks Mr. Cotton is correct on one point, which the Board might consider. He said that the public perception is probably that there is a fiduciary obligation. Mr. Mosso said that if the Fiduciary Activities explicitly excludes Social Security, perhaps it should be elaborated that Social Security has a fiduciary obligation in the broad sense of the term, but not in the narrow sense of the ED definition.

Mr. Jacobson asked if the Earmarked Funds ED should not say that Social Security is an earmarked fund. Mr. Anania noted that Social Security is in the unified budget, so is it an earmarked fund or not?

Staff asked if the Board would want to consider whether both the Fiduciary and Earmarked standards should simply refer to the Social Insurance standard.
Mr. Jacobson noted that paragraph 41 of the ED goes into more detail about Social Security.

Ms. Comes said that at the next meeting, the Board could expect that the Board expect to see recommendations and options, but not a proposal to vote a final statement.

Staff asked a question of the Board for general background relating to earmarked funds. She noted that paragraph 13 of the ED states that “legislation establishing earmarked funds reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose.” She said that she was surprised to see the GAO Report, Federal Trust Funds and Other Earmarked Funds” in the Transparency section (page 38) express almost the opposite idea. It said, “Some believe that the government has a greater commitment to carry out an activity financed by a trust fund [which in the report includes earmarked funds] than its commitment to other government activities. This is not true.” “Contrary to what many citizens may believe, the absence or presence of a trust fund does not necessarily represent the strength of the government’s commitment to a particular activity.” It goes on to say, “Earmarking does not confer any permanent, unchangeable benefits to a program.”

Mr. Farrell said that the statements were not inconsistent, and that earmarking does not indicate a greater commitment to use the earmarked money that way. He said that the ED simply wants to give greater visibility to the earmarked funds. Mr. Anania said that some could say that the statement in the ED is too strong. Mr. Patton said that paragraph 10 emphasizes that earmarked funds can retain funds beyond the current period of time, while general appropriated funds cannot. He said that if earmarked funds were withdrawn and used for something else, it has to be disclosed. He said that paragraph 13 indicates a longer commitment, not a stronger commitment. He said that earmarked funds deal with a revenue stream in and out over long periods of time. He said that the commitment is not so “strong” that Congress can’t adjust it over time. Mr. Mosso agreed that there were no irreconcilable differences between the ED and the GAO report.

Conclusions- Earmarked Funds

Definition: FASAB staff will follow up with OMB and DOI to determine whether the ED defines earmarked funds differently from OMB.

Accounting Standard: FASAB staff will draft language providing additional guidance on “significant” in paragraph 20.

Display: FASAB staff will follow up with Treasury to determine if the U.S. Government-Wide financial reporting in Appendix C is accurate, or if the virtually all of the flows would be eliminated on the government-wide financial statements.

In addition, staff plans to list other issues raised in the comment letters and provide recommendations for the Board's consideration.

Adjournment

The meeting adjourned at 2:30 PM.