

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
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Wednesday, April 28, 2004

Administrative Matters

- **Attendance**

The following members were present: Chairman Mosso, Messrs, Anania, Calder, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen. Ms. Robinson attended from 9:00 AM to 1:30 PM on April 29th.

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

- **Steering Committee Meeting**

AICPA Rule 203 Review Panel Discussion

Chairman Mosso explained that this was a Steering Committee meeting and the Board would actually be receiving an update from the AICPA Rule 203 Review Panel on progress regarding the October 2004 sunset review of FASAB. He then welcomed Mr. Gary Previts, Chair, AICPA FASAB Rule 203 Review Panel, to the Board meeting.

Mr. Previts explained that Mr. Ian McKay (Director of Professional Standards and Services) and Mr. Pete Smith (representative from the Private Sector Council) accompanied him today, as they were both heavily involved in the review process since it began in June 2003. Mr. Previts thanked the Board for the opportunity to meet with them as they are near completing their process as a panel that was appointed by the Board of Directors of the AICPA. Mr. Previts explained that they have received support from the Board of Directors for the resolution that had been previously shared with FASAB.

Mr. Previts further explained that there are a number of documents involved in the conclusion of the process and the carry forward of the process. For example, he explained that an Accomplishments and Aspirations document was circulated. He added that the document allowed the members of the review panel to frame up some comments noted during the process and things to consider moving forward. Mr. Previts also referred to the conclusions and recommendations developed by the review panel and included in a January 8 letter to the FASAB Sponsors.

Mr. Previts noted that several FASAB Board members were involved during the first review process. Mr. Previts explained that there was an extraordinary amount of interest and goodwill and good faith that permitted FASAB to move forward from the October 1999 period. He further explained that since the 1999 AICPA review, the FASAB and its Sponsors have taken numerous and substantive positive actions in response to previous AICPA recommendations, and have taken other actions on their own to enhance the FASAB's structure and operations. Mr. Previts detailed that these actions included revisions to the Memorandum of Understanding (MOU), which established a majority of non-government members on the FASAB and eliminated the Treasury's approval authority; creation of an Appointments Panel with non-government representation; and other enhancements to the FASAB's rules of procedures. He noted that FASAB was tasked to implement the recommendations with the understanding that a subsequent review would take place. Mr. Previts explained that the review panel is in the same mode now.

Mr. Previts explained that the review panel wanted to complete its work prior to FASAB's authority expiring in October. He added that the review panel went to the Board of Directors in April and will go to the Council in May so the

recommendation can be put in place with the hope that FASAB's authority will continue seamlessly, and also with the hope that the recommendations will be addressed and followed up on, just as the process was the last time.

Mr. Previts explained that there were a total of five recommendations, with one recommendation relating to an Oversight Committee being more significant than the others. Mr. Previts explained that he hoped to review the January 8th recommendations with the Steering Committee. He added that the recommendations the panel made (on pages 2 and 3 of the January 8 letter) relate to matters ranging from the structure of the MOU with regard to Treasury's approval authority, rules of procedure, the Accounting and Auditing Policy Committee, and the location of FASAB Board meetings.

Mr. Previts noted that the FASAB Board with all the standards that it is administering, the new standards that it is working on, as well as the conceptual framework project, is going through a very important period and the review panel is very much aware of the fact that adding additional costs of any type may delay the process and would not be welcome. He added that what would be appreciated is some feedback or questions on the recommendations provided as this is an information session, not a decision-making session.

He explained that it would be helpful as the follow-on procedure occurs and the schedule of the next review is anticipated, that it might be better communicated to the Steering Committee that the recommendations are ones which they hope will complete the process and give serious consideration so that when the next 5 year review does occur, it will go relatively well.

Mr. Previts explained that the Council-approved criteria for the review were independence, due process and standards, domain and authority, human and financial resources, and comprehensiveness and consistency.

Mr. McKay explained that the letter indicates that a lot of good has come about in this process in the last six years (including the initial Rule 203 review and the current review panel). He added that the accomplishments of FASAB and with its own structure are well received and well respected. Mr. McKay noted that FASAB has come a long way and that this process will continue to evolve and bring about continued improvements.

Mr. Previts explained that the review panel hopes to leave the Steering Committee with the understanding that the recommendations included in the January 8 letter are important. He explained that the review panel recognizes FASAB's authorities, both the Constitutional and Federal Advisory Committees Act [FACA] authorities, and asked that the Board recognize that the recommendations reflect upon their responsibilities and authorities, which are to the governing council, the AICPA, the Board, and the members. He added that FASAB's focus is naturally on setting standards for the federal government, but that FASAB must also consider that this includes setting standards for the

accounting profession. Mr. Previts explained that with the public-private partnership, we must come together to discuss the experiences with the peer panels and peer standard-setters, who are important, to make this process as strong and independent in fact and in appearance as possible.

Mr. Previts explained that they have had, and continue to have, an interest in seeing this process go forward successfully. He further explained that the panel is aware that the Board is the construct of many individual authorities that exist by the nature of our government.

Mr. Previts explained that they would be happy to answer any questions that the Steering Committee may have or wish to inquire from them about.

The Chairman thanked the review panel for the overview and status of the review and explained that FASAB appreciates all the efforts of the panel. He added that FASAB has benefited from the process and there have been steady improvements. The Chairman noted that Mr. Previts found that one recommendation was more important than the others and asked if he was referring to the first recommendation— *Enhancing the governance of the FASAB by means of establishing an Oversight Panel consonant with other peer Rule 203 standard-setting bodies.*

Mr. Previts explained that there is nothing inherent in the review panel's charge to make a recommendation of that type, yet he believes it is incumbent upon them in looking upon the importance of FASAB going forward to provide a reasonable option for a way of reducing, eliminating, or substituting for a 5-year review process. He further explained that in the panel discussions it appeared that there could be a way that the AICPA Board and Council could essentially extend the Rule 203 authority indefinitely--with some fail-safe, fatal flaw exception going forward so that the 5-year reviews could be discontinued. He added that at the same time, they do realize that there are some folks that believe that the 5-year review is a good idea.

Mr. Previts explained that as the review panel looked at the administrative process and the part-time nature of the Board, the fact that all involved are making heroic efforts to continue to sustain the efforts of the Board. He added that when looking at peer organizations and comparing it to the size of the Board's large domain and the fact that it is a growing domain, there are significant issues and considerations. Mr. Previts explained that the Governance recommendation was a good faith effort by the review panel that might permit the elimination of the 5-year review process. Mr. Previts explained that he believes that there is the opportunity to accomplish this and make this recommendation work, considering the experience and nature of the Board as well as the members of the review panel. He fears that in the future the opportunity to install something more permanent may be lost as there may not be review panel members with the depth of FASAB history. Mr. Previts explained that the language in the proposed charter and the outline of the proposed activities are

just suggested language, but it represents a concept that would certainly be befitting to a board of this stature to consider as another way of conducting its business without interfering with the rights of each of the signature authority sponsors of the MOU.

Mr. Previts explained that he believed the other recommendations were less difficult to implement. He added that he did not want to trivialize the other recommendations by just focusing on the Governance recommendation because the other recommendations are important. Mr. Previts explained that there are some rules of procedure issues and matters relating to the MOU regarding Treasury's approval authority over FASAB interpretations and technical releases. He also explained that the FASAB Board is more visible and the appearance issues regarding independence will be very important moving forward. Mr. Previts explained that the review panel put a lot of effort in trying to come up with a good faith proposal for the governance facility that would not interfere with the prerogatives of the Sponsors.

Mr. Mosso asked if any of the Board Members had questions for the review panel representatives.

Mr. Calder explained that he believed the benefits to FASAB from the reviews have been substantial and he does believe that the 5-year review process is very useful. He added that he believes the recommendations are good and deserve consideration. However, he is not certain if he likes the idea of the recommended Oversight Panel over the 5-year review that is currently being done. Mr. Calder explained that he did discuss the matter with Comptroller General Walker and it is not as if the idea has been totally dismissed, it is still an idea that could happen at some point in time. He added that the other recommendations are much easier to implement and some have actually been implemented or are in the process of being implemented and that all of them will certainly be considered.

Chairman Mosso noted that the recommendation to *Eliminate ex-officio member positions on the FASAB* has been accomplished.

Mr. Reid stated that he concurred with everything that Mr. Calder said. He added that he believed the recommendations five years ago were very instrumental in moving forward and providing a strong authoritative source.

Mr. Zavada thanked Mr. Previts and the review panel for their work and noted that a lot of good progress resulted from the previous review. He added that the Steering Committee would consider the new recommendations.

Mr. Calder asked if the review panel believes that we are in a time when the independence of all three Boards (FASB, GASB, and FASAB) is changing. He noted that GASB is struggling to find support and looking for support from the largest block of those that they regulate and we have FASB, which has gone

from public support to a tax on those whom it regulates. Mr. Previts explained that was a very appropriate question—one that is historical and philosophical, considering that strategically, identification of those kinds of options and contingencies are important to the operation and success to the FASAB Board.

Mr. Previts noted that FASAB is the youngest of the accounting standard-setting Boards, which has the least obvious forms of oversight, such as JFMIP and the Sponsors, that provide active awareness of the implications of the standards. He noted that there is also the whole issue of international standard setting. Mr. Previts explained that the trade-off between efficiency and fairness is in the midst of all this. The efficiency arguments are that clearly the resources that are out there for investment and for other uses (whether for public goods or private goods) and the appearance that the people will trust the markets, that's all in question, with the tax structure in the middle of it. Mr. Previts explained that he believed the FASAB Board would be absolutely vital for the well-being of the credibility of budgeting and taxes as this is a performance review function.

Mr. Previts explained that he did not believe FASAB could quite compare itself to the other standard-setting Boards yet. He noted that once the first government-wide financial statement is fully complete (including the Department of Defense, which may be several years out) FASAB will have reached a point to say what they are all about. FASAB will then have an important technical accounting accomplishment, as well as something that may influence the way in which people evaluate performance. Mr. Previts explained that he did not believe the FASAB Board has yet reached its full operating capacity and that is why the recommendations from the review panel are ones that would assist the Board on its road to maturity.

Mr. Previts also explained that he did not believe the analogy of comparing FASAB to FASB and GASB are quite the same. He added that FASAB is fully funded and with a snap of a finger, the three Principals could decide to dissolve FASAB and 120 days later there would be no FASAB Board. He also noted that if the FACA Officer decided to leave the meeting, technically the FASAB Meeting is over. Mr. Previts further explained that if those in opposition to the FASAB Board wanted to attack the Board, they would do so on the basis of its independence. He added that although the Board has sovereignty and all the due process that the law allows, but it is for a private sector/public sector combination where the Board is setting accounting standards for the federal government and the accounting profession and it is a real challenge for them to be dealing in this public/private partnership.

Mr. McKay added in response to Mr. Calder's question regarding the independence issue, by explaining that independence has changed dynamics across the profession. He explained that as it relates to the FASB and GASB, there is a role for a governance body there as well— such as the Financial Accounting Foundation (FAF). In fact, a lot of the thinking of the review panel did compare FASAB with the peer standard-setting bodies and look at analogies,

especially with the notion of the governance body. The review panel believed something comparable at FASAB could have similar objectives and missions that could exercise those types of independence decisions, working within the current framework of the Principals. Mr. McKay reiterated that the independence issue does exist across all standard-setting bodies, both accounting and auditing, and it is on the fore-front of any standard-setting body in the profession; however, there is a role for a governing body to play vis-a-vis the standard setting body itself in dealing with those issues.

Mr. Mosso explained that although this discussion is part of the Steering Committee Meeting, there are 4 other Board Members present and they are welcome to ask questions if they like.

Mr. Anania requested that the recommendation specific to the governance body be read as he had not seen the January 8 letter. Mr. Previts stated that we would read all of the recommendations. Mr. Previts read the following, which was also put on the screen from page 3 of the January 8 letter:

“The Review Panel also notes that certain Sponsor authorities that bear upon the review criteria have been represented to us by the Sponsors as being necessary and consistent with the constitutional powers vested in the executive and legislative branches of the Federal government, or were established under the Federal Advisory Committees Act [FACA]. Currently, two Sponsors, the OMB and GAO, representing a check and balance between executive and legislative branches, have final authority to object to concepts and standards promulgated by the FASAB. Further the OMB has authority to prescribe form and content of federal financial statements, and may unilaterally elect to direct agencies to depart from generally accepted accounting principles; for example, by delaying the implementation date of an existing standard. The Review Panel recognizes that these authorities have not been exercised by either Sponsor, and would deem any objection or unilateral action to severely diminish the FASAB’s independence and impact its Rule 203 status.

The Review Panel believes that the following steps would address the issues above relating to the FASAB’s independence as well as its due process and operational and strategic matters.

- Enhancing the governance of the FASAB by means of establishing an Oversight Panel consonant with other peer Rule 203 standard-setting bodies. Further details regarding an Oversight Panel and a proposed charter are presented in an attachment to this letter.
- Eliminating the Treasury’s approval authority over FASAB interpretations and technical releases to provide clarity and consistency of authority with the elimination of Treasury’s approval authority over FASAB standards.
- Establishing the FASAB’s authority to approve technical releases in the FASAB’s Rule of Procedure.

- Eliminating ex-officio member positions on the FASAB.
- Holding FASAB meetings at various locations to enhance FASAB’s outreach and visibility.”

Mr. Previts explained that the recommendation specific to enhancing the governance is one of five recommendations made by the review panel. He also explained that the January 8 letter contained a Proposed FASAB Oversight Panel Charter as a model to address this activity. The proposal identifies responsibilities of the panel, the appointment process through the Sponsors, and a modest budget of \$50,000 per annum. He added that he believed that this was as far as the review panel would have a right to take this matter—it is a pro forma idea, but it does address the issue of the fragile nature of the independence and the composition, formation, and existence of the Board. Mr. Previts commented that the FASAB is such a powerfully important Board, with work that is very important.

Mr. Anania commented that he would like to wait and hear what the Chairman and the Steering Committee have to say about the recommendations before offering personal comments. However, he did offer that he would like to see more understanding of what the Board does and more visibility to the Board, and perhaps that could come through adopting some of the recommendations. Mr. Previts agreed and stated that outreach is very important.

The Executive Director, Ms. Comes, explained that she wanted to pass on a comment from the former DOD ex-officio member, Ms. Boutelle. She explained that Ms. Boutelle had submitted her resignation from the Board in light of the AICPA review panel’s recommendation that FASAB eliminate the ex-officio Board member positions. Ms. Comes stated that Ms. Boutelle did want to convey her appreciation for the opportunity to work with the Board and that she will continue to provide input through the normal due process.

The Chairman thanked the review panel for coming to address the Board. Mr. Previts thanked the Board for the opportunity and wished the Board the best with continuing their important efforts.

Agenda Topics

- **Concepts – Objectives**

Mr. Bramlett opened the discussion by reviewing the Board’s conclusions in March, when the tentative discussion had indicated that some members would like to amend the “Systems and Control” objective to preclude any inference that the Board should or would define certain assertions about systems and control to

be an integral part of the basic financial statements. The March discussion had concluded as follows:

1. 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. 2. 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, and then scope down to what we see our role to be, both for stewardship and for systems and control. 3. Mr. Reid asked for more discussion of the purpose of Objectives: are they to guide the Board or to describe something broader? 4. Ms. Robinson said that when we consider stewardship, she would like more discussion about the relationship and difference between financial reporting and the budget.

Pursuant to that discussion, the staff memo for April presented three alternatives for amending paragraph 150 of SFFAC 1, with several hypothetical rationales for the third alternative.¹

Mr. Zavada reported that the CFO Council is surveying existing requirements regarding systems and control reporting. The Council's next step will be to look at the existing audit coverage and assess the appropriate level of coverage. Also, proposed legislation for the Department of Homeland Security would define a process in which GAO would have an opportunity to weigh in.

Mr. Bramlett pointed to paragraph 7 of SFFAC 1 (and similar language elsewhere) as an example of language that might need to be modified, or interpreted differently now than when it was written, in light of changed

¹ The three alternatives were: (1) minimal change to clarify current status of management's assertions on systems and control, without implication about future status; (2) preserve option to elevate status of management's assertions on systems and control; (3) eliminate option to elevate status of management's assertions on systems and control. The hypothetical rationales for alternative 3 were: (1) nature of "basic" information required by accounting standards limited to recognition and measurement on the face of the financial statements; (2) nature of "basic" information required by accounting standards limited to what has been customary business practice; (3) pre-emption by law; (4) comparative advantage; (5) definition of "general purpose" financial reporting; (6) essential relationship to an organizing concept such as financial condition, financial position, specified elements of financial reporting, specified decision models, legal mandates or organizational needs, members' personal expertise, etc

relationships among the Board and its sponsors and the current Board members' perspectives on the role of FASAB and the role of *Objectives*.²

Mr. Anania said that the Board should consider what its role should be, and then see how the language should be modified or adjusted. Regarding internal controls, one way of looking at it is to say, "If existing requirements and procedures are adequate, what more is there for FASAB to do?" Another way of looking at it would be to say that we have to be the AICPA and Sarbanes-Oxley of federal reporting. Currently, he sees things the first way and wonders what more there is for FASAB to do.

Mr. Mosso said there might be a middle ground. We could let the objectives stand. Mr. Reid said that the area is changing rapidly; depending on where it winds up, there might be some positions we might want to take in the future, if we have concerns about fair presentation.

Mr. Schumacher said that he thinks FASAB should play a role. In the private sector, the governing bodies did not act, with results that were obvious. He agrees with leaving us an option to take a stand if it seems desirable. That is why he likes alternative 2 [preserve option to elevate status of management's assertions on systems and control].

Mr. Reid observed that such hypothetical future action might be something specific, rather than a global requirement for management's assertions on internal control. We might want to address certain deficiencies on a standard-by-standard basis. In general, however, he believes that it is management's responsibility to assure adequate controls to assure fair presentation.

Mr. Zavada said he was thinking more along the lines of alternative 1 [minimal change to clarify current status of management's assertions on systems and control, without implication about future status] or alternative 3 [eliminate option to elevate status of management's assertions on systems and control]. This would be more along the lines of traditional financial reporting as prescribed by FASB and GASB. Reporting on internal control seems to go beyond the role of FASAB. In light of that consideration, coupled with the activities to address the issue currently underway, he does not see a need for FASAB to get into the issue.

² "7. The Department of the Treasury, the Office of Management and Budget, and the General Accounting Office expect that, to the extent possible, their reporting requirements will be aligned with the Board's objectives and standards."

Mr. Patton said, “Wouldn’t an alternative be to just drop the objective? If you say there is no reason for FASAB to get into it, it seems more of a distraction than anything else.” Mr. Zavada agreed. Mr. Patton said that the fundamental question is the one posed by Mr. Reid about the purpose of *Objectives*: to guide the Board or to describe something broader? To leave the objective in would leave us where we started. We have enough trouble setting standards for general purpose financial reporting, without delving into areas where others have more skill, more experience, and an incentive to do a good job.

Mr. Anania said that, rather than eliminate the discussion entirely, he would acknowledge the importance of sound internal control, but not to make it part of our responsibility.

Mr. Bramlett said that he understood the reference to “skill set” as part of the rationale articulated for the change. He asked whether one could infer from the members’ comments that they also perceived another rationale, i.e., some concept of what constitutes a “general purpose financial report” or some concept of the proper domain of FASAB’s activity? Did it have to do with “fairly presenting” financial position, or net assets, or some other financial concept? Put another way, is there a reason, other than the current members’ experience and knowledge, why reporting on internal control is inherently not part of FASAB’s concern?

Mr. Patton said that FMFIA and FFMIA have been around for some time, so there is already someone doing that. It is not clear why we need be involved. Mr. Mosso observed that in light of continued deficiencies, it might not be clear whether someone is already taking care of it. Mr. Anania said that is why it is dangerous for us to have such a broad statement of objectives: it implies that FASAB is to some extent responsible for fixing such problems. It sounds as if the problem is covered; yet we don’t deal with it directly.

Mr. Bramlett asked, “conceptually, what is the reason that leads Board members to say that by definition reporting on internal control is outside the scope of the Board’s activity?” Mr. Reid said it goes back to a distinction between what is derived versus what is explicit. Internal controls are necessary to achieve accuracy in the numbers presented. Without internal controls, managers cannot be certain that they have achieved fair presentation. If, as a manager, I need to report this number, then I know that to be comfortable with its accuracy I need to do certain things. That is a management concern. Mr. Reid can envision a standard being a straightjacket that would not make sense from a business standpoint; the standard might upset the balance of prioritization. Therefore, because concern with internal control is a derived concern, it is not a direct, explicit objective for the Board.

At the same time, he can see how one could make an argument the other way. Because Sarbanes-Oxley means that auditors will be attesting to controls over financial reporting when they audit the financial statements of SEC registrants, one could say that the [federal] standard setter should set standards that cover this too. If the CFO Council project leads to a conclusion that we need to have an auditor's opinion on controls, how do the auditors determine that? Is there then a need for an accounting standard? Perhaps we might need to say something about it. Thus, he would like to see how the project evolves, before making a final judgment.

Mr. Zavada observed that there are some standards for internal control now, in the form of GAO's "Green Book."³ He reminded the Board that at the last meeting we discussed the "indirect approach" to dealing with the systems and control objective. He did not see anything in the staff memo about the indirect approach. Mr. Bramlett explained that the "systems and control" objective SFFAC 1 already includes some language about the indirect effect; he had understood the Board's concern to relate to possible inference that FASAB might also directly deal with the objective by requiring management assertions about systems and control as an integral part of the financial statements.

Mr. Mosso said that perhaps he had not focused adequately on some of the language in SFFAC 1 that suggests the *Objectives* might describe objectives for, and guide actions of, agencies other than FASAB. Perhaps we could emphasize that more, explain what else is going on regarding direct reporting on systems and control, and make it clear that we need not necessarily do any thing more than that.

Mr. Patton said *Objectives* is to guide the Board in developing standards. If systems and control is an objective, you cannot give it a zero weight. But it would seem a sidebar to ask, in FASAB's deliberations, whether a standard would improve understanding of systems and control. Board members would invoke the systems objective to support something they supported anyway for other reasons. . He recalls assertions about effects on internal control during deliberations, but not evidence.

Mr. Anania said for Stewardship and for Systems and Controls, he would like Objectives to scope down to what we see our role to be. He does not object to stating the broader notion, but would scope down. He does not want to rely on the indirect effect. We need to be more specific. It is troubling to have broad objectives that sound like we should be doing more. We can say that based on

³ *Standards for Internal Control in the Federal Government*. [GAO/AIMD-00-21.3.1](#)
November 1999

current laws in place, current requirements that exist, this is how we see our role. Mr. Patton agreed.

Mr. Schumacher asked Mr. Anania, "What is our role?" Mr. Anania asked, "Isn't it our role to be aware of what is being done, but not to take responsibility for the fact that systems and control deficiencies remain year after year?" "We observe, we talk about it, but I don't see us taking any actions to deal with ongoing control weaknesses at large agencies."

Mr. Calder said, "What they are doing is not adequate."

Mr. Reid said he would argue that the fact a weakness is disclosed shows that the system or requirement is effective. Mr. Anania said, "We didn't have anything to do with that disclosure." "Depending on how you look at it, in some cases we did," Mr. Reid said. "The accounting standard is something against which the agencies accounting can be measured; our job is done." He would be more concerned about problems that have not been disclosed. That is a difficult thing to do.

Mr. Zavada said that accelerating the reporting schedule to 45 days would force changes and improvements in accounting systems, with a reduction in material weaknesses. Mr. Reid noted that, in addition to the acceleration, quarterly statements would be required; this will improve the quality of the numbers. "It is a real change in business process," Mr. Zavada said.

Mr. Patton said that he salutes that development, but he was trying to make the link back to FASAB and *Objectives*. How does that help him choose among possible accounting standards?

Mr. Anania mentioned some past GAO audits of IRS. In some years, in some areas, GAO abandoned its effort because they could not find supporting documentation. One such area was accounts payable. You can have a system that makes necessary payments and generates an amount to report for year-end closing, but have 20% duplicate payments. If so, the fact that you have an amount to report does not mean that you have good internal accounting control. You need assurance that the payments were made for good and valid reasons, that the goods were received, etc. He is not sure whether the Board has a common definition of internal accounting control. If we have something in our objectives, we need a common understanding of it. He does not know how the Board can take that on and be responsible for how that works in the federal government.

Mr. Reid said that was what he meant when he talked about management setting priorities. This becomes very difficult for FASAB to get involved with. On the other hand, the existence of the accounting systems itself is a control.

Mr. Mosso said that he didn't think FASAB had had anything to do with GAO's "Green Book." Mr. Calder agreed.

Mr. Schumacher said that he agreed with what had been said, but at the same time, he did not see how FASAB could entirely carve itself out of the process. That goes back to "alternative 2." What if the Board wanted to issue a standard to elevate or elaborate on the MD&A requirement to discuss internal control?

Mr. Anania said that the FASB has been around for 30 years without addressing internal control in its objectives; yet the FASB is viewed as being one of the premier accounting standard setters. Mr. Bramlett suggested that perhaps government is different in this regard. In the for-profit world, before Sarbanes-Oxley, it was widely assumed that shareholder and management's interests were aligned; it was assumed management had an incentive to make cost/beneficial decisions regarding systems and control on behalf of shareholders. Regardless of whether those assumptions were appropriate for the profit-seeking sector, the situation might be different in government. Mr. Anania said that he didn't mind FASAB taking on broader responsibilities, if we could meet those goals.

Mr. Jacobson asked whether the role of the standard setter changes, once the preparer of the financial statement becomes subject to a requirement to include an assertion about controls, and once the auditor of the financial statement is required to express some kind of opinion on controls? The 1982 FMFIA requirement regarding internal control reporting was crafted at a time when agencies were not preparing audited financial statements. The language of the Act refers to internal accounting and administrative controls, but as implemented over the past 20 years, the scope of FMFIA reporting is certainly broader than controls over financial reporting.

The guidance from OMB, with GAO's concurrence, has referred to "management controls." Sarbanes-Oxley refers to internal controls over financial reporting, suggesting a focus on a subset of the overall controls management is interested in. He quoted from OMB's guidance implementing FMFIA. Mr. Bramlett observed that the authors of FASAB's systems and control objective were aware of the difference in scope, and did not perceive an inconsistency with the OMB guidance, merely a focus on a subset.

Mr. Jacobson suggested that it may be a mistake to assume that the kind of management reporting that has evolved over the years pursuant to FMFIA deals

with something synonymous with reporting on controls over financial reporting, or that an auditor can deal with that reporting in the same way.

“But someone else has a stick,” Mr. Anania said. “There is no real stick,” said Mr. Calder. Mr. Farrell suggested there might be a question about whether the auditor’s report would deal with conformance with the internal control standards per se, or with the management’s assertions. Mr. Jacobson agreed, noting that GAO’s standards are at quite a high level. Mr. Reid observed that there are constitutional and statutory authorities at one or more agencies that underlie almost everything the Board does. This is not any different in that sense from accounting standards. Mr. Zavada said that part of the CFO Council research project is to look at developments since 1982.

Conclusion: Mr. Mosso asked Mr. Bramlett whether he could write up something based on the Board’s discussion. It would not close the door, but would narrow the focus. Mr. Bramlett said he could attempt to do so, but would need to get input from the members before the next meeting. Possibly a synthesis would be feasible, possibly more than one formulation would be necessary.

- **Concepts – Elements**

Elements

Ms. Wardlow reviewed the discussion on elements at the March 2004 meeting. The Board had agreed that assets have these three essential characteristics (without attention to wording):

- a) There exists a (probable) future benefit (or service potential) to the reporting entity.
- b) The reporting entity controls others’ access to the benefit
- c) The transaction or other event giving rise to the reporting entity’s control of the benefit has occurred.

She explained that the goal for the April meeting was to reach agreement on how the essential characteristics and the resulting definition of assets should be worded. In her paper for the Board, she had discussed five issues related to possible key terms for each of the three characteristics.

ISSUE 1. Should essential characteristic a) (and the definition of asset) refer to “economic benefit,” “service potential,” both terms, or neither term?

She said that she wanted to explore the Board members' views regarding use of the terms "economic benefit" and "service potential," "right," and "resource." For example, do the terms economic benefit and service potential mean the same thing or different things? She also wanted to discuss whether some notion of probability should be included in the definition of an asset.

Mr. Reid asked whether the discussion of essential characteristics in an eventual FASAB document might include examples to help ensure a common interpretation. Ms. Wardlow said that could be open to discussion. Some examples could be helpful, but going too far could create boundaries for future Boards. She envisioned an explanation of the terms used in the definition, with a goal of achieving a common understanding on the part of all who read the definition and associated discussion.

Mr. Anania observed that Ms. Wardlow recommended that both terms (economic benefits and service potential) be included in the definition, which he is inclined to favor. He asked her to explain the difference between the terms, based on the research she has done. She indicated that some people believe that "economic benefit" has a private-sector connotation: the idea that sooner or later economic benefit turns into a cash inflow. "Service potential" could be a broader notion and economic benefit a narrower one, although the Australian board saw it the other way round.

Mr. Schumacher asked whether monuments might be an example of an asset that has service potential but not economic benefit in the sense of future cash inflow. Ms. Wardlow and Mr. Anania agreed. Mr. Schumacher indicated that, in that case, both terms would be necessary in the definition.

Ms. Wardlow observed that some people have associated the term "service potential" with capital assets. In government, the entity has capital assets to help provide service, not to earn cash inflow.

Mr. Farrell noted that something could meet the definition of asset but not necessarily need to be measured.

Mr. Mosso asked whether "service potential" could be used alone, and could encompass financial assets as well as capital assets. He finds using two terms somewhat confusing. Ms. Wardlow said, "to me, yes." She thought that service potential is the broader term and encompasses economic benefits. Mr. Mosso noted that FASB used the term "economic benefits" but then went on to say it meant the same thing as "resources" and "service potential." Ms. Wardlow agreed that the FASB used all three terms in the document, which were interchangeable in some places. They did not explain why one term was chosen over the others for the definition itself.

Mr. Patton said that, to an economist, "economic benefits" is a very broad concept; to a non-economist, there is probably more of a financial side to it.

Since the document will be read by non-economists, it may be useful to have the term service potential as well.

Mr. Schumacher asked Ms. Wardlow whether the Government has any assets that would not be covered by “service potential.” Inventories, etc? “You’re fairly well convinced that all assets would be included in the term service potential”? “The way I read it, yes,” she replied. He noted that he was sympathetic to Mr. Mosso’s concern that using both terms might be confusing, and he asked whether service potential alone would be sufficient, and would the term be explained in the document? Ms. Wardlow responded that the terms would need to be explained whether only one or both terms were used. She thought it was even more important to explain the difference between the terms if both terms were used.

Mr. Reid asked whether it would be possible to add a second sentence to the essential characteristic and say, “There exist either future benefits or service potential (or whichever word you like better) to the reporting entity” and then say “Future benefits is broad enough to include. . .” and then list the relevant terms.

Mr. Zavada agreed that using two terms was confusing; he asked whether we could just say “benefit.” Ms. Wardlow saw no problem, if it was accompanied by a suitable explanation.

Mr. Calder asked, “Are we saying that if it is a benefit to a constituent of the Government, it is of benefit to the Government?” Mr. Mosso followed up, “because it would be the Government’s mission to benefit the constituent?” Mr. Calder added, “So there would be no direct benefit but there would be an indirect benefit to the Government”? Ms. Comes noted the need also to consider the entity.

Mr. Farrell said he thinks we are trying to be as inclusive as possible in what we call an asset. Other organizations have come up with the same words, used at different times, but they are all using economic benefit or service potential. He thinks we should not create new words; we should go with what is out there, use two words, and explain them both. He agrees with staff recommendation (a).

Mr. Reid said there is risk of sweeping in too much, rather than not sweeping in enough.

Mr. Mosso agreed that Mr. Farrell had a point; however, his preference would be to use one of the two terms, not both. Mr. Anania said he could live with service potential, but he would dissent to “economic benefits” alone.

Mr. Patton expressed support for “benefits.” Mr. Schumacher would prefer both, but would accept just “service potential.” Mr. Calder prefers both. Mr. Zavada would use “benefits.” Mr. Reid would prefer “future benefits.” Mr. Patton said he assumed “future” was there. Ms. Wardlow said that was an issue for further discussion.

Mr. Phaup suggested “benefits” or both terms, but not “service potential” alone. Ms. Cohen would prefer both. In a way, “service potential” is not meaningful to her without further explanation. Mr. Farrell is for both. If one believes that “economic benefit” has a business connotation and “service potential” relates to public service, the Government does both. Mr. Anania supports using both.

Mr. Mosso said he could live with any of the three options but, to create a majority, he would say “both.”

Ms. Wardlow asked for a clarification of whether “both” meant “service potential” and “benefits” or “service potential” and “*economic* benefits”? Those who preferred benefits agreed that when used with service potential as well, the term economic benefits would be clearer than benefits alone.

ISSUE 2. Should a notion of probability be included in the definition of an asset or only in recognition and measurement criteria?

Ms. Wardlow observed that, of the accounting standards setters whose work she reviewed, only the FASB used the term “probable” in the asset definition itself. Some of them, including the FASB, note that uncertainty surrounds all economic endeavors. Some of them say that they believe the notion of probability belongs in the recognition and measurement criteria, not the definition. Some definitions may imply uncertainty by using terms like “future” economic benefits, or by saying that benefits “may” result. The FASB itself has noted some concerns about having the notion of probability in the definition. The FASB and the International Accounting Standards Board (IASB) are currently considering a joint project to reexamine their respective conceptual frameworks, including the definitions of elements. One issue for consideration is whether to include the word “probable” in the definitions of asset and liability; the IASB does not include the word in its definitions.

Ms. Wardlow noted that whether to include “probable” in the definitions has been an issue for many standard setters, each of which preferred to exclude the word from the definition but make it clear in the text discussion that the assessment of probability would occur as part of a decision about recognition and measurement. In her view, this decision was related to their decision to separate the issues of whether an item meets the definition of an element from whether the item is measurable and recognizable.

Based on that approach, it is possible to have an asset, but not to recognize it for some reason. Mr. Calder agreed. Mr. Patton agreed also, but said that does not necessarily mean that the word “probable” should not appear in the definition. He thinks there are reasons for including the word “probable” in the definition. He asked whether, without the word probable, there would be no lower bound on the probability of an item producing future benefits to qualify as meeting the definition of an asset? The notion of probability is embedded in different definitions in different ways. To ignore that does not seem to make sense. For

example, Canada says, “benefits may be obtained.” Sweden says, “Benefits are expected.” Those words mean different levels of probability. It would be better to make the level of probability explicit in the definition, rather than implicit, and then have a second step concerning measurability, reliability, relevance of that measure, but have some notion that there is a minimum level of probability of the future benefits that is necessary in order for us to say “we have an asset.”

Mr. Mosso asked whether using the phrase “scarce resource” would be a way to imply value, without explicitly setting any upper or lower limit. That would be saying something without saying the value had to be probable, or the benefits had to be probable. He was not necessarily advocating that, but it was one way somebody got around the issue. Ms. Wardlow said that the FASB and other standards setters generally include the idea of scarcity in the discussion of uncertainty rather than in the definition itself or in the characteristics that accompany the definition.

Mr. Mosso cited the example of writing off bad loans as an example where something that may have value is not recognized; it is written off, but there still is a claim and some of those claims are realized. They have assessed the probability as zero when it is not. Mr. Patton said that struck him as a second set of events. Mr. Reid agreed, but said that was a kind of conservative measurement, or taking a conservative view of measurement, rather than examining the issue of is this an asset or not. It is still an asset; they have got the claim. But the expected value is zero or close to zero.

Mr. Reid asked Mr. Patton, “How would you establish these bounds? Does the word ‘probable’ itself do that, or is more needed?” Mr. Patton said FASAB has two definitions of probable in its standards now; we would use one of those. He asked whether a lottery ticket with a one-in-one-billion chance of paying off is an asset. Mr. Mosso said yes. Mr. Phaup said, we had warrants from an airline, and we calculated that it was impossible that they would pay off, but they are worth a lot now. We treated them as an asset in the budget. No specific level of probability is necessary to the definition. Estimation would be illusive.

Mr. Patton asked whether the same would be true of liabilities. Mr. Phaup said, so far as we know, we would expect parallel treatment. Mr. Reid said, first you must get past the two hurdles: What do we put in the sandbox? And then, how do we measure the sand? So, first you say “it is an asset” and then “how do we go about measuring that”?

Mr. Patton asked whether R&D is an asset. We invest in a project that might or might not pay off. Mr. Reid said, “yes.” Mr. Mosso added a reference to options, whose value might be very close to zero, but in today’s world it still is booked if it has any value at all. Mr. Patton said that this would mean the entire burden would be on the recognition and measurement criteria; it would be useless to have a definition of asset because everything would qualify. Mr. Reid said there

is still the control test. Mr. Mosso said there are still the two other characteristics [control and past event].

Ms. Wardlow said that she liked the discussion in the UK document, which she thought was in line with the FASB's view, in which an asset is something that has the capacity to give you benefits in the future. Some items have no capacity to give benefits in the future; those are the things we normally think of as expenses or losses, because there is no capacity to give future benefits, and usually there is a time factor in there. But there are a lot of things that do have the capacity to give future benefits. In her recollection, the essence of the FASB's discussion of R&D expenditures is that some of them probably should be recognized as assets, but there are practical measurement difficulties associated with assessing which will produce successful results and when that support writing off the expenditures as they are incurred. Mr. Anania agreed that it was purely a measurement issue.

Mr. Zavada asked whether the intent was to have parallel treatment for assets and liabilities? Several members said yes.

Mr. Anania said that he leans towards Mr. Patton's view of the word probable; he was used to seeing it and understanding it. He could live without the word in the definition, but it does not trouble him there.

Ms. Cohen asked, "What is the difference between using the word 'probable' and the phrase 'are expected to'?" Mr. Patton said that both are different from saying, "may" or "may potentially," which are words used by other standards setters. "Expected" is a probability statement of some kind; we just don't know what it is. Ms. Cohen asked whether probable is not equally vague.

Mr. Farrell noted that the word "probable" has definitions in the current accounting model. One is "more likely than not;" another is like 90 percent. Mr. Patton said that "more likely than not" is 51 percent, as we define it, whereas the other one has been established mostly through surveys, rather than through a policy board. There is not a numerical definition, but it is more like 75 percent than 90 percent. Mr. Farrell asked Mr. Patton if he was suggesting that we require that if it is over 51 percent probable, then it is an asset? Mr. Patton responded that then you would go to stage two of the process—to decide whether it is recognizable.

Ms. Comes noted that the FASB specifically disavows the notion that there is a specific degree of probability associated with their use of the word "probable" in the asset definition. There is a paragraph that explains that you assess probability in the context of recognition. Mr. Farrell noted that the New Zealand board had emphasized the same point, with reference to the meaning of probable in their definition. Ms. Comes added that it was simply a way to incorporate a notion of uncertainty in the definition. She understood that Mr. Patton preferred to include probable in the definition because it suggested a

specific numerical threshold. However, none of the standard setters that have preceded the FASB in this endeavor have taken that view. Mr. Mosso said that the reason the FASB has had a problem with the word is that people interpret it as Mr. Patton has suggested and they don't read the paragraph in which the FASB disavows that interpretation. So the battles rage, particularly on the liability side, where the argument becomes a crutch against recognition.

Mr. Reid said that "are expected to flow" and "probable" are not necessarily interchangeable. He thinks that the "expectation" comment gets to intent of use. The expectation of economic benefit from an acre of land in a nature reserve might be nil. He would rather not see the definition get confused with what we expect to do with this thing as opposed to its existence itself. He would rather that the expectations piece occur at the recognition and measurement stage than at the definition stage. He therefore does not like "are expected to flow." "Probable" may be fine, but we need to make it clear that probable does not mean "more likely than not." Something less onerous than that would be fine, but you would need to make that clear somehow in the definition.

Mr. Mosso observed that the Board might have to come back to the notion of expectations. However, first they should focus on the word "probable." Noting that Mr. Patton wants to include the word, Mr. Mosso asked where others stand on using "probable" in the definition.

Mr. Schumacher said his first preference would be to leave it out. Mr. Calder said, "Put it in." Mr. Zavada asked, "Does it make a difference, practically?" Mr. Anania said, you can measure the value of a lottery ticket, is it the kind of asset you want to record?

Mr. Jacobson asked, "If you don't recognize it, might you want to disclose it?" To Mr. Anania, the word probable helps, in applying the definition. If you don't want to report the lottery ticket, you don't want to put "probable" in the definition. Mr. Mosso said he thought that would be dealt with by the recognition criteria.

Mr. Zavada would include the word "probable" in the definition. Ms. Cohen would leave it out. Mr. Farrell would leave it out. Mr. Anania would prefer it in, but could live with leaving it out. Mr. Mosso would prefer it out; hence the "outs" have it.

Mr. Patton asked whether we could discuss and vote on whether the word "expected" should be in the definition. Mr. Mosso said "expected" is not in the characteristics and he would like to finish the characteristics first.

ISSUE 3. What is an asset? Is it the economic benefit or service potential? Is it the right thereto? Or is it simply a resource that may result in economic benefit or service potential?

Ms. Wardlow explained that the third issue had to do with the essence of the asset. The FASB's discussion seems to have a mixture of concepts. The definition talks about the asset as being the economic benefit, but then in the discussion it talks about assets as resources, and about the resources embodying economic benefits, which is less direct than the statement in the definition. The UK standards setter uses "right" or "right or other access" to any economic benefits that may result. She finds the notion of "right" attractive. The possible downside would be whether it leads to discussion of whether the right has to be legally enforceable, similar to the FASAB's discussion at the previous meeting. "Resource" is perhaps the most attractive of the three because it is an everyday term and most people who read it know what it means, that it refers to something good, something of benefit to the entity, and so on. The discussion in the document would further clarify what the Board meant by resource.

Mr. Mosso asked what would be the counterpart to "resource" in the liability definition. She suggested "sacrifice of resources" or "giving up resources" might be appropriate, as there is not a direct counterpart, similar to "right" and "obligation."

Mr. Phaup said that the terms economic benefits and service potential sound like a flow, whereas "resource" sounds more like a stock. If a resource is the capitalized value of that flow, that would make sense. Also, stopping short of calling the flow of benefits an asset seems like a good idea. Mr. Mosso agreed that was more in keeping with what goes on a balance sheet; you have something at a point in time.

Mr. Patton asked whether, in the UK definition, the rights are controlled, or the benefits? Ms. Wardlow said she thought it was the right or other access that is controlled.

Mr. Anania said we might be giving too much credit to how other bodies arrived at their decisions. Once we have determined that service potential and economic benefit are important phrases, why not just reuse them in the definition, which is what a couple of the standards setters do? Also, he noted, "resource" is a very broad term. Is the right to tax a resource? Several members responded that it is. Mr. Anania continued by noting that in that case the only thing that would preclude recognition would be whether the relevant event has occurred. He thought that using the term resource might result in sweeping in the right to tax. Ms. Wardlow observed that the right to tax also would be considered an economic benefit; the issue is whether it qualifies to go on the balance sheet which is a recognition and measurement issue. Mr. Anania said that was the way you would exclude it and she responded that excluding it did not mean it was not an asset.

Mr. Reid noted that some countries try to reflect the current state of the government in their balance sheets and that means that they revalue assets to

current value. He wondered whether some of the words were selected because the standards setters think it facilitates revaluing assets.

Ms. Wardlow said she thought that, by saying that the asset is the “right” to economic benefits, rather than “economic benefits” per se, the UK board was trying to avoid excluding things that might not be providing any benefit at a particular point in time but that have the capacity to provide a benefit to the entity in the future.

Mr. Anania suggested including “service potential” and “economic benefit” in the definition, and not have them as an “essential characteristic” because they would already be in the definition. The essential characteristics just repeat the definition; if it is in the definition it has to be an essential characteristic. Ms. Wardlow agreed, but explained that the FASB’s approach was first to identify the essential characteristics and then build the definition from that. Mr. Mosso pointed out that service potential and economic benefit are just the first essential characteristic; there are two others. Mr. Anania said he would prefer not to create new words, which could be confusing.

Mr. Calder said that he would take the other side because he does not equate an account receivable with an economic benefit. An account receivable may ripen into and be expected to yield an economic benefit, but the economic benefit is not there yet. Mr. Anania responded that the benefit is already embedded and repeated that he would prefer not to add words. Mr. Calder responded that he liked “resource” or, perhaps because he still had a concern about the need for a criterion such as “ownership,” he liked the idea of “right to a resource.”

Mr. Anania said he could live with any of the options--it is the application that counts--but he would avoid new words, which could just create obstacles. Mr. Mosso pointed out that the words were not new; they had been used by most standards setters except the FASB. Ms. Wardlow clarified that Canada, Australia and New Zealand basically repeated the FASB’s wording; the others tried something different.

Mr. Schumacher said he agreed with Mr. Calder. He cited a building owned but not leased as an example of a resource that has a potential economic benefit. But until you do something with it, the economic benefit is not there. There is not an economic benefit just because you have the asset.

Mr. Farrell asked whether “service potential” didn’t encompass that idea and, if so, the issue was addressed in Issue one with the decision to adopt service potential and economic benefit. Mr. Mosso asked him whether that means the asset is the service potential or is the asset the resource? Mr. Farrell responded that he thought service potential was sufficient and that “resource” is redundant.

Mr. Mosso repeated the three choices for members to state their views: Is the asset (1) the economic benefit or service potential, or is it (2) a right to the

economic benefit or service potential, or is it (3) a resource that has the capacity to provide economic benefits or service potential?

Mr. Patton said that assets are service potential or economic benefits controlled by an entity. Mr. Schumacher would use right or resource, with a preference for resource, but he could live without either of those words. Mr. Calder prefers “resource.” Mr. Zavada prefers “resource.” Mr. Reid prefers “resource.” Mr. Phaup prefers “resource.” Ms. Cohen prefers “resource.” Mr. Farrell prefers service potential and economic benefit. Mr. Anania prefers service potential and economic benefit. Mr. Mosso’s first choice would be “right,” but “resource” is acceptable.

ISSUE 4. How should the notion of “control of access” be expressed in the definition of an asset?

Ms. Wardlow said that the idea of “control” was a problem for all standards setters; she thought that adding “of access” helped to clarify the meaning. Mr. Mosso observed that all the standards setters included in the research used the word “control” and that Ms. Wardlow was suggesting to make the term explicit as “control of access” by the entity to the benefits.

Mr. Anania noted that control is a very important characteristic, given the way that certain assets can be divided into pieces. He agreed with including the notion of control of access.

Mr. Mosso said that, whereas it was good to use few words in the definition, it was important to avoid ambiguity. After calling for other comments, Mr. Mosso said there seemed to be a consensus on Issue 4.

Mr. Farrell suggested that staff look at FASB Interpretation No. 46, which deals with some aspects of derivatives. It indicates that multiple entities can control the same asset and in those circumstances each entity would consolidate. The Interpretation might suggest some words that we could adopt.

ISSUE 5. Should the third essential characteristic of an asset, and the asset definition, refer to the relevant transaction or other event having occurred (a) by the balance sheet date or (b) simply, in the past?

Ms. Wardlow explained that at the previous meeting she had included a reference to balance sheet date in the third essential characteristic, but without intending to make that a specific proposal. Some may feel that for an item to be considered a candidate for the balance sheet, the event giving rise to it must have occurred by the balance sheet date. Others may believe that the board should allow for the possibility of subsequent events.

Mr. Mosso said that, from a definitional perspective, an asset can exist independent of the balance sheet. He indicated he liked the clarification

somewhere in the staff paper that the pertinent event is the event that confers control.

Mr. Calder asked whether we are saying that the event that confers control should precede the balance sheet date. He said he liked the reference to the balance sheet date.

Mr. Farrell asked whether that needs to be stated in the definition of an asset, or whether it is inherent in a broader umbrella concerning the preparation of financial statements. Mr. Calder responded that it is a question of whether it is my asset as of a date, and it is my asset if control passed to me prior to that date. If control passed to me after that date, then it was not my asset at the balance sheet date. Mr. Farrell agreed and said he thought that just saying past event was sufficient and simpler; there is enough body of other literature that says you prepare a balance sheet as of a date in time. Mr. Calder agreed but said that for someone not as familiar with the literature, this would make it specific that the event should be prior to the balance sheet date.

Mr. Patton asked whether this is not a recognition issue rather than a definition issue? Mr. Calder said yes, generally, but we are not talking about an asset in general terms. We are talking about whether this is my asset—the asset of the entity—at some date.

Mr. Anania noted that there are many different events that occur with regard to assets and liabilities and it is a question of which event are you talking about. None of the other standard setters have balance sheet in the definition. Sometimes a dispute about control may be clarified after the balance sheet date. So, you might create more problems by trying to limit it to the balance sheet date. Mr. Calder said that uncertainties surround any set of financial statements. The key question is whether the event [getting control of the resource] occurred before the balance sheet date. Mr. Mosso said that was an important question, but it did not seem an essential part of the definition. Ms. Wardlow agreed, saying that the issue may tip us over into recognition issues. The issue here is whether you have an asset that is a candidate for recognition. So, you might not wish to mention balance sheet or any specific reporting date. Rather, what is important is does the item have the capacity to give future benefit and do we have control of access--has the event that gives control of access occurred?

Mr. Farrell asked about taxes receivable. The ability to tax has service potential, so it is possibly an asset. But you cannot record the next 75-years'-worth of taxes receivable. Somebody has to declare the taxes due and collectible before you can think of recording them. Mr. Reid said that the criterion used now is that either the taxpayer or the court has acknowledged the liability. Mr. Farrell said he assumed that in either case the acknowledgement would be based on a past event. Mr. Reid agreed.

In response to Mr. Mosso's request, the members stated their preference on Issue 5. Mr. Calder preferred a reference to the balance sheet date. The other members preferred to omit that reference and refer only to the occurrence of an event "in the past."

Conclusion: Mr. Mosso suggested that the Board defer its discussion of "expectations" (from Issue 2). He asked Ms. Wardlow to word the essential characteristics for the next meeting, based on the Board's discussion of the key terms, and then to draft a definition based on those characteristics and key terms. Ms. Wardlow asked whether she should also begin to look at the characteristics of a liability. Given that some members favor parallel definitions, it might be useful to look at liability characteristics before finalizing assets. The Board agreed this would be helpful.

Mr. Farrell asked Mr. Mosso for a clarification as to whether Ms. Wardlow would be working on the definition or on defining some of the terms we now have in the definition. He indicated that, as Mr. Mosso had said, it will be critically important that we explain whatever terms we have in the definition. Mr. Mosso agreed. Ms. Wardlow indicated that she probably would have to give the Board both at the same time. The order of procedure probably would be: wording of characteristics, explanations, and then build on that to draft the definitions.

Mr. Anania asked whether Ms. Wardlow was not really drafting replacement language for current definitions—what we would use when we revise standards. Ms. Wardlow concurred except that she thought the Board did not have a definition of assets. Mr. Anania indicated that there was a working definition. So, Ms. Wardlow would be working on the language that we would adopt and get into the FASAB literature. Mr. Mosso confirmed this.

Mr. Reid asked whether approval of a new definition would imply amending existing standards to include the new language and, if not, how would we resolve that? Ms. Comes said that she did not recall that the existing standards are built on an asset definition in a way that would imply a need for amendment.

Mr. Zavada noted that the Board is focusing on definitions and asked when the Board would address the second part--recognition. Ms. Comes indicated that she thought the Board would talk about recognition in the same document that discussed assets. For example, we would talk about criteria similar to those used by the FASB concerning measurement and recognition.

In response to a question from Mr. Anania, Mr. Mosso indicated that he thought the Board should complete the work on assets and liabilities

before addressing revenues, expenses, and other elements. It was yet to be decided how much of the total work should be in a single document.

- **Rules of Procedure**

Ms. Comes led the discussion of revised rules. She explained that the draft rules provided in the binder included a long-standing misuse of the term “recusal.” The term means that members not only abstain from voting but also refrain from deliberating on an issue. The original rules and Statement of Responsibilities And Characteristics of Members of The Federal Accounting Standards Advisory () Board treated recusals as abstentions and permitted members to participate in deliberations. Therefore, Ms. Comes proposed that the term “recusal” be eliminated from the rules and statement. She provided the deletions to the members for their consideration. Members concurred with this change.

Additionally a member suggested that paragraph 15 and 16 of the statement should be reversed. The Board agreed.

Mr. Reid asked for clarification of the language describing the “voting blocks” of the Accounting and Auditing Policy Committee (AAPC) (at page 27 of 31) of the rules. The listing of blocks leads him to conclude there are four blocks but three are specified. He suggested numbering the blocks to clarify the membership in each block.

Mr. Reid also asked whether Technical Releases must come to the Board and whether Treasury had a veto authority. Mr. Jacobson explained that the Board was provided a review period and if a majority objected the Technical Release would not be issued. In addition, if any of the sponsors’ representatives on the Board object, the Technical Release would not be issued. Ms. Comes noted that the summary appearing on page 27 was poor. She suggested replacing it with the summary from the table on page 21. The members agreed.

CONCLUSIONS: Ms. Comes collected ballots approving the rules and statement as revised at the table.

Adjournment

The meeting adjourned at 4:45 PM.

Thursday, April 29, 2004

Agenda Topics

- **FY 2003 Financial Report of the US Government**

Ms. Comes opened the discussion by opining that discussing the consolidated financial report (CFR) may be particularly useful this year because SFFAS 24, *Selected Standards for the Consolidated Financial Report of the United States Government*, and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*, were issued last year. SFFAS 24 provides that all accounting standards apply to the CFR unless the standard indicates otherwise. Since that time, she noted that FASAB has begun including CFR specific requirements in most of its proposed standards. Ms. Comes continued by saying that she was not proposing to go back and tailor prior standards for the CFR.

Ms. Comes noted that in past years discussion of the latest CFR had not been structured and that she had included a structured approach for today's discussion in the materials. The first item for discussion was MD&A. Mr. Mosso asked Mr. Reid if SFFAS 15, *Management's Discussion and Analysis*, was helpful? Mr. Reid answered affirmatively. MD&A points to things that might not be included absent SFFAC 3. As an example, he noted MD&A's discussion of commitments. In a post-Enron environment, there is sensitivity about unrecorded liabilities. Treasury was very sensitive about highlighting commitments broadly.

Mr. Reid noted that the "net financial position" concept was not particularly appropriate for the government. The kinds of commitments we have are to be evaluated against the economy broadly – that is, the strength of our system is based on our strong economy and growth.

Mr. Mosso asked about performance measures and what was being reported in the CFR. Mr. Reid explained that performance measures an agency would report are not viewed as relevant to the CFR. Instead, the CFR includes two types of measures – the commitments displays previously discussed and the President's Management Agenda. These are not program performance measures but are viewed as warranting attention by CFR users.

Mr. Mosso asked Mr. Calder about GAO's involvement in establishing national performance measures. Mr. Calder replied that GAO has explored the topic with a panel of experts but has not published anything. He characterized GAO's efforts as being in the early stages but ongoing.

Mr. Patton asked if MD&A was similar to a popular report. Mr. Reid replied that there has been discussion about issuing a popular report but we're not there yet. There is a lack of funding for writing assistance that would direct the report

language to non-accountants. Currently, the report reads as if it were directed to accountants. Obviously, this is not the end objective.

Mr. Anania asked to what extent the CFR is reviewed within the government. Mr. Reid replied that it depends on the area. MD&A is reviewed by about 15 organizations. Social insurance also gets extensive review by the administering agencies and is also scrutinized at Treasury. The statements and the notes are not reviewed extensively except by GAO. Mr. Calder noted that within GAO a number of teams are involved (subject matter teams) - each team gets a part to comment on. There are people at GAO dedicated to the CFR and most of their review involves ensuring accuracy.

Mr. Anania asked if there is feedback from citizens/ citizen intermediaries (media) after publication of the CFR. Mr. Reid noted that there is a congressional hearing with feedback from the oversight committee and there is a press conference at the time of release that results in a few articles. Mr. Schumacher observed that citizens don't know the CFR is available. He asked how we make it available and generate press coverage. Mr. Reid noted that there is a standard distribution of the CFR to agencies, each member of Congress, and anyone who has asked for it previously continues to receive it. Jim Sturgill of Treasury's FMS mentioned that the CFR is on the web and that copies are sent to libraries. Mr. Reid noted that a press conference is held and eight to ten members of the financial press attend. Usually there are about two to three articles as a result.

Mr. Anania asked if there is something the Board should be doing aside from building specific requirements into new standards? Mr. Reid responded that when GAO issues its opinion, it is noted that the CFR does not meet many FASAB disclosure requirements. Appendix 1 of GAO-04-45, *Process for Preparing CFS Needs Improvement*, lists items that are not being disclosed in the CFR. Agencies do not disclose certain items because they are not material to the agency but Treasury cannot prove that those items are not material at the government-wide level – it's tough to prove a negative. Further, Mr. Reid believes that asking agencies to put in place mechanisms to capture disclosure items that are immaterial at the agency level would be a huge burden.

Mr. Calder noted that GAO has provided a list of disclosures for 5 years as part of the audit. The listed disclosures are not being observed at the CFR level and that there is no evidence of consideration of these items. He suspects that many of the disclosures would be immaterial but there is no evidence the disclosures were considered.

Mr. Anania opined that what is going on is a friendly tug of war – technical requirements detract from the ability to communicate. Mr. Anania continued by saying that there may or may not be a role for the Board in addressing the items on the list. He indicated that it is something we may want to consider in the future if the information would detract from the ability to communicate. Mr. Mosso observed that such a role would be critical if a clean opinion was near.

Mr. Farrell suggested that there are many disclosure items buried in FASAB's requirements that were not written for the CFR and cause the preparer and auditor to fight continually. It would be helpful to see a list of items for which relief, in the form of amended standards, would be appropriate. Mr. Calder agreed with this suggestion and suggested that it arises in current projects as well. Mr. Farrell did not believe it should be the Board that searches out the disclosures for which relief would be needed.

Ms. Comes observed that prior to SFFAS 8, the Board focused solely on component entities. Mr. Mosso asked Mr. Reid to come up with a list of items needing relief. Mr. Anania suggested that this matter could be addressed by revising SFFAS 24. An alternative might be to make a general statement about the brevity of disclosures for the CFR.

Mr. Reid indicated that a list would be put together. Treaties are being considered now. The dilemma is that treaties cannot be aggregated or easily summarized. They number in the hundreds or thousands and do not have financial values associated with them. Already, the CFR is more like a 10K than a popular report. An informed reader should be able to go through the CFR easily and that is not true of the current CFR.

Mr. Mosso opined that a summarized citizens' report would be useful. Ms. Comes indicated that FASAB staff would align proposed note disclosure requirements for the CFR with SFFAC 4 going forward so that the Board is alerted to CFR disclosure issues.

Mr. Reid noted that agencies don't all implement standards in the same way and the Board should be aware of this with respect to recognition and measurement. The result is that one entity may be marking to market and the partner entity not for the same financial instrument.

Mr. Mosso terminated the discussion to stay on schedule and noted that Mr. Reid has ideas to work with.

CONCLUSION: Staff will present alternatives for disclosure requirements consistent with SFFAC 4 in ongoing and future standards projects. Mr. Reid will convey his views on existing disclosure requirements at a future meeting.

- **Social Insurance**

The staff presented a paper briefly summarizing the OASDI program characteristics, and presenting for discussion four possible criteria that would have to be met for expense and liability recognition and six alternative recognition points. Staff noted that the four criteria were adapted from the IFAC Public Sector Committee's Invitation to Comment (ITC) *Social Policies*, and/or the Canadian Institute of Chartered Accountants' exposure draft *Liabilities*,

Contingent Liabilities and Contractual Obligations, and were not verbatim from them.

Mr. Mosso said that the four criteria presumably would be linked to the three essential liability characteristics in the elements project as it progresses and he did not think any of the four criteria was incompatible with the liability characteristics. He said eventually the Board would want to work from its formal definition. He said the four criteria were very good and had been developed in relation to social insurance.

Mr. Anania said the threshold question before they go through the six recognition points was whether the Board wants to embrace the notion of constructive obligations. He said he thought it should. It was not a mere coincidence that two other bodies outside the United States that were looking at governmental social programs are using it as a kind of linchpin to determine whether there is a liability. He said, first, it would help him as a Board member to know whether the constructive obligation notion would be embraced; and, second, to acknowledge that, in standard-setting, at least in the United States, the concept has been used, albeit sparingly.

Mr. Mosso said the usage was more than sparring. He cited pension and retirement healthcare liabilities in the private sector, which are not legal liabilities. Mr. Anania agreed they are not legal obligations but noted that the literature has not explicitly cited constructive liability concepts as the basis for many liabilities.

Ms. Robinson noted that she is not fond of the concept of constructive liabilities applied to the Federal Government. She said there are a couple of key problems with it. The most important one is that the Federal Government operates in a different way than a business. When one considers the balance sheet of the Federal Government, agencies have to operate in a legal framework. Agencies are not allowed to think in terms of the four criteria, e.g., established pattern, expectations, etc. She said that another major point is that the information is readily available in the budget, in agency reports, and elsewhere.

Ms. Robinson noted that Congress did not have to pass annual laws to authorize the Social Security program, except for the administrative operations of SSA; but, that a concept that goes beyond a certain distance into the future isn't justified. Congress doesn't assume its laws are immutable. She said that, in the case of Social Security, unlike many other programs, there isn't an expectation that the program will be reviewed every year; but there is a de facto assumption that Congress will intervene at certain points. Changes are expected and certainly the executive branch right now is advocating that it should change.

Mr. Mosso said he did not think the term "constructive obligation" was necessarily the most useful way to think about liabilities. It's hardly mentioned in the private sector literature, which bases recognition on meeting the essential characteristics of a liability. He said he thought it was employed with respect to social insurance

only because a Supreme Court ruling had determined that the benefits are not legally enforceable. Mr. Anania said that the notion that a liability for accounting purposes doesn't have to be a legal liability is generally accepted throughout the world.

Ms. Robinson asked whether that wasn't one of the essential differences between the private and public sectors, that the latter needed legal authority to operate whereas a private company did not. Mr. Mosso noted corporate charters and the legal framework in which private companies operate and doubted whether there was a fundamental difference.

Mr. Zavada said he agreed that whether the members agree or disagree with the notion of constructive obligation was an important question. He said he had a real problem with it because the criteria in the staff paper might be applied across the board to social insurance programs as well as other long-term commitments, even national defense, and he has a very difficult time drawing a line between programs. He added further that if you agree with this criteria for a liability then why not apply it to assets; and then he is back at the beginning looking at long-term projections of flows and spending.

Ms. Comes noted that Congress could change laws affecting many liability amounts recorded under current FASAB standards. She noted the article on page 34 of the FASAB clippings where the Department of Defense wants Congress to ease environmental cleanup laws, which would affect current DoD environmental cleanup liabilities. She said that, taken to the extreme, the argument that Congress can eliminate or reduce a liability and therefore it ought not to be recognized gets you to a position that an accountant would find unacceptable: the failure to recognize liabilities based on what is expected under current laws and because of past transactions or events. She said that to a certain extent past transactions or events are very important in preventing, for example, recognition of a liability for future defense spending. She said that it's a very complex area, but to go to the extreme of saying that liabilities ought not to be recognized because Congress can wipe them away puts the Board in an awkward spot.

Mr. Anania said that you could apply that to the private sector as well. Private companies recognize, for example, environmental or other liabilities pursuant to laws that Congress can and does change. Mr. Schumacher agreed. Mr. Anania said one could make the argument in the private sector, too, that a liability should not be recognized because Congress can change the law. He said he would reject that argument and only current circumstances should be dealt with.

Ms. Comes said if we operated in an environment of existing laws and obligations, to a certain extent the promises embodied in laws, then the meat of the discussion focuses on what is the proper transaction or event, what promises relative to continuing services have been made and what actions have been taken under those promises.

Ms. Robinson asked whether there wasn't a difference with respect to the environmental liabilities, which are booked for current environmental problems. She said we aren't trying to project into the future how much DoD is going to dirty up its sites. Ms. Comes noted that Social Security participants also engage in current transactions or events, and Social Security and Congress tell them what their projected benefit will be based on their work up to today. Ms. Cohen pointed out that the statements one gets from the Social Security Administration are very straightforward: This is what you can expect to receive when you reach the following age.

Mr. Farrell said, with respect to environmental liabilities, there is a question as to where the line is. When it puts a nuclear submarine into service, the Navy hasn't dirtied anything, but under current FASAB standards, a liability is required to be recognized over the service life of the submarine. So the line between past and future events is not as bright as might have been implied in the prior comments: you don't have to dirty anything before recording a liability.

Mr. Farrell said he is also concerned about how broadly to apply this criteria. The four criteria might capture food stamps for example. In the PSC ITC the four criteria are in chapter 8 on old-age or social security pensions.

Mr. Zavada said that the pairing of the social insurance project with the long-term commitment project suggests that the criteria used for social insurance will have a broader application. Mr. Farrell agreed and urged the Board to be careful because the members did not want to capture everything the Government does. Mr. Mosso said this is why he said earlier that the four criteria should be put into the context of the liability definitional work accomplished so far, which has established three essential liability characteristics.

With respect to a program-by-program approach, Mr. Zavada said he didn't think the issues could be separated and the Board should not operate in a vacuum. Ms. Comes said it was important to recognize the Board's process. Three projects are being integrated: (1) the conceptual framework that includes the liability definition in which developments of the four criteria in the staff paper will be addressed; (2) the social insurance liability project in which the four criteria will be evaluated in terms of how they work with a particular program; and (3) long-term commitments. Until the exposure draft stage the Board will be evaluating and analyzing, among other things, how the criteria work with the various programs - Social Security, Medicare, and other programs.

Mr. Zavada noted that at yesterday's session the Board discussed definition vs. measurement and that he was unsure whether the subject of today's staff paper was definition or measurement. If the former, then the criteria and the notion of constructive liability are anchored back to the notion of probability and, if so, then it raises the "probability" issue discussed yesterday. Yesterday "probability" was removed from the asset definition. He asked what yesterday's decision meant for this project and how would it relate to decisions today?

Mr. Anania opined that talk of recognition points is premature for today's discussion. He noted that he and the other Board members were free to change their minds, and quickly, based, for example, on new information. Members should not be inhibited from expressing preliminary preferences for fear of being bound to a position. He said the more the Board talks about it at this stage the better off it would be when it tries to draft a standard and obtain buy-in. He would prefer not to take a position on recognition points until the overall view is further developed.

Mr. Anania said that the recognition criterion (staff paper, top of page 10) he has the most trouble with is the last one: no realistic alternative. Much time could be spent discussing that one criterion. Ms. Comes agreed that that criterion was the most problematic because the Federal Government is never limited in its alternatives. Ms. Cohen said that, if one reads the whole sentence, the second phrase, "but to settle the obligation in the future," is key. The word "settle" is the operative word. It does necessarily imply which participating group would be the settler. Mr. Anania asked Ms. Cohen if she found this criterion easy to apply. Ms. Cohen said that she found it easy to say at this time that there is no realistic alternative but to settle the obligation. Who would settle and how are other questions. She said liabilities do change all the time.

With respect to constructive liabilities in the private sector, Mr. Schumacher asked how the members would view retiree health insurance (also known as other post-employment benefits, or OPEB). He said that in most instances it is not a legal obligation. Mr. Schumacher said that retiree health insurance is a liability that would meet these criteria but the amount of the liability can and does change.

Mr. Anania noted that the private sector OPEB accounting standard does not emphasize the constructive obligation words. He said that the OPEB literature and the basis for conclusions contain constructive obligation ideas without citing the notion explicitly. But the private sector standard gets to the same constructive obligation result by some of the same ideas that are listed on the top of page 10 in the staff paper.

Mr. Zavada asked if there wasn't a fundamental difference for OPEB in terms of exchange vs. non-exchange transaction. Mr. Schumacher said he would acknowledge that one has earned OPEB over the course of his or her employment, but yet there is no legal obligation to pay it.

Mr. Anania asked whether Social Security transactions could be characterized as exchanges based on the payment of payroll taxes. Staff noted that Social Security taxes are not voluntary, which has been a primary criterion for exchange transactions.

Ms. Robinson noted that there should be some discussion of how one recognizes and displays this information. In the private sector, some have argued that

benefits have been reduced to avoid negative effects on the balance sheet and income statement, which can be done because it is not a legal or contractual liability. So in some sense there is a gaming there; and, if it were recognized in another part of their disclosure like social insurance is, then you would not be perpetuating the problem.

Mr. Schumacher agreed that some companies take that track. . They want to improve their bottom line and see a way to do it. He noted that other companies declare bankruptcy or otherwise find they cannot pay the promised benefits. They do not have the ability to tax, to change those events or those facts in the future, so they back out of the liability. Ms. Robinson asked whether this makes the balance sheet less useful and, if so, whether disclosure is preferable. Mr. Schumacher stated that this issue was debated for a long time before FASB Statement 106 in the late 1980s required retirement healthcare obligations to be reported on the balance sheet.

Mr. Anania noted that subsequent events may change the liability amount but recognition was required. He said the global question was whether financial reporting was better for having recognized OPEB or is it worse.

Mr. Reid said this gets back to fair presentation: is \$0 a fairer presentation than some number that might be changed, perhaps significantly, by future events? And does disclosure make up for it, added Mr. Anania.

Ms. Robinson said there was an issue of volatility: is \$0 better than some other thing that is difficult to evaluate. She said this was not the central issue. The central issue was whether there was a transaction that, in and of itself, was binding in some concrete sense.

Mr. Mosso agreed. He said the essence of a liability is a binding promise, and the staff recommendation is that working under a statutory plan that spells out the benefits that you will receive and the taxes you will have to pay is concrete.

Of the four criteria in the staff paper Mr. Calder said criteria “b” and “c” presented issues as well as “d”. He noted that [in *Fleming v. Nester*] the plaintiff was denied benefits that had been promised to him, based on subsequent Congressional action. He said the Government disavowed the valid expectation. Thus, is there a “valid expectation”? What is a “valid expectation”?

Mr. Jacobson noted that Congress could change expectations. The program and therefore expectations can be different, for example, in 2002 than they were in 2001. Mr. Calder asked whether in that case the only “valid” expectation is the one the participant has when filing a claim. Mr. Jacobson said that, in terms of financial accounting, it would be the expectation as of the reporting date.

Mr. Reid noted that expectations are essentially the people’s expectations. The people can change the Congress if they do not agree with program changes.

Mr. Calder said he still had a problem with “valid expectation.” For example, is a 25-year old’s expectation of receiving social security benefits under the current formula “valid”? Staff noted that the SSA Web site’s Q&A section spelled out expectations: if one is 35-years old, expect benefits to be reduced by 27%, if one lives to be 100-years old; if one is 25-years old, expect 33%; if one is near retirement, expect 100%. Ms. Robinson noted that the SSA also explicitly states that benefits will be reduced by a given percentage in 2042 under current law.

Mr. Mosso stated that accounting could add discipline to the process. He said that the SSA percentage cited by staff were somebody’s conjecture. Accounting tries to put a value on what has happened, and if that is done there will be a more solid base for what gets into the financial statements even though we acknowledge the amount may go up or down.

Following up on an earlier point Ms. Robinson asked how the criteria would apply to the Federal student loan guarantees. A liability is currently booked for guaranteed loans when the loan is disbursed, and so the question is whether future guarantees should be booked as well. Ms. Cohen noted that, unlike social insurance, the guaranteed student loan program did not involve the general population.

Mr. Reid said that an interesting aspect of this subject is that, when one looks at the magnitude of Federal programs, Social Security and Medicare dwarf the others. So, it is important for the Board to get the accounting right for these two programs, even if the standard is tailored to them. He said he was unsure if he was ready to apply such a standard generally across Government. He would prefer to at least take this particular situation and see if it is appropriate in the case of Social Security; and, if it is not applicable in other places, then so be it. The Board might want to limit the applicability of this approach to Social Security. However, Mr. Reid noted the risk that tailoring might cause problems. Yesterday it was noted that the question of how Medicare, Part D, would be accounted for under SFFAS 17 was raised because the latter mentions only Parts A and B. Mr. Zavada said it would be hard to selectively apply the notion of constructive obligations and the recognition criteria and he said one had to look across the board.

With respect to the point about applying the criteria across the board, Ms. Comes returned to the example of Federal student loan guarantees. The question was whether an obligation arose at the time a child enters school, and a liability should be accrued because the child will be going through school and approaching the possibility of going to college. She said the children haven’t really participated in any Federal program at that point. The difference between that program and Social Security and Medicare is the latter’s participatory nature.

Mr. Calder said that determining the event that triggers the obligation would be the next step, and the student loan guarantee program is a great example to test these four criteria. Ms. Comes said the four criteria are subordinate to the three

essential characteristics of a liability, and the past transaction is not described as clearly in the four criteria. One would have to first screen through the three essential characteristics of a liability. Mr. Calder said that all that was necessary is for the Board to decide it wants to say the initiating event for Social Security is the birth of the person and it would be in exactly the same position as in the case of the child entering school.

With respect to the question of whether the criteria might be applied more broadly to food stamps and other things called entitlements, Mr. Anania said staff could look at some of those other so-called entitlements and try to describe or define why they are different from social insurance. He said he sensed a difference but would like to know more about such programs. Differences may be that the individual in the social insurance program is paying part of the cost, is getting an individual statement, and, in the case of Medicare, has an option to participate in certain parts of it.

Ms. Robinson said this was an extremely good point. In Social Security and Medicare there is almost an illusion of participation in some respects due to the way taxes are paid, but the fact is that everything is funded by taxes, so we can say we are participating in everything. And, once you are in a program you get a lot of individual statements and one has to visit the immigration people, the social worker, etc. Mr. Patton noted that the PSC ITC has individual chapters on the different kinds of programs, and different conclusions are reached in the different chapters.

Mr. Mosso noted that the staff on the Social Insurance Liability Project was proposing to consider each social insurance program one at a time, and other staff would be presenting programs under the Long-Term Commitments Project. However, Mr. Mosso said he was certain that the Board, as it went forward, would not find the same trigger events, for example, for Unemployment Insurance as for Social Security. He said that presumably in each case there would be some point that triggers recognition – or not; many things presumably would not qualify as liabilities. He said the projects were focused on individual programs simply to keep them manageable.

Staff mentioned periodic means testing as an example of another difference between social insurance programs and some other entitlements. Mr. Patton asked about the requirement in Social Security that, once the participant reaches 62 years of age with enough quarters worked in covered employment, one is fully eligible, and the only thing one needs to do to stay eligible is to not die. He said PSC makes a big deal about whether eligibility needs to be re-validated periodically or not; for example, if a program were means tested, whether it would have to be means-tested every year. The PSC seems to be saying that permanent eligibility creates more of an obligation.

Mr. Reid said he would like to see additional development of the four criteria at the next Board meeting. His sense was that the four criteria were embellishing or

expanding the notion of a liability, and he would like to see the staff fit them into the basic working liability definition. For example, do they expand or enhance it or are they something outside of it.

Ms. Comes said she saw the four criteria as more a way to explain the notion of obligation and to identify the obligating past transaction or event. The criteria did not embellish the liability definition but rather explain or interpret the three essential characteristics.

Mr. Reid said the one thing he did not see with the four criteria is a direct connection with the notion of a past event. The latter would seem to be critical in differentiating between Federal programs for liability recognition. Mr. Mosso agreed. He said for next time the staff needs to refer exclusively to the three essential characteristics of a liability and fit the criteria into that.

Mr. Zavada asked whether probability was still an essential characteristic of a liability after yesterday's decision with respect to assets. Mr. Reid noted that the concept of probability would not be eliminated; the question is where probability fits in: is it a definitional problem or a measurement problem. Mr. Mosso agreed. Mr. Zavada said that that formulation was a bit confusing because, when he looks at the fourth recognition criteria in the staff paper, "no realistic alternative," probability would seem to be relevant. Mr. Farrell noted that "probable" is in the current working definition now. Mr. Mosso noted that yesterday the Board eliminated the word "probable" from the asset definition and decided the asset and liability definitions should be parallel, and therefore it would be fair to assume the word would not be in the liability definition, either. But he said probability is clearly going to be involved in the process of recognition. Ms. Comes said the notion of uncertainty remains in the asset definition. Mr. Mosso agreed. Ms. Comes added that what was really eliminated yesterday was the notion that there is a percentage threshold for the definition.

Mr. Anania said he thought the Board would find that the notion of constructive obligation would not fit exactly with the characteristics the Board has for a liability. The whole preamble in the FASB and other standard-setter's material about constructive obligation is designed to explain why one may go to that notion even if one does not get an exact fit with the characteristics. He said he thought that if one applies the liability characteristics correctly, they would not fit.

Mr. Mosso said that because the Board's current process involves having the concepts move along with the standard-setting process, the Board would do well to stick with the Board's liability definition. He said that if it does not work, then the Board would need to modify it; but if the Board uses somebody else's criteria, then a fit is unlikely. Mr. Anania said he did not think the Board had invented the broad notion of constructive obligation. Mr. Mosso said he was not sure it was needed.

The Board discussed the notion of constructive assets. Taxes were suggested as a possible constructive asset. Several members said that a past event was lacking in the case of future taxes.

Mr. Mosso asked the members if they had a preference with respect to recognition points. Mr. Zavada questioned the wisdom of narrowing alternatives before the Board had a full discussion of notions like constructive liability. He noted the plan for the next meeting was to have a round table of experts and he said he would like to hear that before discussing recognition.

Mr. Mosso noted that the Board would probably continue its work in addition to the round table discussion. Ms. Comes said she hoped Ms. Wardlow would be able to present more on the liability concept, and FASAB staff would be coming back with some discussion – in addition to the round table – on Social Security and perhaps Medicare. She noted that any soundings at this point would be very preliminary, and all members of course reserve the right to change their positions. She said the sounding would provide direction.

Mr. Mosso added that the staff could suspend work on any alternatives the Board did not want to pursue at this point, although a return to any such alternative would be very possible. Mr. Patton said he would like to see all six alternatives pursued at this point.

Mr. Mosso asked the members to focus on the staff recommendation, alternative three. Staff noted that all six alternatives were valid and that the first two alternatives were eliminated because they did not meet the criteria on page 10 of the staff paper.

Mr. Patton noted that if one did not accept the four criteria on page 10, then the subsequent discussion and reasoning behind the staff recommendation was moot. Staff agreed. Mr. Patton said he did not agree with the four criteria. He said he could not have a preliminary preference with respect to a recognition point until he had a concept for reaching one. He wanted to follow up on all six alternatives.

Mr. Mosso asked whether Mr. Patton agreed with the three essential characteristics of a liability (page 7 of the staff paper). Mr. Patton agreed. Mr. Mosso said that the four criteria could be discarded if they do not fit into the three essential characteristics of a liability. Mr. Patton said the Board should go with its definition and not pick some of the items from various sources.

The Board discussed which liability definition would be referenced, the one in SFFAS 5, paragraph 19, or the working definition, perhaps as modified by yesterday's asset discussion. The Board decided to focus on the three essential liability characteristics.

Ms. Comes said Ms. Wardlow would be coming back in June with more on the three criteria for the asset definition and also the parallel liability characteristics.

She added that the three liability characteristics had been discussed at previous Board meetings. They are based on SFFAS 5 and are very consistent with all other standard-setters. Ms. Comes said that the characterization of uncertainty has been debated and may continue to be debated; but the outcome of that debate would not make a substantial difference in the definition, although it would affect tone and impact the recognition criteria that would go along with the definition.

Mr. Reid pointed out that the Board had already recognized a liability for social insurance. It is alternative six on the staff's list, the "due and payable" amount. In short, the Board applied the liability definition in SFFAS 5 to social insurance and concluded that the "due and payable" recognition point was best. He said the Board might now say that that was a mistake, that none of these triggering points are right, and select a new one; but the Board has already gotten over that hurdle.

Ms. Robinson asked whether the new approach would result in future obligations now being recognized. Mr. Reid said that the obligating event is a different concept, for example, what benefits are due as of the reporting date based on work already performed and payroll taxes already paid.

This social insurance liability session ended at this point.

CONCLUSION: For the July 1 Board meeting the staff will relate the four criteria on page 10 of the staff paper to the three essential liability characteristics on page 7 of the staff paper, especially "past transactions or events," and otherwise further develop recognition concepts for the Social Security program.

The Board adjourned for lunch at noon.

- **Long-term Commitments**

Ms. Ranagan presented a preliminary plan for the proposed project on long-term government commitments. Ms. Ranagan provided an overview of the plan and explained that the purpose of the project is to reconsider the recognition, measurement and display of liability and expense, potential new elements or statements, and all related disclosures for commitments of the federal government that could potentially result in a net outflow of resources. Ms. Ranagan further explained that this project is a companion project to the liability elements and social insurance projects.

Ms. Ranagan indicated that her objectives for the meeting were to present the draft project plan, review the intention of the project, obtain agreement from the Board that this is a good project to pursue, and determine whether the Board believes the project approach appears reasonable.

Ms. Ranagan listed several examples of the types of programs that would be reviewed as part of this project if approved by the Board, including Medicaid, Food Stamps, Supplemental Security Insurance, Temporary Assistance for Needy Families, Veterans Benefits, treaties, contractual agreements, and Government Sponsored Enterprises (GSE).

Ms. Ranagan indicated that the first stage of the project would be to research and gather relevant information on significant commitments of the federal government. From there, staff would group the commitments into like categories and address each of the categories in phases.

Several members expressed concern over whether the programs would be reviewed individually or as groupings. Mr. Schumacher initiated the discussion by asking if the programs would be reviewed one by one within each of the phases. Mr. Farrell cautioned that looking at individual programs may not be the way to go as there could be hundreds and hundreds of them; he recommended looking at groupings of programs. Mr. Reid stated that he is concerned about having a laundry list of programs with their own individual set of criteria and then having a program come along that was not considered and may not fit. Ms. Comes indicated that her thinking was that a common set of criteria would be developed for programs with common characteristics and these criteria would be tested individually on each of the major programs within that grouping. Ms. Ranagan agreed and noted that this approach will help to ensure that criteria could later be applied to related programs that fit the category but do not meet the scale of our review.

Mr. Patton asked what we consider commitments to be. Ms. Ranagan referred to the footnote 3 definition on page 1 of the project plan where a commitment is defined as “an agreement or pledge to do something in the future.” This general terminology is used so as not to exclude certain items from consideration or presuppose that the recognition of a liability will be the outcome. Mr. Patton inquired if there would be a law supporting each of these commitments. Ms. Ranagan responded that she believed the commitments to be reviewed would have a law or treaty or some other formal document that could be used to define the boundaries of the commitment.

Ms. Robinson indicated that she has different feelings about each of the groupings and whether they are addressed in budgetary or financial reporting. She feels that GSEs (to which she would add IMF and other similar groups) are much more important and would be considered phase one rather than phase three. Ms. Ranagan indicated that the Board could determine the priority of the groupings to be reviewed.

Mr. Anania feels that the word “commitments” is too broad and would like to see it narrowed. In addition, he indicated that it is too early to commit to the phases in the paper and would like to examine them more completely. He referenced the designations of type made by GAO in the chart of “Selected Fiscal

Exposures” and stated that they may be useful to the Board in narrowing the general concept of commitments. He asked for the Board’s feelings on the categorizations in the GAO chart.

Mr. Calder said he does not believe the Board would benefit from exhaustive research into what the categorizations should be. He said he believed there was a pretty good list in the CFR MD&A.

Mr. Patton stated that he thinks the phases could be grouped according to whether the commitments are explicit or implicit; monetary or non-monetary; and whether the commitments are made to individuals or are collective goods type of commitments. He felt that the way the phases are structured would affect the outcome.

It was tentatively decided that the Board would hold off on developing phases until a preliminary survey of the programs to be reviewed was performed. Mr. Patton cautioned that the net should be cast broad enough to capture anything that looks like a commitment. Ms. Ranagan stated that she would obtain additional information on the types of commitments to be reviewed and then recast the project plan for the Board’s review using the terminology suggested by Mr. Patton before going further into the recognition and measurement stage of the project.

Mr. Patton questioned whether commitments are less than liabilities. Ms. Ranagan stated that the word commitments include liabilities but would also include something that does not meet the recognition criteria but might need to be disclosed.

Mr. Anania pointed to the fourth type on the GAO chart – “Implicit Exposures Implied by current policies or the public’s expectations about the role of government” – as having some of the same notions as constructive obligations. He said he sees where this project will cross over into the social insurance project.

Mr. Schumacher asked what staff sees as the end result of this project (a standard on long-term commitments, a series of standards, etc). Ms. Ranagan responded that it would depend on the result of research and how closely the programs fall out as to whether it would be one standard or multiple standards. She reiterated that this will be a long-term project.

Mr. Patton indicated that he felt the project was worthy but questioned the opportunity cost of what else staff could be working on. Ms. Comes responded that she sees this project as facilitating progress on the concepts and social insurance projects. She does not believe the Board can make reasonable progress on those projects unless they are also concurrently looking at other programs of the Federal government. She would see the opportunity cost of not

addressing this project as slowing progress on the concepts and social insurance projects.

Mr. Anania asked if there was a benefit to looking at this as primarily a research project as opposed to a plan that will end up with one or more standards. He inquired as to what the deliverable will be. Ms. Comes agrees that she views this as research; she sees it as the application of evolving concepts. Mr. Reid agrees that it would be good to know what the impact of the liability definition project would be before crashing ahead.

Mr. Farrell said he thinks there is a disconnect between the background information provided and the project plan. He said he does not think putting the commitments in the financial statements is going to have an impact on whether the behavior of government is going to change. He does not know if the Board should undertake a lot of work in this area if the Board will not have an impact on changing the behavior of government. Mr. Mosso said staff could obtain a list of significant commitments from each of the individuals quoted in the project plan to get a first cut as to what the overall list should be.

Mr. Anania asked for clarification on the title, asking if we were trying to get at other possible liabilities and other possible disclosures. Ms. Comes explained that we originally had an "other liabilities and commitments" title to the project, but having the term liability in the title seemed to presuppose the outcome of the project.

Mr. Mosso summarized three basic outcomes for each of the commitments to be reviewed under the project: (1) recognize on the balance sheet; (2) disclose in some way; or (3) ignore.

Ms. Comes stated that we could title the project "Research into the application of the liability definition." A broad title such as that would suggest that we are in the initial phases of research and not moving towards issuing an exposure draft of standards. A broad title would help distinguish the project from one that is further down the development path.

Mr. Zavada stated that he feels as long as the social insurance project is on the agenda, a project such as this would need to be on the agenda as well, either as part of the social insurance project or as companion research.

Mr. Mosso summarized that everyone agrees that the first stage is research so the terminology characterizing the project need not be finalized at this point. Mr. Mosso directed staff to do some preliminary research and come back with a firmer project plan after performing an initial survey.

Mr. Calder reiterated that he does not feel that research needs to be exhaustive. He recommended that research be limited. Ms. Ranagan indicated her intention to solicit a list of significant commitments from each of the individuals quoted in the project plan to get a first cut as to what the overall population should be.

Ms. Ranagan requested and received positive confirmation from the Board that the agreement for staff to do more research on the project was present.

CONCLUSION: Staff will rename the project “Research into the Application of the Liability Definition.” Staff will solicit input from selected parties regarding the major commitments of the federal government, target the specific programs to be researched, and begin preparing fact sheets as to the specific characteristics of each program. Staff will update the project plan phases to incorporate the suggestions made by the Board, including the use of the terms implicit, explicit, monetary, and non-monetary as distinguishing characteristics.

- **Identifying and Reporting Earmarked Funds**

Staff identified six issues that required Board decisions in order to move the project forward.

1. The term “significant”

Staff reported that numerous respondents to the Exposure Draft (ED) requested clarification on the term “significant. [The term “significant” was used in the ED to describe earmarked funds that should be disaggregated in the Note disclosure.] Staff suggested that the Board choose between two alternatives: (1) to add the term “Significant Earmarked Funds” to the glossary, and provide guidance in the glossary and in the text; or (2) to delete the word “significant” and provide additional guidance regarding factors to be considered in selecting funds to be presented individually. Mr. Patton said that his preference was the second alternative, because it relies on the “materiality” provision included in all FASAB standards [that the standard need not be applied to immaterial items]. Mr. Reid asked if the standard will still require immaterial earmarked funds to be aggregated in the Notes, but included in the total. Staff confirmed that this provision would remain, so that the total in the Notes will relate to the total in the financial statements. The Board reached a consensus for the latter alternative. A new paragraph, shown in the text box below, will be added. Other implementing changes, provided in Appendix B of the April 2004 briefing materials, also will be made.

21. Selecting earmarked funds to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity’s earmarked revenues or cumulative results of operations from earmarked funds; and qualitative factors such as whether an earmarked fund is of immediate concern to constituents of the fund, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the financial statements would be the primary source of financial information for the public.

2. Funds explicitly excluded

Three categories of funds excluded

Staff noted that there were three categories of funds that otherwise meet the definition criteria but were not intended by the Board to be included in the reporting requirements. One category is new. The written responses to the ED noted that credit financing accounts appear to meet the definition criteria. However, credit financing accounts, which are nonbudgetary funds that do not

incur net cost of operations, do not impact the net position of the component entity or the U.S. Government. Mr. Mosso observed that the subsidy is appropriated and reported in a general fund account, and not in the financing account. The financing account serves as a long-term clearing account. In order to deal with all three categories of funds excluded, staff recommended a separate “exclusions” paragraph that would exclude intragovernmental funds, credit financing funds and fiduciary funds from the reporting requirements for Earmarked Funds. Staff noted that intragovernmental and fiduciary funds were excluded elsewhere in the standard. Staff recommended a separate “exclusions” paragraph titled, “Exclusions from Reporting Requirements” to appear immediately following the definition criteria.

Approval of new “Exclusions” paragraph

The Board agreed that the proposed new paragraph 11 should be inserted, and the following paragraphs re-numbered. Mr. Anania recommended that staff contact one of the respondents to see if the changes approved by the Board provided adequate clarification. Mr. Mosso noted that additional clarification and guidance were provided in the proposed changes to the table and description in Item 3. The new paragraph appears in the text box below.

Exclusions From Reporting Requirements

11. Certain categories of funds are excluded from the reporting requirements of this standard. Intragovernmental funds, which are revolving funds that conduct business-type operations primarily within and between Government agencies, are excluded from this standard. Credit financing funds, which are nonbudgetary funds that do not incur net cost of operations, are also excluded from this standard. Fiduciary funds, which are not Government-owned, are also excluded.

Staff also asked the Board if clarification was needed regarding the predominant activity of a fund. Staff mentioned two examples: funds where an intragovernmental fund might increase its business with the public; and when some of the funds were given to Treasury at the end of the year, but some were kept. Ms. Cohen said that the ED had already dealt with the latter issue by specifying that only the funds that were retained from year to year would fall under the definition criteria. Staff asked if the definition should be applied to an entire fund, or below the level of a fund. Ms. Cohen asked what was meant by a fund, and staff responded that in this discussion “fund” meant Treasury account fund symbol. Mr. Farrell asked if anything below the level of a Treasury account fund symbol could meet the definition criteria. Staff replied that this was possible, because the “required accounting mechanism” did not always have to

be a Treasury account fund symbol. Mr. Calder noted that the primary purpose of the proposed Earmarked Funds standard related to Social Security, Medicare, the highway fuel tax and other major funds. Mr. Mosso said that accounting below the level of a fund symbol was not intended.

Mr. Anania noted that the concern was to make sure that the definition criteria in the ED did not “sweep things in” that were not intended to be. FASAB General Counsel Mr. Jeff Jacobson noted that intragovernmental funds were defined in paragraph 11 of the ED, which required that they be “primarily” engaged in business-type operations primarily within and between Government agencies. The Board agreed that the term “primarily” was sufficient to classify funds as intragovernmental funds versus public enterprise funds, and that the term “required accounting mechanism” should be sufficient to cover funds with a variety of activities.

3. Revised Table to Illustrate the Relationship of the Standard’s “Earmarked Funds” to Fund Groups Used in Reporting to Treasury and the OMB

Staff noted that respondents had questions and comments about the table in the ED, and proposed changes to the chart and descriptive paragraph to address concerns identified. Staff pointed out a new sentence, “Regardless of classification for reporting to Treasury or the OMB, funds meeting the definition of earmarked funds promulgated in this standard should be so classified and funds not meeting the definition should not be so classified.” Mr. Patton questioned the word “generally” being used in a standard. Ms. Comes noted that the table was in the “Introduction” section, and not in the standard itself. The Board members indicated no objections and approved the proposed changes. The revised paragraph 6 and table appear below.

6. The following chart shows fund types used in the Federal Budget reporting to the Department of the Treasury and the Office of Management and Budget (OMB). It is intended only to show the general relationship between fund groups and earmarked funds as classified in this statement. Regardless of classification for reporting to Treasury or the OMB, funds meeting the definition of earmarked funds promulgated in this standard should be so classified and funds not meeting the definition should not be so classified.

Fund Groups Used in Federal Reporting to Treasury and the OMB

Fund Groups and Major Classes	Generally Are Subject to the Reporting Requirements of this Standard	Generally Are Not Subject to the Reporting Requirements of this Standard
General Funds0000-3999		X
Revolving Funds.....4000-4999 Intragovernmental Revolving Funds Public Enterprise Funds: Credit Reform Financing Funds All Other Public Enterprise Funds	X	X
Special Funds 5000-5999	X	
Deposit Funds6000-6999		X
Trust Funds8000-8999	X	

4. The term “earmarked”

In response to an issue raised at the public hearing in March 2004, staff asked that the Board review the “pro and con” chart of various terms to consider whether “earmarked funds” was the best term available. Mr. Anania said that he was reluctant to totally walk away from the term “earmarked funds,” and felt that changing the term at this point might create confusion. Mr. Mosso said that OMB uses the term in two different ways, one of which is close to the usage in the proposed standard. Mr. Anania asked if the ED did not adequately cover the difference between OMB’s meaning versus the ED’s use of the term “earmarked funds.” Ms. Cohen said that the question being raised was whether to use the term “earmarked funds” or not, and that she preferred “earmarked funds” but could also accept the term “dedicated,” which was the term used at the beginning of the project. Ms. Cohen said that the other terms listed, such as “reserved,” “restricted” and “special” had different and specific meanings in her environment. Mr. Bob Kilpatrick, staff advisor to the OMB representative, recommended that the Board stay with the term “Earmarked Funds.” Mr. Kilpatrick stated that he had communicated with several individuals at OMB and that although some had thought that

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the term might cause confusion, after discussion had agreed that the explanation of the difference in the ED would be sufficient. After a brief discussion, the Board decided that the disclaimer in the first paragraph of the Executive Summary would be sufficient, and that the term “Earmarked Funds” would be retained.

5. Clarify Reference to Exchange and Nonexchange Revenue

Staff noted that paragraph 3 of the Introduction section of the ED uses the terms “revenue” and “other financing sources” in a manner that may be confusing to readers. Staff proposed revised wording to make the paragraph clearly consistent with the concepts of “exchange” and “nonexchange” in the Revenue Standard (SFFAS No. 7). Ms. Cohen said that the words “from a variety of sources” should be removed from the sentence to avoid redundancy in the revised sentence, and staff agreed. Mr. Anania asked if this change would impact any other part of the Standard, and staff replied that it would not. Staff noted that respondents to the ED had noted that the ED did not sufficiently address exchange revenue. Staff said that the change to paragraph 3 and proposed additional transactions in Appendix C were intended to address that concern. The Board had no objections to the changes, which are shown in the text box below.

3. Earmarked funds receive revenue and other financing sources (such as appropriations) ~~from a variety of sources~~ and serve a variety of purposes. Revenue sources may be exchange or nonexchange and include but are not limited to payroll taxes, excise taxes, customs duties, fees, user charges, ~~and sales of goods and services~~. ~~Other financing sources include appropriations~~ and interest earned. In addition, although earmarked funds are usually the responsibility of a single entity, management responsibility for some earmarked funds is shared by two or more entities.

6. Expanded Appendix C: Pro Forma Illustrations

Staff proposed the following changes to Appendix C:

- Pro forma illustrations should include both exchange and nonexchange revenue
- Pro forma illustrations should distinguish between Treasury Department operations and the Treasury General Fund
- To promote immediate understanding of the term “Earmarked Funds,” the name of the largest earmarked fund should be included in the line titles of the financial statements.

The Board had no objections to the changes.

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7. Other issues discussed

Impact on the Consolidated Financial Report (CFR) of the U.S. Government

Staff also provided the Board with an illustration of how the CFR might appear under the ED's reporting requirements. The illustration was included in Attachment C of the April 2004 briefing materials.

Revisions to Appendix D of the ED

While reviewing the CFR materials, the Board noted that note disclosure requirements were different for the CFR versus component entities. [Paragraph 26 of the ED requires the CFR note disclosure to display eliminations in addition to condensed information about assets, liabilities, net position, gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.] Since Appendix D of the ED illustrates a component entity note disclosure, the Board recommended that staff insert wording into the text and title of Appendix D to make it clear that the note disclosure in Appendix D illustrated a component entity.

CONCLUSION:

Staff will provide a summary of comments. Staff will add a "disposition of comments" column to the summary tables of written comments received, indicating any changes made to address the concerns identified. Staff will contact respondents regarding changes made on several major issues to obtain feedback regarding whether the changes effectively address concerns identified. For the next meeting, staff will prepare a draft with revisions based upon the Board's decisions at the April 2004 meeting.

Adjournment

The meeting adjourned at 2:30 PM.