FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
June 30 – July 1, 2004
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, June 30, 2004 – Marriott Wardman Park Hotel, Washington, DC

Administrative Matters

- **Attendance**

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

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

Minutes on June 30 – July 1, 2004

Agenda Topic

- **Accounting for Old Age, Survivors & Disability Insurance**

Speaker Minutes

June 30, 2004

Messrs. Gutterman, Gokhale and Goss joined the Board and staff for a Roundtable Discussion. Each presented comments on the issue of Accounting for Old Age, Survivors and Disability Insurance (OASDI). Following speaker presentations, members, guests and staff discussed the issues.

Sam Gutterman spoke about actuarial estimates, liabilities, criteria (i.e., relevance to users, reliability, consistency and transparency), and recognition events. With respect to actuarial estimates, he said measurement reliability was a function of (1) the nature of the cash flows, (2) available experience, and (3) the time period over which the estimates are made.

With respect to liabilities, Mr. Gutterman said that the issue involved both liability recognition, measurement and disclosure. Depending on the type of the obligation involved, the use of disclosure in a manner similar to the SOSI may be appropriate.

He emphasized the need for a consistent set of liability criteria. He said relevance is the crucial criterion and might depend on who the users of the financial report information are. Regarding reliable estimates, he said long-term estimates are not necessarily less reliable or less measurable that short-term estimates.

Regarding the consistency criterion, Mr. Gutterman said it had various aspects: consistency among actuaries or other professionals making similar projections or the same projection with the same set of information; consistency with funding objectives of the program; consistency with corresponding assets, if any; internal consistency among assumptions; and, consistency with the measurement of the liability for other federal government programs.

He added that the approach should be transparent, i.e., it should be understandable at the minimum to reasonably knowledgeable professionals and accessible to all who are interested.

Mr. Gutterman noted that liabilities for social insurance programs are more difficult to define than other liabilities in that the liabilities that are responsive to future economic and demographic conditions and changes in these conditions. They represent potentially open-ended current promises. But he said relevant, reliable, understandable information related to performance, obligations and expectations was needed; and, as the vehicle for which, he did not rule-out the SOSI.

Jagadeesh Gokhale, Cato Institute, noted that the project's objectives included FASAB Objectives 2A and 2B (costs and accomplishments of providing specific programs; composition and changes in cost); 2C (efficiency and effectiveness of asset and liability management); 3A (whether the government's financial position improved or deteriorated); and 3B (whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due). He said the program costs occur over the participant's lifetime and an inter-temporal and forward-looking perspective is needed.

Regarding Objectives 2A and 2B, he said that provision of OASDI is expected to last over participants' lifetimes and, therefore, evaluating the composition and changes in costs requires a forward-looking perspective. Regarding Objective 2C, he said assessment of asset and liability management crucially depends on whether those items are defined under a forward-looking perspective. Likewise regarding Objective 3A, the assessment depends on the definitions adopted for financial position. A forward-looking perspective would yield a different judgment on financial position than otherwise.

Mr. Gokhale discussed the taxpayers' and policymakers' concern with the sustainability of current policy. He cited especially FASAB objectives 3A, and 3B. He said sustainability suggests a forward-looking perspective. In short, he viewed all four Objectives as having a forward-looking objective and essentially addressing sustainability.

Mr. Gokhale said that although the current discussion is limited to Social Security, the sustainability issue encompassed the government's entire current policy not just the Social Security program. The information should illustrate whether current policy is sustainable and should reveal the trade-offs involved in making alternative policy choices.

He said that defining financial position of anything requires a reference point, and in the case of a program like Social Security, the reference point is the program's financing constraint. Social Security is financed mainly out of payroll taxes and income taxes on Social Security benefits that are exclusively dedicated to that program. In addition, no other revenues are allocated to paying for Social Security's outlays. Hence, the constraint it faces is that all outlays must be paid for out of dedicated payroll tax revenues. The constraint can be expressed as: The present value (PV) of future outlays (O) minus PV of future revenue (R) and minus the trust fund balance (TF) should equal zero, over the infinite horizon. Evaluating the present values under current tax and benefit policies yields the "open group obligation." It focuses on the future. Using this approach Mr. Gokhale said a sustainable policy is one where PVO – PVR – TF = zero. Under a given policy, (for example, current policy) any result other than zero is the "distance from sustainability" in today's dollars, of that policy. Mr. Gokhale also calls this measure the "fiscal imbalance." He said this formula factors in the net effect of all past transactions, i.e., the TF balance as well as the PV of future outlays and revenue under current policy. He emphasized that the constraint holds only over the infinite horizon.

Mr. Gokhale noted one shortcoming of the fiscal imbalance approach: it does not show the differential economic impact of certain types of policy changes on various generations. For this he said a closed group obligation is needed, which isolates the effect of past and current participants from that of future participants. He calls the closed group measure the "generational imbalance."

Thus, he said the open group obligation tells us how far current policy is from being sustainable and whether any particular policy change brings overall policy closer or moves it further from sustainability. The closed group obligation tells us about the contribution of past and current generations to the overall fiscal imbalance (open group obligation) and about the impact of policy changes on past-plus-present versus future generations.

He presented a financial statement or table that would reflect financial position or sustainability under current policy. The table presented the fiscal and generational imbalances under current policy. He said it would be a very different approach compared to recognizing certain items as liabilities and excluding others.

Mr. Gokhale noted that liabilities involve accrual concepts focused on the past. They won't show, for example, the implications of a new payroll tax rate beginning today. He viewed accrual accounting as predicated on "shutting down" Social Security. But a "valid expectation" is that OASDI will continue in the future (in some form).

Stephan C. Goss, Social Security Administration, noted that people often talk about "promises" that Social Security makes but he said it might be better not to refer to the scheduled benefits as promises. Adjustments tend to be needed and are made that modify the benefits going into the future. It's not that there is an intention to break them, he said, but that modifications are necessary.

Mr. Goss noted that there are several means by which information about the financial status of the Social Security System is conveyed to the public and to Congress. One of the principal methods is the trustees' annual report. It includes an actuarial assessment that addresses the solvency issue. He said there is a distinction between the actuarial status of the program as actuaries and trustees see it and the program's financial status. The latter is more the focus of the financial statements, which is attuned to assets and liabilities. Financial status involves both the SSA's financial statements and the CFS, which contain extensive FASAB-prescribed information.

He said actuarial rules require that evaluations be consistent with the financing mechanism. Actuarial status is related to solvency, defined as the ability to pay benefits and/or whether the trust funds are exhausted or not. The trustees therefore monitor cash flows, including the present values of cash flows. It is a very forward-looking view, as Mr. Gokhale was describing. Mr. Goss characterized Mr. Gokhale's presentation as being very much an actuarial status kind of consideration.

The FASAB's work involves other considerations, including the liability consideration. Mr. Goss would distinguish obligations from liabilities. As used in the Social Security trustees' report, the former represent scheduled benefits. They are not payables. He reiterated that Congress can and does change the benefits. As understood at Social Security, liabilities are obligations payable to date based on past actions. They occur when the program concretely says it will pay benefits of a certain amount to a person at a given point in time. It excludes accrued future obligations because they do not reflect a legal, contractual, fixed commitment from the program. He said future benefits of OASDI obligations are non-exchange transactions and would fail the third essential liability characteristic, i.e., a past transaction or event.

Regarding the six past events included in the staff paper, Mr. Goss opined that the staff's recommended event (work in covered employment) might fail the "past event" characteristic of a liability because the measurement would include future events. He discussed with staff and Mr. Reid the probable focus of that past event, i.e., work in covered employment up to the reporting date but not beyond. He said in that case there would be a past event.

He said that heretofore FASAB has characterized Social Security activity as involving non-exchange transactions where benefits are not presumed to naturally or inevitably derive from work in covered employment and/or paying into the system. The benefits are not connected directly to having paid into the system.

Mr. Goss said he would favor the current "due and payable" measure. He mentioned the alternative concept of constructive liabilities that requires the four criteria in the staff paper (i.e., an established pattern of accepting responsibilities, reasonable expectation, reliance, little or no discretion). He said scheduled benefits clearly fail these criteria. There have been reductions in the obligation in the past, which clearly fail criteria 1, 2, and 4. And surveys of participants clearly indicate a significant lack of expectation.

He suggested that we already report many useful measures of future obligations and of the financial status of the program divided into actuarial status and financial liability consideration. He listed the following:

- Open group unfunded obligation addresses the actuarial status of the program for the period as a whole. The 75-year open group unfunded obligation addresses the actuarial status over that time period.
- Projected trust fund asset levels addresses the question of solvency for each future point in time. The trajectory of trust fund ratios in the final years of the 75-year period is a good indication of solvency: having increasing trust fund balances is a good sign.
- Accrual concepts like those Mr. Gokhale presented and those trustees' annual report now includes are interesting but unrelated to the financial or actuarial status of a pay-as-you-go program. Accrual measures like the closed-group unfunded obligation, the net present value for future entrants, "maximum transition cost", entry–age normal cost are appropriate for evaluating the financial status of programs designed to be fully advance funded.

Mr. Goss concluded by stating that the current FASAB standard is a very sound and reasonable place to be.

Q and As

During the question and answer session Mr. Calder asked the presenters what kind of information should be reported regarding the federal government's solvency and sustainability as a result of Social Security. Mr. Gokhale responded that the open group unfunded obligation that he presented could be calculated for the government as a whole and for the component programs based on current policy. Mr. Gutterman said he thought it would be useful for the users of financial statements to both look at the overall CFS statements and the Social Security Trustees' report. Mr. Goss mentioned that CBO and OMB and others are currently doing forward-looking projections for the government. He said that, if the question is how the notion of constructive obligations relates to programs other than Social Security, e.g., whether there was a constructive obligation for national defense, then that would be a big area to get into.

Mr. Patton asked for comments on the role of expectations in deciding whether to book a liability.

Mr. Goss said he thought that the expectations for Social Security benefits would not be as strong as for some programs where there is a legal contract, or for the government's debt. He said not only do we have uncertainty about our projections into the future because of the unreliability of our methods and the assumptions we make, but there is even uncertainty about what the level of benefits will be. Congress will make changes.

Mr. Gokhale said that as you get closer to receipt of benefits the uncertainty decreases and the expectations and reliance increase.

Mr. Gutterman said he did not think expectations and reliance were black and white issues. They can be difficult concepts to apply. He tends to think age-related closeness to benefits may be just as important as the uncertainty associated with the future payment of those benefits. He indicated that it was quite difficult to determine the extent that future beneficiaries currently rely on their future benefit payments. He said that how to draw the line between reliance and non-reliance because of information regarding the program by the government would be quite difficult and would likely vary by age and income expectations. Regarding consistency, he repeated his earlier statement that consistency is a criterion for judging whether there is a liability or a disclosure item. Inconsistency with the funding pattern definitely should be considered.

Mr. Patton asked Mr. Gutterman whether, if consistency with the funding pattern should be considered, a liability should be recorded if it were possible to fully advance-fund the program. Mr. Gutterman said that in the private sector model it would be a matter of policy in terms of your funding approach to providing the benefits. One would be look toward developing a consistent basis for use in preparing financial statements.

Mr. Gokhale said Mr. Patton's question hit the nail on the head. These types of questions are not fully satisfactorily answerable and that is why we need to focus on a different metric or a different approach that characterizes the styles of current policy, that takes into account both resources and outlays, that shows the implications of current policy in terms of sustainability. Ultimately the decision-maker has to be prepared to change current policy, and that decision has to take into account both sides of the balance sheet.

Mr. Goss said that if the system were fully advance-funded he would still suggest that the notion of liability for the future benefits would be inappropriate under the assumption that nothing changes except the advance funding. The program presumably would retain its mutability. He suggested we would be better off doing what the FASAB did in SFFAS 17 and 25.

Mr. Mosso asked what the panel thought about an approach where a third number would be added to the table or possibly on the balance sheet, in addition to the closed group and the open group numbers. The open and closed group numbers are understandable, he said, because they come from the same basic numbers that you can explain. We cut off certain parts of the population. A third number might cut off another piece of the population.

Mr. Gutterman did not see a problem with such an approach as long as it was clearly described and communicated. Mr. Goss said SFFAS 17 required disclosures and additional ones would be possible. He suggested meeting a liability definition would not be necessary consideration for possible inclusion. Mr. Mosso said SFFAS 17 was up for reconsideration.

Mr. Calder asked whether the open group number bears any relationship to a liability. He sees the open group obligation as a cash flow number that bears no relationship to a liability. The closed group number on the other hand does bear some relationship to a liability.

Mr. Gokhale said the open group number reports a shortfall of resources relative to outlays of a given population over the infinite or other time period.

Mr. Schumacher asked for comments from the panel about the private sector requirement that a liability be recognized for OPEB despite its mutability and vulnerability to cancellation.

Mr. Goss said that, given the mutability, etc. of the OPEB amount, maybe it would be better to refer to it as an obligation and not a liability and come up with different terminology. He said the question is, if you have liabilities that are true contractual liabilities versus others where the employer can pull the rug out at any time, do people understand the difference and know that they are not the same?

Ms. Robinson said that, with respect to the usefulness of those kinds of private sector disclosures, they are not totally out of line with the revenues and cash flows of the entity. But we are talking about putting $44 trillion on the balance sheet, an order of magnitude different.?

The session concluded at this point.

Adjournment

The meeting adjourned at 5:15 PM.

Thursday, July 1, 2004

Agenda Topics

- **Update on Dept. of Defense Progress on Accounting for PP&E**

At the July 1, 2004 Board meeting, Mr. Richard Sylvester, Deputy Director for PP&E Policy, OUSD (AT&L), Department of Defense (DoD) and Mr. Ken Schreier, Senior Accountant, Office of the Undersecretary of Defense (Comptroller), DoD presented: 1) a DoD status briefing to the Board on implementing the new accounting and reporting requirements for military equipment; and 2) an issue that had come up in regard to implementing the new requirements.

Mr. Sylvester described four activities the Department was engaged in during the implementation of the new requirements. The four activities Mr. Sylvester addressed during his briefing were 1) Business Rules 2) Historical Cost Baseline Valuations 3)Military Equipment Valuation (MEV) Training Plan 4)Mid-term Systems Solution:

Business Rules

Mr. Sylvester said that the Department's business rules are divided into financial rules and a property rule. The principle based financial rules were provided to the DoD Inspector General (IG) and the GAO for comment. He noted that representatives from both organizations indicated general agreement. However, two issues remain. One has to do with the Department's capitalization threshold. DoD's capitalization threshold is $100,000. The issue raised by the auditors is whether the threshold is too high. The second pertains to "high value" spare parts. Specifically, should high value spare parts be classified as equipment and capitalized; or, should they be classified as operating materials and supplies (OM&S). An example of the spare parts in question is engines.

In regard to the property rule, Mr. Sylvester explained that the Federal Acquisition Regulations (FAR) is somewhat different than the Department's Financial Management Regulations (FMR) in regard to Government property in the hands of contractors. He stated the Department is working to bring the FAR and the FMR into consonance. That is, to make it clear that the Government has fiduciary responsibility for property in the hands of contractors, while the contractors have stewardship responsibilities. He added that the coordination among all affected parties was going well; and, the draft proposed property rule was to be forwarded to the Defense Acquisition Regulations Council the first week of July.

Historical Cost Baseline Valuations

Mr. Sylvester stated the second activity the Department is involved in was establishing an historical baseline valuation for its military equipment (ME) programs. He explained that there were 890 high dollar programs and, to date, 210 programs have been completed and 159 are currently in-process. Their goal is to have 95% of the ME programs completed, that is, valued, by the end of fiscal year 2005. Their fiscal year 2006 objectives are to: complete any remaining ME program valuations; conduct training with military components; and, transition baseline values to components for updating.

Military Equipment Valuation (MEV) Training Plan

The third activity that Mr. Sylvester said the Department was engaged in was "change management." He explained that they were working on the ability to do training for the work they have been doing. He noted that, since business processes were changing, courses at the Defense Acquisition University would have to be changed and updated. In addition, they were developing four sets of learning courses that can be accessed on line and a web page to communicate with people about the valuation process. The four sets of e-learning courses are:

- MEV Awareness Training -- to create an understanding of the MEV requirement.
- Baseline Valuation Update Training – to train Program Offices how to update the baeline values between now and October 2006.
- Transaction-based Valuation Training – to explain roles, responsibilities, and specific tasks associated with using the valuation template, collaborating with accounting personnel, etc.
- Property Rule Training – to provide on update on recent changes to property requirements and regulations.

Mid-term Systems Solution

Mr. Sylvester noted the fourth activity DoD was engaged in was mid-term systems solution. He indicated this was a very important activity. He explained that after completing the baseline equipment valuations, the Department must develop transaction-based valuation processes and systems to update and maintain the information. Their concept is to use current systems where they are available, making modifications where appropriate. If current systems and modifications cannot meet the requirements for transaction-based systems, then they would develop an enterprise system solution. Mr. Sylvester indicated that they have begun to develop the requirements to support their strategy. He also said the design phase begins this month (July), with the scheduled implementation date being January 2006. ?

Issue- SFFAS No. 23 Language

A detailed issue paper was provided to the Board members. The paper contained background information, details pertaining to the issue, and a suggested solution to the issue. Below is a summary of the issue and a proposed DoD recommendation, which was presented by Mr. Sylester. **Issue -** SFFAS No. 23 has been interpreted by some to require the continuation of the definitions included in SFFAS No. 11. That is, items meeting the SFFAS 11 definition of ND PP&E are required to be classified as general PP&E. This would impose a unique requirement on the Department of Defense and would mean that some items that might properly be reported as OM&S, such as spare parts, would have to be reported as Military Equipment

Recommendation – The Department believes that this issue could be addressed through a Technical Release that clarifies the intent of the Board - items previously defined as ND PP&E should be classified in accordance with existing standards.

The Executive Director, Ms Wendy Comes, noted SFFAS 23 states that in the event DoD is unable to resolve issues, the Board and its staff would be available to consider issues and implementation guidance. She indicated that staff had met with DoD representatives on this issue. In light of the failure to resolve the issue through informal consultation, she believes implementation guidance should be developed. She noted that she did not envision incorporating specific classification guidance. Simply dealing with the notion that SFFAS 23 requires that all items of ND PP&E be classified as general PP&E would permit DoD to apply any definitions that exist in SFFASs to arrive at appropriate classification.

Mr. Anania asked if the issue was strictly a classification issue. Mr. Schreier responded that it was strictly classification. Mr. Calder noted that when the Board issues standards, there are people who read them very literally. He said they should focus more on the principle. Mr. Calder added that he believes DoD can come up with several solutions that would be perfectly acceptable.

Mr. Anania asked if DoD was working with other agencies in regard to system and implementation issues. Mr. Sylvester responded that they were and cited the Joint Financial Management Improvement Program (JFMIP), the Coast Guard, and NASA as examples. Mr. Anania also asked if DoD was working with other agencies in regard to government property in the hands of contractors. Mr. Sylvester replied they were and cited NASA and the DoD's work with the FAR as examples.

The Chairman, Mr. David Mosso, indicated that the Executive Director had been working on this issue and thought it had been resolved. The Executive Director explained that she worked on a draft staff implementation guidance paper. However, after meeting with the DoD Inspector General (IG) auditors involved with this issue and discussing it, she believed the issue had been resolved.

Mr. Mosso stated that the staff would begin the process of issuing staff implementation guidance for SFFAS 23.

- **Administrative Matters**

Ms. Comes introduced new staff member Sebastian Rodriguez and summer intern Jennifer Lloyd. She noted that Mr. Rodriguez would join Mr. Fontenrose in working on Social Insurance issues. Ms. Lloyd has been assisting Ms. Loughan in researching Heritage Asset issues.

Ms. Comes explained that the draft Statement of Board Members' Responsibilities had been clarified to indicate that only federal members may send alternates when unable to attend a FASAB meeting. The Board agreed with the change.

Mr. Mosso noted that the current events clippings included an article about CBO's new Social Security projections and the solvency under various proposals. Ms. Robinson explained that many proposals change the notion of "solvency" for trust funds by providing transfers from the general fund. Mr. Mosso asked if Medicare receives general fund transfers to the trust fund. Ms. Robinson indicated that they did and that it is impossible to assess "solvency" for a trust fund with an uncapped draw on the general fund. It becomes difficult to assess on a single program financed by the general fund distinct from the rest of government – also financed from the general fund.

Mr. Mosso highlighted the article on NASA's financial statements receiving a disclaimer of opinion for FY 2003 (page 25). He indicated that this situation – where an agency received many clean opinions through heroic efforts and subsequently has failed audits – highlights the need to address internal controls. Mr. Reid explained that the NASA situation was exacerbated by an arrangement regarding federal property held by contractors. A prior auditor had accepted the procedures used to value those assets but the current auditor did not accept the approach.

Mr. Zavada explained that NASA also operated in a very decentralized environment – that is, each center had its own financial accounting policies and systems. This complicated the audit as well. Ms. Robinson indicates that the NASA situation must offer a wake up call to other federal agencies -- particularly where contractors run federal programs and facilities. The federal government owns the entire operation but the federal government has limited access to records.

Mr. Anania asked Mr. Zavada if his work on internal controls will include an assessment of situations like NASA (where clean opinions are attained but controls are poor)? Mr. Zavada indicated that this scenario would be included.

- **Identifying and Reporting Earmarked Funds**

<u>Issues Raised by Respondents</u>

Staff noted that the staff analysis in the Earmarked Funds briefing materials identified 19 issues raised by respondents. Staff requested that due to time considerations, the Board members should indicate which, if any, of the 19 issues they wished to discuss.

Staff also distributed a handout with a revised proposal to address Item 16 in the staff analysis. The revised proposal would clarify the Note on Investments by changing the following sentence from active to passive, to clarify that the U.S. Treasury, and not the agency administering the program, that uses the cash raised by earmarked funds for general government purposes: "Instead, the U.S. Treasury uses the cash generated from earmarked funds ~~is used~~ for general Government purposes." No other changes would be made. The Board had no objections to the proposed revision.

Bob Kilpatrick, staff support for the OMB member, noted that the revised draft Earmarked Funds standard was not updated for the proposed change described in the handout. Staff made note of this, and said that the final draft would be updated in accordance with the change approved by the Board.

The term, "required accounting mechanism"

Dr. Robinson noted that upon reading the responses regarding "a required accounting mechanism," she could understand how an agency might be uncertain about whether a separate Treasury fund symbol was necessary. Staff noted, and Mr. Farrell affirmed, that at a previous Board meeting, the Board had been reluctant to name the Treasury Account Fund Symbol or any other specific accounting mechanism since they were subject to change. Staff mentioned that the USSGL Board respondent had indicated that the revised illustrative table, which shows the general relationship of earmarked funds to the major fund groups, had adequately addressed the concern of what types of funds were most likely to meet the definition criteria. Mr. Calder said that "accounting mechanism" needed to be defined. Mr. Anania observed that there is always a tension between having a principle-based standard and having a detail- -based standard. Mr. Farrell said that there was a definition of "accounting mechanism" in paragraph 13 of the ED. Ms. Comes suggested a footnote to the words "report on" that a "report" may be something other than a stand-alone audited financial statement for the earmarked fund. Mr. Anania asked if it would be better to tie paragraph 13 to the statute.

Staff noted that there were two suggestions being discussed: 1) add a footnote to the word "report" in criteria 3 in paragraph 11 saying that a report does not necessarily mean separate audited financial statements for the earmarked fund, and 2) a footnote to paragraph 13 that the statute need not require a particular type of accounting mechanism. Mr. Anania asked why there would need to be a footnote rather than an addition to the text of paragraph 13. Mr. Mosso asked staff to combine those two thoughts and insert them into paragraph 13. Mr. Anania and FASAB legal counsel Mr. Jacobson agreed that "may or may not" would be preferable wording. Staff read the proposed new sentence to the Board: "The statute may or may not require a particular type of accounting mechanism or report, such as separate audited financial statements." Mr. Calder said that he interpreted the term "accounting mechanism" to mean "fund," and asked why the standard did not say that. Mr. Farrell replied that the accounting mechanism may or may not be a fund, and referred to the sentence in paragraph 13, "Application of this standard, however, shall not be based on whether a statute or the unified budget labels the accounting mechanism as a fund." Mr. Calder said that the standard should say that there is a requirement to track what was taken in and what was expended. Mr. Farrell replied that this is already described in criterion 1 of the definition. Mr. Calder said that in that case criterion 3 is not needed. Mr. Anania and staff confirmed that criterion 3 is an expansion of criteria 1 and 2. Mr. Jacobson asked if Mr. Calder's concern could be addressed by removing the term "accounting mechanism" from criterion 3. Staff replied that the term "accounting mechanism" could be removed from criterion 3, but suggested that it should remain in paragraph 13, which described methods that might be used to account for an earmarked fund.

Mr. Calder suggested that the term "accounting mechanism" be completely removed from the standard. Mr. Anania said that as long as the concept is there, the term is not needed.

Board Consensus: The Board reached a consensus that the concern about the term "accounting mechanism" would be addressed by removing the term "accounting mechanism" from the standard.

Exclusions

Moving to item 2, Exclusions, Mr. Calder asked why credit financing accounts were mentioned in the standard. Staff replied that credit financing accounts met the definition criteria and would be considered earmarked funds unless they were specifically excluded. Mr. Calder asked whether credit financing accounts met criterion 1, and suggested that they represented recovery of debt rather than revenues. Staff replied that the cash flows included interest revenue and expense, forfeiture and disposition of collateral, fees, and other items in accordance with the Credit Reform Act of 1990. Dr. Robinson agreed that credit financing accounts do meet the definition of earmarked funds, and said that if the Board does not want them included, they must be excluded. Mr. Jacobson and Mr. Kilpatrick confirmed that credit financing accounts meet the definition criteria.

Ms. Cohen brought up a point of grammar, noting that paragraph 4 stated that earmarked funds "receive revenue and other financing sources (such as appropriations)" and said that you cannot "receive" a "source."

Ms. Cohen said that credit financing accounts should be excluded from earmarked funds. Mr. Calder said that the Board would be deviating from a principle-based standard if credit financing accounts were excluded. Ms. Comes noted that there was a consensus that credit financing accounts should be excluded. Mr. Mosso suggested that staff work on the definition criteria to exclude credit financing accounts. Staff said that at the last Board meeting, the Board had voted against adding a proposed fourth definition criterion that would have excluded credit financing accounts and intragovernmental funds, by excluding funds that did not have an impact upon the consolidated net position of the U.S. Government. Mr. Anania said that if there were going to be exclusions, the standard should explain why. Staff noted that at the previous Board meeting, two options had been presented to the Board: a fourth definition criterion, or an exclusions paragraph. The Board had voted in favor of the exclusions paragraph. Staff referred the Board to page 46 of the April 2004 Meeting Minutes, which were included in the June 2004 briefing materials. Ms. Comes said that that staff would work up additional options for exclusions.

Format of Statements

Mr. Calder called the Board's attention to the illustrative financial statements in Appendix C. He noted that the standard would be expanding the financial statements, and that he was only interested in several very large earmarked funds. Staff noted that the illustration referred to was a consolidation worksheet, and not a financial statement. Mr. Schumacher noted that the worksheet had been included because respondents had requested it. Mr. Calder said that the financial statements would be expanded for agencies that had a large number of immaterial earmarked funds. Staff noted that agencies were not required to list all of their earmarked funds in the financial statement disclosures, but only to indicate where such a list might be found. Mr. Anania said that there was a provision that information about smaller earmarked funds could be aggregated, and that not every one had to be shown separately. Staff noted that the Board had previously considered respondents' requests to have disclosure limited to the Notes, but had decided that the financial statement disclosures in the ED were too important to have "buried in the notes." Ms. Comes mentioned that at the last Board meeting, the members were provided with an illustration of how the government-wide financial statements would appear, using a "row" approach as opposed to a "column" approach. Ms. Comes noted that there is nothing in the standard to prevent using lines instead of columns for the display of information. Ms. Comes said that during the development of the ED, the original proposal was to display only the cumulative results of operations separately on the face of the financial statements. However, the Board decided that the ED should require some additional "flow" information to be displayed on the face of the financial statements. Ms. Comes noted that there is no requirement to display individual earmarked funds separately on the face of the financial statements; that disclosure appears in the notes. Mr. Anania noted that if all of a component's earmarked funds were immaterial, then the "materiality" provision would apply, and disclosure would not be required. Ms. Comes agreed.

Ms. Cohen directed the Board's attention to paragraph 70, which requires information on selected earmarked funds to be displayed individually. Staff noted that this paragraph had been changed at the last meeting, in accordance with the Board's decision to remove the term "significant."

Board Consensus: Mr. Schumacher suggested that the word "selected" should be inserted to clarify. The Board agreed.

Mr. Reid directed the Board's attention back to paragraph 32 and expressed concern that it would involve a voluminous disclosure if the component agencies had to be named. Mr. Farrell noted that the component agencies were already individually named in the government-wide financial statement disclosures, and suggested that the note could refer the user to that list. Ms. Comes noted that the requirement is for a reference, not a list.

Board Consensus on Issues Raised

Mr. Mosso asked the Board to come to a consensus on the issues that had been discussed and the actions that staff should take.

On the issue of exclusions, Mr. Patton said that he would prefer an "exclusions" paragraph, but that it should explain the reason for the exclusions. Ms. Comes said that what all three exclusions had in common is that they do not affect the net position of the Federal government. Mr. Anania said that this should be stated in the exclusions paragraph. Dr. Robinson asked how many of the 392 funds in the GAO report[1] would be excluded by the earmarked funds standard, and how many would still be there? She asked if respondents had provided lists of funds that would be included or excluded. Staff replied that copies of written responses were provided to the Board at the February 2004 meeting, and that those responses did not include lists of funds. Mr. Jacobson noted that many funds would be excluded based upon materiality. He noted that the GAO report provided no distinction based on size, and that many of the funds listed had very small balances. Mr. Mosso said that if any more information was required, staff would take a look at it. Mr. Mosso continued the vote on the exclusions issue.

[1] "Federal Trust and Other Earmarked Funds: Answers to Frequently Asked Questions," January 2001, GAO-01-199SP.

Board Consensus: A majority of the Board approved keeping the exclusions paragraph, with an added explanation of the reason for exclusion.

Mr. Mosso then asked about paragraph 19. He noted that the Board had previously decided on the disclosures on the face of the financial statements, and that it had been a key decision.

Board Consensus: Mr. Mosso asked if there were any objections to that decision, and there were no objections.

Mr. Mosso said that the Board members should contact staff about any concerns that had not been discussed at the meeting.

August 2004 Agenda Request: After the session, Board members indicated to staff that they wish to discuss item 17 (display of comparative data in the "prior year" column in the initial year of implementation) at the next Board meeting. The Board members want to discuss what the rationale would be for "permitting" restatement, rather than requiring or prohibiting restatement of prior-year comparative data.

The Board members did not object to any of the other staff proposals in the June briefing materials.

Conclusions:

1) The standard should indicate that the word "report" does not necessarily indicate separate audited financial statements for a specific earmarked fund.

2) The term "accounting mechanism" should be deleted from the standard.

3) The "exclusions" paragraph should include an explanation about why certain funds are excluded from the reporting requirements.

4) The required financial statement presentation (Balance Sheet and Statement of Changes in Net Position for Components; Balance Sheet and Statement of Operations and Changes in Net Position for Government-wide) should **not** be moved to the footnotes.

5) At the next (August 2004) Board meeting, the Board wishes to discuss display of comparative data in the "prior year" column in the initial year of implementation.

Action items for staff:

1) Add a footnote to the word "report" in criteria 3 in paragraph 11 saying that a report does not necessarily mean separate audited financial statements for an individual earmarked fund.

2) Remove the term "accounting mechanism" from the standard.

3) Draft alternative wording for paragraph 4 to avoid the word "source."

4) For item 16 (clarify Note on Investments), implement the proposed change in the July 1, 2004 handout (described on first page of this document), and not the proposed change in the staff analysis.

5) Insert the word “selected” into paragraph 70 to clarify sentence.

6) Draft an explanatory sentence for the exclusions paragraph (paragraph 12).

7) Prepare August 2004 briefing materials for discussion of prior-year comparative data in the initial year of implementation.

- **Concepts – Objectives**

Ms. Comes opened the discussion by discussing her memo, which presented four options:

1) Develop a working paper on the objectives of the Federal Accounting Standards Advisory Board (or GAAP based financial reports)

This document would have status similar to the “blue” and “pink” papers relied on internally by GASB in addressing elements and communications methods. These papers were developed by GASB staff and deliberated by the GASB but not issued for public comment or published. They have been relied upon in internal deliberations for some time. Currently, GASB is working to formalize these papers in its conceptual framework.

2) **Develop and publish “strategic objectives” for FASAB (or GAAP based financial reports)**

This document would be publicly available and refreshed periodically. It would identify the objectives from SFFAC 1 that most influence FASAB’s choice of projects for the period with a stated goal of updating the strategic objectives periodically (perhaps every 3 to 5 years).

3) **Develop a Statement of Federal Financial Accounting Concepts on the Objectives of the Federal Financial Accounting Standards Advisory Board** (or **GAAP- based financial reports)**

The Board would explain the nature of SFFAC 1 and propose a subset of the SFFAC 1 objectives that are “Objectives of the Federal Financial Accounting Standards Advisory Board.”

4) **Amend SFFAC 1 by clarifying the Board’s role relative to broad objectives**

The Board would explain the nature of SFFAC 1 and propose changes to each chapter of SFFAC 1 to explain the (expected) role or contribution of FASAB towards meeting the objectives.

Initially she was neutral on whether the project resulted in a published product; she has subsequently concluded that the work should be preserved.

Mr. Mosso said there is a choice between objectives of FASAB or of GAAP-based financial reports: the basic issue was broad versus narrow. The options could apply to either approach.

Ms. Robinson asked whether the "objectives of FASAB" equal "the role of the financial statements," as opposed to something broader? She equates them, but sometimes we talk about all of federal financial reporting, which encompasses many other things, most notably the Budget. She asked how other Board members see it?

Mr. Mosso noted that GAAP-based financial statements include the Statement of Budgetary Resources (SBR). Ms. Comes agreed that FASAB standards say that a set of financial statements is not in conformance with GAAP unless it includes a report on the budget (the SBR), although FASAB does not promulgate the standards for budgetary accounting. Similarly, the Board might in theory say that a set of GAAP-based financial statements was not complete without certain performance measures, or certain assertions from management on internal control. The notion of GAAP-based reports is somewhat elastic.

Mr. Zavada noted that the standards for preparing the SBR are provided in OMB Circular A-11.

Ms. Robinson said one might ask, "does the Board consider in its deliberations the objectives for the entire portfolio of federal financial reporting," or is it saying, "What is the role of the financial statement as it coexists with all the other financial reports?" If something is disclosed in the Budget, should FASAB consider that? The question becomes, "what is your goal for requiring disclosure in another way?" That is how she perceives the Board's role. Mr. Zavada continued her thought: "looking at accountability in a broader context, not looking at the financial statements in a vacuum."

Mr. Mosso suggested that we have always looked at it as "financial reporting," not just "financial statements." He would orient the concepts to help FASAB in setting standards.

Mr. Anania said that he feels the objectives are stated more broadly than FASAB is currently functioning. He has suggested that the output of this should be for FASAB to communicate where people should look to find all the information needed to meet the objectives, and also more explicitly narrow down to indicate what FASAB is trying to do. If that were the approach, it could be an amendment to SFFAC 1, or it could be a new statement of concepts. In any event, we need a formalized output.

Mr. Mosso agreed, observing that we might want to test it before finalizing an amendment or new statement of concepts. Mr. Anania noted that GASB has been doing this for years.

Mr. Zavada agreed with the idea of testing some concepts on a preliminary basis.

Mr. Calder observed that GAO believes that the objectives should be viewed broadly. Mr. Walker believes that the financial reporting model is broken and does not tell enough. Looking at net income and net assets alone is not sufficient. Assertions about internal control and performance measures are needed. In the 21st century, more current and more detailed information can be reported on the Internet than was feasible when reporting on paper in the 20th century.

Mr. Mosso agreed, but said he does not know what parts of the SFFAC 1 mean. Mr. Calder said he agreed with that.

In response to a question, Ms. Comes observed that option 2 would not foreclose going back to our SFFAC 1 model and picking up something else as progress, priorities and resources change over time. Option 4 would be somewhat draconian if it said that FASAB should not say anything globally about government accountability. Options 1 and 3 could work together – that is, option 1 leading to option 3 over time. There could be some strategic advantages to option 2, if one takes a long view.

Mr. Anania said the amendment to SFFAC 1 he envisioned would add, for each of the objectives, information about where functions and reporting are performed that inform against the objective. Then it would say where FASAB fits into that.

Ms. Comes said this could be a large undertaking, especially given the evolutionary nature of federal reporting. Would the Board undertake to keep such a document current in the future? It has been suggested before, and we could explore ways to accomplish it, if that is what the Board wants.

Mr. Farrell agreed in concept with the broader view Mr. Calder had articulated, but said practically that goal must be viewed in the context of FASAB's resources. We could be criticized for having broad objectives and not addressing them.

Ms. Robinson suggested that we could proceed on options 1, 2 and 3 simultaneously, with thought papers. When and if we become sufficiently comfortable with them, we could elevate them to the status of a published document.

Mr. Patton said that we should strive for option 3 as a goal, but we could get there via 1 and 2. He thinks there should be a permanent or definitive statement eventually, because every new Board member struggles with this.

Mr. Mosso said that he does not want to throw out SFFAC 1, but it does need to be updated and modified.

Ms. Comes said staff should start working on a draft white paper that would express the Board's views. Mr. Anania asked whether the paper would state what the Board had decided as it went along, rather than what it was trying to do? In other words, would it state our draft definition of assets and characteristics of other elements? Ms. Comes said it would focus on objectives. Mr. Anania asked, do you mean the objectives of the project, or the outcomes of our deliberations? Is the paper to explain what we are trying to do, or giving interim information on the decisions we have made? Ms. Comes said it would give information on the decisions on objectives.

"But in order to deal with objectives, we are looking at definitions of elements," Mr. Anania said. He does not want to waste time on a paper that is only trying to explain what we are trying to do. He would rather have the paper incorporate something brief about the objective, and then tell the world what we have decided.

Mr. Reid said we might be able to incorporate that into option 2. If you are thinking strategically, you would go through a process that focuses on the environment and what is being done, then reach a logical conclusion about where to focus your energy. This could allow us to keep all the objectives in SFFAC 1, but also to say, "Here are some directions we are going, based on where we stand now." That might imply taking action on some things now, while taking a wait-and-see approach on others.

Mr. Anania said he wants to develop a closer look at what we are doing, as opposed to the whole federal reporting community. This would include an explanation of why we are revisiting elementary things, such as the definition of an asset. We could mention PCAOB and the things Mr. Walker has been saying about the need for a more robust model.

Mr. Bramlett suggested that this sounded a bit like a paper that addressed the conceptual framework project as a whole. Ms. Robinson said it sounded as if we were talking about different things. There is a mission statement for the Board, and a strategic plan. Someone reading SFFAC 1 might ask, "is this FASAB's mission statement?" Nowhere in it is there a statement of FASAB's mission.

Mr. Anania said he thinks the mission statement and strategic plan are apart from concepts for the work we do. The concepts should define what our role is and the role of financial reporting that comes out of our standards. The strategic plan should state our plan to do things better, faster, brighter, etc.

> Conclusion: Mr. Mosso suggested that staff first to sketch out option 1, then 2, and ultimately come down to an addition or revision to SFFAC 1. At some point we will need to bring into our concepts what we are doing on elements. The paper could sketch out our plan for doing that.

- **Concepts - Elements**

Ms. Wardlow led the discussion on elements. Her memo transmitted preliminary drafts of the assets section of a concepts statement on elements and a discussion of uncertainty, and it identified six issues for the Board:

> **1. Does the Board agree with the wording of the three essential characteristics of an asset (paragraphs 3 and 4 of the draft, which begins on page 4)?**
>
> **2. Are the explanations of the meaning of "economic benefits" and "service potential" and the difference between them clear (paragraphs 5 through 7)? Should any of part of that discussion be expanded? Should any part of that discussion be eliminated? Does the Board have examples of specific federal assets that could be included to clarify the discussion?**
>
> **3. Is the explanation of the meaning of "control of access" clear (paragraphs 8 through 13)? Should any of part of that discussion be expanded? Should any part of that discussion be eliminated? Does the Board have examples of specific federal assets that could be included to clarify the discussion?**
>
> **4. Is the explanation of the significance of the occurrence of a past event clear (paragraphs 14 through 16)? Should any part of that discussion be expanded or eliminated? Should there be a specific reference in the discussion to the balance sheet date--that is, the past event must have occurred prior to the balance sheet date?**
>
> **5. Does the Board agree that a discussion of the effects of uncertainty on financial reporting would be useful? Is the draft discussion of uncertainty (paragraphs A through E, beginning on page 9) useful? Should any part of that discussion be expanded or changed?**
>
> **6. Does the Board agree with the proposed definition of assets (paragraph 2)? Does it appropriately capture the three essential characteristics that the Board has identified and**

that are discussed in paragraphs 3 through 16? What, if any, wording changes would the Board propose?

Ms. Wardlow explained that the draft provided to the Board drew upon the published work of other accounting standard setters, including the FASB, the UK standards board, and the Australian standards board. The Australian document was written with public sector entities in mind, so parts of its language seem better for government than that of other authorities that focus on the private sector. The draft was intentionally “bare bones” to encourage the Board to indicate where it would like to see an expanded discussion or the addition of examples pertinent to the Federal government. The discussion of uncertainty in the draft was almost verbatim from the FASB’s discussion of that topic in SFAC 6.

Regarding the use of the word “resource” in the discussion of asset characteristics, Mr. Patton said that he is not sure what a resource is. Ms. Wardlow said that at the previous Board meeting the Board had agreed that, rather than define an asset directly as being “economic benefits” and/or “service potential,” it might be better to begin with a more common word like resource, meaning something good, something advantageous to the entity, or something one can draw upon. In writing the draft, she had found that using “resource” made it easier in some places, but more difficult in others, to discuss the characteristics of assets. An alternative to “resource” that was discussed at the previous meeting is the word “right.” (That is, “an asset is a right that has the capacity to provide economic benefits or service potential . . .”)

Mr. Patton, noting that at one point the paper says a resource may be an object or a right, asked whether “resource” is just another word for “asset”? Mr. Mosso pointed out that “resource” is a general term and that the discussion goes on to say that an asset is a particular kind of resource that has the specific characteristics identified by the Board. Continuing his comment on resources being objects or rights, Mr. Patton opined that it is not the object that is an asset, it is the economic benefit provided by the object that is the asset. Ms. Wardlow agreed but noted that “object” and “economic benefit” could coincide. An asset could be an object or it could be a right. It does not have to be an object, but it could be. The term “resource” is intended to be a user-friendly way of getting into the definition. “Resource” is a broad term; the additional discussion is intended to say that an asset is a particular kind of resource.

Mr. Patton said that a definition should build on primitive terms. The draft language makes it sound like an asset is a “thing.” Mr. Anania said “thing” would be another word. Mr. Patton continued that when he thinks of a “thing,” he thinks of an object. Ms. Wardlow said that a resource could be an object or it could be a right. Mr. Anania observed that some other standard setters had used the term “resource.” Ms. Wardlow added that some standard setters had found difficulty defining an asset as *being* “economic benefits;” some had chosen “right” [to economic benefits]; others had chosen “resource” [giving rise to economic benefits].

Mr. Patton then suggested saying that “assets are objects or rights that provide the capacity . . ., etc., ” instead of using the word “resource.” However, Ms. Robinson asked “what about information?” Others agreed that resources could be information or knowledge, so that referring to objects or rights could be too limiting. Mr. Patton noted that the definition might be too broad; a definition should prescribe a domain. He also noted that the draft language does not include a reference to probability, so that the definition might include anything. Mr. Mosso said that the language seemed merely to be saying that all resources are useful in some way, but not all are physical objects. Mr. Schumacher added that the draft goes on to say that to be an asset, a resource must have some economic benefit or service potential. He said, “We have to start with some generic term.” Mr. Anania observed that, regardless of the definition, unless it was a very long definition, one would need to look at the characteristics to make the definition operational. The definition itself does not help you functionally decide on issues unless you look at the characteristics.

Mr. Patton suggested an operational/functional definition based on what assets ***do***, e.g., "assets provide the capacity for future economic benefits." Ms. Wardlow asked whether that really said what an asset ***is***. Talking about what assets do does not tell you what characteristics all assets share that make them assets. Mr. Patton said "it is what they do that makes them an asset, not the fact that they are an object, right, or information by itself."

During this discussion, Mr. Farrell suggested that, if we are using "resource" as a primitive term, we might add a dictionary definition of it. Ms Comes consulted on-line dictionaries and projected definitions from two of them[2] on the screen. Ms. Robinson said that one of the things she liked about the first definition is that it has the word "valuable" in it. Mr. Farrell liked the terms "possession or quality." Ms. Comes suggested that "useful" seems to embody the "future economic benefits" part of our definition.

Mr. Mosso indicated that the Board should move on to other issues and asked if there were other comments on "resources." Mr. Anania said that he was happy with the term. Mr. Mosso said that it was not his first choice at the previous meeting, but that he had become more comfortable with it.

Still with reference to paragraph 3 (characteristics of assets), Mr. Mosso said that he liked the wording of the first of the three characteristics of an asset, as stated in the draft: "First, it must have the capacity to provide future economic benefit or services." That is, it leaves out the word "potential" [as in "service potential"]. He likes that because "capacity" seems to imply potential, so that including the word "potential" as well is redundant. Ms. Wardlow agreed and said that maybe "potential" should be eliminated from the definition as well, which also would make the definition simpler and more grammatically correct.

On another issue, Ms. Cohen asked what is meant by "scarce" capacity in paragraph 5. Ms. Wardlow responded that "scarce" came from a discussion in FASB Concepts Statement 6 of the fact that all entities have to deal with a scarcity of resources. After discussion, several FASAB members preferred to delete the word "scarce."

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[2]From *The American Heritage® Dictionary of the English Language, Fourth Edition*
Copyright © 2000 by Houghton Mifflin Company:
1 a useful or valuable possession or quality of a country, organization or person:
The country's greatest resource is the dedication of its workers.
Britain's mineral resources include oil, coal and gas deposits. From *Cambridge Advanced Learner's Dictionary*
Something that can be used for support or help: *The local library is a valuable resource.* An available supply that can be drawn on when needed. Often used in the plural.
The ability to deal with a difficult or troublesome situation effectively; initiative: *a person of resource.*
Means that can be used to cope with a difficult situation. Often used in the plural: *needed all my intellectual resources for the exam.*

resources The total means available for economic and political development, such as mineral wealth, labor force, and armaments.
resources The total means available to a company for increasing production or profit, including plant, labor, and raw material; assets.
Such means considered individually.

The Board then discussed paragraph 4. It was agreed that the wording includes intangible as well as tangible items.

Regarding the third essential characteristic cited in paragraph 3, “the event giving rise to the entity’s control of access must have occurred,” Mr. Patton suggested saying instead that “the event giving rise to the resource and the entity’s control of it.” Ms. Cohen said, however, that the existence of the resource is already covered two lines earlier. Ms. Wardlow added that in the third characteristic, the event in question is the event that gives rise to control, not the event that gives rise to the existence of the resource. Mr. Farrell added, “If you don’t have a resource, you don’t even get to the first characteristic.” Mr. Patton responded that he was thinking ahead to the liability definition, assuming a parallel with the asset definition; that is, the event giving rise to the obligation must have occurred.

In that regard, Ms. Wardlow mentioned a recent paper, prepared by the FASB staff for the FASB’s Advisory Council, which had been distributed to FASAB members. The paper suggests that if “liability” is defined as a “present obligation,” the event must have occurred and, therefore, the third characteristic (past event) is redundant. Ms. Robinson suggested that the logic of that paper implies one could drop the third characteristic of assets. Mr. Mosso agreed. The Board agreed that the notion of past event is needed, but that the third characteristic is not essential and should be deleted. Mr. Mosso indicated that if the third characteristic were deleted, we would need to explain that the notion of past event is relevant, but is present in another characteristic. Also, Mr. Mosso suggested that staff research the notion of past event. As he recalled, the FASB originally included it to eliminate hidden reserves from the balance sheet. Thus, the third characteristic may be redundant, but sometimes an extra emphasis can be useful.

The Board then discussed whether the words “be able to” [control] are essential to the discussion of control. Mr. Jacobson asked whether we should add “presently” before “control” in the second characteristic. Several Board members agreed with that suggestion. Another suggestion was to say “must control,” rather than “be able to control.” However, Mr. Anania said “be able to” might be needed to cover situations where some intermediate step is needed, such as exercising an option.

Responding to Mr. Mosso’s call for other issues, Mr. Anania objected to including the notion of conservatism and would delete the reference to conservatism at the bottom of page 11. Mr. Mosso agreed, saying that conservatism is incompatible with the idea of providing unbiased information.

Ms. Robinson thought the discussion of economic benefits was good. Paragraph 7, however, seems to be more about control; she would move it below the heading, “Control by a particular entity.” Ms. Cohen agreed with respect to the last sentence of that paragraph but thought that the first two sentences were about benefits and should not be moved to control. Mr. Patton agreed with Ms. Robinson. Mr. Reid disagreed, saying that a lease agreement itself is a way of sharing an asset—ownership vs. use—so that it is consistent with the previous discussion of benefits, as opposed to the lease being a control element; the reference to control may be a bad example.

Mr. Calder said that technically one does not share the asset. There can be several assets associated with a piece of land, for example: one is the right to defease land and sell it; another is the right to use the land at a present time—a leasehold interest, which is an asset; and you have a residual interest which is an entirely different asset. So, when we deal with “access,” the question is "access to what?"—to the benefit that stems from the leasehold interest or to the benefit from the residual interest? Thus, the asset "land" breaks up into a number of other assets.

Ms. Robinson said this issue is important. It comes up on page 7, lines 6-10. CBO deals with the issue regularly. CBO does not own or control the walls of the building it occupies; does it receive the economic benefits of them? (There followed a discussion of control versus ownership versus receipt of the benefits in the particular case of CBO.) Ms. Wardlow said she is still struggling to understand what we mean by control. More examples would be helpful, at least in raising questions. Mr. Schumacher said that we need to be careful, because in paragraph 9 we say that an asset is specific to an entity, so we do not want to have two or more entities reporting the same asset. Ms. Wardlow agreed, but noted that a given property might comprise a bundle of benefits, which might be different assets. Mr. Schumacher agreed.

The Board then turned to the wording of some sentences. For example, Mr. Anania said that a limiting word such as "certain" was needed on page 7, line 8. Mr. Patton suggested using "implies" instead of "synonymous" in line 11 on page 7.

Mr. Patton asked for clarification of the reference to public highways. The draft says that the entities that use them receive economic benefits, but the highways are not their assets; they are the assets of those who are responsible for their operation. Ms. Cohen clarified certain aspects of the issue with reference to federal and state relationships to the interstate highway system. Mr. Anania asked whether a toll road is an exception to the draft discussion. Ms. Robinson said that the fundamental concept is that of a public good. No one necessarily owns public goods. Ms. Cohen asked about sales of air rights. Ms. Wardlow explained that the paragraph is attempting to address public goods and is saying that an entity may benefit from a public highway, but it cannot claim it as its asset because it cannot restrict the access of others to the highway. In answer to Ms. Cohen, she said that the same applies to air and water, except when they are controlled by the sale/purchase of rights thereto. Ms. Wardlow added that the paragraph emphasizes the importance of the concept of "control by a particular entity," because, without that concept, you cannot identify whose asset it is.

Ms. Robinson noted that the paragraph goes further, saying that government has a role in accounting for some of these items that benefit everyone else: a highway is a government asset, though the government itself is not getting all the benefit and service potential from it. The government does get the benefit of fulfilling its mission to provide service.

Ms. Cohen said that with regard to public highways, ownership, rather than operation, was the key to which entity should report them. Ms. Wardlow said the Board had concluded that we do not have to own something for it to be our asset.

Mr. Zavada asked about airspace: the Government charges foreign air carriers for using our airspace. Ms. Wardlow responded that this was a similar idea—the need to control access in order to have an asset. Mr. Jacobson thought that maybe that was the solution: Maybe "responsible for their operation" (line 2, page 8) should be "controls their operation." Other similar situations raised by Board members included FAA air rights, international waters, and the electromagnetic system.

Continuing with other issues, Mr. Mosso said that in paragraph 5 we should not limit "economic benefit" to items that eventually result in cash inflows but should include, for example, barter. Mr. Reid asked whether we could say "value" there instead of cash. Mr. Mosso agreed.

Ms. Robinson directed attention to page 9, line 5, and the word "consume" in relation to when an entity no longer has an asset. Mr. Reid said that the word "collects" in that passage is inappropriate, since a receivable could be an asset prior to collection. Ms. Wardlow said she would review this paragraph from FASB Concepts Statement 6 and clarify its meaning.

The Board then discussed the draft paragraphs about the concept of uncertainty. Ms. Robinson said there could be uncertainty, even about whether something is an asset or a liability, but the role of financial reporting is to take your best guess at the time. We have encountered this with loans. She mentioned a loan the Government made to a troubled airline that initially looked like a liability, but eventually became an asset. Ms. Wardlow said certainty is not necessary to meet the definition of an asset, but whether you book it or not is another question. The FASB has maintained a clear distinction between whether an item meets the definition of an asset and whether it should be reported as an asset in the financial statements (measurement and recognition issues.).

Mr. Patton said that his interpretation of the language in the draft was that there was no lower bound any more: there could be a 0.001% probability you would collect, and it would still be an asset. Hence, your best estimate of collectability would not matter so far as defining it as an asset goes. When asked whether he agreed with that approach, he said no. If there is essentially a zero probability of a future inflow, it does not seem one has something that most people would think of as an asset. Mr. Reid responded that that statement confuses measurement with definition. It is an asset, but it may not be one that has a material value for the financial statements. Mr. Reid added that there are some things, such as the air over LaGuardia Airport, with a value that is not measurable, but those items still have the characteristics of an asset. We have control over the air space, but we do not know how to measure it.

Ms. Robinson said there is another aspect to probability. If the federal government were negotiating with the State regarding the air space over LaGuardia, and if former court cases indicated there was some uncertainty how the dispute would be resolved, would it be okay to book it as an asset? Mr. Reid said it is an asset if we have control, but having control does not necessarily mean that it is recorded. Referring to the previous day's panel discussion of social insurance [at the AGA conference], Mr. Reid said that the notion of whether social insurance is or is not a liability was, in his view, being confused with (1) Do you measure it at all? and (2) How much do you measure? or how do you measure it? versus the definition of a liability. In that particular case, we have already defined it as a liability. Ms. Robinson responded that in the example in the draft before the Board there is uncertainty about control, not value. She asked whether uncertainty about control was allowable in booking an asset." Mr. Reid said it was one of the things you would factor in to the measurement issue.

Mr. Patton said he was not addressing measurement uncertainty, but uncertainty about the existence of future economic benefits. If the probability of existence is 0.001%, he does not think there is an asset. Mr. Calder said an example for the states might be the tobacco settlements. The case went on for many years, with many court decisions and appeals involved. At some point the states wanted to obtain the cash by issuing bonds secured by the settlement, saying the states had an asset. Mr. Calder noted that they were saying the probability was high, but he did not know the assessment of the bond analysts. Ms. Cohen said that bond issues against tobacco settlements have been accepted in the market as an asset sale. The market has viewed the settlement itself as an asset to the recipient government and that the government should sell it—effectively to themselves through the creation of an authority. Through the bond issue the government has passed the risk to the bondholders. Mr. Calder opined that there was uncertainty as to the value but also as to whether there is a claim—an asset. Ms. Cohen acknowledged that there was uncertainty about future cash flows.

> **Conclusion**: Ms. Wardlow said she would amend the draft for the next meeting. She also would present a paper on the characteristics of a liability. Mr. Patton said that including "little or no discretion" [in the characteristics of a liability] seemed to introduce the notion of probability into the definition of a liability. If we are to have parallel definitions of asset and liability and we have dropped "probable" from the definition of an asset, he would like staff to think about the appropriateness of including "little or no discretion" in the definition of a liability. Mr. Schumacher asked staff to mark changes to the asset paper.

The Board adjourned for lunch at noon.

- **Social Insurance Assumptions**

Ms. Comes introduced the topic by explaining that the exposure draft, *Presentation of Significant Assumptions for the Statement of Social Insurance*, resulted in eight responses with no objections to the proposal. Two respondents supported the proposal contingent on suggested changes. One suggested a change in audit guidance – a matter not determined by the Board. Another suggested requiring disclosure of the uncertainties inherent in the process. Ms. Comes did not recommend changes as a result of either of these suggestions.

Ms. Comes noted that members have a draft SFFAS for consideration. Mr. Mosso asked if there were any concerns. Ms. Robinson asked how the Social Security Administration's concerns regarding auditing the development of assumptions would be addressed. Ms. Comes explained that the AICPA's task force would work through the issues raised on their proposed audit guidance.

Mr. Mosso asked if there were any objections to finalizing the standard. Members offered no objections. Ms. Comes asked that any editorial comments be provided after the meeting and indicated that a ballot draft would be delivered to members as soon as possible.

Mr. Mosso noted that requests to defer the effective date of SFFAS 25 and 26 were received. He introduced Ms. Linda Springer, Controller, Office of Management and Budget.

Ms. Springer thanked the Board for providing time to address the request for deferral. She began by affirming her support for the reclassification of the Statement of Social Insurance (SOSI) as a basic financial statement. She believes the audit will be beneficial to management. Her objective is to have the implementation occur in a year when there is adequate time to plan based on known audit guidance. The current implementation date would result in a truncated process. She provided a chart illustrating the typical financial statement audit timeline and the timeline for development of the projections. The timeline for the Trustee's development of projections is advanced relative to the audited financial statement's timeline. Thus, the

Statement of Social Insurance audit work commences much earlier for the projections than it would for a typical audit. The audit work would have already started at this time for fiscal year 2005 projections and it has not.

Ms. Springer opined that the audit of the Statement of Social Insurance is too important of an issue to rush and deal with in a compressed timeline. She assured the Board that there is no sloppiness or delay in the process of developing audit guidance -- the audit guidance simply is not finalized.

Mr. Mosso asked if there is a target date for completing the audit guidance. Ms. Springer was not aware of a target date but noted that the exposure draft was issued in March 2004 with a May due date for comments.

Mr. Reid noted that ideally supporting schedules would have been drawn up at this point and they have not been. So, the initial effort may be significantly larger than a normal audit. Familiarizing the team with the process will be a significant first time effort.

The current effective date is fiscal year 2005 and the proposal is to defer to fiscal year 2006. Mr. Mosso asked if the one-year delay would be sufficient? Ms. Springer said it would be sufficient.

Mr. Anania asked what needed to be done to accomplish this deferral. Ms. Comes explained that the effective date is GAAP just as the requirements of each standard are GAAP. Thus, the effective dates would have to be amended through a process similar to any other amendment. She indicated that a proposal would have to be exposed for the minimum thirty-day comment period. She explained that both SFFAS 25 and the new SFFAS 26 would be amended.

Mr. Anania asked if there had been prior requests for delays in the effective date? Ms. Springer indicated that they had not requested a delay but had expressed concern about the timing of the audit guidance. Ms. Comes noted that the exposure draft leading to SFFAS 25 had proposed a fiscal year 2004 effective date and that the Board adopted a fiscal year 2005 date. She noted that this was not due to an OMB request but did relate to preparing for the effort.

Mr. Farrell asked what would happen if they do not complete the audit guidance. Mr. Zavada indicated that the audit guidance was very far along and he does not expect further delay. Ms. Comes indicated that it was feasible that the audit guidance would be finalized before the Board completes work on this requested deferral.

Mr. Patton asked if we might be asking auditors and preparers to gear up to audit the Statement of Social Insurance in fiscal year 2006 only to change what we require with respect to social insurance through our currently active project considering application of accrual concepts for social insurance liabilities.

Ms. Comes indicated that (1) the Statement of Social Insurance is valuable in addressing sustainability questions and would not necessarily be rescinded in favor of a full-accrual liability approach and (2) the lessons learned through auditing the Statement of Social Insurance would be applicable to auditing an accrued liability. Thus, she did not believe there was a risk that proceeding with implementing SFFAS 25 could waste resources. Mr. Farrell concurred that the Statement of Social Insurance and an accrued liability were not mutually exclusive. Mr. Mosso agreed and asked if there were other issues.

Mr. Calder indicated that the AICPA task force was moving diligently. He added that the task force has addressed all issues raised by respondents except one issue submitted by GAO. He added that he does not wish his approval of this proposal to be interpreted as a blanket endorsement of deferrals.

Mr. Mosso polled the members. All members agreed and most indicated that this should be viewed as a one-time approval and not a general endorsement of delay.

Ms. Comes committed to providing an exposure draft for vote as soon as possible. Ms. Springer thanked the members for their time.

> CONCLUSION: A ballot draft SFFAS regarding the assumptions and ballot draft exposure draft will be circulated by staff as soon as possible.

- **Social Insurance**

Social Insurance Liability Project

The staff presented a paper relating the four criteria (for identifying constructive and equitable obligations and potential liabilities that was discussed at the April FASAB meeting) to the liability characteristics and otherwise developing the criteria further. The four criteria would primarily assist in applying the concept of present obligation to social insurance and other programs when a legally enforceable obligation has not been incurred.

The Term “Obligation”

The Board discussed the meaning and usage of the term “obligation.” Ms. Robinson noted that the staff paper included the FASAB Glossary’s definition of “obligation,” which reflects the budgetary usage where “obligation” means legally binding rather than constructive or equitable. She asked for clarification regarding how the term was being used.

Staff said it was proposing that the Board define the term “obligation” generally as does FASB, e.g., see *Webster’s Dictionary*. The general definition denotes duties imposed legally or socially where one is bound by contract, promise, moral responsibility, etc. FASB’s definition includes equitable and constructive obligations as well as legal obligations. [See SFAS 146, pars. 37-40]. The staff said it was proposing further that the Board define “present obligation” as well and distinguish these usages from the budgetary usage. Staff noted that FASB, the CICA, and PSC have used the term “obligation” in their definition of liability, although the Australians and others had not. Also, the Board directed the staff to consider the term “present obligation” for the FASAB liability definition.

The Board discussed the prior FASAB usage of the term. FASAB concepts and standards have used the term “obligation” in both the general sense and the budgetary sense.[3]

[3] For example, see the usage in SFFAS 7 regarding the statement of budgetary resources and the statement of financing where “obligation” is used very much in the budgetary sense. But elsewhere in the FASAB standards it’s employed generically. See for example SFFAC 1, par. 16, “Federal financial reporting should provide information that helps the reader to determine whether … future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due …”,

The Board discussed alternatives to "obligation," e.g., "promise," "commitment." Mr. Calder noted that the stewardship standard (SFFAS 8) used "responsibilities."

Mr. Reid opined that preparers would be inclined to look at obligation in a contractual sense, not a liability sense. He said accountants tend to view obligations in the outstanding obligation sense; it's unexpended budget authority, which is a critical limiting factor for federal expenditures. He said he did not have a good alternative. Mr. Mosso agreed.

Ms. Comes suggested specifically using the term "budgetary obligation" when the budgetary sense is meant.

Ms. Comes also suggested deferring the discussion of alternatives for "obligation." She said the context in which "obligation" is used signals the meaning. She suggested that the Board would be in a better position to find a new word when drafting a final document. In terms of working through the deliberations, she said "obligation" does effectively communicate since we understand the context in which the term is being used and that there are two meanings. By flagging the less often used meaning "budgetary", we will ensure clarity for deliberations.

Mr. Anania asked if there would be any help in GASB or non-U.S. public sector guidance. Ms. Wardlow noted that GASB had used "duty" temporarily but no one particularly liked it. She said some members felt "obligation" was the same thing as "liability;" i.e., it was redundant. The word had actually been taken out of the working definition.

Mr. Mosso asked Ms. Wardlow to give some thought to alternative terms during her work on the liability definition.

<u>The Four Criteria</u>

Mr. Zavada opined that the suggested criteria are not workable in practice. The answer could be yes or no in every case and when applied to other programs. He said that when you go beyond social insurance and apply the criteria to other programs it becomes unworkable.

Ms. Robinson observed that national defense is a stronger obligation than Social Security. She said the requirement for national defense resides in the Constitution.

The Board discussed whether the requirement to provide for the national defense would meet the four criteria. Mr. Anania said the Board had discussed the need for assets and liabilities to be reciprocal concepts. He asked who would have the asset side of the national defense obligation.

Ms. Robinson responded that those on the other side would not prepare financial statements, but said perhaps Lockheed Martin would consider it an asset. But she said the unworkability of the criteria is a real issue.

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and similar references at SFFAC 4, par. 34; SFFAS 5, par. 10; SFFAS 8, pars. 3 and 14; SFFAS 17, pars. 1 and 7; and SFFAS 25, pars. 8, 22 and 26.

Staff said that national defense is a collective benefit and that for liability recognition one had to focus on individual beneficiaries. With respect to the latter it is possible to have reliance and specific past events.

Ms. Robinson said the public relies on national defense. Mr. Zavada noted the asset would be the safety and security of the country and what that means to the business environment and the country as a whole.

Mr. Mosso said the four criteria do not stand-alone. They relate to the three liability characteristics. Ms. Robinson said she thought national defense meets the three characteristics.

Mr. Reid said that the requirement to provide for the national defense is a future obligation, not a present obligation. He said that for national defense one can easily make the argument that what was purchased last year may not look like what is purchased next year. He said it is not a continuum like certain social programs.

Ms. Robinson said the country has had a standing army longer than its had Social Security.

Mr. Jacobson offered another example: Do United Nations dues represent a liability? Mr. Schumacher asked what the event would be. Mr. Jacobson suggested the signing of the UN Charter.

Staff suggested that future UN dues are a future obligation. The United States is not obligated to pay future UN dues.

Offering another example, Mr. Jacobson said that while his mother expects to receive Social Security benefits, he was not sure she should book an asset. Staff responded that Mr. Jacobson's mother might have an implicit asset in an amount equal to what would be needed to generate her monthly Social Security cash inflows.

Mr. Reid said a point was being missed in the discussion and some of the examples. The benefits of United Nations membership or of defense occur in the year in which those expenditures are made. The question is whether there is some residual benefit earned by the participants in Social Security as a result of their past contributions. He said when the snapshot is taken at the end of the year you are more likely to say: "well, yes , maybe there's something there that ought to go back to those folks." He said the objective is to match the cost on the statement of net cost with the government's revenue for that particular year. Applying that criterion would help separate the defense cases and presumably some of the welfare situations and the United Nations from some of these other programs.

Mr. Mosso said that Mr. Reid's point is applicable to a lot of the discussion. The test is whether an accrual notion is present regarding the benefit one gets this year. If you capitalize a future liability to the UN, what would you have to put on the other side: an expense or would you capitalize the asset, too? And if you capitalize, then where do you stop. Mr. Zavada responded that that problem is what makes it unworkable.

Mr. Patton said he had trouble understanding why criteria two and three, i.e., reasonable expectations and reliance, are relevant in establishing a liability for the government. He said the only way he could rationalize it a bit was to say that those expectations and reliance influence the amount of discretion the entity has to avoid the obligation. And, if that's right, then it seemed to him that criteria two and three are redundant because criterion four dealing with discretion (i.e., no realistic alternative but to settle the obligation in the future) would cover them.

Mr. Mosso observed that criterion four is the real criterion. He noted that criteria 1-3 serve to explain why there is no realistic alternative.

Staff asked Mr. Patton whether criteria two and three were inherent in criterion four. Mr. Patton responded that they were part of criterion four. He said there might be six or 10 other things you could point out that would decease the entity's discretion, but the fundamental principle is criterion four.

Mr. Reid said more would need to be done to clarify who has the discretion. He said Mr. Mosso's point yesterday was very well taken. Simply because Congress can make a change does not mean we should not account for the item. He would separate the ability to make changes in a program from the lack of discretion under current law. The entity would not have discretion under current law but to make the payment. He suggested none of the accounting would make any sense if it were predicated on Congress' ability to legislate the program out of existence.

Mr. Patton added that an entity is also necessary, and perhaps a construction such as: "The entity has little or no discretion under current law" would be workable. Mr. Reid agreed.

Mr. Mosso asked for the members' reaction to focusing on criterion four and using criteria 1-3 as reinforcement. The latter would be reasons why the entity may have little or no discretion.

Ms. Robinson said that, as a practical notion, if one uses the "under current law" definition, then you eliminate national defense and UN payments, which are all in the discretionary side of the budget. But one would book as liabilities the two-thirds of government payments that are mandatory.

Staff noted that federal employee pensions are often listed in the budget and elsewhere as mandatory entitlements, but they are booked as liabilities under federal accounting standards due to criteria established by the Board. Likewise the social insurance project is attempting to determine if there are such criteria for social insurance programs.

Ms. Robinson agreed and said she did not think the proposed criteria eliminate any programs.

Mr. Mosso indicated that the Board is going too far off track and that it would help to look at other programs next time to see if they have obligating events.

Staff said that the project plan called for moving from Social Security to Medicare and the other social insurance programs. The plan was predicated on finding workable criteria to distinguish Social Security as a program suitable for liability treatment beyond "due and payable," and then applying the criteria to the Medicare and the other programs. However, if the Board does not find the proposed criteria useful in distinguishing the Social Security program for liability recognition then perhaps the search for criteria should continue.

Mr. Zavada said he did not think the work should be done in a vacuum. Mr. Reid suggested labeling the work "criteria for Social Security." He said he thought everyone was afraid of the "slippery slope." However, a second question could be whether the concepts developed for

Social Security could be applied more broadly. He said that the Board should not do things piecemeal but some criteria are needed for the staff to use to compare programs.

Staff added that the proposed criteria would separate Social Security from other programs. Participants are making payments under the programs, are or should be expecting future benefits and relying on them when making current investment decisions. Mr. Zavada said that expectations are difficult to gauge.

Mr. Farrell noted that some call the Social Security payments income tax. Ms. Robinson said it was an income tax. The government is using that money right now.

Mr. Anania asked whether the contributory nature of Social Security made it different from the rest of the entitlements. The Board members had differing views on the extent of people's reliance on receiving future Social Security benefits, and whether they would rely equally on other programs financed by the general fund. Mr. Mosso suggested that the contributions are not essential, that reliance creates an asset the other side of which is a government liability.

Ms. Wardlow opined that it is hard to find a triggering event for non-exchange revenue. She said the GASB had the same problem with non-exchange revenues. The GASB found that it is necessary to introduce some kind of time consideration, the period you are talking about, or the point at which there is real eligibility on the part of the person who "has an asset." If not, then you end up saying, well, we've got to book revenue for all future taxes. It can't be that it's in some law because you end up with an endless stream of assets and liabilities. The notion of time runs through GASB Statement 33. The revenue is associated with a period of time, e. g., property taxes are associated with the time period that those taxes are applied to; grants are often associated with a period of time and/or with an individual or an entity becoming eligible in some fashion. Although she said there is nothing wrong with the proposed criteria per se, she suggested that perhaps there is something missing there that makes it useful in practice.

Mr. Zavada asked whether that isn't what we have with the statement of social insurance. It looks at revenue and expenses over a period of time. He asked whether it gets you one step further. Ms. Wardlow agreed it did but said that the issue was the point at which events get into the SOSI.

Mr. Reid opined that Social Security and Medicare are different in nature from other programs. It is somewhere between an exchange transaction and a non-exchange transaction, and this makes a difference when considering what the liability might be. Mr. Schumacher agreed that the social security program does have some exchange transaction characteristics and that there is something in between.

Mr. Zavada agreed with this characterization – something in between. He said that after hearing the panel discussion yesterday, he was not sure the Board was answering the right question, i.e., is it a liability. He said that question may not be as important as the question of what information can we put in the financial statement that can address solvency and sustainability.

Mr. Reid continued by saying that the current presentation (i.e., the SOSI in SFFAS 17) is great for considering sustainability. He said Mr. Gokhale made a good point yesterday. Mr. Gokhale's presentation illustrated which segments of the population are benefiting and which are not based on policy decisions. This is useful for adjusting policy to make it more equitable. But Mr. Reid said the Board talks frequently about the meaningfulness of the financial statements and they don't show the liability for earned benefits for these programs (earned as of today). On the other hand, he said we talk a $44 trillion obligation. Some people ask: how do you fund that? Investing $44 trillion would be a problem. He said that clearly some of the basic assumptions behind the traditional kinds of accounting begin to show rough edges when applied to such large numbers. He added that, when you look at sustainability, it is fine to go out to 75 years or further into the future. But, when you are talking about what we have already promised, where are we right now, today, you do not use the kinds of computations that yield $44 trillion. You ask: what have the citizens earned as of today? A liability computation is a different kind of process.

Mr. Zavada said that what the Board heard yesterday was that probably the most relevant way to look at the issue is through the analysis of revenue and expenditures, as opposed to pealing a number off in isolation and placing it on a balance sheet.

Mr. Mosso said that another main point made yesterday was that you need consistency. Consistency with other liabilities, consistency with other things, and he would add consistency with how the private sector accounts for their promises. He noted that considering that the Board is putting out an <u>accounting</u> statement, it is legitimate for FASAB to focus on what piece might be a liability so we can have a complete balance sheet. This would not mean that other numbers are not as useful or as important. He opined that the Board is concerned as accountants with only one piece of the total pie for the balance sheet but we can be concerned with all of it for disclosure purposes.

Mr. Zavada asked what the purpose of the reporting would be, e.g., solvency, sustainability?

Mr. Mosso responded that the purpose would be to reflect what we're committed to as of today. People have worked so much, earned so much, received statements about it. This is the same purpose as for any other liability. It measures what has happened period by period and what has accumulated and what has been paid off. It is a relatively simple concept and gets complicated when you apply these definitions.

Mr. Reid drew a parallel with the Civil Service Retirement System where we use one kind of accounting and other, similar programs where we do not. That is where the consistency issue arises.

Mr. Mosso said this affects the Board's credibility. The issue keeps coming up that FASAB does not recognize the liability and the meaning of the statements is questioned.

Mr. Patton asked why perpetuate the illusion if one does not think there is a liability. People come to think that they will be getting the benefits and money is being set aside. He asked why record a liability for that unless your goal is to try to solidify the program. But the Board wants to be neutral.

Ms. Comes asked, in that case, why record a liability for environmental cleanup costs when there is no appropriation, no plan to fund it, nothing that says we are going to pay down these liabilities. Further, why book employee pension liabilities?

Mr. Patton responded that his notion of what constitutes a liability might be different than Ms. Comes'.

The members disagreed about whether Social Security participants earn benefits by working in covered employment.

Ms. Robinson brought up the concept of payroll taxes. This money is supposedly dedicated to the Social Security program, but in actuality it goes to the trust fund and is immediately loaned out and used for other purposes. She said she thinks of payroll taxes as being like other taxes. She does have expectations about everything and views herself as a participant in it through paying her taxes. She thinks she has earned it in a broad sense. However she said she does not think anything in particular is going to come to her.

Ms. Cohen said that, unlike many federal programs, the Social Security is provided through a system. This makes it different than a citizen's general expectations of government.

Ms. Robinson said there are other systems, too, e.g., farmers are part of a system, the agricultural extension service.

Ms. Cohen responded that that would depend on the farmer; it would be his or her voluntary choice, unlike the mandatory participation of Social Security. One starts paying Social Security taxes as soon as one starts working.

Ms. Robinson added that one starts paying all income-related taxes at that time.

Ms. Cohen said that unlike Social Security payroll taxes, income taxes are not earmarked for specific programs.

Mr. Farrell added that the payroll taxes are borrowed from the Social Security program. The money is not just taken.

Mr. Mosso opined that a liability would be accruing even without the payment of payroll taxes. Congress has said, if you work this much in this kind of employment, the government will pay you at a determinable time.

Mr. Reid opined that a program where benefits are earned during a 40-year career is not fairly presented when amounts are reported only after retirement.

Mr. Mosso replied that this project is about fair presentation. Mr. Mosso said that this is a liability recognition project.

Mr. Patton offered that the SOSI represents a fair presentation and perhaps a richer way of presenting the information than a single number on the balance sheet. Alternatively, another element might be created for things that are not quite liabilities; they could be responsibilities or commitments of some kind and recorded periodically.

Mr. Mosso said that this project was added to the agenda to see if there were any liabilities that should be recognized. He said the Board should make that assessment, even though some members might say no.

Mr. Zavada suggested that an off-balance-sheet presentation would be his preference.

Ms. Comes asked a question about the willingness to move away from a balance sheet approach. The balance sheet is described as a statement of financial position. If a new prescription drug program is created during the reporting period that obligates the government in the future, did the financial position of the government change?

Mr. Patton responded that the government's financial position might have changed but not the government's liabilities. He said he could imagine considering alternatives to liabilities on the balance sheet, and he said he believes this would be relevant to the liability project. If one does not think something is a liability but it is something else, then the concepts are linked.

Mr. Anania opined that there are exchange transaction elements in these programs. He noted that when people pay into the program to the point where they become eligible and survive long enough to collect against that eligibility, there is something there that needs to be examined that might make the program different from other things in the federal budget that are in a sense non-discretionary. Also, he is not willing to say that Social Security payroll deductions are general revenues and that the Social Security program is not different that other annual expenditures. He said that perhaps what we are trying to do with constructive obligations does not get us there because it may not be prescriptive enough. He concluded by saying that the discussion evokes so much emotion that people forget this is an accounting discussion. He would be careful about sending a message to the world that the Board is trying to totally look through (ignore) what the federal government has told the people.

Mr. Calder indicated that Mr. Anania framed the question. Two hundred seventy million Americans say these are liabilities and a few hundred people in Washington DC say these are not liabilities. Where does FASAB come down on this?

Ms. Robinson replied that it really comes down to one's view of the purpose of the financial statement. She said she does not regard Social Security or any other federal program as mirages but she can't distinguish them from other programs that people are participating in. Although not as explicit as Social Security, the benefits of other programs are expected and relied upon. She said if the Board goes down this road it would end up booking it all. And that might be okay but that means it is a very different financial statement than what it is now. She asked rhetorically if that is what the Board wants to do.

Mr. Anania asked Ms. Robinson if there were an element of exchange here that does not exist in other programs. She responded negatively. He said the exchange idea might be a kind of linchpin. People pay into the system and expect to get some of that money back with interest.

Mr. Patton said in conclusion that he was not unalterably opposed to recording a liability for Social Security, but that the current liability definition and criteria did not convince him that Social Security is a liability. He said there might be merit in the suggestion to return to the exchange, or quasi-exchange notion.

Also, Mr. Patton noted the word "expectation" in the second liability characteristic on page seven of the staff paper (i.e., an expectation that the present obligation will be settled by a future outflow of resources). He said that the Board had decided not to use this word for the asset definition in the spirit of getting rid of probability expressions. He asked staff to consider a parallel construction for liabilities for next time.

Mr. Reid noted that the third characteristic (i.e., the transaction or event that creates the obligation has occurred) seems to be incorporated in "present obligation." He said he would like to know why that phrase is part of other definitions.

> CONCLUSION: Mr. Mosso asked staff to bring back an analysis that goes back to the three essential characteristics of a liability and describes why there might be a liability in this program and when the accrual should occur. The staff should look at more than one

program so that the Board has comparisons. He said the main issue is liability recognition, but in addition new balance sheet constructs and/or disclosures would be within the scope of the project.

- **Natural Resources**

Staff, Rick Wascak led the discussion. Staff explained that the paper the Board had received contained: 1) background information about the agencies that would be involved in the accounting for oil and gas; 2) a proposed methodology for valuing proved oil and gas reserves; and, 3) a proposed accounting framework at the government-wide level for proved oil and gas reserves. Staff also explained that the Board had received a transmittal that contained questions to guide the discussion on oil and gas, including whether a round table should be held and if an Invitation to Comment document or a Preliminary Views document should be issued. Staff indicated, however, that if the Board was in general agreement with the proposed valuation methodology and the proposed accounting framework, staff would expand the paper without taking additional steps such as convening a roundtable of experts.

Staff described the proposed valuation methodology and explained that the proposed measurement attribute used in the formula was current market value. Staff added that the measurement attribute was one area that would be expanded. Staff would provide alternative measurement attributes and information about them in regard to their characteristics and use. The Executive Director, Ms. Wendy Comes, opined that discounted cash flows may appear to be the best measure, however, because of various uncertainties, it may not be the proper measure to use.

Mr. Patton noted that if there are different types of assets on the balance sheet and some of the assets have different measurement attributes, the Board should have a rationale for this. Mr. Patton suggested staff keep this in mind in determining the measurement attribute for oil and gas reserves.

Mr. Patton expressed his concern about the reliability of the Energy Information Administration's proved oil and gas estimates. He asked if there are studies about the predictions to determine the reliability. Mr. Anania stated that Mr. Patton's concern on the reliability of the estimates becomes a unit of measure question. He asked Mr. Patton if looking at a field, a well, a series of wells would satisfy him, or the methodology used by a company. Mr. Patton replied that performing a study on a well didn't make sense and he preferred the study be performed at a company level. Mr. Reid asked if there were standards that are used to determine proved reserves for the purpose of entering into sales transactions. Staff responded that it would research the two matters.

Mr. Farrell asked if the Board should entertain the thoughts of auditors in regard to identifying any barriers to audit proved reserves, similar to the work that was done with the Social Security project. Mr. Mosso agreed that the Board should seek guidance from the auditors.

Mr. Mosso stated that staff's proposal was to come back to them with something along the lines of the paper they received for today's meeting, however more developed in terms of alternatives and additional research. He asked if that was acceptable to the Board members. There were no objections.

Conclusion: Staff will come back with alternative measurement attributes for valuing proved reserves, their characteristics, and use; research and provide information on the reliability of EIA's oil and gas predictions; and, research and provide information about any standards used to determine proved reserves for the purpose of entering into sales transactions.