

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
August 25 - 26, 2004
Room 7C13
441 G Street NW
Washington, DC 20548

<i>Wednesday, August 25, 2004</i>	<i>1</i>
Administrative Matters	1
• Attendance	1
Agenda Topics	2
• Identifying and Reporting Earmarked Funds	2
• Concepts – Objectives	3
• Concepts – Elements	9
• Social Insurance	21
Adjournment	31
<i>Thursday, August 26, 2004</i>	<i>31</i>
Agenda Topics	31
• Inter-entity Cost	31
• Deferral of the Effective Date of SFFAS 25 and 26	40
• Natural Resources	40
• Lease Project Plan	44
Adjournment	46

Wednesday, August 25, 2004

Administrative Matters

• **Attendance**

The following members were present: Chairman Mosso, Messrs, Anania, Dacey, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen. Messrs. Torregrosa and Holtz-Eakin attended for Ms. Robinson.

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

Chairman Mosso introduced the new Government Accountability Office member: Mr. Robert Dacey, Chief Accountant.

Final Minutes on August 25-26, 2004

- **Approval of Minutes**

Chairman Mosso explained that revisions had been circulated via e-mail from staff member Richard Fontenrose prior to the meeting. The revisions were limited to text addressing Mr. Gutterman's remarks at the Roundtable. No members objected to the revisions and the minutes were approved. Final copies are to be provided with the briefing materials for the next meeting.

- **Current Events**

Chairman Mosso noted that there were a number of articles relevant to FASAB issues. Members noted articles about the cost of Sarbanes-Oxley (SOX) requirements as well as the voluntary implementation of some SOX provisions by privately held and non-profit entities. It was noted that the CFO Council consideration of internal control measures for federal entities continues. Further, a careful weighing of the costs and benefits is needed in each environment.

Agenda Topics

- **Identifying and Reporting Earmarked Funds**

Issues Raised by Board Members During and After the June 2004 Meeting

Staff presented, and the Board approved, the following revisions to address issues raised by Board members during and after the June 2004 Board Meeting:

- In the initial year of implementation, entities should not restate "prior period" columns, for the same reason that early implementation is prohibited. Duplicate reporting, or gaps in reporting, could occur if some agencies impacted by paragraph 20 implement early, or choose to restate prior periods, and others do not. Paragraph 20 states that if more than one component entity is responsible for carrying out the program financed with earmarked revenues and other financing sources, and the separate portions of the program can be clearly identified with a responsible component entity, then each component entity should report its portion in accordance with the requirements of the Earmarked Funds standard.
- Language was added to make it clear that disaggregated information in the note disclosures is mandatory.
- The standard will explicitly state that there is no requirement to report earmarked funds separately on the Statement of Net Cost.

Board Approves Pre-Ballot Draft

The Board unanimously approved a pre-ballot draft of the Earmarked Funds standard. A ballot draft will be sent to the Board members on September 1, 2004. Responses from the Board members are due by mid-September.

CONCLUSION: If approved, the ballot draft will be submitted to the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), the Comptroller General, and the Director of the Congressional Budget Office for a 90-day review period. If the Comptroller General or the Director of OMB raises no objection, the new standard, Statement of Federal Financial Accounting Standards (SFFAS) 27, "Identifying and Reporting Earmarked Funds," will be issued 90 days after the date of submission. It will be announced in the Federal Register and published by FASAB. The new SFFAS would become effective for periods beginning after September 30, 2005.

- **Concepts – Objectives**

Mr. Bramlett opened the discussion on objectives by calling attention to a report titled *Toward a Report to Citizens on the State of Their Nation and the Performance of Their Government*. The Association of Government Accountants published the report a decade ago, after presenting it in draft at AGA's 1993 Conference. Mr. Bramlett suggested that it had influenced the evolution of the federal "Accountability" report, now known as the "Performance and Accountability Report." He said that the report attempted to describe a conceptual and practical framework for such reports, which might be useful for FASAB in its current deliberations on defining the roles of FASAB and of GAAP-based financial statements.

The Board had been discussing these roles for several meetings, as it reviewed SFFAC 1, *Objectives of Federal Financial Reporting*. At the July Board meeting, members had discussed four options presented by Ms. Comes:

- 1) Develop a working paper on the objectives of the Federal Accounting Standards Advisory Board (or objectives of GAAP based financial reports)**
- 2) Develop and publish "strategic objectives" for FASAB**
- 3) Develop a Statement of Federal Financial Accounting Concepts on the Objectives of the Federal Financial Accounting Standards Advisory Board (or objectives of GAAP based financial reports)**
- 4) Amend SFFAC 1 by clarifying the Board's role relative to broad objectives.**

Mr. Bramlett noted that his memo for August focused on two related issues that might be developed in this endeavor: “methods for narrowing down” and “reliance on users’ needs versus accountability.”

Mr. Anania said it would be helpful to focus on concepts we want to update. “Concepts” to him are about what the Government is trying to do with regard to financial reporting; a “strategic plan” is how we go about doing it. The strategic plan refers back to the objectives to explain how the Board should carry out the mission as stated in the concepts. Whether we want a strategic plan is a separate issue from our focus on concepts.

Mr. Mosso agreed. Ms. Comes had laid out four possible ways for us to move forward. He thought that the Board had agreed we would not try to amend SFFAC 1 until we had worked out the issues that had been bothering Board members. He visualizes a working paper on issues that have come up in our last two or three discussions. It would develop pros and cons. We could then develop a plan after we determine what the statement on concepts ought to cover.

Mr. Anania noted that FASB set standards for 20 years without a strategic plan. Once we have worked more on objectives, the mission, and where we fit, then it may be appropriate to ask whether a strategic plan will help us.

Mr. Bramlett agreed that “concepts” have “conceptual primacy,” and observed that they could have implications for planning as well as conducting the standard setting endeavor. For example, we might first seek accountability, then try to address users’ information needs to the extent that doing so seems cost/beneficial. That might be a reasonable priority and sequence -- both among projects and within the context of a given project -- given the limited number of external users identified thus far. He mentioned the idea, described by Jones and Pendlebury in a paper provided to the Board, that the public may not be interested in governmental financial statements, but the public interest may nevertheless be served by the process of publishing and auditing certain information.¹ He asked for the members’ perspectives.

Mr. Anania asked to what extent SFFAC 1 contains that idea now. Mr. Bramlett said it is possible to read that idea into SFFAC 1, but the notion of a hierarchy or priority of accountability vs. decision usefulness is not explicit.

Mr. Anania did not want to abandon either decision usefulness or accountability, but he agreed that decision usefulness might not be as important as it is in standard-setting for the for-profit sector. He would hope, however, that Congress and others would also look to financial statements for decision-useful information.

¹ “A Theory of the Published Accounts of Local Authorities,” by Rowan Jones and Maurice Pendlebury, *Financial Accountability and Management*, Vol. 20 No. 3, August 2004, pp. 305-325.

Final Minutes on August 25-26, 2004

Mr. Zavada agreed, suggesting that accountability is the more direct benefit in Governmental reporting, with decision-usefulness being more of an indirect benefit. The additional disciplines, control, and accuracy of information arising from preparing and auditing financial statements benefits the underlying reports that management uses day-to-day.

Mr. Anania suggested that a way to test this might be to ask how often people in Government use information that come out of standards FASAB promulgates to make decisions. "In other words," he said, "to what extent are the outputs of the reporting we require being used by Congress or others making decisions on behalf of the Government?"

Mr. Patton said that a few years ago, before electronic distribution became the norm, he surveyed some federal agencies to learn how many copies of the published financial statements were produced, to whom they went, and what uses were being made of them. The number of printed reports was relatively small. Some were used to comply with requirements to supply them to Congress and OMB; the rest mostly went to people within the agency. It seemed that the financial statements were not being used much, due to the lack of timeliness and detail, and due to the agency focus of the statements versus the program focus of the decision makers.

Ms. Comes, referring to Mr. Zavada's comment, said that one could broaden the way one thinks about the usefulness of information that comes from our standards. For example, reporting and auditing accounts receivable can be helpful in addressing concerns with improper payments. Similarly, the ability to talk about cost in a comparable and consistent way in other contexts depends on the existence of audited financial statements. To consider decision-usefulness in the Government one needs to look at it in a somewhat different way than is true for financial reporting by profit-seeking entities.

Mr. Torregrosa mentioned that the PBGC's financial report is receiving Congressional scrutiny now because the budget really says little about the PBGC's condition. He wondered if this was an atypical situation. Mr. Bramlett noted that the PBGC is a Government corporation and therefore, like other Government corporations, follows FASB's standards. PBGC is not unusual in that sense. One sees the direct relevance of business-type financial statements most clearly in Government corporations.

Mr. Mosso said another example of the "indirect effect" arose from FASAB's standard on accounting for fixed assets. Prior to the standard, the cost of assets was largely unknown in some agencies. Now OMB has a massive project on asset management underway, which really would not be possible without the improved records.

Mr. Zavada agreed. While recognizing the limitations of financial statements *per se* as the source of decision-useful information, he added, we don't want to forget the benefit of having accrual-based information and full-cost information available for management. The process of putting the financial statements together and having them audited provides a foundation for more detailed unit cost information to be developed.

“So there is an internal value,” Mr. Anania said, “as opposed to just looking at decision-usefulness as being an external idea.” Mr. Mosso agreed, saying, “maybe that is a point we ought to develop in the working paper.”

Mr. Bramlett observed that the emphasis on such internal uses is clear in SFFAC 1; from his perspective, it was comments from some current Board members who are uneasy about that focus which raised the question for discussion. Mr. Anania said we should retain in the concepts the notion that there is an internal use and value.

Mr. Patton said that full cost could be dangerous for decision making when incremental or marginal cost would be the relevant cost. Tolerance for subjectivity is greater in internal reports. The focus of internal decision makers seems to be on programs, not usually on agencies. Management needs detailed information for internal decision-making, and needs it timely. For reasons such as these, he worries about our product being accounting standards for GAAP, versus information for some other uses. It occurs to him that we may need different product lines.

Mr. Anania agreed, noting that he did not mean to say the product of FASAB's standards would be the source of information for internal users. They need a much more detailed set of reports. But we could embrace the idea that there could be a benefit for internal use.

Mr. Mosso said that cost information is an example of where the indirect effect could be substantial. For example, we have a Statement of Net Cost, which can report cost by segment or program at a high level. So we have a framework at whatever level an entity reports with some cost accounting built into it. That may be as far as FASAB needs to go; this presumably would have some effect on how the entity constructs its own management reporting system within that framework.

Mr. Anania said our current concepts do not elaborate on what may be needed for internal management, and on how FASAB pronouncements help meet that need. Mr. Bramlett agreed that we could further develop the discussion of the indirect nexus.

Mr. Anania asked if that helped to address Mr. Patton's concerns. Mr. Patton said that our premier product is standards for audited financial statements. Trying to rationalize the existence of the Board based on indirect effects seems like a second or third order effect compared to the direct effects; he would hope we have more direct effects as the rationale.

Mr. Reid said that one of the benefits for internal users is that the records are more complete and organized. In the past, there may have been records in various locations that were not organized and collected. A manager above those organizations would have had difficulty in making comparisons, because the information was in systems designed for each particular program. Today each of those organizations has a standard general ledger that can be consolidated with others. Costs can be

Final Minutes on August 25-26, 2004

accumulated in a consistent way across the agency. Given where we were, those are substantial indirect benefits of the standards.

Mr. Dacey said that requirements to report things like the allowance for doubtful accounts drives a whole set of systems and processes. The financial statements *per se* may not be useful for management, but the standards identify types of information that FASAB thinks are important to users, including internal users.

Mr. Anania said that it is safe to say that the accounting standards provide a structure and discipline for improved reporting. "A good control environment," Mr. Zavada added. "And completeness," said Mr. Reid, "and now the information is available at all levels, not only at the top." Mr. Mosso agreed that completeness should be an important objective.

Mr. Patton suggested that there may not be incentives in the Government comparable to those in the profit-seeking sector for management to develop certain information, so we have this indirect goal to encourage that kind of development.

Mr. Reid said it is also a matter of providing guidance. People designing systems often are happy to provide for certain information, but need guidance as to what is needed. JFMIP does not initiate systems requirements, but rather it collects requirements developed by others, e.g., for property accounting. New accounting systems offered by vendors are tested against that list of requirements. Thus, for example, there should be no problem in reconciling budgetary and financial accounting with a new accounting system from an approved vendor.

Mr. Zavada said that he didn't know that it is an issue of incentives. The value is having information in another structure; i.e., having accrual information to supplement the information that is currently available. He sees what FASAB is doing as a supplement to existing information.

Mr. Farrell said that it sounds like we are doing accounting; we tell people how to account for things. We are not sitting here deliberating decision usefulness; we deliberate accounting. So what is our objective? Our objective is accounting. Occasionally, with some of the things we do, e.g., where we count items instead of dollars, we are doing a little bit of accountability.

Mr. Schumacher said that he agreed with Mr. Farrell but we also couldn't ignore the effects of our standards.

Mr. Mosso noted that when FASB required accrual accounting for retiree healthcare costs, it focused management's attention on these benefits. Similarly, there was incomplete risk management in many companies until FASB's standard on accounting for derivatives was issued. One can also point to other standards in the private sector that focused attention on managing; again it is an indirect effect.

Mr. Anania noted that SFFAC 1 frequently refers to users' needs. When it comes to the citizenry, he is not sure we understand what those needs are. He infers from Mr.

Final Minutes on August 25-26, 2004

Farrell's comments a suggestion that the idea of "users' needs" may be elevated higher in SFFAC 1 than it needs to be. He would not ignore users' needs, but would deemphasize it and talk about accountability and users' needs in broad terms.

Mr. Farrell said he was talking about practicalities. He likes SFFAC 1.

Ms. Cohen noted that GASB also is concerned with users needs, including capital market participants. As has often been noted, the federal government's relationship to the capital market is different from that of other entities. Mr. Farrell wondered whether this would always be true.

Mr. Mosso directed attention to a list of topics that prior discussions had identified as areas where concepts articulated in SFFAC 1 might need to be further developed or revised.

Regarding the definition and role of "general purpose financial statements," Mr. Reid acknowledged that voters and citizens generally don't read the Consolidated Financial Report, but, he said, there is an opportunity to educate the Congress and press. Particularly if that report has been audited, it provides a common set of information for use in debates and decisions. It is easier if everyone is working from the same set of information.

Mr. Anania said he would like to see a white paper, instead of immediately trying to revise SFFAC 1. The paper could look at some areas of concern that have been expressed, such as internal accounting control and stewardship. It might also discuss whether SFFAC 1 should address federal financial reporting in general, or only reporting pursuant to FASAB's standards. Mr. Mosso said he envisioned a neutral discussion of such areas. Mr. Anania suggested that a roundtable with some interested parties might be useful at a later date.

In response to a question, Mr. Bramlett said that ultimately, the Board's process might lead to a revision of SFFAC 1, or it might lead to additional documents in a conceptual framework. We are currently working on elements, which could become a statement of concepts. Other possibilities have been mentioned, e.g., a conceptual statement on reporting model or communications methods. Today's discussion may suggest that further developing the notion of "indirect effect" of reporting standards might help to address concerns some members have expressed about getting too far into managerial issues and roles.

Mr. Anania said he could see a broad introduction to a statement of objectives that would then narrow down to deal with FASAB. Mr. Farrell said he thinks that is what we do. Mr. Anania said it is not clear to him from our concepts statement whether that is how we should direct our efforts. .

Mr. Patton asked about the implications of "Rule 203 status" for FASAB. Did it make everything we do part of GAAP? Could we produce GAAP for audited statements, and have other products outside of that? Mr. Mosso said that is an issue, part of the "broad versus narrow" debate.

Mr. Zavada said that gets to what FASAB's mission is. He would think that FASAB's mission is to develop standards for GAAP-based financial statements.

Conclusion: Mr. Mosso asked for an outline of a paper for the next meeting. This would be a neutral working paper on issues that have come up in our last two or three discussions.

The Board adjourned for lunch at noon.

- **Concepts – Elements**

Ms. Wardlow presented two papers for discussion. The first was a revised draft of a potential "assets" section of a concepts statement on elements, which incorporated members' comments at the last meeting. For example, she had added a discussion about "resources" and made various editorial changes. She asked whether members agreed with the changes and whether there were other topics they wanted to explore further.

The second paper was about liabilities. It presented the FASB's notion of what a liability is, along with liability definitions from other standards setters. The main purpose of the paper was educational. She hoped to identify issues on which the Board would like to have more information for future discussion.

Asset Definition

Mr. Schumacher asked why Ms. Wardlow said in the paper that she was reluctant to abandon the notion of control of access. She explained that she found it difficult to include it in the definition, but had retained it in the discussion.

Mr. Patton suggested that the word "capacity" has embedded in it some notion of probability. If the Board wanted to avoid probability in the definition, the word "capacity" may bring that idea with it. Mr. Mosso agreed there might be some implication of probability.

Ms. Wardlow said that we are talking about future economic benefits, and there is inherently some uncertainty about the future. To her, having the capacity to provide benefits is important to the definition. One makes the judgment that one believes the resource has the capacity to provide benefits, without a formal assessment of probability.

Mr. Farrell asked Mr. Patton if we could take out the word "capacity" and say, "that can provide benefit," then one would still be making a value judgment. Ms. Cohen agreed, noting that "can" means "is able to."

Mr. Patton said we don't want to use "will," for the same reason FASB did not: it would imply certainty.

Final Minutes on August 25-26, 2004

Mr. Jacobson asked if “could” was the desired notion for asset definition, whereas “would” is the notion you look at when you consider recognition.

Mr. Schumacher said some element of uncertainty is necessary. Mr. Patton agreed. His concern is that we may be carrying the probability notion along with us without acknowledging it. He thinks that is dangerous.

Several members asked Mr. Patton what he would prefer to say. Without endorsing it as an answer to their question, Mr. Patton noted that the FASB uses the phrase, “probable future economic benefits,” whereas we have added the word “resources.” Ms. Wardlow said that is an important addition, to avoid confusing what is today with what we expect in the future. Continuing his response, Mr. Patton said he found it awkward to add his wording, if we don’t use the FASB’s phrase, but instead use the word “resource.” He suggested something like “resources controlled by an entity that will probably result in economic benefits . . .” . Mr. Anania said that other standard setters had omitted “probably.” Ms. Wardlow confirmed that and added that the FASB is now considering whether to omit “probable,” because of the problems they have encountered with it. However, she said, that is not to deny that there is uncertainty about receiving economic benefits, which there is because you are talking about the future.

Mr. Dacey asked for confirmation that the Board is addressing whether there is an asset, and not whether the asset should be recognized. The Board agreed. He then said that probability seems to relate to recognition of the item rather than to its definition. He liked the suggestion of “could” because it implies some possibility that it could happen and then, for recognition, you would have to evaluate that possibility. Mr. Reid added that he likes “could” because it encompasses two things: (1) you are not sure what the value of an item might be—but that is a measurement issue and you can still say it is an asset, and (2) “could” covers the fact that you have no intention of disposing of the asset—thus, it covers the existence of an asset and the government’s intent, and the rest are measurement issues.

In response to Mr. Mosso’s question, Mr. Reid said he would use “could” as a replacement for “have the capacity,” and not say “could have the capacity.” Ms. Wardlow added that to say both, i.e., “could have the capacity,” would seem to deny something fundamental to the definition of an asset. That is, one could say it “could provide” or “may provide” or “might provide,” economic benefits, but not that it only might have the capacity to provide benefits, which would water things down too much.

Mr. Mosso noted that even “resource” is defined as a “useful or valuable possession,” implying that one had made that judgment.

Mr. Anania asked whether we could leave the notion of probable or capacity out of the definition and just cover it in the characteristics, as he believes other standard setters have done. Ms. Wardlow said that some of them have used “expected” to qualify future economic benefits.

Final Minutes on August 25-26, 2004

Mr. Patton thought we should not include something in the characteristics that is not covered by the definition, because the definition should be based on the characteristics.

Mr. Anania responded that it seems we are trying to avoid the word “probable” by using substitute words. The notion he gets is that “as of today” we expect these items to provide future economic benefits. We are making an assessment as of today. Ms. Wardlow agreed and noted that other standard setters, such as the IFAC Public Sector Committee, had adopted that approach, including the notion of “expected” future benefits. However, some people have problems with “expected” because of the work that has been done on measuring expected values and bringing that into accounting measurement. So, there is a concern that “expected” takes you too far.

“It is like a threshold as well,” Mr. Patton said. “Could” has the advantage of setting the threshold near zero, he continued, which is what a majority of the Board has said they want for the definition stage. He added that “could” was better than anything he could come up with at this time.

Mr. Mosso asked for other members’ comments on “could” instead of “has the capacity to provide” economic benefits, in the definition. Mr. Anania said it was a low threshold. Mr. Patton agreed but said that the majority of the Board has said they prefer that for the definition stage, but not when you get to recognition. Mr. Dacey agreed that the question for definition is “Could it possibly have some benefit?” Recognition, he added, is another story.

“That definition does not rule out many things,” Mr. Patton observed. Mr. Reid said that if one is to err, it is better to err on the side of at least examining more things, rather than less things. In addition to the economic situation of the government, you also have the stewardship side to consider, so that, if it is in fact an asset, the citizens are probably expecting you to preserve it. So, you are probably better off to be more inclusive than less inclusive.

Mr. Schumacher said we might want to be careful on the liability side. We have often said that liabilities are a mirror image of assets, so if there is a low threshold on the asset side, we may need to be careful on the liability side.

Mr. Mosso suggested that Ms. Wardlow retain the alternatives (“could” or “has the capacity”) for the moment and consider whether there are other alternatives.

Ms. Wardlow expressed her view that as long as the idea of uncertainty is included in the discussion, it is not essential to include a word like “probable” in the definition. To include “probable” in the definition invites the view that a formal assessment of probability is needed at the definitional stage. That is the problem that has arisen for the FASB and for other standard setters who initially considered including it in their definitions, she said.

Mr. Patton suggested that the word “capacity” carries a similar implication. However, other members thought there was a difference between something having the capacity to provide future benefits and the future benefits being probable.

Final Minutes on August 25-26, 2004

Mr. Jacobson asked whether the definition is supposed to capture “possibility” while the recognition decision deals with probability?

Ms. Wardlow said that the FASB’s original proposal did not include the word “probable,” but comments received objected to that proposal, saying that to omit the word would imply near certainty was essential. Then, after the FASB added the word “probable,” people started to want to put percentages to it.

Mr. Reid suggested that something could be an asset even if we have made a decision not to sell it or convert it to derive an economic benefit. The Washington Monument comes to mind as an example of something that is an asset even though we have no intention of doing anything other than preserve it. Measurement is another thing, but it is still an asset.

Mr. Mosso asked Ms. Wardlow whether she preferred “capacity” to “could.” She replied that either would be fine, as long as the terms are explained in the draft. She thought that “has the capacity” and “could” meant the same thing. In any event, she said, it will be important to convey in the document that a one- or two-sentence definition must be read in conjunction with a longer discussion about characteristics and intent. She referred, for example, to the discussion of “uncertainty,” in the draft.

Mr. Anania asked if it would help to use an example. Consider a parcel of land, he said, that the government decides to acquire. At the time of acquisition, there is a known environmental problem. But they acquire the land anyway for \$10 million and the assessment now is that there is only a remote chance that the environmental clean-up can be accomplished. Whether you have “capacity” or “could” or no word in the definition, you still have to make an assessment of what is the possibility of being able to bring that asset to fruition. Is the question in the definition in that case, or in the measurement? He thought it was in the definition. Ms. Wardlow thought it was in the measurement because there still was a chance of future benefits. Mr. Anania thought his example showed the difference between “probable” and “capacity,” because with “probable” his example would not meet the definition. Mr. Reid disagreed, saying that if the government has purchased the asset, then the free market has established a certain probability that is inherent in the price. Mr. Farrell agreed that this was a question of measurement.

Mr. Schumacher compared Mr. Anania’s example to the example of a deferred tax asset, which in your best judgment today you may think has the capacity to provide benefits in the future, but it may not. Mr. Anania responded that he was just trying to see whether the words “could” or “capacity” or no word in the definition make a difference. Mr. Patton said that “could” has the advantage of making the uncertainty explicit. He thought it was clearer than “capacity.”

Ms. Wardlow said that regardless of what any other board has done, the answer should depend on what the FASAB wants. She suggested that, both for assets and for liabilities, the Board wants to look at items that “could” or “have the capacity” to result in future benefit or sacrifice.

Final Minutes on August 25-26, 2004

Mr. Anania said he could support “could.” In response to Mr. Mosso’s question, it appeared that the members in general were comfortable with “could,” at least for the present. Mr. Mosso directed Ms. Wardlow to work with “could.” In response to her question, the Board indicated that it was not instructing her also to pursue alternative words.

On another issue, Mr. Anania asked why “future economic benefits” in the previous draft definition had been changed to “economic benefits in the future.” Ms. Wardlow said it was an editorial change to avoid the implication that a “future economic benefit” is something that exists now. Mr. Anania said that he found eight subsequent uses of “future economic benefits.” Ms. Wardlow agreed that those uses should have been conformed to the change in the definition.

In response to Mr. Mosso’s call for other comments, Mr. Patton directed attention to page 2, line 20. The definition says “controlled,” but the characteristic says, “must be able at the present time to control access to the resource,” etc. Ms. Wardlow said the Board had discussed this, and had concluded that the entity need not actually exercise control as long as it is able to do so. She prefers “ability to control” because it is more inclusive. She acknowledged that it would be useful to conform the words in the definition and in the discussion of the characteristics, but it was difficult to include so many words in a simple definition. Mr. Jacobson suggested that “controllable” might work in the definition.

Mr. Schumacher said “controllable” might be better. Mr. Anania pointed out that other standard setters did not seem to have a problem with the notion of control. Mr. Patton asked, however, whether the potential ability to control was not the same as being able to control at this time. He would favor deleting “be able.”

Mr. Anania said, “You may have an option instrument that you could exercise which would permit you to gain control.” Mr. Patton said that either you have control or you don’t. In response to Mr. Mosso’s question, Ms. Wardlow said that she thought it would be acceptable to delete “be able” from the definition as long as the discussion of characteristics made it clear that the entity did not have to be actively exercising control at the present time, as long as it had the ability to do so. Mr. Mosso said he thought there should be an explanation anyway. Mr. Patton indicated that he thinks the relationship between the characteristics and the definition needs to be as close and as clear as possible.

Mr. Farrell suggested replacing “must be able to” with “can,” which he said would cover situations where the entity is not actively controlling now but could do so.

Ms. Comes asked if deleting “access to” from the characteristics would be a conforming change. Ms. Wardlow said she might be able to do that, if she could not get the words back into the definition; the idea of access then could be included in the subsequent discussion. In her view, it was important to include the notion of access somewhere.

Mr. Mosso suggested that “control” means you can obtain the benefits for yourself and can prevent others from doing so. Mr. Farrell suggested saying that instead of the third sentence of paragraph 3. Mr. Dacey cautioned that one who controls an asset can direct the benefit to someone else. Mr. Mosso suggested that was part of control; you can do what you want with it. Ms. Wardlow noted that part of the issue is how the document is structured. She pointed out that the more expansive discussions appear later in the document. That is, the definition is brief, then the characteristics are more expansive, and then there is further discussion of the characteristics. For example, paragraph 11 expands on the meaning of control, saying that “The entity controlling an asset is the one that can, depending on the nature of the asset, hold it, exchange it, use it to provide goods or services, exact a price for others’ use of it, or use it to settle liabilities.” Once you get to that point, she said, the terms should be clear, but the difficulty is getting the more succinct explanations up front to the same point. Mr. Farrell agreed that you cannot get the full explanation in the one sentence in paragraph 2, and if the reader stops reading at that point, the meaning will not be clear. In his view, the intelligent reader would continue through with the explanation. Mr. Reid agreed and noted that, in his view, the definition itself should be as broad as possible, and then let the other sections “whittle away” at those things that do not qualify. He added “You want people to read on. You don’t want them to conclude from the definition that they don’t need to go any further.”

Mr. Mosso asked if there were any other thoughts on the assets draft. Mr. Dacey noted that control relates to the economic benefits that flow from an asset, not to the asset. Ms. Wardlow agreed, saying that one need not even be in possession of the resource to control it. Mr. Dacey suggested that some of the extra words might not make that clear—that those are future benefits. Mr. Patton said that he thought you need to be in control of the asset because the benefits are in the future, so you cannot control them now.

Mr. Bramlett asked whether we need to think about the fact that Congress routinely directs the economic benefits in various ways through mandates and regulations that dictate how other entities must use resources they own. CBO routinely quantifies the effects on resources of nonfederal entities of certain types of such mandates. Ms. Cohen said this does not give rise to a federal asset. Mr. Reid thought the language referring to control at the present time took care of that. In his view, we are talking about a snapshot, not what Congress could do in the future. Mr. Farrell asked if a regulation requiring a utility to build a higher smoke stack would be an example—whether Mr. Bramlett was suggesting that, the fact that Congress passed a law requiring the company to use its own money, that might somehow be captured by the language on control? Mr. Bramlett said Congress would be directing the use of the benefits. Mr. Farrell said the company did not have to make the expenditure, even though it would be breaking the law. He understood what Mr. Bramlett was saying, but he thought it was a different sort of control.

Ms. Wardlow said that maybe she needed to expand on the discussion in paragraphs 3 and 4, even though a fuller explanation appears later. Mr. Farrell thought it might be possible to take a totally different tack—to explain all the concepts first, then introduce

the characteristics, with the definition last. Mr. Mosso noted that the document explained all the key words in the definition. Mr. Farrell pointed out that, without double-spacing, the document would be only four pages, and that you would think that somebody would read four pages on assets. He did not think that moving things around would make much difference. Ms. Comes said that concepts statements are intended primarily to help the Board, so that the Board should decide first what would be most helpful to them. Mr. Mosso added that auditors and others also use concepts statements.

In response to a question from Mr. Mosso, Mr. Farrell said he was not really suggesting that the order of the material be reversed, although it could be done that way. But he did not think that was really the answer. Mr. Patton pointed out that, if you put the definition at the end, people will skip to the end. Also, in his view, it is easier to justify the “punchline” if you start with it, because otherwise the discussion could lead to other possible lines of reasoning. Mr. Farrell suggested referring the reader in the earlier paragraphs to later discussions of the terms used. Mr. Anania suggested a paragraph between the definition and the listing of the characteristics to explain that the characteristics and subsequent discussion paragraphs are designed to help the reader make the definition operational.

Mr. Patton suggested deleting the parenthetical example of intellectual capital on page 3, line 15, because including that example might prejudice the Board’s future conclusions about intellectual capital.

Characteristics of liabilities

Mr. Mosso then directed the Board’s attention to the paper on liabilities.

Mr. Anania asked whether we had solved the problem of using the word “obligation.” Ms. Wardlow said no, there was sentiment last time to try to avoid that word in the formal definition because it is used in budgetary accounting. Because the paper for this meeting was educational, however, she had continued to use “obligation” in its everyday sense. She was considering “claim” as an alternative for the definition. Mr. Anania asked if we could just not use the word “obligation” with our own definition of the term. We have done that with other words. Ms. Wardlow said that could be one approach.

Mr. Mosso directed attention to the broad issues on page 15 of Ms. Wardlow’s paper on liabilities:

A. Broad Issues:

- 1. Are the essential characteristics of liabilities identified by the FASB for private-sector entities also essential characteristics of federal government liabilities?**

- 2. Do federal government liabilities have any essential characteristics that have not been identified for private-sector entities' liabilities?**

Ms. Wardlow observed that members might need to consider those questions in the context of the more specific issues as well:

B. More Specific Issues:

- 1. Is a liability a *present obligation* to another entity or entities?**
- 2. Does the Board agree that, conceptually, the federal government may have a liability for the provision of goods and services, not just for financial obligations?**
- 3. Does the Board agree that, to be a liability, a present obligation does not have to be legally enforceable? That is:**
 - a) Does the Board agree that constructive obligations may be liabilities?**
 - b) Does the Board agree that equitable obligations may be liabilities?**
- 4. Are most liabilities the obligations of only one entity at a time?**
 - a) How relevant to federal government liabilities is the concept of "jointly and severally liable"?**
- 5. Does the Board agree that when two entities have the same obligation, the obligation is ranked, rather than shared (primary debtor and guarantor)?**
 - a) Does the Board agree that both entities may have a liability, even if the guarantor's liability may not be recognized in the financial statements?**
- 6. Does the Board agree that not all assets have liabilities as mirror images?**
- 7. Does the Board agree that it should pursue the best possible definitions of asset and liability separately, and defer the issue of potential symmetry in the definitions until each definition is quite developed?**
- 8. Does the Board wish to add any issues at this time?**

Final Minutes on August 25-26, 2004

Mr. Anania said that, in trying to respond to question B2, he found the material from the Australian and U.K. boards in the section on “Issues Specific to Governments” to be helpful. His instinctive answer to B2 is “no,” but he thinks we need a framework to get to that answer, and the material was helpful. He did not think there was anything in the U.S. accounting concepts materials that would help the Board in this area.

Ms. Wardlow said that she did not think the Australian and U.K. boards were saying that governments could not have a liability for goods and services at some point. Rather, a political promise, e.g., to provide education, does not necessarily create a liability. She liked the U.K. classification, which distinguishes between general and specific promises, but it left questions as to how she could explain it further. Unfortunately, there was no further discussion in the U.K. document.

Mr. Patton asked if prepaid services, such as for trash pick up from his local government, would create a liability for goods and services on the part of the government? Mr. Farrell said it is more of a deposit; the government has to provide the service or give your money back. Mr. Reid asked if it was a tax. Mr. Dacey mentioned SEC registration fees.

Ms. Wardlow said that we need to distinguish between the overall political promise of government and something else that converts it into a liability. Part of the reason she had included the issue was to question where the dividing line might be. The other point was to call attention to the Canadian definition, which says that liabilities are financial obligations. That seemed narrow to her. She speculated that it might have something to do with the measurement focus/basis of accounting they are using, but she was not convinced by the rationale presented.

Mr. Reid said that one of the essential issues is the notion of the “slippery slope” that concerns the Board. There needs to be a firewall such that everything to the left of the wall gets recognized and everything to the right of the wall does not. Because, he said, “as soon as you get on that slippery slope, you wind up there with defense [being a liability].” He asked whether there was a way in the essential characteristics to build in an exchange notion to avoid including things we do not want. We have the concepts of “exchange” and “exchange like” and the “constructive obligation” notion. He wondered whether it was possible to build into the definition of transaction, as meaning an exchange or exchange-like event, or into the essential characteristic itself, something that would say that just because the government provides a benefit does not mean it has a liability for it, or just because the government provides national defense does not mean we have to capitalize the next 75 years of national defense expense.

Ms. Wardlow said she thinks we need some kind of triggering event although it ought to be a conceptual notion. But, she did not see it as an exchange/nonexchange issue. For example, if someone has met all eligibility

requirements for a grant, is that not a liability? And that would be a nonexchange transaction, she said. Mr. Reid said there may be a liability after the Government agrees to make the grant, but there could be many people who are eligible and there would not be a liability to all of them. Ms. Wardlow said there needed to be a dividing line. Mr. Farrell mentioned the U.K. document and its distinction between a general promise and a specific obligation, where one is and one is not a liability.

Mr. Anania asked Ms. Wardlow if her paper included a statement that she did not regard the exchange/nonexchange distinction as the most useful approach. Mr. Fontenrose said that Mr. Anania was referring to a section of his paper on accounting for social insurance. Mr. Anania asked Ms. Wardlow to think about it.

Mr. Zavada suggested that legal enforceability may be the bright line. He acknowledged that the concept of liability may go beyond legal enforceability, e.g., with environmental liabilities. He is, however, much less comfortable with the notion of constructive liability and even less comfortable with the notion of equitable obligations as being liabilities. So, as far as a bright line is concerned, he thought the notion of liabilities goes further than legal enforceability but not as far as constructive or equitable obligations.

Mr. Anania asked Ms. Wardlow if she had seen a governmental standard-setting body deal directly with the concept of constructive obligations. She said that she had not seen it *per se*. The place where an analogous idea has come into GASB's deliberations thus far is in connection with accounting for retirees' benefits other than pensions (other post-employment benefits or OPEB). Both FASB and GASB have said that one cannot account for such benefits only on the basis of what is written down: there is a "substantive plan," and when your employees have understood that they will receive the benefits, a liability can arise, even though you think you did not plan for that or that you could change your mind. A number of court cases in the private sector have supported the existence of a liability in those circumstances. Court cases related to state and local government plans have been fewer and more mixed in their results, but that is where the notion of constructive obligation has been discussed most recently, in her recollection.

Mr. Patton commented on the three "essential characteristics" listed on page 2 of Ms. Wardlow's paper that come from the social insurance project:

- Existence of a present obligation²
- An expectation that the obligation will be settled by a future outflow of resources

² Ms. Wardlow's paper noted that the term "obligation" had been used in the paper with its everyday meaning (duty, responsibility, etc.), as indicated in the second footnote to the FASB's definition of a liability.

- The transaction or event that creates the obligation has occurred.

Mr. Patton observed that the word “expectation” brings with it a probability assessment, as does the phrase “will be settled by.” He asked whether the concepts of probability and uncertainty should be dealt with in parallel fashion when discussing assets and liabilities. He noted that the word “probable” is used in FASB’s list of essential characteristics upon which its definition of a liability is based:

- (a) It embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand.
- (b) The duty or responsibility obligates a particular entity leaving it little or no discretion to avoid the future sacrifice, and
- (c) The transaction or other event obligating the entity has already happened.

Also, the phrase “little or no discretion to avoid the future sacrifice” implies to him a strong probability statement. He said he did not have a solution, but he had questions about whether we want to have probability statements in the definition of a liability.

Mr. Reid asked what is the risk or downside of including a reference to probability. Mr. Patton said he was in favor of including such a reference in the definition of asset; given that the Board decided not to do that, he asks whether the Board wants parallel definitions. A lack of symmetry seems to introduce a different burden of proof. In the discussion of an asset definition, others had argued that it was desirable to cast the net widely; would they not want to do the same for liabilities?

Mr. Reid said that introducing probability implies that judgment is needed, which strikes him as a good thing and it would be good also for those applying the definition to exercise judgment, so that the definition is not arbitrarily inclusive or exclusive. He was trying to ascertain whether Mr. Patton thought that including probability in these characteristics was a good thing or whether it was something we should avoid.

Mr. Patton said that the Board voted for “could” in the definition of assets, which sets a low threshold to conclude that something meets the definition of an asset. Given that, it seems natural to have a low threshold for something that meets the definition of liability. One would then decide whether to recognize it using more formal assessments of probability at the recognition and measurement stage. If we had said “probable” in defining asset, then he would say to use “probable” in defining liability. To him, a mismatch would result in different hurdles and he thought we would have to justify that.

Final Minutes on August 25-26, 2004

Mr. Anania asked if Mr. Patton was saying that the word “could” should be used instead of “probable” and Mr. Patton and Ms. Wardlow gave examples of how that might work.

Mr. Dacey suggested there is a parallel in that the definitions determine what asset or liability relates to a given entity. In one case, the entity controls the resource; in the other case, it is the entity’s obligation. He thought that characteristics (a) and (b) in the FASB’s asset and liability definitions were quite parallel, without a specific assessment of probability. However, he agreed with Mr. Patton that “little or no discretion” introduces a probability statement. Ms. Wardlow suggested that might not be the case if “little or no discretion” refers to the present—as a parallel for “control at the present time” in the asset definition. It would not necessarily be making a probability assessment about future sacrifices.

Mr. Mosso said that he thought the concepts in the asset and liability definitions were the same in terms of probability, but one could not merely take the asset definition and use the words in reverse; there would be some wordsmithing to do. He then asked whether there were any other quick comments about the questions on page 15, before moving to the next topic.

Mr. Reid said he was less concerned about the “mirror image” notion than with arriving at good definitions. If there are ways of synchronizing, that would be good, but if it is determined that is not possible, then he could live with two definitions that are not synchronized.

The Board discussed whether there is an asset for every liability. Mr. Mosso said he thought the notion of “mirror image” only really comes into play when you are talking about claims receivable and claims payable; if you have the one there has to be the other. Mr. Jacobson asked who has the asset for an environmental liability? Mr. Mosso said that there may be exceptions where you cannot identify a specific individual or entity that holds a corresponding asset. There is an asset only in the sense of some public benefit or some people in a particular area. But, we have said that does not let you off the hook; you still may have a liability.

Mr. Zavada said that symmetry would become more of an issue if the Board were to expand the definition of liability with some concept such as “constructive obligation.” He said again that he has concerns about going there, but if you were to go there, symmetry would become more of an issue in terms of having parity and having bounds on both sides. The issue of a parallel with the power to tax was mentioned.

The Board discussed whether the concept of joint and several liability is relevant for the Government. Mr. Jacobson said that there could be instances in which multiple agencies could be severally liable, but the concept does not work as it does for nonfederal entities.

Final Minutes on August 25-26, 2004

Ms. Wardlow solicited input from the Board about issues to develop. Probably the two biggest issues, she said, were “constructive and equitable obligations” and the “bright line” notion in the U.K. document—that is, to see if we can come up with something like that. Mr. Fontenrose noted that the Board would discuss issues B1 and B3 further in the next session, while deliberating accounting for social insurance.

Mr. Dacey said he thought those were important areas but he was not sure that the concept of constructive or equitable obligation applies for the federal government. Ms. Wardlow said that she is not sure whether it applies or not, but if it does not, we should explain why not, because other standard setters include the concept in their definitions of liabilities.

Ms. Wardlow asked whether the Board was comfortable not addressing symmetry head on at this point, with the understanding that we would come back to it. In other words, she would make the amendments to the asset document that had been agreed at this meeting, but would not take the document any further. Would the Board agree then to leave the asset paper aside until it had moved further on liabilities, and then look at whether there are problems of symmetry? The Board agreed.

Conclusion: Ms. Wardlow will amend the asset draft as discussed. On liabilities, she will further develop ideas and issues related to the concepts of “constructive and equitable obligations” and to the need to distinguish liabilities from political promises.

- **Social Insurance**

The staff presented a paper to the Board discussing 6 issues. The paper sought to determine if a consensus – that is, a majority view -- existed relative to certain issues 1-3. Issue 4 compared select characteristics of several federal programs to Social Security. Issues 5-6 raised other issues. Fact sheets of all the newly introduced programs were included in the paper as well as tables and charts illustrating the discussion points of the paper.

Issue #1

Issue #1 in the staff paper presented the distinction between present obligations and future obligations and its importance in recognition of a liability. The staff sought to confirm whether there was a consensus among members that the concept of “present obligation” was valid for social insurance programs and if that concept should be emphasized in the project.

Chairman Mosso asked if that meant that we were not reaching out for “future outlays just because there was a Government program going on.”

Final Minutes on August 25-26, 2004

Staff confirmed that the focus was on the present obligations for the current period not on future outlays. The example of future employee salaries was discussed. These salaries are for future services and are not accrued in the current period. The goal was to give a cut-off point for recognizing the liability.

The board discussed the definitions of present and future obligations.

Mr. Mosso asked if there was any disagreement with the notion of present obligation.

Mr. Zavada stressed that present obligation would only be useful if you thought Social Security was a liability beyond the “due and payable” number currently reported. He said he felt it did not go beyond that and therefore felt present obligation was not important to the argument. Mr. Zavada said he did not feel Social Security created a present obligation to the U.S. Government.

Mr. Anania stated he believes that present obligations certainly narrowed the scope of which liabilities to recognize.

A member stated that this served as a control so as to not recognize future oriented obligations like defense, education, etc.

Mr. Mosso made reference to the paper Ms. Wardlow gave the Board on the UK standard-setters differentiating government obligations between general policy and specific obligations.

Mr. Farrell asked the Board to be careful when defining what the “past event” should be. He made reference to the passing of a budget being construed as that type of event and recognizing a liability for that.

The staff asked for a consensus among Board members, on the emphasis, not stating what it is, but simply emphasizing the concept of present obligation.

Conclusion re Issue #1:

There were no objections to the staff emphasizing present obligation with regard to recognizing a liability for the Social Security project.

Issue #2

Issue #2 in the staff paper sought to clarify whether there was a consensus among members to proceed under the assumptions that (1) it is not necessary to develop the concept of constructive obligation further for the purpose of the Social Insurance Liability Project; and (2) strict or technical legal enforceability of liabilities is not required for recognition.

The discussion began with the staff stating that, at the June meeting, the Board seemed uncomfortable with the ideas of reliance and expectations. But, if the Board considered that a liability does not have to be legally enforceable, then that was enough for this

Final Minutes on August 25-26, 2004

project and the concept of constructive and equitable obligations could be further developed in the Elements Project.

Mr. Reid expressed his feeling that if the Board decided that legal enforceability was not necessary, then it also needed to go beyond that and deal with the nature of the transaction. He said that the fact that the transaction was structured in a way that is like an exchange transaction to the taxpayer was significant. He said it would also help to exclude some of the other programs from liability recognition. Mr. Reid said that his concern was that as soon as you start using notions of constructive obligation “everything in the world becomes a liability and that [we] need some way to control that.”

Mr. Schumacher agreed with Mr. Reid and pointed to the GASB reference made in the staff paper to exchange-like transactions and asked for clarification on the term “exchange-like.”

Ms. Wardlow gave a brief background on the use of the term. She discussed GASB’s work. She was the manager for that project at GASB. Ms. Wardlow said “the notion was that there are certain transactions that are so similar to exchanges, why not treat them like exchanges and acknowledge that they have features such that they can be treated as exchanges.”

Mr. Schumacher directed attention to SFFAS 17, where the Board deemed Social Security as a non-exchange transaction. He added that the Board might have to look at the program differently now.

Mr. Anania said the Board has to review its prior pronouncements if we want to keep that exchange – non-exchange relationship.

Mr. Mosso added that he did not want this to mean that non-exchange transaction could not lead to liabilities.

Mr. Anania said it would not lead to that, instead, “it would look at all transactions regardless if you think they are exchange or non-exchange and then apply the definition and guidance.”

Mr. Mosso agreed and added, “There comes a point at which you’ve committed and the other party has relied upon [that commitment] to the extent that you really need to book a liability.”

Mr. Holtz-Eakin asked, “What would we be relying on in order to book a liability?”

Staff said that the idea of constructive obligation was still there, but legal enforceability would not be necessary.

Mr. Anania said that the idea of constructive obligation did not need to be developed further since it had been around, it has been defined and its use had been tested. Mr.

Final Minutes on August 25-26, 2004

Anania wants to use the concepts that are already developed and see how they apply to these types (social insurance programs) of obligations.

Staff said that in the past the Board has not felt comfortable with using those ideas to define a liability. Ms. Comes gave examples of liabilities booked now that are not legally enforceable, like environmental clean-up costs and some employee retirement benefits.

Mr. Zavada said that with retirement liabilities there is an exchange. Employees provide service now in exchange for benefits later. He said this is not the case in Social Insurance, since the government is not receiving any services. He did agree that environmental cleanup was such a liability. Mr. Zavada said that the exchange is relevant with regards to the occurrence of the obligating event. Staff said it did not have to be in this case because of all the other events that tie the Government's hands and leave it with little discretion. Staff said that if the program ended today "the current beneficiaries' benefits would continue."

A member brought up the long-term liabilities booked for VA and DoD healthcare. Mr. Dacey said those were entitlements that are not legally enforceable.

Mr. Zavada reiterated that the exchange triggers the obligating event. In the DoD case your employer is the Government so there is an exchange.

Mr. Mosso stated that what the staff intended to get out of this discussion was that the Board would agree that the concepts of Liability and Constructive Obligations should be developed in the Elements project. For the sake of this project those items have been developed enough for the Board to continue.

Conclusion re Issue #2

A majority of the Board members agreed that (1) it is not necessary to develop the concept of constructive obligation further for the purpose of the Social Insurance Liability Project; and (2) strict or technical legal enforceability of liabilities is not required for recognition.

Issue #3

Issue #3 in the staff paper discussed the importance of current law and asked the Board if there was a consensus that current law should be emphasized in the project.

Mr. Jacobson explained that for the Social Security and Medicare programs the Congress does not have to do anything to keep the programs going. He said the statutory framework was in place to keep pay benefits without anything else being done. However, in some of the other programs Congress has to act, e.g., pass appropriations acts. Also, other programs must regularly reestablish eligibility. For Social Security on the other hand there is, under current law, a program in place: budget authority is enacted and benefits can be disbursed without further Congressional action. The program was essentially on "auto-pilot." Although Congress can change the framework, there is no entity in the Government that has to do anything to keep the program going.

Final Minutes on August 25-26, 2004

A member asked whether “permanent indefinite” appropriations make a program eligible for liability recognition.

Mr. Jacobson replied that permanent indefinite is critical because no Government action is needed to pay out money. However, that is only money going out. The other part is the funding of money coming into the program, which, with Social Security, is also provided by Congress. That differentiates Social Security from many other entitlement programs. Mr. Jacobson said that due to those qualities the Federal Government would have to do something to avoid honoring those benefits in the future.

Mr. Holtz-Eakin stated that the Social Security program was not automatic because the money is not in the trust funds and in order to pay the Congress would have to step in.

Mr. Jacobson said that he meant that Congress would not have to do anything in terms of a funding source. He did agree that the actual redemption of the benefits in the future would require a certain “ministerial” act. The question was more of how significant that act is.

Conclusion re Issue #3

A majority of the Board members believes that current law is important to the Social Insurance project and in determining when a present obligation exists and possibly finding a specific obligation event.

Issue #4

Issue #4 in the staff discussed selected essential program characteristics of Social Security and compared them to other government programs. Those characteristics were the following (1) Means Testing, (2) Accumulated benefits, (3) Dedicated collections, (4) Finance with General Funds or User Fees, and (5) Type of Budget Authority. Staff sought to identify the Board’s views on whether these characteristics were sufficient to create a present obligation.

Staff directed the Board’s attention to Table 1, which provided a table illustrating the program characteristics as well as possible obligating events that might tie the program to a present reporting period.

Mr. Holtz-Eakin asked whether the fact that higher income individuals’ benefits are taxed mean that Social Security is means tested.

Ms. Cohen replied by adding that that is not the case because that would mean her having a job is also means tested.

Mr. Anania believed that means testing was not sufficient to create a liability.

Ms. Cohen said that means testing, meant that it is not universally available, you’re either in or out at one point like the Medicaid, TANF or Food Stamp programs. She believes Social Security to be very different from those programs because they do not

Final Minutes on August 25-26, 2004

have the lasting obligations Social Security has. Ms. Cohen added, that the other programs were more of a cash outlay than a liability.

Staff mentioned that in some programs beneficiaries have to report every month any changes that would limit their benefits. Agencies are required under the Deficit Reduction Act to test income and eligibility at least quarterly. Staff added that these programs have no accumulation of benefits; payments are made once a month. The means testing determines how much you will get for one month only and does not carry over to other periods.

Mr. Anania said he does see that means testing creates a difference between Social Security and other programs. However, he said, if you have 5 million people in it every month (even if you have people in and out) there is still debate as to whether the program creates a liability.

Staff said that for most programs the money was given to recipients on the first day of the month. So basically at the end of that month the program has no obligation to that individual for further benefits.

Mr. Mosso said that if you account on a daily basis the process sounded more like the program was giving an advance and booking an asset instead of a liability.

Staff mentioned the idea that benefits in Social Security accumulate over time as you are in the workforce.

Mr. Zavada said that he did not believe the benefits “accrued” in any of these programs. He also stated that when an individual is eligible for benefits, the SSA uses a formula to derive the exact amount of benefits he/she is to receive. The formula is based on quarters and past earnings. Mr. Zavada added that there is no accumulation of benefits as one goes through their earnings career, it is simply a “formula used to get the benefit at the end.”

Ms. Comes disagreed with Mr. Zavada, stating that as one goes from a job at the low end of the salary range to a job at the high end of the range; that change impacts your end benefits. She said that what individuals do today has a direct correlation to their future benefits. Ms. Comes finds it reasonable to say that benefits “accumulate” over time in covered employment.

Mr. Anania asked Mr. Zavada to apply that same logic to government retirement plans where a formula is also used to compute definitive benefits.

Mr. Zavada answered by pointing to the existence of an exchange transaction in retirement programs. Mr. Zavada said that that “element [exchange transaction] is missing from Social Security.”

Mr. Anania said that the rest is all the same except for the exchange – non-exchange relationship.

Final Minutes on August 25-26, 2004

Mr. Zavada said that the statement the SSA mails out to participants includes a statement on what your benefits will be when you retire not what you have earned as of this point in your career.

The Board discussed whether dedicated collections were an essential characteristic in deciding whether a liability exists.

Ms. Cohen said that SSA payroll tax was the only tax delineated on each person's paycheck, and that that alone should make it somewhat different from other forms of taxation, e.g., income taxation.

Mr. Zavada said that that only relates to the revenue stream and that there are many other earmarked funds. He also pointed to taxes in the Highway Trust Funds.

Ms. Cohen added that OASDI and Medicare are the only taxes levied in this explicit manner. And said those other taxes are earmarked but not levied in the same way. She said that when you pay the tax on gas, you do not receive anything telling you what that money is for.

Mr. Reid concluded by stating, "that speaks to this notion that we are creating some sort of expectation when we do that. And that is where I was going in the beginning, that's one thing that may differentiate these programs from some other ones: that we set up this exchange-like situation where somebody feels like they are entitled to something. For me that distinction is more significant than things like constructive obligations. Whether that was the intention or not, we created this notion that folks are earning these benefits. I think that if you ask the average participant, 'Did you pay for this pension?' they are all going to say, 'Yeah sure, I worked hard for that so I am entitled'."

Conclusion re Issue #4

The board viewed some of the characteristics (e.g. dedicated collection and budget authority) as being important in differentiating the programs. However, there was no consensus as to whether any of them were critical in determining if these programs gave rise to a liability beyond due and payable.

Issues # 5-6

The last two issues in the staff paper asked the board whether (#5) the members wanted to consider the question of a liability for social insurance, beyond the "due and payable" amount, in the context of balance sheet reporting as a whole (objective thereof, format, etc.) or as a separate issue; and (#6) whether a "fair presentation" of Social Security requires a liability beyond the "due and payable" amount on the balance sheet.

Mr. Mosso asked the members to address Issue #6. He said the Board has avoided these questions for a long time and asked members to say where they stand on the

Final Minutes on August 25-26, 2004

issue. He also acknowledged there is still a lot of work to be done in this project. Mr. Mosso said the Board needed to address this issue and not put it off any longer.

Mr. Anania asked if the question of measurement and other aspects would be secondary.

Mr. Mosso answered that this question has to be worked out first. He said this would benefit the staff in their work.

Mr. Zavada said he did not believe there needed to be any additional liability on the statements. He did ask staff if they would look at some off-balance-sheet presentations. Mr. Zavada said that he believes this to be important information and thought that there could be better presentations than what is on the SOSI.

Mr. Dacey said he did not want to preclude going beyond a due and payable liability. He agreed with Mr. Reid that we are paying into the program and there are some expectations that there is some benefit to be derived. He said the exchange/non-exchange argument is not important to him. He ended by stating, "Something beyond due and payable exists because of the structure." Mr. Dacey voted "yes" on issue #6.

Mr. Schumacher said he believed he had seen enough literature on the subject to sway him to vote "yes." He said he wanted to pursue it beyond a "due and payable" liability.

Mr. Patton said he did not feel as if the case for something beyond a due and payable liability had been made yet. He did add that maybe with further development in the Elements project that case could be made, but as of today it had not been made.

Mr. Reid said he is not as concerned about the liability being recognized as with the "fair presentation" of the program's cost on an annual basis. Mr. Reid said the accounting statements should include all the costs as they are incurred in the period. He added that the changes in actuarial assumptions could vastly distort the presentation on statements. He said he did not want to preclude going beyond a "due and payable" liability, but he is certainly not an advocate of using any of the liability figures out there now.

Mr. Mosso added that accrual accounting is about accumulating cost over a period. He asked Mr. Reid to clarify what he meant by saying he wanted to see costs; and how is that achieved.

Mr. Reid said that that is the quandary. He said he would like to see costs matched up better with revenue than they are now but a liability for the sake of a liability doesn't do very much for him. He said we have that now. Mr. Reid said the SOSI net present values are not what he would want to equate with a liability because the numbers on a liability basis would certainly be smaller numbers than on the SOSI. He said that is why he is anxious to get beyond the liability notion of this and look at some of the other pieces. He concluded that he did not want to simply limit the liability to the "due and payable" amount because he wants to look at the issues and see where that takes us.

Final Minutes on August 25-26, 2004

He is looking at the value of segregating the liability side of the balance sheet and having other categories.

Mr. Holtz-Eakin voted “no” on issue #6. He said that if you recognized a liability for this program, you would never be able to find the corresponding asset. He believes it would fail any standard of high quality accounting. He said that having concerns about the program was one thing but actually putting a number on the balance sheet was different.

Ms. Cohen voted “yes” on issue #6. She said she would like to move ahead.

Mr. Farrell said he believed there was something beyond due and payable. He said he wasn't sure about the exact presentation on the balance sheet, and offered that maybe some other category would be appropriate.

Mr. Anania said he would like to go beyond due and payable.

Mr. Mosso said there is a liability there that is measurable in the same way that liabilities are measured in the private sector, in GASB, and even in the Federal Sector. He told staff that the Board supports moving ahead in the project.

Staff said that a paper on different presentations would be the next step if the Board agreed.

Mr. Holtz-Eakin expressed concern about whether the Board had a clear understanding of what question was being voted on.

Mr. Anania said he'd like to understand why staff felt that Social Security and Medicare were different. He asked if it were better to focus on Social Security and come back to the other programs later or maybe make a cut now.

Staff said they preferred to look at just Social Security for now and come back to the other programs later.

Mr. Anania said he had no problem with that but said they needed to come back to that at a later point.

Mr. Zavada asked if the Board was moving towards a discussion paper or an ED.

Mr. Mosso said he believed the issue had been discussed enough and the Board should move towards an exposure draft.

Mr. Patton said that, if the objective is an ED, alternative views would be appropriate.

Mr. Zavada said he wasn't sure if the Board should move forward with an exposure draft. He thought there should be more conceptual work done before that can happen.

Final Minutes on August 25-26, 2004

Mr. Mosso said that previous documents have had very detailed elaboration on the pros/cons about recognition and that the conceptual work will be done concurrently in the Elements project.

Mr. Reid pointed out that the Board is a long way from issuing an exposure draft. He said there are a lot of critical concepts involved here that have not been developed, many which may make or break an argument. He said that charactering what Staff will be working on as drafting an ED would be an overstatement.

Mr. Mosso said that it was time to make a decision and to push as fast as possible towards an exposure draft.

Mr. Dacey said that if the Board were heading towards an exposure draft, then he would anticipate a series of issue discussions along the way to discuss the issues and options – that discussion cannot be in an exposure draft.

Mr. Anania said there are two options: (1) Identify all the issues that you need to deal with and bring them to the Board several issues at a time and while you do that, draft the ED concurrently; or (2) Take enough time, try to get all issues into a draft ED and then work that in terms of redeveloping that draft. He said some say you should build your basis of conclusion as you are doing the ED.

Mr. Mosso said, “We would have a basis of conclusion where we discussed all significant issues and how we decided on them”.

Mr. Zavada said he’d like to see the issue of alternative presentation done concurrently to the liability question.

Staff said they could come back with a discussion incorporating what Mr. Zavada said.

Mr. Reid said he was uncomfortable with using the numbers in the Trustees report because of their larger scope. He said he’d like to see what is out there in terms of beyond “due and payable.”

Mr. Anania said that staff should identify all the issues the Board is going to deal with in order to be able to write the ED. He said that there maybe between 15 and 20 issues and that should be considered before drafting an ED.

Mr. Mosso agreed, and clarified that what he meant was that the end product should be an ED.

Mr. Farrell added that maybe the first issue could be presentation and the Staff could put alternative Balance Sheet presentations like “liability, long-term liability, mezzanine number, special liability, and maybe a staff recommendation.”

Mr. Anania said he would like to see what the staff has to say on all the issues.

Conclusion re Issues 5-6

Staff will begin work on collecting all relevant issues regarding the Social Security aspects of the Social Insurance project for the Board. The Staff will develop a paper on recognizing a liability beyond due and payable on the face of the balance sheet as well as alternative presentations.

CONCLUSION: For the October meeting, staff will develop the paper described in issue 5-6 above (e.g., a paper presenting a list of issues, recognition and measurement options, and display alternatives). With respect to issues 1 through 4, the Board discussion will inform development of issue papers and, ultimately, a basis for conclusions. The Board discussion suggests:

- (1) Staff should describe further the present obligation that exists for Social Security and how that differs from future obligations to provide ongoing services.
- (2) Strict legal enforceability is not a threshold requirement for a liability to exist; however, it is not essential to this project that we develop a framework for distinguishing between constructive obligations that are liabilities and those that are not.
- (3) Current law is essential to identifying the obligating event (that is, the ability to change laws is not relevant to the existence of a liability – rather, future changes in law are relevant only to the settlement of liabilities).
- (4) No consensus was developed regarding whether means testing, earmarked revenues, etc are essential to existence of a liability. However, some members supported the notions of “exchange-like transactions” and “program continuity absent legislative action”.

Adjournment

The meeting adjourned at 4:30 PM

Thursday, August 26, 2004

Agenda Topics

- **Inter-entity Cost**

Staff member Ms. Loughan began the discussion on Inter-Entity Cost by explaining to the Board that the exposure draft (ED) entitled *Inter-Entity Cost Implementation: Amending SFFAS 4 Managerial Cost Accounting Standards and Concepts* definitely sparked quite a bit of interest as an additional three comment letters were received after

Final Minutes on August 25-26, 2004

the Board Binders were sent. Staff explained that the additional three letters brought the total responses to 21, which may be a record for number of responses received in quite some time.

Ms. Loughan then provided the Board with a high level summary of responses to the questions included in the ED:

- 12 of 21 **agree** with the Board's proposal that the inter-entity cost provisions of SFFAS 4 be fully implemented for reporting periods beginning after September 30, 1997. In other words, 9 of 21 **disagree** with the Board's proposal.
- 13 of 21 **agree** with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis. Staff explained that there was an overlap of 4 respondents agreeing with both the ED proposal and the alternative view.
- 11 of 21 **believe** that there are now non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS4.
- 14 of 21 **believe** that federal entities will seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.
- 10 of 21 **believe** that additional guidance is needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity.
- 9 of 21 **believe** that additional guidance is needed to apply the broad and general support exception.

Staff then asked the Board if they had any comments or questions about the individual letters before moving on to the staff analysis. Mr. Anania commented that it was his observation that the three additional letters really did not change the analysis or affect staff recommendations. Staff agreed with Mr. Anania's comment.

Mr. Patton asked if staff believed that this was an example of a debate of principles versus rule-based standards. Staff concurred with Mr. Patton's assessment. Mr. Patton further explained that the question appears to be how much detail does the Board want to include in a standard. He further added that if the Board offers too many examples and detail, the Board might actually end up serving the Alternative View in a sense.

Staff explained that it would be very difficult to add anything specifically to the standard that would actually address the comments. Staff explained that a Technical Release or Staff Implementation Guidance would be the vehicle to address the issues. Staff explained that there are basically 3 main buckets or areas that the comments addressed—1. Materiality and recognition criteria; 2. Broad and general; and 3. Management and operational issues.

Final Minutes on August 25-26, 2004

Mr. Farrell explained that he had very similar thoughts in that it is becoming a pattern that when the Board issues a standard or exposure draft that is principles based, there are a lot of respondents that request more information or instructions on how to do something. He noted that Mr. Reid made an interesting point on this issue in another project by commenting that we have a lot of great people out there who will work their heart out to do exactly what we want them to do as long as we tell them exactly what to do. Mr. Farrell explained that he believes that the Board needs to take a position as to whether it will provide broad guidance or detailed guidance as a practice. He further explained that he believes the Board should lean toward offering broad guidance because the Board is not in a position to know everything, especially the ability to write detailed instructions on every activity.

Mr. Anania supported Mr. Farrell's comments and added that he believes that a general or principles based standard will stand the test of time. The more specific the standard gets the more reason it provides to go back and amend and update. Mr. Anania explained that it is a tug of war on which way to go on each topic.

Mr. Farrell added that FASAB does not have the staff resources to provide instruction books or technical bulletins to address guidance issues. Ultimately, it ends up consuming staff resources to solve all these types of problems, although the Board makes a decision not to include the detail in a specific standard and not to spend the limited staff resources. Mr. Mosso explained that even if staff does not produce formal guidance, there is nothing that stops individuals from phoning staff for guidance on issues.

Mr. Dacey commented that he believes everyone is in agreement that guidance is needed, so the question is—who should provide such guidance. Mr. Reid commented that SFFAS 4 anticipated this and that is why it designated OMB to provide such guidance. Mr. Zavada explained that OMB has the same pressures that FASAB has with regards to limited staff resources. He further explained that OMB provides broad guidance and that it too, often receives many detailed questions and they don't have the time to delve in to each one. He added that there are vehicles that can be used to get that guidance out—whether it is the CFO Council, PCIE Committee, or the AAPC—that can be utilized to develop guidance on the most important issues.

Mr. Farrell commented that it is similar to the EITF in the private sector—there are principles based standards and if enough people ask the same question, the EITF deals with the issue. Mr. Anania commented that a good example was FASB's standard on derivatives, the Board knew there were issues and after it was implemented there was a standing body to address such issues and questions.

Mr. Zavada commented that some of the issues identified are items that just have to be worked out between management and their auditors. He added the most important ones could be addressed in some form of additional guidance.

Chairman Mosso asked staff if they concluded that none of the issues could be addressed in the standard itself. Ms. Loughan explained again that it would be very

Final Minutes on August 25-26, 2004

difficult to add anything specifically to the standard that would actually address the comments. Staff explained that a Technical Release or Staff Implementation Guidance would be the vehicle to address the issues.

Mr. Shumacher commented that several respondents noted that with respect to the materiality and criteria for recognition, there was a question as to whether one or all three criteria had to be met. Mr. Schumacher stated that the standard is not clear in this area and he believed that should be made clear. Staff explained that in reading the entire section in SFFAS 4 related to the recognition criteria, along with the Basis for Conclusion, it does not appear that all 3 criteria must be met, the criteria are to be considered with judgment. However, staff did agree that this is a bit vague and could be clarified.

Mr. Patton stated that the Board has gone out of its way not to strictly define materiality, so it should not change at this point. Staff directed the Board to the excerpt of SFFAS 4 that was included in the ED—specifically the paragraph that relates to this topic states that “materiality should be judged in light of the following factors...” Staff also directed the Board to paragraph 113, which states “The decision as to whether the cost of non-reimbursed or under-reimbursed goods and services should be recognized requires the use of judgment. None of the criteria listed above are, by themselves, fully or exclusively determinative. They should be considered in combination. Ultimately, inclusion or exclusion of the cost should be decided based on the specific facts and circumstances of each case, with consideration of the degree to which inclusion or exclusion would change or influence the actions and decisions of a reasonable person relying on the information provided.” Staff noted that one could interpret that to mean that all are not required, but it is still a bit vague and it could be clarified in the additional guidance that may be developed.

Mr. Dacey stated that he did believe that additional guidance is necessary but he is not sure if it would fit in the standard or some other separate guidance. Mr. Dacey pointed out another concern is in the situation where the providing entity does not have the cost information and it may not be reasonably estimable for either the providing or receiving entity, then what type of disclosures would be required, especially in the context of related party transactions. He added that there could be situations such as this that don't necessarily meet the recognition requirements.

Mr. Reid explained that one of his concerns relates to the fact that if you can't get the cost information from the providing entity then the entity may be in a situation where they must prove to the auditor that it is not significant. Mr. Anania noted that in those situations, the receiving entity is required to estimate the costs. Staff commented the SFFAS 4 basis for conclusion elaborated on the use of estimates and the fact that the Board believed that the situations that would require the use of estimates would be limited as entities (in this case, providing entities) implemented the full cost standard of SFFAS 4, the cost information should be available.

Mr. Anania suggested that the Board should decide if they want to re-write the paragraphs that relate to materiality and the criteria for consideration in recognition.

Final Minutes on August 25-26, 2004

Chairman Mosso asked if Mr. Anania was suggesting an actual amendment to SFFAS 4 and Mr. Anania confirmed that was a possible resolution but he is a bit reluctant to go that route considering the ED did not address it. However, Mr. Anania explained that better language was needed for paragraph 113.

Staff requested the Board's position on whether the issues could be addressed in additional, but separate guidance (as recommended by staff) versus incorporating it in the proposed standard. Chairman Mosso explained that he would prefer to not include it in the proposed standard and if it creates a real problem, then additional guidance could be issued.

Executive Director Comes explained that when she proposed this approach after the AAPC Task Force Report was completed, she prefaced it with the fact that it could be accomplished without significant amounts of staff resources or Board time. However, an attempt to amend SFFAS 4 would actually result in much more resources than originally planned, especially considering the staff resource could be on another major project. Ms. Comes explained the model she envisioned would be to remove the barrier by removing paragraph 110 and then individuals would come to the AAPC for guidance.

Mr. Farrell explained that he believed the comment letters highlight the fact that entities want a checklist. He further explained that materiality is clear as mud anyway and that people must make judgment. Mr. Farrell added that when you look at the introduction to the section on materiality in SFFAS 4, it is actually referring to a different type of materiality (versus general materiality). Ms. Comes added that the Board was moving to a more limited recognition in this case than general materiality would suggest—meaning things that are very significant to the entity.

Ms. Comes suggested that she is very reluctant to pursue amending SFFAS 4 as this would demand staff resources that could otherwise be used to take up another major project. Ms. Comes explained that she saw two alternatives—1. Leave things as they are and leave it to OMB to add requirements with the knowledge that there are not major government-wide costs but that some entity specific costs probably exist. Or 2. Rescind paragraph 110 and provide additional guidance through staff implementation guidance (or technical bulletin) or through the AAPC. Ms. Comes suggested that the second option could be considered a middle ground between providing principles based standards and a cookbook of guidance.

Mr. Reid suggested that OMB could still address the issue through the CFO Council or some other group that would include representatives from the affected agencies. Mr. Reid explained that he is very concerned about leaving the door open for all costs and that is what the proposed standard (Ms. Comes option 2 above) would do. Mr. Reid added that he believes that there needs to be some sort of fence around the possible costs.

Ms. Comes explained that the positive aspect of taking the ED approach is that you establish a date certain for implementation—meaning you put a little fire under them and entities will come forward and resolve the issues through the AAPC or other

Final Minutes on August 25-26, 2004

manner. Ms. Comes also explained that utilizing the AAPC (versus CFO Council or other group) may be preferred as its resolution is in the GAAP hierarchy.

Chairman Mosso explained that FASAB must issue something to rescind paragraph 110. Mr. Mosso explained that he supported moving forward with the proposed standard versus leaving things as they are.

Mr. Anania explained that he thought the ED was good but he did have a few concerns. He explained that the output of any additional guidance would have to have input and support of OMB and the CFO Council. Mr. Anania asked if it was possible to have some sort of joint release, as it appears FASAB must embrace the input of the other parties in drafting the additional guidance. Mr. Anania explained that he is presently reluctant to issue a standard that includes a must-to-do by the FASAB and an implementation date that is four years off. He asked if consideration has been given to delaying the issuance of the final standard until the guidance could be developed or at least that the process is in place. He added that there has been a lot of effort so we don't want it to die or just sit on the shelf; he was just suggesting that some of the implementation issues be worked out further.

Chairman Mosso explained that the delay in the effective period was so that the implementation issues could be worked out. Ms. Comes explained that the goal of the ED was to establish a date certain. The avenues for addressing the issues related to implementation exist regardless.

Mr. Anania asked if there is enough interest and cooperation from the other parties that FASAB can reasonably assume that the guidance can be accomplished. Ms. Comes explained that there are many competing pressures and initiatives and that is why staff recommended and she concurred with adding an additional year to the implementation date. She added that she believes that entities value their clean opinion and will do what is necessary to keep it. Ms. Comes explained that OMB in conjunction with the CFO Council could provide guidance on the timelines and milestones for implementation. Ms. Comes reiterated that she believes absent a date certain this will not be a priority for agencies.

Mr. Anania asked Mr. Zavada if it would be possible to get a commitment from OMB and the CFO Council to jointly work with FASAB on issuing formal guidance so the prospect of meeting a date is feasible. Mr. Zavada explained that it would be possible but OMB faces the same resource constraints as FASAB, but he believes collectively something could be worked out. Mr. Anania asked if there were other players that should be considered, such as GAO. Mr. Dacey explained that GAO would always be available to provide input or comments but they typically only issue guidance related to auditing.

Mr. Zavada suggested that it would be difficult to walk away from the issue now that FASAB has issued the ED. He explained that he did believe it would be possible to work on the guidance jointly.

Final Minutes on August 25-26, 2004

Ms. Comes asked if the Board would feel more comfortable addressing this after staff has had a chance to develop the partnerships, timelines, and put in writing the types of guidance that would be envisioned from the different sources—AAPC, staff, etc.

Mr. Mosso added that one of the next steps would be to include certain reasoning in the Basis for Conclusion (the reasons why the Board addresses certain areas and not others) and that could naturally go into detail about the forthcoming guidance.

Mr. Mosso explained that he supports the staff recommendations, but would like to see the language for the Basis for Conclusions. Mr. Anania suggested that what he is looking for regarding the commitment from other parties would also go into the Basis for Conclusion. Specifically, he would like to see something more than just the intent to issue guidance.

Mr. Zavada explained that really the AAPC would be the avenue for developing the guidance as it does have all the players—OMB, FASAB staff, and a representative from the CFO Council.

Mr. Anania asked Mr. Reid if having the AAPC develop guidance in any way alleviates his concerns expressed in the alternative view. Mr. Reid stated that it actually exacerbates the issue, as now there is FASAB staff resources consumed in addressing the issues when he doesn't support the proposal. He added that the AAPC already had a chance at resolving the issue so there is a strong possibility that it may totally fall back on staff resources. Ms. Comes explained that there may be certain issues that staff could resolve or address and that could be included in the plan that the staff will come back with that addresses the overall plan to develop the guidance. However, Ms. Comes would not want anything to rise to the level that it prevented staff from making progress on their primary projects.

Mr. Anania again reiterated that he believes the mechanism for addressing the issues needs to be in place before FASAB issues the standard. Specifically, if the mechanism cannot be put in place in the next 3-5 months, then it would raise speculation if it will ever be put in place. He explained that the document counts on the fact that something will be done to assist with implementation.

Mr. Farrell asked if FASAB just issued the standard, how many people would truly come forward with the issues or will they just figure it out themselves. He explained that a lot of the issues could be dealt with by the entities. Mr. Zavada explained that it is a bit different because it does involve two agencies and there is concern about consistency. Mr. Reid explained that there is also the issue with the auditors and that there has to be a very well documented review of what costs were possible and ways of dealing with materiality to show that you have in fact satisfied the standard.

Mr. Dacey asked Mr. Reid if he was concerned with the process itself or the possibility of differences due to judgment. Mr. Reid explained that he does not see the cost information significantly affecting the decision making process and there are other priorities that agencies have to address. He explained that there are so many

uncertainties in this area. Mr. Reid compared it to the problems that exist in the intra-governmental transaction area, which is much more straight-forward than the inter-entity costs. Mr. Dacey explained that if it were done in some organized fashion, such as agencies must perform an analysis by a certain date and then at another date the agencies meet to discuss the costs identified. Mr. Reid explained that a committee of the CFO Council could meet to determine the significant ones that affect multiple agencies and then those affected agencies could meet and come to an agreement on how to handle and perhaps then go through OMB to finalize. Mr. Reid explained that he thought with a process such as this, it would take FASAB out of the process and gives OMB the business decision to determine the merit.

The CBO representative explained that when he considered how this would affect CBO, he realized that there are costs such as their rent to the Architect of the Capitol (AOC) that they are not charged for. He further explained that if the AOC could not provide them with the actual costs, CBO would be able to estimate a cost for the rent. He explained that in the absence of the ED, entities would not be motivated to do so. He added that there is much merit in the ED and it is very doable. Mr. Mosso added that with the President's Management Agenda and other like efforts, he finds it hard for FASAB to walk away from full costing.

Mr. Anania explained that he wanted to make it clear that he is not opposed to the proposal, he would just like something in place so that we can follow through on the guidance. Mr. Zavada explained that he believes the guidance could be accomplished through the AAPC and OMB will play an active role in that process. Mr. Anania requested that staff write a paragraph that embraces that information in the Basis for Conclusions. Mr. Mosso explained that the Board will have a chance to review the implementation plan process and determine then if it needs to be more elaborate. Mr. Mosso explained that he would favor a plan that does not promise too much as he believes that most of the issues could be worked out by the agency themselves.

Mr. Mosso explained that he wanted to find out if the Board was generally comfortable with this approach—which is basically agreeing with the staff recommendations included in the analysis:

1. The proposal should include what type of additional implementation guidance will be forthcoming. Staff recommends a Technical Release be issued that would address the concerns and questions raised in the comment letters related to implementation guidance. Staff believes that respondents included valid questions and concerns that should be addressed in guidance. The Board should include a target date for issuance of the guidance.

2. The AAPC Inter-entity Task Force should be commissioned to continue and work with FASAB staff on developing the guidance suggested in Recommendation 1. The Task Force could build upon their already extensive survey results and research, as well as the comment letters and staff analysis in developing the guidance. Additionally, the Task Force could utilize existing guidance related to cost accounting in developing the guidance. Specifically, the

CFO Council's Cost Accounting Implementation Guide and the Joint Financial Management Improvement Program's System Requirements for Managerial Cost Accounting, among others, are good sources of information.

Additionally, the AAPC Inter-entity Task Force may wish to solicit volunteers from the agencies that provided comments to the ED for assistance. Also, volunteers could be requested from agencies that will have successfully implemented Interpretation Number 6, Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4 considering the effective date for this is for periods beginning after September 30, 2004.

3. The effective date should be delayed for periods beginning after September 30, 2008. The proposed effective date in the ED is for periods beginning after September 30, 2007. Staff believes that the Board should delay the implementation date so that a target date of September 30, 2006 could be provided for the issuance of guidance described in Recommendation 1. Staff believes it will take a substantial amount of time to develop the detailed guidance and if it is released via a Technical Release, go through the due process required. Staff believes that sufficient time should also be allowed after release of the guidance as the implementation may require detailed reviews of inter-entity activities and coordination with agencies on obtaining cost information.

Mr. Farrell asked if staff had envisioned how detailed the guidance would be. Staff explained that they had envisioned that the guidance would address some of the general questions related to materiality and the criteria for recognition, as well as some of the issues regarding the broad and general questions. Staff also explained that there was a possibility that a listing of broad and general costs could be developed. Staff also explained that operational type guidance, that may include milestone dates for analyzing potential costs and such would have to come from OMB and not from FASAB.

Chairman Mosso noted that the only important issue that he saw was the issue related to documentation when the receiving entity estimates costs and how that may affect eliminations. Mr. Farrell suggested that it seems like there could be some sort of centralized reporting mechanism, such as through FACTS, to include this information. Mr. Dacey added that this is a potential issue, especially when a cost is not material to the providing entity.

Mr. Patton noted that the proposal gives agencies 4 years to implement and he believes that is adequate time to resolve problems that have been identified. He also stated that he agrees that if the Board does not set a date certain, the agencies will not address the issues.

Mr. Zavada explained that he would be interested in having a public hearing to hear the extent of the implementation issues that were discussed in the comment letters and it would be helpful in developing guidance down the road. Chairman Mosso noted that was one of the decisions the Board was supposed to make today—whether there should be a public hearing on the topic. Chairman Mosso suggested that staff should work on a Basis for Conclusion that would incorporate some sort of mechanism for addressing issues. Mr. Anania reiterated that he wanted the idea of guidance worked out a little further to ensure the promise does not fall back too much on FASAB.

Final Minutes on August 25-26, 2004

Chairman Mosso requested the Board's vote on whether to hold a public hearing. He suggested that based on the volume of responses, that it would be essential for the Board to hold a hearing. He asked if any member held a different view. No members objected. Ms. Comes suggested that the public hearing be delayed until the December Board meeting because the individuals that would be coming to testify would be in the midst of preparing their financial statements to meet the November 15 deadline. In addition, Ms. Comes noted that the project does not have a FASAB staff member devoted full time. It was agreed that the public hearing would be held on December 16, 2004.

Chairman Mosso suggested that staff could work on drafting the guidance or a plan before the public hearing it may assist the Board in asking questions. Ms. Comes agreed that staff would come back with a draft plan of guidance for the October meeting.

CONCLUSION: Staff will develop a draft plan of guidance that would include the partnerships, timelines, and types of guidance that would be envisioned from the different sources—AAPC, staff, etc. In addition, a public hearing will be held on the ED on December 16, 2004.

- **Deferral of the Effective Date of SFFAS 25 and 26**

The Board concurred with staff's proposed next steps on the project.

CONCLUSION: Staff will provide any additional comment letters and a pre-ballot draft SFFAS to the Board on September 1st with comments requested by September 9th. A ballot draft SFFAS would follow as soon as possible after September 9th.

- **Natural Resources**

Staff, Rick Wascak, led the discussion. Staff explained that it had provided a preliminary exposure draft (ED) on reporting for oil and gas resources to the Board members. The objectives of the meeting were to get general approval from Board members on the proposals contained in the ED and to get feedback and suggestions from them in regard to all areas of the ED. Mr. Mosso suggested that the Board first focus on the basic issue of valuation of the estimated cash inflow of royalties.

Staff explained that the valuation method is: 1) multiplying the estimated quantity of proved oil and gas reserves by a market value and the respective royalty rate on a field-by field basis, and 2) summarizing the estimated cash inflow for all the fields. Ms. Cohen commented that the term "market value" was confusing throughout the ED. That is, in some places the term was used to address valuation and in other places it was used to address price. Staff responded it had done additional research and found that an average wellhead price for oil and gas could be obtained and used in place of using a market value. Staff added that, if the Board members agreed to using the wellhead price in place of market value to calculate the estimated cash inflow for royalties, this should correct the problem. Staff explained the wellhead price is the value for oil and gas at the mouth of the well and that it is considered to be the sales price to the initial

purchaser without the addition of any other costs, such as the cost of transportation and insurance. Whereas the market value (or spot price) includes other additional costs. Staff explained that the Energy Information Administration (EIA) calculates an annual average wellhead price separately for oil and gas based on information it collects from producers (sellers). Staff added that the wellhead price is what the royalty payment is based on. The Board members agreed to the use of the wellhead price in place of a market value.

Other comments and suggestions by the Board members are presented in the following paragraphs:

Mr. Patton suggested that the document include some conceptual foundations linking oil and gas to the “assets” aspects of the elements/conceptual framework project, specifically addressing why proved oil and gas reserves meet the definition of an asset and why they meet the criteria for being recognized. In addition, he suggested that the general notion of how to value these assets and why that valuation is preferred should be included in the document. That is, the document should explain why these assets must be valued in the way the standards are proposing as opposed to other kinds of assets that are valued differently. For example, explain why market value is proposed and why historical cost or present value is not.

Mr. Torregrosa suggested that research be performed on subsidized royalty rates that may be charged producers for leases issued under non-competitive bids. He commented that where royalty rates are subsidized on non-competitive bid leases some loss should be recognized for the subsidy. Staff responded it would perform research on non-competitive bid leases to determine if there is any type of subsidized royalty rate provided to producers. Mr. Mosso asked staff to explain in the Basis for Conclusion how royalty rates are set.

Ms. Comes suggested that staff could prepare a visual to explain the activities involved in the production of oil and gas. She explained the visual could show the different stages involved in the production of oil and gas, the flow of funds in each stage and the appropriate proposed accounting entries. The Board members agreed that the visual would be very helpful.

Various Board members commented that additional information was needed in regard to the accounting for bonus and rent collections referenced in the government-wide accounting standards proposed in the ED. Ms. Comes stated that she believes that accounting for bonus and rent collections is a custodial activity at the agency level and should be address in component-entity standards. She explained that staff was focusing on the Government-wide standards first and would address in detail the custodial activity in subsequent meetings when agency standards were addressed. Mr. Mosso asked that the document provide additional information on bonus and rent collections and explain what the custodial activity arrangement was for them and where and how they were distributed.

Final Minutes on August 25-26, 2004

Mr. Reid suggested that the title of the proposed standards be changed from “Reporting Requirements for Federal Oil and Gas Reserves” to “Accounting for Federal Oil and Gas Reserves.” The Board members agreed.

Mr. Farrell suggested that the presentation of all definitions be organized in one section of the document. Mr. Farrell noted that there is a section for definitions in the document, however, there were other definitions presented in other different areas of the document. Staff responded that it would make this correction.

Ms. Comes explained that there would be a nine-month lag between the latest estimated quantity information used in calculating the estimated cash flow for royalties and the end of fiscal year for which financial statements are prepared. Staff explained that the estimated quantity of proved oil and gas reserves is available once a year at the end of the calendar year, December. Information for determining the estimated quantity of proved reserves is collected from producers once a year and is due by April 15 for the previous calendar year. As a result, quantity information is not available for the following nine months, January through September, of the fiscal year for use in calculating the estimated cash flow for royalties. Mr. Mosso asked staff to prepare material based on historical information showing what the changes were from year to year for the estimated quantity of proved reserves, including new discoveries, depletions, acquisitions, and sales.

Mr. Patton noted that, at some point, the Board must explain in the Basis for Conclusions that it believes the estimated quantity of proved reserves used in calculating the estimated cash inflow for royalties is relevant and reliable and why it believes so. He also commented that the “Overview” section of the proposed standards would have to change based on the meeting’s substantive discussions.

Mr. Anania suggested that a Round Table (RT) discussion be held to discuss the proposed standards and to get input from the impacted parties. Mr. Mosso agreed that a RT would be helpful, but believes it is premature to have one before the standards are developed further.

Mr. Mosso noted that staff would also be working on proposed disclosures for Federal oil and gas resources and the Agency-wide standards.

Ms. Comes commented that she would prioritize the issues the Board members want explored. She explained that not all of the issues would be able to be researched in time for the next Board. She added that the prioritization would be included in the minutes and the Board could provide comments on the priority of the issues.

The list of issues in prioritized order to be researched is provided below:

1. Prepare a visual that identifies the universe of federal oil and gas, segments the universe, names each segment, and identifies available information relating to each segment. Events triggering accounting activity will be identified for each segment under both current and proposed accounting standards.

Final Minutes on August 25-26, 2004

2. Provide conceptual foundations for the assertion that proved oil and gas reserves are assets meeting the recognition criteria in the Basis for Conclusions.
3. Explain in the Basis for Conclusions why the Board believes the estimated quantity of proved reserves is relevant and reliable.
4. In the Basis for Conclusions, identify the measurement attribute proposed for proved oil and gas reserves. If the measurement attribute is “fair value” – assess the Board’s use of fair value methods against the framework proposed by FASB in its recent ED. Explain why this measurement attribute was selected over other attributes.
5. Provide all definitions in one section of the document.
6. Prepare material based on historical information showing what the changes were from year to year for the estimated quantity of proved reserves.
7. Explain how the estimated cash inflow for royalties are valued, and why, in the Basis for Conclusions.
8. Explain in the Basis for Conclusion how royalty rates are set.
9. Perform research on non-competitive bid leases to determine if there is any type of subsidized royalty rate provided to producers.
10. Proposed disclosures for Federal oil and gas resources.
11. Agency-wide standards.
12. Provide additional information on bonus and rent collections and explain what the custodial activity arrangement was for them and where and how they were distributed.
13. Change the “Overview” section of the proposed standards.
14. Hold Round Table (RT) discussion

Specific Board decisions made at the meeting:

1. Change title of proposed standards to “Accounting for Federal Oil and Gas Reserves.”
2. Use the wellhead price in place of market value to calculate the estimated cash inflow for royalties.

CONCLUSION: Staff will work on issues in priority order based on feedback from Board members.

The Board adjourned for lunch at noon.

- **Lease Project Plan**

Staff member Monica Valentine opened the discussion by reminding the Board of the Lease research report presented to the Board October 2003 by FASAB detailee, Susan Lee. During the October meeting the Board agreed to keep leases on the list of items to be considered for future projects as well as, possibly providing interim guidance based on FASB's existing guidance. Based on the work done in the research report Staff proposed that the Board accept "Leases" as the next major project of the Board. Ms. Valentine asked the Board if they did accept leases as the next major project what approach would the Board like to take for the project. The two approaches proposed by Staff were (1) the "new approach" currently being researched by the IASB or (2) provide comprehensive lease guidance based on the current FASB literature.

Mr. Patton noted that he asked Staff about the rankings decided by the Board at the last agenda setting discussion. He noted that the list included social insurance, performance reporting, actuarial changes, and cost accounting, in addition to a host of other liability-related items. Mr. Anania asked if Staff normally referenced the FASB guidance when lease questions were asked. Ms. Valentine noted that normally Staff could reference the existing literature in response to many of the lease questions asked. Ms. Comes stated that it was not clear to Staff if those references to the existing literature were producing consistent results throughout the community.

Mr. Anania asked the Federal members of the Board if they could comment on any specific lease issues that they may have seen "bubbling up". He also wanted to know if there are other issues that may have risen higher on the radar screen than the lease issues. Mr. Zavada stated that there seemed to be more budget related issues with leases as outlined in the CBO paper. Mr. Dacey noted that he was not aware of any specific leasing issues raised. However, he believes that a better question would be does the Federal government have any unique lease issues that cannot be addressed by the existing literature. Mr. Dacey also pointed out that the Board should also monitor the work of the IASB and the new approach to see if FASAB could use the new approach to address lease issues throughout the Federal community.

Mr. Anania suggested that a third alternative to the lease project plan could be for FASAB to formally accept the existing FASB literature on leases as FASAB's guidance. Mr. Zavada noted that he would prefer the Board taking more of a "leader" approach and pursue application of the "new approach" for the Federal sector. Mr. Mosso stated that he would not be in favor of accepting FASB's literature on leases as FASAB's guidance. Mr. Dacey mentioned that FASB guidance is already available to Federal entities in through the GAAP hierarchy. Both David Torregrosso of CBO and Bob Kilpatrick of OMB noted that budgeting for leases is very convoluted and the accounting application of the "new approach" could also have a positive effect on the budgeting side. Mr. Mosso reiterated that FASAB does not set standards for the budget, but if there is a positive spillover from the accounting standards that would be a plus. Mr. Mosso also pointed out that there are a lot of complicated lease transactions being entered into by Federal entities lately, so FASAB could assist by establishing appropriate accounting standards to address these new transactions. He also

Final Minutes on August 25-26, 2004

suggested that FASAB could pick up on the work of the IASB and determine how that approach could be applied to the Federal sector. Ms. Valentine mentioned that the IASB is planning to release an exposure draft on the “new approach” sometime in 2005.

Mr. Patton asked if there were Federal specific issues that cannot be resolved with the existing literature. Ms. Comes mentioned a leasing issue at a VA facility in Illinois.

Mr. Anania asked if Staff had seen a response to the initial *Special Report: Accounting for Leases: A New Approach* that was written by FASB. Ms. Valentine noted that she had contacted the FASB Research Director to find out about FASB’s initial response to the “new approach” and to determine if FASB is currently doing any follow-up work on the “new approach”.

Ms. Comes noted that there was an omission in the February 2003 meeting minutes. She said there was no documentation of the Board’s final decisions on the agenda setting. She stated that the top four agenda items based on the December 2002 meeting were social insurance, performance reporting, actuarial changes, and cost accounting. Based on her recollection of the February 2003 meeting, performance reporting and cost accounting had been dropped lower in the rankings. Since that time social insurance has been taken up and actuarial changes, as well as some of the other potential projects later in the list, will be included in Julia Ranagan’s long-term commitments/liability project.

Ms. Comes then suggested a full agenda setting discussion at the October meeting. The materials would include a description of all the projects that are potential. She further explained that the leases project rose to the top of the list because of the work that Susan Lee did and what we have observed in the community in the area of leases. Mr. Mosso commented that he is in favor of the performance reporting and cost accounting projects, but only after the Board has completed its work in the objectives project. Mr. Patton asked if there were any current projects that the “extra” staff time could be used on in order to complete those projects more quickly. Ms. Comes noted her skepticism that combining staff time would move projects along any quicker. However, she did note that she does plan to juggle staff time so that Staff will be assigned more than one project at a time. Mr. Farrell asked if there was any plan to work on various pieces of the natural resources project simultaneously. Ms. Comes’ response was that the plan was to work on the various resources consecutively.

Mr. Mosso summation of the Board’s views on the lease project was that there is interest in the lease project from the perspective of the “new approach”, but would like to see the list of other potential projects. Mr. Anania suggested the possibility of participating in the international group that is researching the leases “new approach”. He also questioned whether there were any leasing nuances that were unique to the Federal government that were not already addressed by private sector standards.

CONCLUSION: Ms. Valentine summarized the **next steps for the leasing project:**

Final Minutes on August 25-26, 2004

- Gather information from FASB on the current status of their work on the leasing “new approach” as well as their initial response to the February 2000 report on the *Implementation of a New Approach*.
- Provide examples of any unique leasing activities within the Federal government that are not covered by the existing guidance.
- Review the possible application of the “new approach” to Federal leasing transactions.

Adjournment

The meeting adjourned at 2:00 PM