FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
December 15 - 16, 2004
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, December 15, 2004

Administrative Matters

- **Attendance**

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

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

- **Approval of Minutes**

The minutes were approved with one change identified by Ms. Comes.

- **Current Events**

The Board discussed briefly some of the articles included in the clippings.

Agenda Topics

- **Concepts – Objectives**

Mr. Bramlett opened the discussion by saying that he understood the objectives project to be motivated by the Board's desire to develop conceptual tools for the Board to use in setting standards and "narrowing down" its focus within the broad framework described in SFFAC 1. He explained that the staff paper discussed possible "comparative advantages" of federal accounting in general, and GAAP reporting in particular. The memo listed several possible "advantages" for the Board to consider and endorse, if the members regarded them as helpful in accomplishing their objectives. The material provided to the Board also dealt with some related concepts, including "completeness," "neutrality," "economic reality," and "representational faithfulness."

He noted that Professor Rowan Jones had questioned the accuracy of a statement in the staff paper: a passing comment that suggested that the phrase "generally accepted accounting principles" was a term of art before the creation of the SEC. Mr. Bramlett acknowledged that it might be true that the phrase had not been used prior to the creation of the SEC. The question might seem to be mainly of historical interest, but possibly could be relevant to FASB's current action to move the "accounting hierarchy" from SAS 69 to the accounting literature.

Mr. Anania observed that it had always seemed curious that the accounting hierarchy should be found only in the auditing literature. Mr. Dacey noted the existence of the "true and fair" override in some international accounting practice and standards, and its relation to the ideas of "fair presentation" and "principles-based standards." He explained that the "true and fair" override was somewhat akin to the "Rule 203" provision in AICPA's Code of Ethics.

Mr. Bramlett noted that international accounting standards now call for disclosure of any departure from IAS arising from exercise of the override. He suggested that the nature of the "correspondence" between the financial statements and "economic reality" is a relevant question for the standard setter as well as for the auditor and preparer. How one understands that correspondence may influence one's view of the feasibility of "principles-based" standards as well as one's understanding of "representational faithfulness" and "neutrality." He observed that an SEC staff report had recommended elevating the statements of concepts in the accounting hierarchy.

Mr. Dacey noted that FASB's Advisory Council had recently discussed the topic of principles-based standards. Some suggested that FASB's statements of concepts are directed primarily at the *standard setter*, for use in deliberating standards. International statements of concepts, on the other hand, may be directed also at the *preparer* or *user*.

This difference in focus might affect where the different kinds of concepts would appropriately be placed in the accounting hierarchy.

Mr. Anania asked whether FASAB had discussed the hierarchy for federal reporting. Mr. Bramlett said that initially federal accounting standards were regarded as an “other comprehensive basis of accounting.” In that context, there had been discussion of the hierarchy, including the place in the hierarchy of OMB’s Bulletin on “Form and Content.” He did not recall discussions at FASAB since AICPA took action [with SAS 91] to recognize federal accounting standards as GAAP, apart from some discussion of applicability of FASB and FASAB standards within the federal domain. “So we would look to SAS 91,” Mr. Anania asked? Ms. Comes indicated that we would.

Mr. Dacey noted that international accounting standards include the notion of fair presentation in accordance with a hierarchy of accounting literature. FASB is taking action to put the accounting hierarchy in the U.S. accounting literature for the private sector. He said FASAB should consider whether that is something we should have in our standards. Public companies now have management certifications being signed by top management officials. SEC requires them to certify that their financial statements “present fairly.” The accounting standards are not driving that certification. Putting consistent criteria in the accounting literature would mean that the preparer and auditor were working from similar criteria. Mr. Anania asked if this would be a topic for the FASAB white paper currently under consideration? Ms. Comes noted that GASB has no current plan to put the state and local governmental accounting hierarchy in the accounting literature but that staff would monitor FASB’s efforts.

Mr. Mosso said he thought the topics staff had listed were helpful. He asked members to comment, and to suggest others that needed to be covered.

Ms. Robinson said she would like to learn more about the current division of labor with regard to the reporting that is done by the agencies. How the different reporting requirements and vehicles fit together would be an important contribution. In the private sector there seems not to be as much public reporting and transparency as there is in the Government. We have the Budget, the GPRA reports, et al. How do these fit together; which things fit where? There have been discussions on the budgetary reporting for multilateral financial institutions; there are possible implications for other reporting models, including how they are represented in the financial statements and even for GPRA.

Mr. Zavada said the model now has the Performance Plan with the Budget, i.e., the goals and the resources to meet the goals. Then there is the Performance and Accountability Report (PAR), which includes the financial statements as well as the performance results. OMB’s guidance pursuant to the Reports Consolidation Act and GMRA encourages agencies to consolidate their reports on results in the PAR. He thinks of these like bookends.

Ms. Robinson noted that these reports overlap, particularly for the prior year. For example, there is a cash flow presentation in the Budget and various presentations in the other reports. Everyone works hard to make sure the numbers are the same, but different pictures are presented.

Mr. Zavada said ideally the numbers should agree, or be reconcilable when they are on different bases. We have been getting better at this. Ideally the “actual” column in the Budget should agree with what is in the audited financial statements. There are differences in basis of accounting: the Statement of Budgetary Resources is on an obligations basis.

Mr. Reid noted that the Budget never closes, unlike the accrual statements. If 20 years from now you discover something that belongs in FY 2004, you put it in 2004. Historically, these kinds of adjustments have been insignificant.

Mr. Anania asked if the plan for the “white paper” included identification of key Acts and Executive Directives? One can’t comprehend what is involved in federal financial reporting without reference to the laws and requirements. Mr. Bramlett agreed; he envisions providing an updated appendix, with a more concise narrative discussion of how we see that framework impacting FASAB. Mr. Anania noted there could be a nexus with what we would see as the “hierarchy” for federal government reporting. Mr. Bramlett agreed, adding “and also with our domain.”

Mr. Patton asked whether the objective of this project is to state the objectives of FASAB? “Restate,” Mr. Reid said. Mr. Bramlett said that he perceives the Board to want a better focus on its objectives and how to attain them. Mr. Patton would like to see us carve out from the broad spectrum of federal reporting what is FASAB’s domain, versus what might more efficiently or effectively be left to others. At the other end would be some definition of what products we have to serve objectives within that domain.

Mr. Reid agreed with the need for prioritization, with the caveat that we not preclude ourselves from doing what seems appropriate. Mr. Patton suggested that if we don’t pare down our current objectives in a fairly decisive way, we would be left with what we have now. Mr. Reid said the Board or future Boards could always change directions or emphasis, within the constraints set by the MOU and other sources outside the Board. He agreed that it should be possible to articulate more clearly the connection between the statement of objectives and what the Board actually does. Mr. Patton said he would prefer to narrow the objectives now, and let a later Board change the objectives later, if it wanted to do so.

Mr. Mosso noted that financial reporting is always evolving; he suggested that Mr. Reid did not want to preclude further evolution. Mr. Reid agreed.

Mr. Dacey asked if it was a matter of distinguishing near-term or mid-term objectives from possible longer-term objectives? Mr. Reid agreed. “Should the fact that some objectives are not reflected on our current agenda lead us to remove them from the statement of objectives” he asked? He recalled the discussion of the internal control objective, which developments outside FASAB’s purview subsequent to SFFAC 1 may have addressed. Something more concrete, such as Mr. Patton suggested, would be helpful to him.

Ms. Robinson observed that in considering our mission we are in some sense following the natural strategic planning framework. It always takes some time to re-crystallize your mission statement.

Mr. Anania said he thinks of the concepts as the broadest way of looking at what federal reporting might be. The mission statement is our "carved out" part of the total array of federal reporting: *what* we should do. The strategic plan is *how* we are to accomplish the mission statement. When he joined the Board, he questioned whether our concepts included objectives to which we were not paying day-to-day attention. This raised the question whether the objectives should be modified.

Mr. Schumacher agreed. That is why it is important to know where we fit in to the broader context of federal reporting requirements.

Mr. Jacobson said that a list of laws is hard to digest. He asked whether it would be better to describe the legal framework by subject (e.g., systems, controls, performance reporting) instead of by law. Messrs. Mosso and Anania said it would be useful. Mr. Jacobson said he would write such a high-level narrative.

Mr. Anania said that trying to do this for the federal Government is much more complex than it is to describe corporate reporting and what the standard setter should be doing in the private sector. He is not sure to what extent this was done for SFFAC 1, but even if it was done then, there have been significant changes in the environment since then. Also, Mr. Bramlett noted, the original Board members may have had a more homogeneous "internal representation of reality" as some academic accountants would say. It perhaps seemed less necessary to articulate some aspects of the legal framework and overall reporting model when most members were familiar with it because they had worked within it.

Mr. Jacobson said it is hard for the reader to figure out how laws passed years apart fit together. Laws passed at different times may overlap and may seem to be—if not inconsistent—duplicative. Ms. Robinson noted that a topical presentation might also simplify a coordinated explanation of the regulations that elaborate upon and implement legislation. For example, the Government Performance and Reporting Act took things so far, and then a section of OMB Circular A-11 elaborated on the law, as have subsequent circulars. Mr. Jacobson said he envisioned providing a high-level summary based on the legal framework; further details could be added later where the Board saw a need for more detail.

Mr. Zavada said that—putting the laws aside—he sees FASAB's role as similar to FASB's and GASB's: a set of standards for fair and consistent accrual-based reporting. That can be a component of the Performance and Accountability Report. One can get caught up in all the laws, but he would focus on our goal. It is easy for him to compartmentalize FASAB's role in the context of the laws. Viewing things broadly complicates matters. There are a lot of financial reports, including the Budget; FASAB's role is to promulgate a set of standards for fair and consistent accrual-based reporting.

Mr. Anania said he would want to know what is contained in the laws and the Form and Content material to be able to determine where the Board's responsibility fits in to some areas, e.g., stewardship and internal controls. He has said that FASAB does not do much directly regarding internal control. In the private sector, certain contemporaneous documentation is required for certain accounting treatment, e.g., in accounting for derivatives. One can argue that that is an accounting control. He does not know to what extent a similar requirement for documentation exists in the Government.

Mr. Jacobson said that there is a law that requires documentary evidence with respect to recording obligations. There was concern that agencies were recording nonexistent obligations against appropriations to avoid losing the budget authority.

Mr. Anania said he wants to get a better handle on what the Board is taking on with respect to some areas such as stewardship and internal accounting control.

Mr. Mosso suggested that he hears two ideas: there is the "view from 30,000 feet," which is a "forest management" view, but some want a "lumberjack" view that will help them cut some timber. Some of each viewpoint is needed.

Ms. Robinson alluded to the inter-entity cost issue on the Board's agenda. She noted that GPRA has, as a subtext at least, the need for full cost information. OMB has stated the same in A-11. The idea was that one would allocate cost based on how one wants to report performance. She asked whether we are sending conflicting signals? The wider view could help address such questions.

Mr. Zavada said that some of the inter-entity cost discussion had been down in the weeds. The challenge in this project was to stay above that. "Above the weeds, but at the board-sawing level," Mr. Reid summarized.

Mr. Mosso said that the notion of comparative advantage should help us decide what we can do best, versus what other entities can do.

Mr. Bramlett noted that some of the possible advantages listed in the staff paper relate to accounting in general. Those advantages were potentially relevant when FASAB first deliberated on objectives. Other possible advantages relate more specifically to financial statements that are described as being in conformity with "generally accepted accounting principles." FASAB's standards gained that designation after SFFAC 1 was published. That designation was based largely on institutional factors that were deemed to enhance the Board's independence and its ability to mandate reporting "bad news." Arguably that designation enhanced the credibility and impact of financial statements prepared in conformance with FASAB's standards. He asked whether the Board found some of the aspects or advantages listed on page 21 of the memo as useful conceptual tools to help it "narrow down" its focus and set standards.

Mr. Anania said that we could assume that comparative advantages exist and people accept that. It becomes a matter of deciding the implications of the advantages for FASAB.

Mr. Patton observed that some of the characteristics listed apply to the Board as an institution, while others apply to the information itself. It may be that some of the relevant characteristics of the information may be derived from characteristics of the institution. So for example “neutrality of process,” “independence,” and “designation as GAAP” seem to be characteristics of the Board. Many of the other characteristics listed seem to be characteristics of the information that the Board or someone else might require. Those characteristics might have an advantage, say, over unaudited information.

Mr. Mosso referred to an excerpt from an accounting textbook that staff had sent to the Board. He thought it caught the essence of comparative advantage, though it did not elaborate.[1] The excerpt put it in terms of “credibility.” That is probably the best one-word description of our comparative advantage. He would elaborate on it by noting the roles played by:

(1) audit,

(2) the accrual accounting model, with 500 years of history, which brings a discipline to the process, and

(3) the Board’s independence and the related characteristics.

Mr. Anania asked if the Board could shortcut this. He also had focused on “neutrality of process,” “independence,” and “designation as GAAP.” It seems that there is

---

[1] The textbook cited is *Accounting Theory: An Information Content Perspective*, by John A. Christensen and Joel S. Demski, published by McGraw-Hill Irwin, 2003. Chapter 20, "Professional Opportunity and Responsibility" includes three paragraphs on pages 441-442 under the heading "Comparative Advantage":

> Fourth, in managing the accounting system, remember to play to its strengths, its comparative advantage. This strength is its credibility, the fact that it can be and usually has been audited. It is no accident that accounting systems shy away from recognizing revenue before production has taken place even if customers are standing in line. It is also no accident that we do not see finely honed, real-time internal reporting mechanisms that highlight the temporal option value of the firm's various resources. Nor is it an accident that the firm's external reporting is subject to reporting standards, auditing, and enforcement.
>
> This comparative advantage theme suggests a degree of caution, if not moderation, when it comes to quickly expanding the accounting system's base. For example, a currently popular theme is to stress the reporting of fair value for a firm's assets and liabilities, including its intangible assets. Yet this calls for a dramatically larger information conveyance task and arguably runs counter to the system's comparative advantage.
>
> The accounting system survives and thrives in a competitive environment. Economic actors have access to a myriad of information sources, but nevertheless we see concern for and anticipation of what the accounting system will report. This strongly suggests that the responsible professional understand and play to that system's comparative advantage.

considerable information available about the comparative advantage of accounting and financial reporting. Could we as a Board summarize that and say that we accept that in a broader way? We could then say we want to think more about comparative advantage in the context of what we are trying to do and why we are best equipped to do that.

Mr. Bramlett asked whether identifying these advantages provided the kind of tools and focus for standard setting that the Board was seeking? Mr. Reid said “no.” We can accept that we have a comparative advantage in certain respects. The issue is how far the comparative advantages extend. It gets fuzzy as one gets out to the edges in certain areas. If we could crystallize the edge better (i.e., does it go as far as this, or how about that?), it would be helpful. It is a given that the Board is the accepted source of federal accounting standards; it is now also a given that the Board is a source of GAAP. The question is, “how do we use that, how do we translate that into objectives, how far does that go?” We don’t need to go back to the beginning, but in light of how the law has evolved, what does it mean for us?

> **CONCLUSION:** The “white paper” will provide information about the reporting that is done by federal agencies. The paper will summarize information available about the comparative advantage of accounting and financial reporting for the Board to affirm as relevant. In particular it will mention the roles played by audit, the accrual accounting model, and the Board’s independence. The Board’s role as the accepted source of federal GAAP will be taken as a given. Staff will provide a summary of the legal framework arranged by topic. The white paper will explain how the different reporting requirements and vehicles fit together. The Board will further consider, in light of that information and what it defines as the relevant comparative advantages, the focus of its standards. While recognizing the evolutionary nature of financial reporting, it will consider how to prioritize or carve out from the broad spectrum of federal reporting what is FASAB’s domain, versus what might more efficiently or effectively be left to others, at least for the near term. It will also define what products we have to serve objectives within that domain. The paper will also address fair presentation in conformance with a specified “accounting hierarchy,” and whether this hierarchy should be part of the federal accounting literature.

- **Concepts – Elements**

Ms. Wardlow said that the planned discussion would continue deliberations at previous meetings, with a view to conclude whether the “essential characteristics of a liability” listed by FASB also apply for federal accounting. From the essential characteristics, we would then build a definition of liability. The Board has discussed previously the position taken in SFFAS 5 that no liability should be recognized for nonexchange transactions until an amount becomes due and payable. The Board needs to decide whether to take a similar position from a definitional standpoint—that is, whether in nonexchange transactions a liability can be incurred before the due and payable date, even if it is not recognized at that time.

Ms. Wardlow said that her paper addresses how other standard-setting bodies have dealt with nonexchange transactions and illustrates different points at which obligating events have been held to occur. The standards share the view that the fact that a transaction is a nonexchange transaction does not mean that an obligating event cannot occur before the point at which something becomes due and payable and, by extension, such an obligating event may mean that the obligation extends beyond the current year and may involve outflows of resources beyond the current year. Although the standards deal with recognition rather than definition, they rely on certain concepts that may be useful to our discussion of elements. It is sometimes difficult to separate definition and recognition, but we are looking at the obligating event that contributes to meeting the definition of “liability,” and not whether or when the liability should be recognized.

Many of the standard setters cited in the staff paper use the concept of legal enforceability to help identify the point at which recognition should occur and some of them distinguish between legal and constructive obligations. The Board has previously discussed aspects of those concepts. In today’s discussion, Ms. Wardlow said she would like the Board to consider whether to use the concept of legal enforceability as an essential characteristic in defining a liability, or whether it is a concept to consider later during deliberations on recognition criteria.

Ms. Wardlow said that she would like the Board also to consider the issue of exchange/nonexchange. She believes that this classification is not an essential characteristic that would affect the definition of a federal liability; rather, it is relevant to identifying conceptually the obligating event needed to meet the definition of liability. In exchange transactions, we are accustomed to the idea that the obligating event is the exchange. With nonexchange it is different. Most of the standard setters cited in the paper have tried to find a set of conditions or criteria, one of which may be legal enforceability, for recognition of nonexchange transactions. The Board may wish to pursue that when considering recognition criteria. However, she asked whether we can put aside the exchange/nonexchange classification when we are discussing the essential characteristics of a liability. If so, then we would end up with the same definition of a liability, regardless of whether a transaction is exchange or nonexchange.

Ms. Robinson asked for clarification of two points. One is about the word “future.” If future can mean “due and payable,” which she considers to be immediate—if that can be a “future outflow”—then she agrees with having a single definition; she does not agree if a liability has to be a *future* outflow. That is, if “future” can encompass “immediate,” then one can have a broad definition of liability and focus on due and payable for recognition. Ms. Wardlow said she believes that “future” can encompass any point from now on. Mr. Schumacher said it could be the next day. Ms. Robinson’s other question had to do with recognition. It seems that part of the shared knowledge of the prior Board members [who deliberated SFFAS 5] was that there is a distinction between exchange and nonexchange transactions for recognition. Is that consistent with what Ms. Wardlow found?

Ms. Wardlow said she thinks there is a distinction, but the distinction is not whether there is an obligating event or not, or what the definition of a liability is. The distinction is in when the obligating event occurred and what criteria you use to support that it has occurred. If we can identify a pure exchange transaction, we are comfortable with saying that the exchange is the best point. In practice we may not know when an exchange has occurred and there may be reasons why we have difficulty in identifying the right point, but conceptually it seems quite straightforward. For nonexchange transactions it is not straightforward. Especially if it is a pure nonexchange with resources flowing only one way, at what point does the recipient have an asset and the promisor have a liability?

Ms. Robinson said that SFFAS 5 tries to make it clear: nonexchange liabilities are not recognized until due and payable. Ms. Wardlow said there is a difference between saying you should not recognize a particular liability until it is due and payable, perhaps for practical reasons, and saying that there is no liability before that time. If one looks at the history of what has been done in state and local governments and in not-for-profit entities, there has been a movement away from saying “If it is nonexchange, we cannot do anything; we have to do cash basis because we do not know at what point to accrue.” The FASB, the GASB, and other standard-setting bodies have said “That does not sound right to us, there has to be a point earlier than that.” For some nonexchange transactions, in practice one may not recognize the transaction before cash is transferred, but at least one is trying to do it on an accrual basis.

Mr. Schumacher said that SFFAS 5 seems to define nonexchange as a one-way flow. He asked how the prior Board dealt with transactions that are not pure exchange or nonexchange, but somewhere in between, where there is some element of exchange? Mr. Bramlett said that prior FASAB members recognized when deliberating SFFAS 5 and SFFAS 7 (where revenues are classified) that some transactions have elements of both exchange and nonexchange. The Board decided to accept that in any classification scheme some debatable judgments about things near the borderline would be necessary. Mr. Fontenrose said the judgment was based on the predominance of one element (exchange or nonexchange) or the other. Mr. Bramlett said that some staff members had briefly explored the notion of trying to split such transactions into exchange and nonexchange elements, but the Board did not pursue that idea. He added that, as Mr. Fontenrose said, it came down to a judgment about predominance and all transactions would be classified as either exchange or nonexchange.

Ms. Wardlow said that was, in effect, where the GASB ended up. In contrast, the FASB says in its Statement 116 on Contributions that if a transaction has clear aspects of both exchange and nonexchange, then the transaction should be divided. GASB acknowledges there is a spectrum or range of transactions between pure exchange and pure nonexchange; one looks for what is most helpful to find an appropriate recognition point. There are some differences in the way different standard setters define nonexchange. Whereas SFFAS 5 speaks of a one-way flow, other standard setters speak of an unequal exchange, which may include a one-way flow but would not be limited to it.

Mr. Patton said he thinks he agrees that it is possible to use a single definition of liability for exchange and nonexchange transactions. But it seems that the specific obligating event would be different for exchange versus nonexchange. So we have to debate the nature of obligating event as part of the definition of liability. The FASB's second characteristic includes the phrase "little or no discretion to avoid the future sacrifice." So we can say that is what an obligating event is.

Ms. Wardlow said that she thinks that is the position other standard setters have taken, though GASB has not formally defined "liability." The decision has been taken to look at the obligating event in the course of deliberating a standard. That will vary; some guiding criteria are needed.

Mr. Reid said Ms. Wardlow was suggesting that there is a series of potentially distinct obligating events that would potentially apply to whole classes of transactions. Below that there are criteria for recognition. She said that from the perspective of the essential characteristics of a liability and for defining "liability," one stops at obligating event. One states what an obligating event is, but one does not identify specific obligating events for particular transactions. When the Board sets recognition criteria, it will need to consider appropriate criteria for all different kinds of transactions. That again may be at a fairly high level. Then, when one gets to a standard that applies the concepts to, say, grants or whatever the particular topic is, then one would zero in and say that for these classes of transactions, these are the things that would constitute the obligating event or justify a conclusion that an obligating event has occurred. Ms. Wardlow said she would hope that could be done by classes of transactions, rather than attempting to look at a wide array of individual transactions.

Mr. Zavada asked how relevant for GASB is the level of recovery of costs, for example with fees and licenses, to classifying a revenue transaction as exchange or nonexchange? Ms. Wardlow said that is not expressly stated in GASB Statement 33; there is some judgment. If there is not enough of an exchange element to identify an exchange point, then other criteria for recognition are needed. The preparer is encouraged to use judgment.

Ms. Cohen asked "Wouldn't most fees be nonexchange?" Ms. Wardlow agreed that many fees are. Ms. Cohen noted that for state and local governments many fees are taxes. Some, such as business licenses, can be classified as exchanges. "So there is no particular threshold," Mr. Schumacher said. Ms. Wardlow agreed. Some additional guidance has been given in the GASB's Question and Answer documents.

Mr. Patton said he would like to focus on Recommendation 3: "Staff recommends that the Board continue to consider including constructive as well as legal obligations in the definition of a liability." He reviewed the minutes for the prior meeting and found half a dozen references to "legal," such as "legally enforceable," "legally-based obligation," "legal liabilities," and other related terms. The exercise of figuring out exactly what we mean by each of those terms would help him decide whether we ought to include constructive as well as legal obligations. For example, in one of the documents we have seen constructive obligations were a form of legal obligation. So, he thought that sorting out those definitions would be a good idea, and then the next step would be to decide whether the Board wants to include each of the “sorted-out” versions in the document.

Mr. Mosso said he had exactly the opposite conclusion. We should eliminate “legal obligation,” “constructive obligation,” and “exchange obligation” from our vocabulary. We are looking for an event that clinches a promise and leads on the one side to the inability to avoid an outflow and on the other side to a reasonable expectation or reliance based on the belief that they will receive the outflow. The whole notion of exchange/nonexchange has been passed by in the literature. When FASB got around to dealing with nonexchange transactions, they got the same answer as for exchange transactions: the obligation exists if you have made a promise that will result in an outflow. End of story. It is the transaction that is important. If it happens to be an exchange transaction, that probably clinches the idea of expectation and reasonable reliance. If it is legal, again, end of story; there is no question that is a liability. So, let’s not spend time on legal, exchange, nonexchange, and so forth. Let’s look in terms of a promise that is going to lead to an outflow.

Ms. Robinson said she had a lot of sympathy for that view, but the word “promise” in the governmental context is too broad to be useful, and the GASB and others have looked at what is a promise. To her, the language of governments is laws. She refers not to the idea of legal “enforceability” but to “legally based.” Unlike a board in the private sector that can make an announcement and be held to that, no person can speak for the government except through law. To her, the concept of “legally based” helps to narrow the concept of “promise,” which is important because in government the only promises that matter are those that are legally based.

Ms. Cohen said she was reminded of a case 20 years ago in Oregon arising from problems with a veterans loan program. The courts held that even though there was no legal obligation to do certain things, the government was obligated because it had led participants in the program to have certain expectations. She acknowledged that the federal Government is different, but States are sovereign within their own borders and she would point out that there are cases where one goes beyond legality.

Mr. Mosso said he could interpret a law that sets up, say, a Food Stamp program, as representing a promise that if certain things happen, if certain conditions or circumstances exist, then it becomes a liability.

Mr. Anania asked Ms. Robinson, with regard to her statement that no one can speak for the government, whether in certain situations an agency, by its actions, by what its management group does, could create expectations and in effect be speaking for the Government? Ms. Robinson said that agencies are only allowed to operate within their authorizing statutes. They should be only implementing their charge, which is legally based. There are examples where agencies have been found to act beyond their legal authority. Mr. Anania said he thinks that agencies are doing things that obligate themselves and the federal Government as a whole to perform certain services that may not be clear or exact and described in legal documents. Ms. Robinson said that the agencies cannot obligate the Government and they cannot spend money without

Congress saying they can, and Congress does that by passing a law. Mr. Farrell noted that laws are interpreted by regulations, and agencies promulgate regulations, so are regulations not part of this? Ms. Robinson agreed, but said that agencies do so in accordance with the law that instructs them to do so; the regulations must have a legal basis. Mr. Farrell asked whether "legally based" includes regulations as well as laws and Ms. Robinson agreed.

Mr. Anania said he liked what Mr. Mosso had suggested as a way to cut through the language. He expressed concern, however, that other standard setters are trying to deal with notions like "constructive obligation." If we drop it from our language, it may create some confusion about what we are trying to do versus what others, including the FASB, are doing. Mr. Anania added that if you accept the idea that a liability can exist and it does not have to be legal, you can get to the requirement of recording a liability in a standard. It does not matter exactly what path you take to get there. Once you accept that a liability does not have to be a legal obligation, you can find a basis for requiring that a liability be recognized. So, he thinks that the debate starts with—and almost ends with—"Does it have to be legal, or not?" If it does not have to be legal to be a liability, it is a matter of how you frame the rest of the debate: whether you use the term "constructive obligation" or go right to the characteristics.

Mr. Mosso said that he would go directly to the characteristics. One reason is that "legal enforceability" is not operational. No contract has ever been written that could not be challenged in court and thrown out. Mr. Anania agreed. Mr. Mosso continued that, from an accountant's viewpoint, one has to take a leap of faith with some of these things, and the leap that has been taken, regardless of specific wording for the moment, is one of a probable outflow that cannot be avoided and that leads to some reasonable expectations that it will happen. He agreed that if the Board does not use the same terms used by others, it should explain that the reason is that the terms are not relevant to the way the Board uses the term "liability."

Mr. Zavada asked whether the only difference between Recommendations 1 and 3 is that in 3 there is a reference to constructive obligations, whereas in 1 there is not?[2] He thought the two recommendations were substantively the same. Mr. Anania said that Recommendation 3 is broader than Recommendation 1. Ms. Wardlow said that legal enforceability is one of the features of constructive obligations. Recommendation 3 follows from discussions at the previous meeting when the Board indicated that it wished to consider further a notion of constructive obligations with perhaps a narrower definition than other authorities have used. Legal enforceability may be one aspect of some constructive obligations, but there are other aspects.

---

[2] *Recommendation 1*: Staff recommends that the FASAB also consider these concepts [*legal enforceability* and *satisfaction of conditions* (FASB term) or *eligibility requirements* (GASB and IFAC-PSC term)] as a way to develop some general criteria for determining when obligating events occur in nonxchange transactions. *Recommendation 3*: Staff recommends that the Board continue to consider including constructive as well as legal obligations in the definition of a liability.

Mr. Dacey said that, even if you accept the construct that one definition of liability would cover both nonexchange and exchange transactions, you still have to consider, when you get to obligating events, whether there is a legal commitment at that point or something less than that. So, you still have to decide whether you wish to allow an obligating event to be something less than a legal obligation, and a definition of "legal obligation" might be helpful to that decision. "Legally enforceable" might have some connotations that take one further than legal obligation in that a court can do something about it. Maybe "legally binding arrangement" might be a better term. Mr. Mosso pointed out that the accounting profession has already gone further in many instances by recognizing things that clearly are not legal obligations, such as healthcare plans.

Mr. Patton said that Mr. Mosso's suggestion about going directly to the characteristics is not in conflict with his own suggestion and it might be a more elegant solution to the problem. In effect, the analysis of all the different terms might leave "mush," rather than the clear distinctions he was seeking. If the Board follows Mr. Mosso's route and does not define terms such as "legal obligation," he thinks the Board would be left with the concept of "little or no discretion to avoid the future sacrifice," which he thinks is the essence of a liability. In deciding in particular situations whether there is "little or no discretion," some Board members might conclude that there has to be a legal obligation of some kind, whereas other Board members might not, and he thinks the Board might have to live with that situation. Mr. Mosso agreed and added that, if there is a legal obligation, that reinforces the notion that the obligation is hard to avoid, but if there is not, that would not end the assessment of whether there is a probable future outflow of resources that is hard to avoid.

Mr. Jacobson said he thought the members were not very far apart. It would seem that exchange transactions and legally enforceable nonexchange transactions meet the condition of being hard to avoid, so the debate is about nonexchange transactions that are not legally enforceable. As Ms. Robinson has pointed out, everything the Government does must be legally based, that is, based on a system of applicable statutes and regulations. So, it is a matter of analyzing the applicable statutes and regulations for a particular activity to decide whether the activity meets whatever characteristics of a liability that the Board lays out. In theory, there could be some government programs in which the statutory framework and regulations, while not legally enforceable, are sufficiently definite in the commitment the Government makes and the way the program operates that you would say the characteristics are met and there is a liability. In contrast, there may be a whole range of other government programs in which the Government's commitment, while evidenced by a statute, leaves enough flexibility and uncertainty that the activity falls short of meeting the characteristics of a liability.

Mr. Anania asked Mr. Jacobson whether another way to frame the issue would be that the legislation, the law, the legal documents, may be as broad as simply an enabling action, and that everything that happens after that is based upon regulation, interpretation, and so forth? There is a legal structure, but it may be very unspecific, so that it does not pinpoint whether or not a liability is created. Mr. Jacobson agreed.

Mr. Mosso asked whether the federal Government ever becomes involved with common law? Mr. Jacobson said that the courts sometimes use common law principles to resolve a dispute, but generally the Government's actions have to be based on some grant of authority through either the Constitution or a statute. But, you can have things that are not contemplated in law and that result in liabilities—for example, a tort committed through negligence by a government employee acting within the scope of his duties. Congress has not passed a law that grants funding to compensate individuals for such torts, but there are laws that give people the right to seek redress through the courts. If an employee commits the tort, the Government may have a liability. When or whether that liability is recognized is another issue.

Ms. Robinson said that part of the tension in the discussion is that when she approaches a definition, she likes to be as narrow and specific as possible. However, she thinks the Board could adopt a broad definition of liability and then follow the course suggested by staff. That is, the Board would proceed systematically using a framework to decide how "obligation," "no discretion," and other characteristics would be applied. The Board then would not need to decide those issues now, but members should have confidence that the issues will be decided in a uniform way at a later time. In her view, exchange versus nonexchange is one of the parameters the Board will need to use to divide the universe of possibilities, but it does not have to be included in the definition of liability.

Ms. Cohen and Mr. Reid concurred with Mr. Mosso's position. Mr. Reid said he is not certain how to reconcile the notion of "fair presentation" and the statute. From the Board's perspective, he believes that fair presentation has to be the primary issue, and the statute somehow comes in under that. His focus would be "Do the statements fairly present the situation?" If he has reached a position that he believes to be appropriate, then he does not wish to be precluded from a fair presentation of the results by the fact that the statute has not yet reached that point. Mr. Mosso agreed and observed that currently liabilities are recorded even if no money has been appropriated to pay for them. Mr. Reid said he could see a situation that would go beyond that—one where Congress would forbid making a payment. That would not necessarily cancel the liability or remove it from the books, but it would mean one could not write the check. Ms. Cohen said that if one limits liabilities to what is due and payable, one is back to cash basis accounting.

Mr. Anania summarized the several views for the staff by saying that the Board agrees with the staff recommendations, but at issue is the mechanics of how the Board wishes to portray its manner of determining whether there is a liability or not. It could be done through the essential characteristics of a liability, without specifically embracing constructive obligations. In fact, he thinks that characteristic (b), "The duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice," is really the heart and soul of constructive obligations. Ms. Wardlow said she thought it was the heart and soul of all obligations. Mr. Mosso agreed. Mr. Anania said that he finds those same words used in all discussions of constructive obligations. He said that, for himself, he agrees with the staff recommendations and he likes Mr. Mosso's suggestion of not dwelling on whether that is a strict endorsement of what others have written about constructive obligations.

Mr. Dacey said that the essential characteristics may be incorporated to say that characteristic (a) establishes a present duty: "It [a liability] 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," whereas characteristic (b) establishes which entity has the liability. Other members are talking about it differently. However, whatever interpretation the Board adopts, he believes that the Board's deliberations and papers should clearly reflect what some of the terms used mean, so that everyone is using the same definitions.

Ms. Robinson said that the Board should not delay for too long a discussion of what the Board means by the term "obligation." "Obligation" has a very specific meaning in the budgetary context and is directly based on legality. So, she does not believe it is sufficient just to assume that something broader is meant by "obligation" in the Board's discussions. Mr. Farrell asked whether "obligation" is not defined in the FASAB Glossary? Ms. Comes recalled that in previous papers staff members have noted that the Board is using "obligation" in a different sense from the budgetary meaning. She thought those papers mentioned an everyday, dictionary definition of the term, whereas the Glossary uses the budgetary definition. Mr. Bramlett concurred, indicating that the Glossary definition comes from SFFAS 7.

Mr. Anania observed that the term "obligation" is broader than the term "liability," because an obligation must meet other criteria in order to be a liability. Mr. Jacobson said sometimes there are obligations that are not liabilities and liabilities that are not obligations. Mr. Anania disagreed that one could have liabilities that are not obligations, but Mr. Jacobson said he was using the term "obligation" in the budgetary sense. For example, there is currently no obligation of budget authority for some environmental liabilities that are recognized. Mr. Reid added that he believes most of the liabilities currently recorded do not have obligations, in the budgetary sense—for example, pensions, the debt, and most environmental clean-up. Ms. Robinson agreed and said she thought the point was when would the Board revisit some of those issues? Mr. Reid said that he agreed with Ms. Robinson that, at a minimum, the Board needs something that explains "liability obligation" or "obligation in the liability sense" versus "obligation in the contractual sense." Ms. Robinson added that we need to define what the liability sense is.

Mr. Jacobson suggested that when the term "obligation" is used in the budgetary sense, one should always say "obligation of budgetary authority" and not use the word obligation on its own. Mr. Dacey suggested that another word be found, instead of "obligation," for the non-budgetary meaning. Several members recalled why previous attempts to find a viable alternative had not been successful. Mr. Reid noted that "duty or responsibility" had been suggested but had some disadvantages. Ms. Wardlow said that phrase had been used in several staff documents to avoid confusion with obligation in the budgetary sense. Also, she recalled that the GASB had problems with the word "obligation" in its deliberations on liabilities and tentatively adopted the word "duty" instead. However, there also were problems with that word. She noted that the Board and staff had previously discussed the need to address the issue of the meaning of "obligation" in a document on elements, if that term is used in the definition of a liability or its essential characteristics. There followed a brief discussion of the possibilities for using a word other than "obligation" when the term is used in the non-budgetary sense; however, no immediately acceptable alternative was found. Mr. Kilpatrick observed that in some budget documents the OMB has used the word "responsibility," giving it a broader meaning than "obligation of budgetary authority" and deliberately avoiding an accounting-like term, and using it as an all-encompassing term to include longer range items, such as social security, PBGC, and national defense.

Mr. Patton indicated that he thought there was support on the Board for characteristic (b) "leaving it [the entity] little or no discretion to avoid making Social Security payments provided for under the law to avoid the future sacrifice," and how that would be made operational is another issue. If that is correct, then characteristic (b) suggests that the future sacrifice is probable. In past discussions of a definition of liability, the Board has consciously avoided including the word "probable," and he believes that is an inherent conflict, if the next step is to move to a definition of liability. Also, the FASB's first characteristic [(a) above] includes the word "probable." So, to the extent the FASAB is working from the FASB's characteristics, the Board should be careful to either continue to exclude the word "probable" or, based on the tension he sees between characteristic (b) and omitting the word "probable," maybe to reconsider whether to include probable in the definition.

Mr. Reid said he was not sure the Board needed to use the word "probable" in order to include a notion of probability. Mr. Patton responded that in previous discussions the Board had consciously set a low standard of probability, particularly for the definition of assets. So, the issue is whether the Board wants to have the same conscious, low standard for the definition of liabilities, or have some other standard, or leave the issue unaddressed, which he thought would be the worst of the three possibilities. In response to a question from Mr. Anania, Mr. Patton said he would like to have the word "probable" in both definitions—assets and liabilities—but the majority Board position was to leave the word out of the definitions. He thinks there should be correspondence between the characteristics and the definition itself.

Mr. Dacey said he thought the Board had previously discussed the issue of symmetry between the definitions of asset and liability and the possibility of using alternative language to the FASB Statement 5 language—using "could," "can," and words like that to convey uncertainty about what is an asset or liability [definition], and then deal later with criteria for recognition. Ms. Wardlow noted that the Board had also discussed the position of the FASB and other standard setters that it is not possible to convey in one or two sentences, or even in one or two paragraphs, exactly what the Board means. She said that the way the FASB's concepts statement on elements is set up, there is a specific, rather precise definition of liability. This is followed by a presentation of the essential characteristics of a liability. As Mr. Patton said, the definition builds on the characteristics, so at that point the reader has a bit more information. Following that, there are paragraphs and sometimes pages about how the FASB arrived at those characteristics and what they mean.

The problem is that readers who do not go as far as that make different interpretations of what the word “liability” means. Ms. Wardlow explained the problem the FASB has experienced as a result of having included the word “probable” in its definitions of asset and liability: Readers have misinterpreted the word “probable.” This might not have occurred if they had read the whole document, because it discusses the issue of uncertainty and explains what the FASB did and did not mean by the word “probable.” Apparently, when readers see the word “probable” in the definitions, they wish to quantify it for purposes of assessing whether an item meets the definitions. In contrast, from the FASB’s perspective, the assessment of probability should come at the measurement and recognition stage, as part of measurement.

Ms. Wardlow said that she did not know how to avoid those problems completely. She thought that the issues of uncertainty and probability would need to be discussed in the document, whether the word “probable” was included in the definitions or not. For example, one could omit the word probable from characteristic (a). In fact, the FASB originally proposed that, but people protested that the definition meant that one had to be certain that an item met the definition of asset or liability. As a result, the FASB included the word “probable” in the final statement, which has created another problem. She agreed with Mr. Dacey that the FASAB had discussed including “could” or “may” in the definitions. But, she thought the document on elements still would need to include a discussion of uncertainty and the Board’s treatment of it, and the Board would have to hope that readers would read the whole document; otherwise there could be multiple different interpretations of the definitions.

Mr. Mosso said that part of the problem is that a lot of obligations involve contingencies. For example, if one guarantees someone else’s loan or cosigns it, one has little or no discretion to avoid a future sacrifice. If it happens to be Warren Buffet’s loan, one has little probability of making a future outflow, but one still has little or no discretion if there is a default—one has to pay. Mr. Mosso thought that situation would meet the definition of a liability but would fail the recognition test. Mr. Patton said that, under current FASB thinking, it would meet the recognition test; one would have to measure the fair value of the guarantee and record it as a liability. Mr. Mosso agreed, but said the fair value could be zero. Mr. Patton concurred and said the guarantee would meet the definition of the liability and it would meet the requirement for recognition, but its measurement is the third issue and there it would go to zero. Mr. Mosso agreed.

Mr. Anania said he would not have a problem with omitting the word “probable” from characteristic (a). He asked if Mr. Patton agreed, whether he was having a problem with consistency and that would address it? Mr. Patton responded that the Board had not decided whether there should be symmetry between the asset and liability definitions. Mr. Anania thought the Board had agreed to that. Ms. Wardlow reminded the Board that they had not completely finished the asset definition when they began discussions of the liability definition. The Board agreed to set the assets proposal aside, address the liability definition independently, without considering the issue of symmetry, and come up with the essential characteristics of a liability. Then the Board would consider later whether the two definitions are symmetrical and, if not, whether they should be. The reason was so that the tentative definition of assets would not necessarily "drive" the Board's thinking about a liability definition, if the Board thought something else was appropriate. In her view, symmetry might be desirable, but there might be some reasons why pure symmetry was not the best course. She was not speaking for or against symmetry at the present time.

Mr. Patton said that, even if one does not need symmetry between asset and liability definitions, one does need internal consistency between the characteristics and the wording of the definitions. Ms. Wardlow agreed. Mr. Patton continued that he thought that to avoid the issue of probability but include a characteristic that refers to "little or no discretion" is internally inconsistent. Mr. Mosso agreed with Mr. Patton but said he would prefer to omit the word "probable" from the definition because he thinks it is troublesome. Mr. Mosso asked Ms. Wardlow if she had any ideas about how to deal with this issue. She said she thought the Board needed to address the whole issue of uncertainty, not just whether the Board should include a word like "probable" or "expected," or how the Board wishes to convey the idea of uncertainty, or whether the Board should omit the word "probable" and then explain the issue of uncertainty in some other fashion in the document. She said she did not have a conclusion or a working definition of liability at this point. She thought the next step should be to define the characteristics, whether with the FASB's wording or using other wording that the Board might wish to consider. If we can agree on the wording, then we would build the liability definition from that. She agreed with Mr. Patton that the notion of uncertainty has to be conveyed, but she was concerned about including a word [probable] that other standard setters have had a problem with. It would be advisable to find another way of doing it.

Mr. Patton said the simplest solution would be to include "leaving it little or no discretion to avoid the future sacrifice" in the definition itself. It would be unwieldy, but it would be internally consistent. Mr. Mosso asked Mr. Patton whether that would be done instead of keeping "little or no discretion" as a separate characteristic? Mr. Anania indicated that it would become part of the definition. Ms. Wardlow said she would try Mr. Patton's suggestion and see how it works. What the Board has been looking at, with both the FASB's and other standard setters' work, is the desire to have a one-sentence definition that captures all the essential characteristics. Then, one looks at the characteristics to see what the individual phrases in the definition mean, and then you further explain what the characteristics mean. But, one could have a two-sentence or a three-sentence definition. However, if the definition becomes too long, then one starts to get into more trouble, because there are more things for readers to misinterpret. She thought one could look at different ways of achieving the Board's goals. Mr. Patton said he would rather have the definition longer and consistent than shorter and puzzling. Mr. Mosso commented that he thought the Board had used a longer format for the definition of fiduciary activities.

Mr. Dacey repeated his earlier comment that he is not sure what characteristic (b) means. In contrast to the Board's discussion, he said it could be read as referring to the particular entity that is responsible for recording the cost of the present duty or responsibility. So, whatever the Board decides, it ought to be clear what the Board is trying to say. Although symmetry may not be essential, the issue with the asset definition was to identify what is an asset and state that it is an asset of a particular entity. He thought that liability characteristic (b) may be only saying that the liability was that of a particular entity.

Messrs. Mosso, Patton, and Dacey discussed characteristics (a) and (b). Messrs. Mosso and Patton thought that both (a) and (b) refer to a particular entity, although it is not stated in (a), and Mr. Patton said he believes that "little or no discretion" refers to the probability of the future sacrifice. However, Mr. Dacey thought that characteristic (a) defines a liability as a duty or responsibility and characteristic (b) may refer to that liability as being of a particular entity. In his view, "little or no discretion" may not refer to the probability that there is a liability, but to there being little doubt about which particular entity has the duty or responsibility. Ms. Wardlow commented that the structure may be causing the difficulty. She thought that "little or no discretion" belonged with (a) but could not be included before "particular entity" is referred to in (b). Mr. Mosso asked Mr. Dacey whether moving the reference to a particular entity into (a) would clarify the meaning for him? Mr. Dacey said he thought there may be two different concepts corresponding to two different assertions, similar to financial statement assertions and auditing considerations: one, there is a right or responsibility and two, that right or responsibility is of a particular entity. Mr. Anania said that he had never read the characteristics the way Mr. Dacey has, but he could understand Mr. Dacey's interpretation.

After some further discussion, Mr. Mosso said that Mr. Dacey's point was well taken. The FASAB is not locked into the FASB's language, and the Board needs to be sure that whatever words it uses clarify the issue that Mr. Dacey has raised. Mr. Dacey repeated that he is not locked into a particular answer. He merely thought that the structure for liabilities was similar to the structure for assets: first, there is an asset or liability, and second, it is the asset or liability of a particular entity. Mr. Patton said that he would urge keeping the notion of "leaving it little or no discretion to avoid the future sacrifice" somewhere in the characteristics, because that is the core reason for the Board's not addressing at the definitional stage whether an obligation has to be "legal" in order to be a liability. Other members agreed. Ms. Robinson asked whether, if the Board retained "little or no discretion," Mr. Patton would advocate taking out the word "probable," because it is in conflict? He responded that he could accept including the phrase in the definition, but in his mind it means the same thing as probable. Ms. Robinson asked whether including "little or no discretion" in the definition would clarify the meaning of probable for others? Mr. Patton said he thought so, and that if the Board proceeds that way with the liability definition, then it might return to the issue for the asset definition.

Mr. Mosso said that assets and liabilities are almost symmetrical by definition because a liability always has a recipient, but there is a problem with the asset definition because there are all those assets that are not the reciprocal of a liability, and they do not quite fit in the same set of words.

Mr. Farrell asked how Ms. Wardlow would deal with obligating events and how she would structure discussion? He said that would be the next level down, if the Board has agreed that the definition of liability can include both exchange and nonexchange, and those words would not be used for the definitions. How do you then begin to separate those transactions? Would the Board do something similar to the GASB and identify four classes of nonexchange transactions and address how to deal with each class? Ms. Wardlow thought it would be desirable to take that approach, but she was not sure that this is the right point for the Board to do it. Our purpose now is to develop the conceptual definitions of the elements and explain what the definitions mean. The work of the GASB and the other standard setters discussed in this meeting's paper are standards; they address how a preparer should address recognition and apply standards.

However, Ms. Wardlow said that she thought there was the intent later in the project to address criteria for recognition, and maybe the possible classification of nonexchange transactions would come in there. If so, then she would recommend an approach similar to that of other standard setters. That is, the Board would need to identify a set of conditions that would need to be met in order to conclude that an obligating event has occurred. She would hope those conditions would not be developed for specific types of programs, but rather that the Board would take a broader approach and group transactions that have similar characteristics, so that a similar set of conditions would apply to transactions within the same group.

Ms. Wardlow said that she thought the next step at this time would be to take the essential characteristics identified by the FASB and write them in a way that is useful to the FASAB and the federal community. Then she would develop the definition of liability, and then she would look to completing the work on assets and liabilities, so that the Board could move forward to considering definitions of revenues and expenses.

Mr. Mosso asked Ms. Comes what she had planned for the next stage, after the definitions are complete? He said that the discussion around the table suggests to him that members will not be comfortable with the definitions without a notion of how obligating events fit into them. That would take us into the recognition phase. Ms. Comes said that her understanding from the work already presented on assets was that once you have stated the three characteristics, then you explore paragraphs and pages of text on each characteristic, and you build an understanding of when each characteristic is met, and that would embrace obligating events in a conceptual way. Finishing that would give the Board a better sense of what obligating events confirm the existence of a liability. Then we would move to recognition criteria.

Therefore, Ms. Comes said, she would be comfortable with Ms. Wardlow's description of the next stage: that she would start to develop a paper on liabilities similar to the assets paper, not in a parallel sense but in the sense of talking about each characteristic and what it takes to meet each characteristic, and about the role of uncertainty. Mr. Mosso asked whether that exploration would address obligating events as a general topic? Ms. Comes said she saw that as part of the definition. Ms. Wardlow added that the topic would be addressed at a high level with, perhaps, some general examples, but not with such program-specific examples that would lead one into recognition criteria.

Mr. Anania said that he thought the Board had a majority position on a preliminary definition of an asset, but he was not sure there was a majority position yet on a definition of liability. Ms. Wardlow said that no liability definition had yet been proposed. The Board had been addressing whether the FASB's essential characteristics are appropriate for the federal environment. The Board has looked at the FASB's definition of a liability, and other standard setters' definitions, but only as examples. Mr. Anania said that, before the Board looks at obligating events, it should try to achieve a consensus on both the characteristics of a liability and a preliminary definition. He asked Ms. Comes whether she was saying that looking at obligating events would help the members finalize the characteristics? Ms. Comes said she believes that one of the characteristics is an obligating event, and writing more about what it takes to be an obligating event, without specifying obligating events for specific transactions, but just a conceptual discussion to support that characteristic, would be helpful before the Board moves forward. Mr. Reid said he saw no harm in crafting a preliminary definition of a liability; it might help the members put everything in context.

> **CONCLUSION**: In response to Mr. Mosso's inquiry about the next meeting, Ms. Wardlow said she would plan to present a tentative definition of liability, which would be based essentially on the substance of the FASB's three characteristics but would not necessarily be expressed in the same way. She also would include some paragraphs that would further explain the characteristics. The format would be similar to the drafts she presented a few months ago on assets. The proposals would be tentative and might include alternatives. They should give the Board a basis for considering language and where additional explanations are needed. Contrary to her suggestions in her paper for this meeting, she would not explore possible specific obligating events for different classes of transactions. Based on this meeting's discussion, it seems premature to consider identifying specific events.
>
> Ms. Robinson asked Ms. Wardlow to attach to the liabilities paper a copy of the most recent version of her paper on the definition and characteristics of assets. Ms. Wardlow agreed.

The Board adjourned for lunch at 12:15 PM.

- **Social Insurance**

The Social Insurance Liability Project staff presented a memorandum on Social Security characteristics. The staff mentioned that over the past months certain characteristics had been selected that might create a present obligation, in conjunction with an obligating event, prior to the point when benefit payments are due and payable. The staff also mentioned that the Board had discussed "constructive obligations" but to date a working concept in that regard is limited to the notion that present obligations do not have to be "strictly or technically" legally enforceable; and, that the Elements/Concepts Project is considering the scope of the not-legally-enforceable concept.

The staff memorandum presented the following characteristics for discussion. The staff explained that these characteristics might create a present obligation because they induce reasonable expectations and reliance or for other reasons the Government has no realistic alternative under current law but to settle the obligation.

(1) Eligibility is permanent: Current law provides the conditions that, once met, qualify participants "permanently" to receive a benefit without further conditions being required. If further conditions are required and the likelihood of them not being met is remote, then we would not find them relevant to the notion of a present obligation.
(2) Benefit level is specified in current law.
(3) A permanent funding source is made available under current law.
(4) Future benefit payments are legally enforceable under current law.
(5) The participants and benefits can be specifically identified well before the due and payable point.
(6) The participants are performing under the terms of the program. They are working in covered employment and the wages they earn therein determine the amount of their current dedicated taxes and future benefits.
(7) Participants may be viewed as exchanging current resources in the form of taxes for future benefits, an exchange or exchange-like transaction.
(8) Information about the participants' accruing benefits is directly communicated to the participants.

Presentation of each characteristic in the staff memorandum ended with the question of whether the characteristic by itself would create a present obligation (in conjunction with an obligating event) prior to the point when benefit payments are due and payable; and, if not, whether it is relevant for establishing a present obligation in combination with other characteristics.

The staff memorandum noted that, if these characteristics individually or collectively are relevant for distinguishing between programs for liability determination, then the next question for determining a "present obligation" would be: what is the obligating event? The staff memorandum also encompassed that question. The staff noted that recognition and measurement issues would be considered in due course.

Ms. Robinson questioned the relevance of characteristic 1 ("eligibility is permanent"), saying that, with Government programs, identifying who can claim the asset is problematic. She said she thought one of the tenets of the Board was that the Government does not have to know who the specific beneficiary is going to be. She was not sure that characteristics of the beneficiary should translate for the Government's liability. She explained that, if the Government has a program and there are going to be beneficiaries, who the beneficiaries are or whether or not their access to the program is permanent, seems irrelevant. Identifying the beneficiaries seemed to her to be more of a measurement issue.

Staff explained that establishing permanent eligibility might create a firmer obligation than temporary eligibility where re-qualification is necessary.

Ms. Robinson said that means testing was a case in point. With respect to means-tested programs, she said beneficiaries qualify at any given point, and we can talk about where the obligating event occurs in relation to that; but means testing would not preclude a program from having obligating events that would create liabilities.

Staff explained that the fundamental issue is whether the eligibility conditions are met. A means test represents an eligibility condition. Also it might be relevant for measuring the duration of the liability.

Ms. Comes asked Ms. Robinson whether the following statement of the characteristic might help clarify the principle in question: "current law provides the conditions that, once met, qualify the participants to receive a specified benefit." Ms. Robinson said it might and that the notion of permanency seemed to be more of a measurement issue. Chairman Mosso added that the beneficiary might meet the conditions for a month, a year, or forever.

Mr. Patton said he had a somewhat different take on the issue. He said he had been linking the list of program characteristics to the liability characteristics, and one of the important liability characteristics is "little or no discretion to avoid the future sacrifice." He said that achieving permanent eligibility is a significant factor for concluding that the Government has "little or no discretion to avoid the future sacrifice." He said this characteristic, by itself, was fairly important in establishing the existence of a liability, although the Board could debate exactly when there was sufficiently little discretion to say that the definition has been met.

Chairman Mosso said he also looked at the list of characteristics in terms of how they affect the Government's inability to avoid the obligation, do they create an expectation, or similar considerations. He added that he did see characteristic 1 helping him in that regard.

Mr. Farrell added that the word "permanent" may be a problem and that perhaps the characteristic should simply say that the thresholds have been met.

Mr. Patton said he was linking it to the IFAC, which distinguishes having to reestablish eligibility. IFAC would say that for programs where the beneficiaries must reestablish eligibility in two years, that there is a liability for that period.

Staff asked Mr. Patton if he agreed with the IFAC position. Mr. Patton said he thought he would.

Mr. Reid said he would argue for "eligibility criteria met" instead of "permanent." He agreed that the latter term focused on measurement rather than the existence. He added that he was not sure all the criteria would have to be met. For example, one of the criteria for getting Social Security benefits was that the beneficiaries had to be a certain age, 62, 65, etc. He was not sure that that necessarily was the test of an obligating event. He said he would be influenced more by other characteristics on the list than whether the participant had reached a certain age. He said he would be more swayed by characteristic 6 ("the participants are performing under the terms of the program”) because expectations are created at that point. He said there should be some threshold there, like the starting point or 40 quarters or whatever it may be; but that performing under the terms of the program is more basic than that simply once you become eligible you cannot become ineligible.

The members discussed how the characteristics would relate to a decision about the existence of a liability. Mr. Reid said that there is a certain amount of art in deciding whether a liability exists. He said you look at the factors that would tend to contribute to your decision that the threshold for obligating event had been met. You take them cumulatively. It is not a situation where you say all of them have to be met and if they are not all exactly met then it is clearly not an obligating event. He said some of the characteristics on the list would not be persuasive for him at all.

Mr. Anania said that in his view there are these eight characteristics and the staff is asking at the end of the discussion of each whether you can look at that one alone and reach a conclusion or do you have to look at that one along with others. He said the only one he could reach a conclusion on, by itself, would be characteristic 4 (“future benefit payments are legally enforceable under current law”). He noted that the Board has said liabilities do not have to be legally enforceable, but if you have legal enforceability that that would be conclusive. He said the way he answered the question on the other seven characteristics is that, on the first part, he answers “maybe.” On the second part, yes, it is relevant and should be considered along with other characteristics. Mr. Anania said he believed that the latter approach is similar to what Mr. Reid was describing.

Mr. Reid said that, with a hierarchy, he might start with “legally enforceable;” but, if the answer there were “no, it’s not legally enforceable,” other characteristics might still lead him to conclude that the liability definition had been met. Mr. Anania agreed.

Mr. Reid asked staff how this discussion would relate to other areas. Would we have a unique list for each of the programs within social insurance or are we trying to put together a list for all programs? Staff responded that the principles developed for Social Security and the other social insurance programs presumably would apply generally, i.e., to other than social insurance programs.

Ms. Robinson said that, with respect to characteristic 3 (“permanent funding source”) there are a lot of programs that are on “autopilot” forever, most of which are in the social insurance category, although there are a few that are not. There is also a group authorized for a long period of time. The education programs and TANF get authorized every five years. She said the fact that the funding source is permanent relates to measurement: how much of the liability do you include. She said that if the Board was going to go down this routine, a five-year stream for education did not seem that different than a longer stream for other programs. She said that it was more whether the funding exists in the future to match the obligation rather than that it was “permanent.” She said permanence was not relevant.

Mr. Anania said he would go a step further. He said that for him this characteristic was the weakest. He said you could have a liability whether you have funding or not.

Staff explained that the idea for this characteristic was not that funding was provided per se, but that it demonstrated the strength of the Congressional commitment.

Mr. Zavada said the provision of funding would not be persuasive for him.

Chairman Mosso agreed that funding should not have anything to do with recognizing a liability.

Mr. Reid suggested reversing the perspective and saying “a future funding source is not required.”

Mr. Schumacher said the question of funding was relevant to Social Security. He noted that, when the Board had discussed veterans’ benefits, one of the reasons given for only booking the due and payable liability was that the funding source had to be reestablished each year and the exact amount was uncertain. He said funding might be relevant for measurement rather than for the existence of a liability. Ms. Robinson agreed.

Ms. Comes suggested the following wording might capture the notion that the legislative provision of a funding source was evidence of intent rather than a necessity for the existence of a liability: enactment of a funding source is not required to settle the liability; it is evidence that the Government has put more weight behind the likelihood that these obligations will be paid in the future.

Ms. Robinson warned of a potential danger. She said many laws instruct agencies to undertake activities but the agencies do not do it because they do not have the money. She said the courts have distinguished between what the agencies have to do and what they do not have to do based on whether money has been appropriated to do it. She added that there are countervailing examples the most recent of which is the nuclear waste issue where a company sued because it was storing its nuclear waste and they had been promised Yucca Mountain and it had not been provided and the Government actually agreed to an out-of-court settlement.[3] She also mentioned the Claims and Judgments Fund. She concluded that there is a permanent “out” regarding funding, but

[3] The Yucca Mountain litigation is complex. Attachment 1 is a Department of Energy (DOEn) summary of the status of the Yucca Mountain litigation and standard contract litigation (spent fuel cases) as of October 28th, 2004 when . DOEn submitted its contingent liability reports for FY2004. The DOEn representative we contacted thinks the summary at Attachment 1 adequately describes the spent fuel cases and the main Yucca Mountain case and states that no significant events have occurred in these cases since the October report.

if the court finds the Government is liable and the money has not been provided the plaintiff can get a legal determination and go to the CJF. She concluded that it was a very messy situation on both sides about whether there is a requirement and whether the requirement must be related to money and what kind of options people have.

[Staff note: SFFAS 5 attempted to address the issue of Congressional authorization by specifying that the probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. "If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) ***it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided***. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources." SFFAS 5, par. 33 (Emphasis added).]

Mr. Dacey noted that exchange transactions do not require funding, that many FASAB liabilities are not "funded." He was not sure that non-exchanges change the equation.

Mr. Patton said that the questions regarding each characteristic asked whether each were sufficient by itself to create a liability and, if not, whether it was relevant along with others. He said for his own review he restructured the question to ask whether the characteristic was necessary or whether with others they were sufficient. He said with respect to the question at hand about the permanent funding source that it wasn't necessary but the fact of a permanent funding source does reduce the discretion of an entity to avoid the sacrifice.

Mr. Anania asked Mr. Patton whether, if he were looking at two possible situations regarding a liability both of which had three of these characteristics lined up perfectly, but one also had a permanent funding source, would that make a difference?

Mr. Patton responded that a permanent funding source was not a necessary condition for a liability to exist but given the task at hand to say whether they could help establish a liability, the answer is "yes," it would make a difference.

Mr. Anania said he viewed it differently. The existence of a permanent funding source would not make a difference to him.

Mr. Patton said the question was whether one had little or no discretion to avoid a future sacrifice, and a funding source reduced discretion.

Staff asked whether the $1.5 trillion in the Social Security trust fund would make a difference since they are claims on future resources. Mr. Reid added that it would go beyond the claim on future resources. He said the statutory language says something like the trust funds are specifically appropriated to pay benefits. In other words, it is more than accumulating resources and in fact when the funds are exhausted in 2040-50 something else than paying full benefits would have to be done.

Mr. Reid said that characteristics 1 ("eligibility is permanent"), 3 ("permanent funding source"), 5 ("participants and benefits can be specifically identified well before the due and payable point"), and 8 ("information about the participants' accruing benefits is directly communicated") did not resonate with him with respect to the Social Security program. He said characteristic 5 involves measurement and does not necessarily address the existence of an obligation; and characteristic 8 can be manipulated because the government can determine whether to communicate or not. He said he would want the substance of the transaction to be determinative, not the communication. He said he views characteristics 6 ("participants are performing under the terms of the program") and 7 ("participants may be viewed as exchanging current resources") working together.

Mr. Zavada said the characteristic "permanent funding source" is not useful. He said, first, that it was not useful with respect to situations like the Airport and Airway Trust Fund (AATF), which is a dedicated funding source from which the FAA and other agencies fund a lot of their operations. And, secondly, it was not useful regarding the notion of appropriated entitlements, which function like entitlements even though the funding is not permanent. He agreed with Mr. Reid's contention that the characteristics needed to be assessed broadly, on the basis of current facts and circumstances, rather than individually.

Mr. Schumacher asked whether the reason Mr. Reid would exclude characteristic 1 ("eligibility is permanent") was the word "permanent." Mr. Schumacher said that one of the characteristics of an obligating event for social insurance programs is that you have to meet eligibility requirements.

Mr. Reid said he would put eligibility more at the measurement end of the problem, after the obligating event is determined. He would measure the liability for programs with permanent eligibility differently than programs where eligibility is gained and lost.

Ms. Robinson asked regarding characteristics 5 ("participants and benefits can be specifically identified well before the due and payable point") whether the exact individual would have to be known; or would a categorical approach suffice, e.g., "woman, head of household, with an income less than $30,000, will qualify for a benefit." Staff responded that knowing the specific individual, for example, by social security number, would add weight to the argument that there is a liability.

Chairman Mosso asked Ms. Wardlow how that notion fit into her work on the liability definition. Ms. Wardlow said knowing the specific individuals is not necessary. For Social Security the specific population is known, but Ms. Wardlow said that as a general principle she did not think knowing the specific individuals was relevant.

Mr. Reid reiterated that he would move characteristic 5 ("participants and benefits can be specifically identified well before the due and payable point") down to something that would be significant for measurement. He said it depends on which side of the equation you are looking at. In terms of what might bolster your thinking, he said a lot of this material is good; but in terms of what would be the essence for getting him over the top for deciding that an obligation existed, he would not need at least half of the characteristics. But he said the nonessential characteristics would enhance your conclusion.

Ms. Comes noted that Mr. Reid identified characteristics 2 (“benefit level specified in current law”), 4 (“future benefit payments are legally enforceable”), 6 (“participants are performing under the terms of the program”) and 7 (“participants may be viewed as exchanging current resources”) as essential. She asked Mr. Reid if he could prioritize or weight them. He said characteristic 2 could be viewed as an obligating thing or computational thing. He said he viewed characteristics 6 and 7 as working together. And if you had characteristic 4, you would be locked in absent anything else. He said he agreed with Mr.Anania that characteristic 4 is a threshold thing. Otherwise, he would look to characteristics 6 and 7 to see how we are representing the program to others, and are they in fact acting on that representation. So, his formulation would be, first, the Government has represented a program in a certain way; and, second, the people to whom it has been represented are acting on those representations; therefore, something needs to be done from a computational point of view to represent the obligation. At that point some of the other characteristics would be considered. He said just because you have a liability does not mean you have a number. You may have a note disclosure.

Mr. Patton said he agreed with Mr. Reid that a lot of the characteristics are liability indicators but are not essential for a liability. He said the key characteristic seems to be that there is little or no discretion to avoid the future sacrifice, and the only characteristic that seemed to be both necessary and sufficient to create an obligation where there is little or no discretion to avoid the future sacrifice is characteristic 1 (“eligibility is permanent”), modified to avoid the “permanent” issue. He said that once a person is eligible for a benefit without further conditions being required, the Government has little or no discretion to avoid that future sacrifice. All other characteristics may bolster the conclusion that there is little or no discretion. He said therefore that the eligibility characteristic is necessary and also sufficient. The other characteristics are not necessary, and if they are not necessary, then they are not the essence of the obligation.

Mr. Schumacher said eligibility also supported liability characteristic “(c),” i.e., “past event.” He said that the beneficiaries believe there is an obligation once they become eligible.

Mr. Anania added that there is a danger in saying that these are important items in terms of reaching a conclusion because, if they then disappear, does that mean you have an issue about reversal? Mr. Anania said that an essential characteristic ought to be one that is required for a liability to exist. If the characteristic is not present, then a liability does not exist. Mr. Patton said he agreed completely.

Mr. Reid asked Mr. Patton whether benefit programs with less than permanent eligibility periods, e.g., 5-year eligibility, could meet the liability definition. Mr. Patton said he had agreed to take out the word “permanent” and therefore meeting the eligibility requirement presumably would be the key.

Ms. Cohen noted that Social Security eligibility cannot be changed, but for other programs eligibility requirements do change, e.g., Medicaid. She said that eligibility requirements change frequently for some programs.

Mr. Reid noted that the duration of eligibility would be a measurement issue involving probability.

Ms. Robinson said that both existence and measurement should be assessed equally.

Mr. Dacey said that there is an issue about whether we are in a position to judge which programs are likely to continue and which ones are not. He said he was not sure we should second-guess Congress and the President.

Mr. Reid said there was a certain going condition assumption built into accounting in general. He said he was not sure how applicable it is to the Government but there has to be a presumption that there will be a Government.

Mr. Dacey said characteristic 1 (“eligibility is permanent”) was important. He said he would characterize the IFAC PSC’s position on social obligations as being far from a consensus. He noted the majority position of the PSC’s steering committee at this point uses eligibility as the prime consideration. He said he would not say that eligibility should be the only consideration, but that eligibility is important. He said there is an issue regarding how you define it. For example, the PSC steering committee’s condition of eligibility is that you have to be alive, and that is a regular, continuing, updated thing eligibility. . He said eligibility seems to be an important aspect; you need to have it in some form. Mr. Dacey added that characteristic 4 (“future benefit payments are legally enforceable”) is important as well because of the way the Government operates. He said he would agree that characteristics 2 (“benefit level specified in current law”), 5 (“participants and benefits can be specifically identified well before the due and payable point”), and 6 (“participants are performing under the terms of the program”) involve the reasonableness measurement. If you do not know those things, measurement becomes harder. He was not sure about the relevance of the other characteristics.

Mr. Patton asked about characteristic 4 (“future benefit payments are legally enforceable”). He said that he had thought the Board had decided earlier in the discussion to abandon legal enforcement as a criterion and explicitly rely on the notion of little or no discretion.

Staff said that characteristic 4 would lend weight to the argument that there is little or no discretion to avoid the obligation rather than be dispositive.

Mr. Patton said that this goes back to the problem he has with the structure of the questions. He asked Mr. Dacey whether he thought legal enforceability was a necessary condition.

Mr. Dacey said he was not sure. He said it is perhaps more dispositive than some of the others.

Mr. Reid said he needed to know whether the Board intends for the Social Security standard to say that certain characteristics exist and the obligating event has occurred. Or, on the other hand, to present a list that might lead Social Security to believe that the obligating event has or has not occurred, and Social Security should make its own judgment.

Ms. Comes said it would depend on the context in which the Board tries to assert its position. If the context is the basis for conclusions, then it can be explained that not all members agreed and different members weighed different things, but that the members generally agreed on characteristics 1, 4, 6, 7 considered together. But with respect to the Elements Projects and any list of characteristics developed to determine whether a present obligation exists, it might be desirable to have the members vote on each characteristic on the list. She said that the important thing for the Social Security standard is the selection of the obligating event. And even that is not the final answer because then you want to talk about relevance and measurement options.

Mr. Reid said he concluded from what Ms. Comes had said that at this point the list of characteristics would be things that help Board members inform their judgment regarding whether or not the obligating event was one of the three listed in the staff memorandum.

Ms. Comes answered affirmatively. The characteristics would be used in combination with the notion of little or no discretion.

Ms. Robinson said she had an issue with the obligating event for Social Security. She said that one of the issues regarding the notion of little or no discretion is <u>who</u> it is that has little or no discretion. She said perhaps SSA has little or no discretion. But would the Government or Congress have little or no discretion?

Mr. Jacobson affirmed that under current law the Government or Congress would have little or no discretion.

Mr. Robinson asked how does current law relate to discretion. She noted that the liability characteristic says “little or no discretion,” not “little or no discretion under current law.” She asked whether Congress have discretion to change the law or not.

Ms. Comes responded that, in a private sector context, a corporate CFO might look at a liability and say, “well, I’ve got some lobbyists and I’m going to get the law changed and so I’m not going to record a liability.” However, the CFO would still be required to book the liability until laws are actually changes. So, that even in private sector accounting the ability to change laws exists but does not influence liability recognition.

Ms. Robinson said that this is the essential difference between the private and public sectors. When you talk about the Government you are talking about a sovereign entity, a “lord,” i.e., Congress being able to change its mind, with no recourse.

Ms. Comes responded that one is not able to forecast changes in mind. Accountants operate on the evidence about what will happen based on events that have occurred.

Mr. Reid said that, if you take Congress as a body, there are a lot of laws with which Congress can do virtually anything it wants without political ramifications. He said Social Security was not one of those laws. He said he did not know how much discretion Congress would think it had with respect to Social Security, but that ending the benefits for current retirees is probably not an option. Congress could and does tinker but it probably could not cut benefits by 50 percent. So there is uncertainty. He said he could probably add a characteristic about the judgment of the Congress: how likely is it that a representative or senator can substantially modify the program and still be a member of Congress? He said that it is not a question of whether Congress has the authority to change a program but whether it is likely to do so. He would ask whether a reasonable person would conclude that Congress would take that action. He said he could see how you could go through a probability continuum: for the people already retired, significant change is highly unlikely; for the next group who are about to retire, maybe there is a little less unlikelihood; and the farther one gets from retirement, more likely the change.

Mr. Schumacher added that private sector benefit programs frequently change and are adjusted accordingly. That characteristic does not preclude the private sector from recording a liability.

Ms. Comes noted the discussion earlier in the day during the session on the Elements Project regarding assessing legally enforceable where the Chairman asserted it is not something one can operationalize. She said she would summarize Mr. Reid's point as advocating assessing political enforceability. She said she did not think accountants could operationalize that.

Mr. Zavada agreed. He said all veterans programs are probably in the same political enforceability category as Social Security. He questioned how one would operationalize political enforceability.

Mr. Reid said that programs with potent political constituencies are much less likely to end or to be significantly changed. He said that politically enforceability could be operationalized via a "pass/fail" test. The political constituency would be one of those things that would be a factor.

Ms. Cohen said that participation in Social Security is not discretionary. Generally, if you work, you have Social Security. Babies are required to have Social Security numbers. She said it is quite different from student loan eligibility or many other programs. She said the members were losing sight of the obvious and in some ways going off on unnecessary tangents.

Ms. Robinson said she was trying to bring up the difference between legally enforceable and little or no discretion. She said it seemed to her that, if the notion of "little to no discretion" is the standard, then legal enforceability was the only feasible approach.

Legal enforceability would allow explicit reference to what Congress has said and this can be the basis of the liability until Congress changes the law. But she said "little or no discretion" is too vague; for example, what does "discretion" mean in the Government context?

Ms. Cohen said she would agree with what Mr. Reid said. She said "little or no discretion" in the Government context means politics, it means getting elected, it means the expectation of the electorate.

The Chairman said he did not think political probability would have to be assessed. He noted it could be read in what Congress says about the program and in what individuals say and in what is in the press all the time. He said the way the current reforms are being approached bears out what Mr. Reid said about the relative lack of discretion as one approaches retirement.

Mr. Patton noted that Mr. Reid had said characteristics 1 (eligibility) did not resonate with him and asked him if it continued to fail to resonate . Mr. Reid said those things are valid measurement criteria that need to be taken into consideration, but there are not the essential things that get him over the bar for obligating event. They come after the decision is made that an obligation exists.

Mr. Patton said he had thought Mr. Reid was describing a situation where the discretion to change benefits for people who were already fully eligible was very low, and it got a little higher as you got away from that; and that somewhere along that continuum one would draw an obligating event because of little or no discretion.

Mr. Reid responded that he was viewing the program in a somewhat larger sense and was viewing drawing the line as a measurement issue rather than an obligating event. In other words, because of some of these other characteristics, he would argue that there is little or no discretion at a certain point. He would then back that up by saying that, from an eligibility standpoint, there is an appropriate point on the continuum and therefore he would want to do something with regard to the calculation.

Mr. Patton asked whether Mr. Reid would agree that there is a lower amount of discretion the further into the eligibility you get. Mr. Reid agreed. Mr. Patton stated that, given that "little or no discretion" was one of the key characteristics of whether a liability exists or not, it would seem that logic would say that eligibility is part of the obligating event.

Mr. Reid said that if there were no one in the program that was eligible, he was not sure he would say that eligibility was essential to a liability. He could conclude that an obligating event occurred even though no one is yet eligible to collect benefits. He said it helped the argument that a liability exists but was not one of the critical things.

Mr. Anania asked Mr. Jacobson to clarify a point he inferred from the staff memo regarding legal enforceability. He noted a particular Supreme Court case often cited by the Social Security Administration. Mr. Jacobson responded that he was a little bothered by the discussion of characteristic 4 ("future benefit payments are legally enforceable"). He said page two of the staff memorandum might give members the belief that further Social Security benefits are in fact legally enforceable today but they are not. He said what is legally enforceable today is the due and payable amount already recorded on the balance sheet. He noted that, if nothing changes over the next twenty years, the participant could sue for the payment; but the participant could not sue today for the next twenty years' worth of payments. Staff noted that this is no different than for all other obligations, even interest or principal on Treasury securities: the payment is not legally enforceable until it is due. Ms. Cohen noted that that is only in the sense of demanding payment.

The Chairman asked staff what it purposed to do next. Staff indicated that the Board's discussion did not indicate support for characteristics 3, 5, and 8, but did indicate support for characteristics 1, 2, 4, 6, and 7. Staff asked whether the Board members were ready to look at the obligating events listed on pages 27-8 of the staff memorandum (see immediately below) in relation to the characteristics, and indicate what preliminary conclusion, if any, they would draw.

(1) Full eligibility, 62 years old for Social Security.

(2) "Threshold eligibility," at 40 quarters of work in covered employment for Social Security; and

(3) Beginning of work in covered employment.

Mr. Reid said obligating event (3) ("beginning of work in covered employment") definitely does not appeal to him. Mr. Anania agreed. Mr. Reid said a participant with only 39 accumulated quarters would collect nothing. He said he might want to give credit for the entire 40 quarters after the 40^{th} quarter is worked, but he would not want to start recording a liability at year zero.

The Chairman asked Mr. Reid how he would square that with pension accounting generally, including federal. The Chairman said 40 quarters is a vesting notion and pension accounting would not wait for vesting to begin recording a liability.

Mr. Reid said he would square it with reference to the deductibility and other funding considerations that begin immediately with employment, which he does not see in the Social Security program.

Messrs. Patton and Zavada said Social Security is not a pension.

Mr. Reid said he could go with either obligating events (1) ("full eligibility, 62 years old for Social Security) or (2) ("threshold eligibility at 40 quarters of work in covered employment for Social Security"). He noted that the Board had not begun to discuss measurement. He said his theory about that does not look much like what is being done on the sustainability computation. He said he would view it as much more restrictive than sustainability. He said a sustainability measure over 75 years is probably not a very good liability. He would look at the issue in terms of what the liability would represent and what would match up with the revenue with the costs appropriately.

The Chairman asked what Social Security is if not a pension. Mr. Patton responded that he would call it a "social program." Ms. Cohen said it was very much like a pension. Mr. Zavada said if it were a pension, a pure exchange-type transaction, the Board would not be discussing all these complexities.

Mr. Anania said his reaction was similar to Mr. Reid's with respect to obligating event (3) ("beginning of work in covered employment"). He said he expressed previously that he was leaning toward the threshold eligibility notion. He said he recognized that it is a vesting notion and at odds with pension accounting. He said he had trouble going beyond that at this interim point.

The Chairman said that in the private sector most pension plans incorporate Social Security. He said such plans first calculate the benefit under the company's plan and then deduct Social Security, and thus it is part of the pension.

Mr. Anania agreed. He said he thought the rationale for that is that they are paying part of the Social Security benefit through the employer contribution and therefore they feel their plan should be permitted to reduce the amount of the benefit, because in effect they would be paying twice. He said it is generally called integration of Social Security into the plan, and the approach makes Social Security seem similar to a pension payment.

Ms. Comes asked Mr. Reid about his assessment that a liability could exist at 40 quarters. She noted that characteristics 1 (eligibility) states, in part, that, "If further conditions are required and the likelihood of them not being met is remote, then we would not find them relevant to the notion of a present obligation." She said, on an individual participant basis, she would have a hard time saying whether a participant currently working in covered employment would change to non-covered employment and thereby fail to accumulated 40 quarters. But looking at the entire participant population, she could come to some conclusion that for 95 percent of the population failing to accumulate 40 quarters is remote. She asked if that is something that would be a factor in his decision.

Mr. Reid said he would say that the distinction between beginning work in covered employment and 40 quarters is fairly thin. He said it would be crisper to say that we are calculating for those who have attained eligibility and regardless of where they go to work we have an obligation to them. He said the 40-quarter point appealed to him as distinctive and, once you attained that and reach 62 years of age, you are entitled to a benefit. On the other hand, the point of beginning of work in covered employment at age 15, say, at McDonalds, or wherever, and doing accrual accounting from that point did not appeal to him.

Ms. Robinson took issue with the word "remote." She said if you are born in the United States it is pretty remote that you will not be working and paying Social Security taxes, etc.; and especially on the other end, she did not think it remote that you might die, sometime while you are getting your benefits or before. Also, she said it is possible for the Social Security population to change significantly. Thus, when discussing eligibility criteria, she wondered whether the Board was going to treat the "staying alive" criteria differently than 40th quarters or others.

Ms. Cohen noted that the concept was a statistical one. Ms Robinson said statistical concepts permeated the Board's work on this topic. Ms. Cohen agreed, saying the difference between threshold and beginning-of-work obligating events is arbitrary. A participant is either qualified or on his or her way to being qualified.

Mr. Farrell noted that the Board was taking about the obligating event and not measurement. He said intuitively he likes obligating event (2) ("threshold eligibility"; 40 quarters for Social Security) but his accounting sense points him toward (3) ("beginning of work in covered employment") because there are all these other people for which we are incurring an obligation. He said that perhaps the answer is that the obligating event is "beginning of work in covered employment," but a reliable estimate is not possible for that event and therefore you use (2) or even (1) ("full eligibility, 62 years old for Social Security). He noted that years ago such an approach for private pension accounting was labeled "cliff vesting," and that it is no longer in use. Mr. Anania and Ms. Cohen agreed that it was "cliff vesting." Mr. Farrell concluded that he could make an argument after considering all the characteristics and the Board's discussion that the obligating event is number (3), but he did not want to measure it at that point.

The Chairman said that cliff vesting is troubling him, too. He said the main part of the accrual process is to record costs over the period they are being incurred, and to wait until you are on the edge of the cliff means you are going to have nothing recorded during the time you are getting to the cliff.

Mr. Farrell said that it is very difficult to project the future salaries of a 15-year old over the next 40 quarters. He said a reliable estimate is much easier with respect to an older person who has attained 40 quarters and especially for 62-year olds. The Chairman noted that the Social Security actuaries are doing that now. Ms. Comes added that such projections would be subject to audit in two years. Mr. Farrell noted that all the auditors would be doing was auditing the various actuarial methods currently used.

Mr. Dacey said he wanted to raise a question for the members. He noted that the consolidated Statement of Social Insurance (SOSI) will be reporting a $37 trillion open group amount for FY 2004 and will also show the closed group and beneficiary amounts. He asked what is the Board's objective in trying to decide what component of that is a liability. He noted that the total cost of the new Medicare prescription drug benefit is given a present value of $ 8 trillion or so on the FY 2004 SOSI, and so the question is: is that the cost of our decision or is it some subset of that? He said he is struggling with what the liability is supposed to represent.

Mr. Reid said the thing that strikes him is that we have a sustainability computation that does a very good job of answering the sustainability question; and maybe it does a good job also with the "what if" analysis. But from a cost perspective, there were unanswered questions, e.g., what is the annual cost for programs should be reported on the statement of net cost? And how does that affect the operations of the entire Government for 2004? Mr. Reid said sustainability computation is not useful in answering these questions. He said the cost measure is a very different concept than what might be viewed from a sustainability standpoint. For cost viewed from an accounting perspective, he said one would ask, for example, whether all revenue over the next 75 years ought to be included in the measure. He said there are a lot of questions to be answered with respect to cost. He said the important question is what affect do these programs have on cost.

Mr. Dacey said that that was part of this question. He asked how the Board would define cost for the Social Security program?

Mr. Reid said he thought in the final analysis that the cost will be the change in the liability.

Mr. Dacey said he is trying to understand the objective. He said if we have a number that says the change in total expected 75-year "cost" or the expected excess of spending over receipts is 13 trillion dollars, but our net cost in our current statements is let's say $4 trillion – is that confusing? He said that was his question. He said he was not saying it would be confusing but it seemed that the members were arguing for something less than that to be put on the balance sheet and the statement of net cost.

The Chairman said that the reason he pointed out the financial statement example in the Clippings this morning was that he liked the layers of disclosure there, and he would like to see the SOSI be more along those lines. He said some of those layers would not meet the liability definition, and what the Board was really looking for was an amount to recognize on the balance sheet that met a liability definition and recognition criteria. He said a balance sheet or statement of financial position ought to include all the things that meet the recognition criteria.

Mr. Reid added that one of those recognition criteria is the "has occurred" concept.

Mr. Dacey said that perhaps this approach would mean that the Board would have to decide as accountants that his son is less likely to get Social Security than his parents or he. He said he was not sure he was qualified to make that judgment. He said he was trying to answer the question as to the purpose of the reporting. He noted there would be two numbers that might be referred to as "cost" showing up in the statements.

Mr. Reid said we would have to be very clear about that, especially if the sustainability discussion is retained.

Regarding Mr. Reid's point on cost, Mr. Zavada noted we currently have a situation where the liability for veterans compensation creates material swings in net cost from year to year, and if we go to a liability for Social Security that would be a larger number with greater swings from year to year. What you could end up with is a net cost number that is not representative of what your costs are.

Mr. Reid said that that was one of the reasons for the Social Security project and he had been very clear that we need to separate the impact of changes in assumptions from what would be viewed as the normal cost. He said certain costs should go through the operating statement because they are the cost of this year. However, changes in the liability due to assumption changes, which presumably for Social Security and Medicare are fewer and farther between [than for veterans], would go somewhere else in the statements. He said that if this concept is applied to Social Security and Medicare it should be extended to all actuarially computed programs. He noted the impact of actuarial changes on current reporting. He said the MD&A in the current USGFR explains the impact.

The Board discussed the problem of objective actuarial assumptions and their effect.

Mr. Patton noted that the effect of changes in assumptions varies depending on which obligating event is chosen. He also noted that the amount of discretion varies depending on obligating event. He concluded the obligating event (1) ("full eligibility, 62 years old for Social Security") is the first time there is little or no discretion.

Mr. Anania mentioned that literature he has read suggests that the accounting information is as much in the disclosures as in the statements. He said he thought that, whatever the Board comes up with, the reader will have to read the notes; also, the sustainability and other information would be important. He said that the Board should get as much in the statements as the members' concepts and belief system tells them should be there, to deal with that as best as it can, and the rest of the story has to come in the notes and supplemental information.

Mr. Reid said all the alternative numbers could be provided in the reporting. The Chairman agreed.

The Chairman asked staff to come back with an analysis of the obligating events, assuming the members were comfortable with the three obligating events in the staff memorandum. He said in would be helpful to have some numbers to compare the relative magnitude of the options.

Staff indicated also that the characteristics would be re-shaped and possibly a few could be deleted.

Mr. Reid asked that, for each of the three obligating events, when pros and cons are discussed, to talk about impact on potential cost determination. For example, what one alternative would do versus others. He noted the discussion of measurement and said it would be helpful to see what the effects would be for a given year on the total value of the liability, at least in terms of pluses and minuses if not with actual numbers.

Ms. Comes asked if the members thought it would be helpful to see six or seven of the historical Social Security program changes in terms of the impact from an accrual versus cash accounting perspective for each of the three obligating events. She said a previous FASAB staff analysis of the changes from an accrual versus a cash accounting perspective was available and could be adapted. Mr. Reid asked whether the staff had that data. Ms. Comes said she had the list of changes but they were not quantified. Ms. Robinson said that SSA would have the 75-year projection of the effect.

The Chairman said that staff ought to approach the work in terms of the point Mr. Patton made about having little or no discretion and also from the other side concerning reasonableness of the expectations. He said these were two sides of the same coin, one side being that of the promisor and the other the promisee; but they interact.

Mr. Reid said the flip side of what Mr. Patton stated is computational risk. The closer one gets to the end of the payment the more likely the payment and the less discretion. But the further away one gets from the payment the more risk that the computation will be unreasonable.

Ms. Robinson said that that was a measurement issue, not a definitional issue about discretion. Mr. Reid agreed. She said if one accepts the argument that current law governs, then there is no discretion: as long as current law is unchanged it must be carried out. She said it did not matter how far in the future the payment is. The only discretion one can exercise is to change the law.

Mr. Patton said there would be much higher probability in 50 years than in zero years.

Ms. Robinson asked if current law would become less and less binding over time.

Mr. Reid said the definition issue was pass/fail. He said measurement questions involved a broad spectrum that you can work with.

With respect to the 8 characteristics listed on page two of the staff memorandum, Mr. Patton asked whether any Board member besides himself believe any one characteristics was necessary to say there is a liability – not sufficient but just necessary in the sense that if it were not there you would not have a liability.

Messrs. Schumacher and Anania mentioned eligibility.

Mr. Patton concluded that characteristic 1 (eligibility) was necessary, maybe not sufficient but at least necessary. He asked if there were any other necessary characteristics.

The Chairman mentioned characteristic 6 (participants are performing).

The Board discussed whether eligibility could encompass all three of the obligating events.

Ms. Wardlow said it depends on how you look at eligibility. She said if you take a broad view of eligibility, as she discussed in her paper from the point of view of conditions that have to be met, eligibility requirement number one is that you work in covered employment, and the longer you work you more benefits you accumulate. The accumulation starts when one starts working and making the mandatory payments, along with one’s employer, into the program.

Mr. Patton said one is not eligible as soon as one starts working.

Ms. Wardlow said Mr. Patton is interpreting eligibility to mean that the participant has accumulated 40 quarters or has attained 62 years of age.

Mr. Patton said that characteristic 1 states that conditions once met qualify participants to receive a benefit without further conditions being required.

Ms. Wardlow said that there is a broader view of eligibility where all of the conditions that need to be met are considered and a determination is made as to how many of those conditions are needed to cross the liability threshold. She said this is preferable to just ignoring the work in covered employment before 40 quarters.

Mr. Patton said that the characteristic proposed says "without further conditions being required," and further conditions are required until 40 quarters or age 62. He said the broader notion of eligibility that Ms. Wardlow was espousing might be another concept.

Chairman Mosso mentioned the matching concept whereby the Government is taking in revenue from day one and we are taking about not recognizing cost until some time after the revenue has been counted so we are not matching the cost with the revenue.

CONCLUSION

The staff will

- Re-shape the characteristics to reflect the members' comments.

- Provide an analysis of the three obligating events on page 27 of the staff memorandum addressing the pros and cons for each event. Numbers will be provided where possible to compare the relative magnitude of the options.

- Address the impact of the three obligating events on potential cost determination when discussing the pros and cons. For example, the staff will illustrate what the effects would be for a given year on the total value of the liability, at least in terms of pluses and minuses if not with actual numbers.

Staff will approach the work in terms of the point Mr. Patton made about having little or no discretion and also from the other side concerning reasonableness of the expectations.

- **Fiduciary Activities**

<u>Introduction</u>

At the October 2004 Board Meeting, the Board requested that staff provide information about the criteria used by the Treasury Financial Management Service (FMS) to establish "deposit funds," in which many fiduciary and fiduciary-like activities are reported. The Board also asked staff to develop three alternative methods for reporting on fiduciary activities for staff to analyze.

Treasury FMS Criteria for Deposit Funds

Staff noted that the description and staff analysis for the deposit fund criteria were included in the Board's December briefing materials. Staff noted that since the deposit fund criteria met the definition of fiduciary activities and provided no conflicts, Chairman Mosso had recommended that the Board's discussion should move directly to the consideration of the alternative methods for reporting on fiduciary activities.

Alternative Methods for Financial Reporting

Staff provided a brief description of the three alternative methods that the Board identified at the October 2004 meeting for staff research and analysis. The three alternatives were:

1. Certain fiduciary assets reported on the component agency's balance sheet and all fiduciary flows and assets/liabilities reported in a note disclosure

2. All fiduciary flows and assets/liabilities reported in a note disclosure

3. All fiduciary flows and assets/liabilities reported on a separate principal financial statement.

Staff asked the Board to direct its attention to Alternative 3 (separate principal financial statement) and briefly reviewed the pros and cons for Alternative 3. Staff recommended that Alternative 3 would best address the reporting objectives of operating performance and systems and control and would provide the highest level of accountability for fiduciary activities.

Mr. Schumacher asked where Treasury FMS Category 1 activities[4] are currently reported. Staff replied that current standards required this category to be included in the component entity's principal financial statements. Mr. Schumacher asked how the proposal would change that. Staff replied that for this category, Alternative 3 would not make much of a change. Staff noted that although this category of funds meets the definition criteria for fiduciary activities, the Board's primary intended scope for the fiduciary activities exposure draft (ED) was Treasury FMS Category 3.[5] Staff noted that Alternative 3 would change the reporting requirements for Category 3 by requiring a separate principal financial statement.

---

[4] "Monies withheld from Government payments for goods and services received. Agencies may treat this transaction as a deposit fund liability only when they have charged a budget account and the Government is holding the funds pending payment (for example, payroll deductions for savings bonds or State income taxes)." See 1 TFM 2, Section 1535 for descriptions of all three Treasury FMS categories of deposit funds.

[5] "Deposits received from outside sources for which the Government is acting solely as a banker, fiscal agent, or custodian. This includes certain cash and investments held outside of Treasury." Ibid.

Accountability and Audit Coverage

Mr. Reid questioned whether a principal financial statement would result in more accountability than a note disclosure. Mr. Reid said that a note disclosure would also be subject to audit. He said that a separate principal financial statement might be misunderstood in that readers might conclude that the fiduciary assets belonged to the Federal government. Staff replied that with Alternatives 1 and 2, there would be financial information that did not relate to any of the line items in any of the financial statements. Mr. Reid said that he understood that, but that the same information would be reported; "it's simply geography" in terms of whether they would be reported in a financial statement or in a note disclosure. Staff replied that it would be a question of how a reader could find the information if it were not displayed in any of the principal financial statements. Staff noted that under Alternative 2, none of the fiduciary assets or flows would be reported in any of the financial statements. Problem number one would be where to put the note. The reader would have a difficult time knowing where to look for the information if it were not reported in any of the financial statements.[6] Problem number two would be how to get auditors to apply the same rigor that they would apply to a principal financial statement.

Mr. Reid said that he would let Mr. Dacey speak to the audit issue. He said he did not agree that the information would be less reliable or that readers would not be able to find it in the report.

Placement and Format of Information

Mr. Anania said that the information can be included in the notes in a form that looks like a financial statement. He noted that he was not saying that he supported the alternative suggested by Mr. Reid. Mr. Anania referred to certain notes in the oil and gas industry that resembled financial statements.

Mr. Mosso pointed out that the note disclosures for oil and gas related to line items in the financial statements, and that Alternative 2, which Mr. Reid was supporting, would not do so.

Mr. Reid said that you could even put a line item in the financial statements that said, "Fiduciary Activities- Note 7," as is done with a number of other things, except that there would be no balance on the line item.

Treasury FMS Category 1 (Withholdings)

Dr. Robinson referred to Treasury FMS Category 1 activities, and asked staff to confirm that they were currently reflected in the principal financial statements. Staff replied that

[6] Staff noted in the December briefing materials that the Office of Management and Budget (OMB) Bulletin 01-09, Form and Content of Agency Financial Statements, currently lists 39 standard note disclosures to the financial statements.

they should be; the assets would be reported on the balance sheet as non-entity assets with an offsetting liability. Mr. Farrell asked if this would continue under the three alternatives. Staff replied that this would continue only under Alternative 1. Dr. Robinson asked if Alternative 3 would be a lot more work for agencies to put this activity (Treasury FMS Category 1) on a separate financial statement, or whether it would be the same in terms of cost/benefit. Staff replied that Alternative 3 would not have much of an impact on Category 1, but that staff would like to further research the actual activities in all three Treasury categories and report back to the Board at the next Board meeting. Staff did mention that only the central payroll agencies would be expected to have large balances for this category of activity. Staff said that any agencies that might have large unidentified balances in those deposit funds might have to do more work to research and correct the amounts, but that was extra work that should be done.

Mr. Reid said that Treasury Category 1 amounts would be removed from the balance sheet under Alternative 2, and that would be a major change.

Mr. Reid asked if there were any precedents for treating this category as fiduciary activity. Ms. Comes replied that in the Government Accounting Standards Board (GASB) model (state and local government sector), funds similar to Treasury Category 1 were considered fiduciary funds and asked Ms. Wardlow to confirm. Ms. Wardlow confirmed that similar funds, called agency funds, were used to collect payroll withholdings due to others and were categorized as fiduciary funds. Ms. Wardlow noted that agency funds were reported as assets with an equal offsetting liability, whereas other fiduciary funds such as trusts were more long-term and reported with an equity balance, with the equity being the amount available for distribution to the beneficiaries.

Ms. Comes noted that staff had discussed the possibility of excluding Treasury Category 1 from the proposed fiduciary reporting requirements, and that it appeared to be a matter of preference or significance as to whether they were excluded or not. Ms. Comes noted that staff planned to obtain additional information about this category, but that it was a possibility that the Board might wish to exclude this category from the proposed reporting requirements.

Materiality

Ms. Comes commented on an item in the briefing materials for Alternative 3 regarding whether the audit community might need to issue guidance regarding the audit opinion. When the GASB issued Statement 34, the communities had a dialogue that resulted in the issuance of audit guidance that included "opinion units" for fund reporting, including fiduciary fund reporting. To a certain extent, this would be a "pro" for Alternative 3, in cases where a large agency has significant fiduciary activity that might be immaterial relative to the agency's non-fiduciary activity. Such audit guidance, if issued, would likely cause fiduciary activity reported in a principal financial statement to receive more audit scrutiny than if it were reported in a note disclosure. Mr. Mosso agreed that to evaluate materiality for fiduciary activity using the same materiality levels as operating activity seemed inappropriate.

Mr. Reid asked Mr. Dacey if there is currently a requirement to do such a computation for materiality in current audit guidance. Mr. Dacey replied that it would have to go through the same process of thought that was used for social insurance, which has a statement that is not articulated in the financial statements,[7] and if the audit opinion is on the financial statements taken as a whole, how the non-articulated statement enters into that calculation. Mr. Dacey said that it would be presumptuous in advance of such a process to say what the result would be. Mr. Dacey noted that in the case of GASB 34, the audit community had asked how GASB viewed materiality so that audits could be performed using an appropriate level of materiality for the various financial statements.

Mr. Reid said that the Government Accountability Office (GAO) current audit guidance does not appear to make any distinction among the Federal financial statements in terms of materiality. Mr. Dacey said that there could be some independent judgments made based upon the audit guidance- for example, to base materiality for social insurance upon materiality to the Statement of Social Insurance, and not other statements, in particular because it does not articulate to the other statements. Mr. Dacey noted that the Statement of Social Insurance would have larger numbers, and likely a larger materiality threshold, than the other financial statements, whereas the proposed fiduciary statement would generally have smaller numbers. Accordingly, it would not be appropriate to use the same level of materiality for the Statement of Social Insurance as for the other statements. To summarize the answer to Mr. Reid's question, Mr. Dacey said yes, such an audit discussion would certainly be possible.

Non-Articulated Financial Statements[8]

Mr. Anania said that it is a fairly high hurdle to take information that is currently in the financial statements and to put it into a new principal financial statement that does not articulate. He said that the Board should be very clear on why it wanted to do this. Mr. Anania said that he recalled that in the past the Board once discussed the Statement of Custodial Activity. He said that Alternative 3 would set up a new statement that resembled the Custodial statement. Staff responded that the new statement would have some similarities, but that the Custodial statement is designed to be purely intra-governmental.[9] Mr. Schumacher pointed out that the same "high hurdle" existed for Alternative 2, if you were going to take the information and put it in a note.

---

[7] A "non-articulated" financial statement is one that does not directly relate to changes in the line items of the agency's balance sheet. If fiduciary activity were moved from the balance sheet and/or note disclosures to a separate financial statement, the resulting financial statement would be a "non-articulated" statement.

[8] See note 4, above.

[9] "Intra-governmental" means that the activities are between or among Federal component entities, and would be eliminated in the consolidation process.

Pros and Cons of Reporting Fiduciary Elements on the Balance Sheet

Mr. Reid said that, at a minimum, there ought to be two parts to Alternative 2: one would be to leave on the balance sheet what is currently reported there, such as payroll withholdings, and report the rest in a note. Ms. Comes noted that other items besides payroll withholdings are currently required to be reported on the balance sheet; for example, seized monetary instruments are currently required by SFFAS 3 to be reported as seized assets on the balance sheet with an offsetting liability; the justification was enhanced control and audit coverage. If the Board pursued Alternative 2, those items would have to come off the balance sheet. However, there is an argument that could be made conceptually, that payroll withholdings are a part of operations.

Mr. Reid agreed that you could easily say that payroll withholdings are an element of the government's cost of operations. Staff agreed.

Staff said that in answer to Mr. Anania's first question, the Board might consider a reference item in the December briefing materials: a discussion at the March 2004 Board meeting on the topic of financial statement elements, where the Board had appeared to concur that non-entity assets should not be reported on the balance sheet. Staff noted that there was an additional reference item in the briefing materials, where a former Board member had argued that non-entity assets lacked an essential quality of an asset, in that the future benefits of the assets would not flow to the entity.

Dr. Robinson said that the question of misleading users of the financial statements by including non-entity assets was an important one. Mr. Anania noted that most of the Board members had moved away from the original fiduciary exposure draft, and were trying to find a solution so that a new exposure draft could go out.

Dr. Robinson said that she supported the solution in Alternative 3, with the possible exception of Treasury Category 1. She said that she supported the idea of having a wholly separate, non-articulated statement because that was precisely what was appropriate for fiduciary activities.

Mr. Schumacher asked Mr. Anania whether his only objection to Alternative 3 was taking assets off the balance sheet. Mr. Anania replied that there were two issues that he was still considering. One issue is taking items off the balance sheet. The other issue related to an issue he expressed in the Alternative View that he wrote when the Board addressed social insurance: he does not like statements that do not articulate. He said that he is concerned about the impact of non-articulated statements upon the understandability of the financial statements in assessing the performance of the Federal government.

Mr. Farrell said that he would not support taking the Treasury Category 1 items such as payroll withholdings off the balance sheet, because they were clearly related to operations. He said that he preferred Alternative 2 to Alternative 3 because he did not feel that fiduciary activities warranted a separate financial statement. He said that it appeared to him that instead of having the Required Supplementary Stewardship Information (RSSI) category, the Board was simply adding new statements. Dr. Robinson pointed out that there were also currently 39 note disclosures. Mr. Farrell asked whether the information could be included in Required Supplementary Information (RSI). He said that audit requirements were not the Board's responsibility. Mr. Mosso said that if the information appears anywhere in the financial statements, including the note disclosures, the audit question would not be an issue. Mr. Farrell said that agencies could display a very detailed note disclosure that looked like a financial statement but appeared as a note. He said that you could also have a more condensed note disclosure, and refer the reader to the RSI section for more detailed information.

Note Disclosures Unrelated to Financial Statement Amounts

Dr. Robinson said that the note disclosures were supposed to explain items that are reported in the financial statements. Mr. Farrell said that contingencies are not reported on the financial statements, but are disclosed in the note disclosures. Dr. Robinson said that contingencies could affect the financial statements, but that fiduciary activities could never affect the financial statements.

Overall Materiality of Federal Fiduciary Activity

Staff noted that the largest category was Treasury Category 3, with the TSP "G fund" being the largest at $56.4 billion. Staff noted that the TSP fund was audited, but that the administrative agency, the Federal Retirement Thrift Investment Board, is currently not audited and is not included in the U.S. Government-wide financial statements.

Mr. Patton said that it seemed to him that the audience for the fiduciary information is limited. He said that an additional financial statement might be distracting, and that an interested reader should be able to find a note disclosure that describes the information. He said that he preferred Alternative 2. Staff noted that if in the future there were individual Social Security accounts, those accounts would fall under the criteria of fiduciary activity.

Mr. Reid noted that the Thrift Savings Fund is not consolidated in the U.S. government-wide reports, and that the largest fiduciary item included in the consolidated reports might be the Indian Trust Funds. Staff said that the next largest activity would be the Department of Defense (DoD) foreign military sales, and named five other activities that were larger in dollar amounts than the Indian Trust Funds. Mr. Reid compared the dollar amounts with government-wide operations and suggested that Mr. Farrell's approach with a summary note disclosure with additional RSI might be the most appropriate treatment for fiduciary activities. Staff noted that the dollar amounts included only amounts held in the U.S. Treasury, and that the total dollar amounts were much larger than the amounts held in the U.S. Treasury. Staff also noted that the Federal Retirement Thrift Investment Board was in the budget. The senior support staff for the Office of Management and Budget (OMB) member noted that being in the budget was a “conclusive criteria “for being subject to FASAB requirements and included in the U.S. Government-wide financial statements.

Dr. Robinson noted that the list of deposit funds included some that might be considered problematic. Mr. Reid said that he was not sure that reporting requirements would change that. Staff noted that currently the DoD was reporting foreign military sales in the Statement of Custodial Activity in compliance with a 1998 agreement between the OMB Deputy Controller, the DoD Inspector General and the Deputy Chief Financial Officer. Staff noted that the DoD intends to comply with whatever the Board determines to be the appropriate reporting for fiduciary activities.

Mr. Mosso said that it does not seem likely that fiduciary funds, which are not agency funds, receive the level of audit attention that operating activities receive. He said that getting them separated so that they receive some individual attention is very important.

Objectives for Fiduciary Reporting Standards

Mr. Dacey said that he is wondering what the end goal of the reporting standards should be, since fiduciary activities do not appear to be material in terms of the government-wide financial statements. He said that he was not sure how much audit attention fiduciary activities would receive, whether they were in the note disclosures or in a separate statement. Mr. Reid said that in terms of the big picture, it seemed to make more sense to have a summary note disclosure with additional information in RSI. He noted that it might not be material in terms of the agency report. Staff noted that the total deposit funds at the end of 2004 were $81 billion, and that some of the largest amounts, such as foreign military sales and the other funds within the Thrift Savings Fund, were not held in deposit funds. Staff noted that agencies are not required to use deposit funds for fiduciary activities. Staff noted that fiduciary activities (using the definition criteria) appear to exceed the non-fiduciary amounts that some Federal agencies report on their balance sheets.

Accountability to Beneficiaries

Mr. Patton said that although the audience for fiduciary activities might be limited, the information is very important for those individuals, and that fiduciary accountability is an important issue. He said that it would not be appropriate to relegate the detailed information to RSI, which has much less audit scrutiny than the financial statements. He said that this would not meet the objectives of Federal financial reporting. He said that Alternative 2 is a better solution than reporting in the RSI.

Mr. Anania asked if federal accounting principles require a note disclosure discussing the entity’s accounting principles to help the reader understand the financial statements. Ms. Comes replied that FASAB standards do not have such a requirement, but that the OMB’s Form and Content does require this. Mr. Anania asked if there was any way to require a reference to fiduciary information in Note 1, so that the fiduciary note would be easier for the reader to find. This would mitigate somewhat the issue of the information being “buried in the notes.” Mr. Dacey said that this might be accomplished by requiring that it be contained in the Summary of Significant Accounting Policies note disclosure. Mr. Dacey said that it would be good to communicate some information about how agencies maintain accountability for fiduciary funds—for example, if some of the fiduciary funds are separately audited. He said that the Board had discussed this concept regarding heritage assets.

Mr. Mosso asked to clarify a point on the options for dealing with withheld payroll amounts. Staff said that Alternative 1 required those amounts to be reported as assets with an offsetting liability, and that the Board could retain this treatment even under the other alternatives by excluding this category. Staff said that this would be preferable to removing this category from the balance sheet.

Current Requirements

Mr. Reid asked whether an asset is currently reported. Staff replied that current standards require an asset with an offsetting liability.[10] Mr. Dacey asked whether the asset was segregated from entity assets in the financial statements. Staff replied that the distinction between entity and non-entity assets is displayed in a note disclosure, in accordance with the OMB's Form and Content instructions. Mr. Dacey said that it would be impractical to remove non-entity Fund Balance with Treasury from the balance sheet. He said that recognizing a liability would be the most appropriate treatment.

Mr. Reid said that he did not know how the central payroll agencies actually reported deposit funds. Ms. Comes said that it would beneficial if staff could research this question and report back to the Board at the next meeting. Mr. Reid agreed.

Preference for Alternative 2 (Reporting in a Note Disclosure)

Mr. Mosso suggested that the Board postpone discussion of this category until the next meeting, and direct its attention to the other categories. He asked the Board members could concur on an initial preference for reporting on the other two categories. The three alternatives presented in the briefing materials were:

- Alternative 1: The original exposure draft, with certain fiduciary assets reported on the balance sheet with an offsetting liability, and all fiduciary assets reported in a note disclosure.

- Alternative 2: Fiduciary assets excluded from the balance sheet, and all fiduciary assets reported in a note disclosure.

[10] Paragraph 26 of SFFAS 1 states that, "Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements. Non-entity assets reported in an entity's financial statements should be segregated from the entity's assets. An amount equal to non-entity assets should be recognized as a liability (due to Treasury or other entities) in the entity's financial statements."

- Alternative 3: Fiduciary assets excluded from the balance sheet and reported in a separate principal financial statement.

A majority of the Board members indicated initial support for Alternative 2. Mr. Mosso, who indicated support for Alternative 3, asked if the Board would be agreeable to requiring the note to have a format resembling a financial statement. A majority of the Board members indicated some level of support for a structured note or schedule.

Dr. Robinson asked if Alternative 2 would require materiality to be set at the level of the operating statements. Ms. Comes pointed out that SFFAS 7 sets materiality for "dedicated collections" as "material either to the reporting entity or to the beneficiary or contributors."[11] Mr. Dacey said that the fiduciary standard could stress the qualitative aspects of materiality.

> **CONCLUSION:** Mr. Schumacher said that he would like staff to suggest alternative methods of referencing the fiduciary note disclosure—for example, as a note to the balance sheet, or a line item without an amount.
>
> Mr. Mosso requested that the next meeting:
>
> - A mockup of the statement/schedule for a fiduciary note disclosure
> - Information and recommendations about how payroll withholdings held in deposit funds actually appear in agency-level financial statements
> - Information about additional deposit funds, such as negative balance funds.

Adjournment
The meeting adjourned at 4:50 PM

Thursday, December 16, 2004

Agenda Topics

- **Inter-entity Cost Public Hearing**

<u>Summary of Testimony Provided by Dan Fletcher, Department of Interior (DOI)</u>

Mr. Mosso introduced Mr. Fletcher accompanied by Debra Carey. Mr. Fletcher thanked Mr. Mosso and began his testimony by stating that while the proposed change to

[11] SFFAS 7, Paragraph 84.

SFFAS No. 4 is not a new issue, it is very complex and presents a significant concern to DOI.

Mr. Fletcher said that instead of presenting any new or novel ideas, he would like to focus on some tried and true points raised by others. In addition, he pointed out that cost/benefit constraints should always be looked at and is an underlying principle of DOI's position.

Mr. Fletcher stated that DOI does not concur with the proposal in the Exposure Draft to rescind paragraph 110 and a portion of paragraph 111. He said they agree with the dissenting opinion by Mr. Reid for a number of reasons, most notably because it addresses cost benefit constraints.

Mr. Fletcher noted that DOI has concerns that DOI will spend a lot of energy looking for imputed and other inter-entity costs, be involved in constant debates with their auditors, and wonder whether they are sufficient in their search for these types of costs.

Mr. Fletcher referred to the specific examples provided in his prepared testimony and stated that he is reminded consistently by their auditors that "materiality" is an auditor term, not an accounting term. Therefore, he feels that, going with a principle of conservatism, DOI could be pushed to sufficient levels of disagreement with their auditors over whether something is immaterial but have no basis to support their argument.

Mr. Fletcher provided the following suggestions on how to make the guidance more beneficial for DOI and the rest of the federal agencies:

- Recommend that the following actions be taken by OMB, in their original role provided by SFFAS #4:
    1. Establish a task force or committee to publish case studies illustrating costs that should and should not be imputed; and
    2. Establish a dollar threshold, such as 5% of total costs, with the provision that an agency not be required to seek out, research or report potential imputed costs under that amount.
- Develop a mechanism for identification of highly significant costs that should be imputed;
- Set up a clearance process for questions raised by auditors or other 3rd parties in order to have a way to resolve issues in a timely manner, including those that often seem to come up at the last minute.

Mr. Fletcher turned his discussion to the topic of reimbursable agreements. He noted that while he understands that the use of reimbursable agreements could solve a lot of issues related to inter-entity costs, he is not convinced that the use of reimbursable agreements would be a solution. Mr. Fletcher stated that there are real, out of pocket costs associated with the establishment and management of reimbursable agreements. In addition, Congressional direction and other management considerations have to be considered in establishing additional reimbursable agreements. Thus, reimbursable agreements, while useful when appropriate, are not a one-size-fits-all solution.

Mr. Fletcher said in closing that DOI does support the identification and reporting of the full cost of agency operations, but they believe that there should continue to be a role for OMB as the "captain of the ship" in establishing consistent direction, communication, and cooperation across government. Mr. Fletcher thanked the Board for the opportunity to provide comment.

Board Discussion/Questions to DOI

Mr. Mosso thanked Mr. Fletcher for his comments and asked him who is the financial statement auditor for DOI. Mr. Fletcher stated that KPMG is the auditor for all of DOI. Mr. Mosso then asked Mr. Fletcher if any of his concerns had been resolved by the proposed staff plan for AAPC to resolve any implementation problems, rather than OMB. Mr. Fletcher responded that OMB has been an "effective broker" in the past in helping resolve other issues that DOI has had to deal with. He went on to state that, while he feels AAPC could be used as a technical reference, as far as a "manager of the process," DOI would look to OMB.

Ms. Loughan pointed out that the draft plan has a provision for AAPC case studies to be forwarded to OMB. Mr. Anania commented that OMB would not "get out" of the process; they would remain involved to answer questions, provide consistency, and so on. Mr. Anania summarized that he felt DOI would prefer to go back to the way things were, apply the alternative view, and allow OMB to have a broader role. Mr. Fletcher concurred with that summarization.

Mr. Anania questioned if anyone has formally asked OMB what it thinks about providing assistance on inter-entity costing. Mr. Zavada replied that OMB would address any individual issues that were brought to them by agencies like they do with other issues. Mr. Anania asked Mr. Zavada if he was aware of any issues that are with OMB right now; Mr. Zavada responded "no." Mr. Fletcher said they have used OMB in the past to help resolve several inter-entity related issues and OMB has been an effective "icebreaker" in getting the process moving, bringing all parties to the table, and getting the issue resolved.

Mr. Zavada said he felt the process being proposed by staff could be used to identify any candidates that need to be addressed, but to date he is not aware of any specific issues that have been raised.

Ms. Robinson asked Mr. Fletcher if he only deals with full costing for accounting or if he also deals with full costing for budget purposes and whether he has any examples of conflicts between the different kinds of cost accounting taking place. Mr. Fletcher says that DOI uses an activity-based costing system and, as they try to use the system to align budget and performance integration, they often debate with the budget office over whether the unit should be based on a budget basis or an accounting/cost basis.

Ms. Robinson then asked how the bureau statements are prepared and audited. Mr. Fletcher responded that each of the bureaus undergoes a full-scope audit and then each of their statements are consolidated into the Department-wide statements. Mr. Fletcher confirmed that all of the bureaus and the department are audited by KPMG. Ms. Robinson asked at what level guidance is needed from OMB – at the bureau level for allocating costs for the department's accounting system or at a higher level, such as determining fire costs from Agriculture? Mr. Fletcher responded that DOI could handle issues within the department; the interaction is needed when dealing with other agencies outside of the department.

Ms. Robinson further asked if the auditors have been involved in the process for determining how the costs for the department's accounting system would be allocated. Mr. Fletcher responded that they have had preliminary communications with the auditors on the process and believes that the auditors will look at the department's methodology with some interest.

Ms. Comes asked Mr. Fletcher if DOI had representation on the AAPC task force that addressed inter-entity costs. Ms. Carey responded that she does not believe that they did. Ms. Comes said if they had, her follow-up question would have been why they think that no case studies emerged from a yearlong process to address precisely what DOI is currently recommending, but she would not want to put them on the spot since they were not involved in the process. Mr. Fletcher said he did not have an answer to that question.

Mr. Reid asked if they had given any thought to what DOI would do to provide an auditable estimate in a case where the providing entity was not willing to cooperate by providing an imputed cost. Mr. Fletcher said they do not have a lot of instances that are large dollar where they do not have cooperation but there are a number involving smaller dollars. However, he said he does not think they have done a full enough analysis of those that do not cooperate to enable him to respond. He said they do have enough instances involving differences of opinion that could be representative of the types of problems that they would encounter.

Mr. Anania asked if DOI has a list of areas that they need to pursue further to determine if there are additional inter-entity costs that need to be captured. Mr. Anania referred to this list as a "possibles list or maybe list." Mr. Fletcher responded that they have a maybe list. Ms. Carey said that in terms of costs as a whole, they have not created a specific list; most of the relationships with other agencies are captured in either the budget allocation process (e.g., fire fund), working capital fund, or government-wide services (i.e., OPM, Justice, Labor, and Treasury).

Mr. Mosso inquired if DOI provides any non-reimbursed services to other departments to any significant extent. Ms. Carey responded that all services provided were fully reimbursed. Mr. Mosso confirmed that they would therefore not be concerned about unreimbursed costs from a provider point of view.

Mr. Schumacher asked Mr. Fletcher to expand on his earlier comment that they do not have the basis to argue that a cost is immaterial. Mr. Fletcher said there are areas where the guidance is not specific enough and they feel they would experience conflicts with the auditors on materiality but he did not have any specific examples to offer.

Mr. Dacey clarified that Mr. Fletcher felt that DOI would have trouble getting their auditors to agree on the sufficiency of their search for unreimbursed costs. He asked if Mr. Fletcher felt that this would be an area where additional guidance would be helpful? Mr. Fletcher said that is one part of how the guidance could be improved.

Ms. Carey said the problem is that without a base, DOI and their auditors would not know when they are done identifying costs. She presented an example of the costs of two Treasury personnel that come as guest speakers for two hours at DOI's annual financial managers conference. The dollars are miniscule but could still lead to identification in the search for all unreimbursed costs. She also questioned if DOI records costs, would Treasury record revenue. Ms. Carey said there are numerous examples like that where identification could need to be made if the guidance is wide open.

Mr. Reid asked if the amount that is billed to other agencies through reimbursable agreements is significant to them. Mr. Reid clarified that he is trying to get an order of magnitude of the different costs that are occurring. Ms. Carey responded that in most cases where there is significant activity, a reimbursable agreement is in place. She said she is not aware of any instances where they are receiving significant unreimbursed benefits from other government agencies aside from the common benefits (i.e., Treasury, and Justice),

Mr. Farrell asked if DOI used the five percent threshold they were proposing, (1) would they record anything, and (2) would the five percent be individual or aggregate. Mr. Fletcher said he could not provide a hard answer, but felt that while they would still record some inter-entity costs, the threshold would probably limit the amount of small, insignificant costs they would have to chase. Ms. Carey said the threshold would probably need to be at an individual level; otherwise, the agency would still have to find all of the smaller costs in order to demonstrate that the aggregate amount is beneath the threshold.

Mr. Mosso thanked Mr. Fletcher and Ms. Carey for their testimony.

<u>Summary of Testimony Provided by John D. Webster, Chief Financial Officer, Library of Congress (LOC)</u>

Mr. Webster thanked the Chairman and the Members of the Board. He then introduced Jay Miller, the Library's Financial Reports Officer. Mr. Mosso asked Mr. Webster to keep his opening comments brief in order to have time for questions.

Mr. Webster explained that in contrast to the Library's position on the Heritage Asset proposed standard, the Library agrees with the Board's assessment that the current procedure in paragraph 110 of standard number four has not made sufficient progress in the identification of additional inter-entity costs and the potential benefits provided to users from reporting the full costs of program outputs and outcomes may exceed the costs of the additional reporting requirements.

However, Mr. Webster explained that the Board must resolve the dilemma of garnering these benefits without creating an undue reporting burden and potential conflicts between Agencies and their auditors. Mr. Webster added that the Library believes that the best forum for determining inter-entity costs would be a central body to add consistency and rigor and whose purpose would be to strike the proper balance between cost and benefit, which is also needed with heritage assets. Mr. Webster explained that the Library supports the proposed centralized structure using the AAPC, OMB, and CFO Council as a good start. However, he noted that the AAPC does not currently have a representative from the legislative branch and explained that having a representative from the legislative branch would be beneficial to the Committee especially since some of the legislative branch's bodies are following the FASAB standards.

For the remainder of his statement, Mr. Webster provided the Board with several examples that demonstrate how the task of identifying and reporting inter-entity costs is complicated and potentially costly to implement. He explained that he hoped the information would be useful in finalizing the standard.

Mr. Webster explained that the first example involves the application of materiality, which the Library agrees is a very important concept that should be used to identify inter-entity costs based upon the three factors listed in statement 4--(1) significance to the receiving entity, (2) directness of relationship to receiving entity's operations, and (3) identifiability to the receiving entity.

Mr. Webster explained that because the Library is a legislative branch entity and has more flexibility than the executive branch, the Library already recognizes two inter-entity costs for goods and services provided by the Architect of the Capitol and the Government Printing Office. He added that neither of those costs are identified by the OMB as "inter-entity" costs, but the Library included them as inter-entity costs in its financial statements because the Library considered them to be "material." However, the reason why the Library considers them material differs for each situation.

Mr. Webster explained that by law, the Architect of the Capitol (the Architect) is responsible for the structural and mechanical care of the Library's buildings and grounds. The Architect is appropriated separate, identifiable funds to support these services. As a result of this arrangement, the Library does not recognize its buildings and grounds on its financial statements. Mr. Webster explained that the Architect had just completed its first published financial statement under the FASAB standards. Mr.

Webster explained that annually the Library asks the Architect what the cost of caring for those buildings were so that it could be recognized as an inter-entity cost. He added that the cost to Library is considered significant; during fiscal 2004, the Architect provided 37.2 million dollars of support for Library buildings and grounds. Mr. Webster explained that the inter-entity cost was included on the Library's financial statements because of its significance to overall costs (the first factor in determining materiality).

Mr. Webster explained that the next example, the Library's recording of inter-entity Government Printing Office (GPO) costs, is more complicated. Mr. Webster explained that during fiscal 2004, the Library received about $800,000 from the GPO in materials and services to support the international exchange program and the building of the Library's collections. He added that the GPO gets an appropriation to print extra copies of government documents to send internationally on the Library's behalf and in return, those international entities also send the Library their similar information for free.

Mr. Webster explained that although the amount is not material, the Library included this inter-entity cost because it meets the second factor in determining materiality, "directness to the receiving entity's operations." While the factor states "directness to the receiving entity's operations," Mr. Webster explained that the Library believes that "directness to the receiving entity's mission" would be more appropriate and meaningful wording, as the GPO materials and services are essential to the Library's mission of collecting official governmental materials from other nations. Mr. Webster explained that although the costs are not material to the Library's statements, the costs are important to the Library for budgeting and reporting purposes.

Mr. Webster noted that the recognition of the Architect and GPO inter-entity costs has been successful because the Library, the Architect, and GPO are members of the Legislative Branch Financial Management Council. He explained that the Library's membership and participation in this council have been instrumental in providing the cooperation and exchange of information needed to obtain the inter-entity cost data. Mr. Webster explained that the Library would like to use its experience as an example to further support the Board's direction of a central structure to determine guidance on inter-entity costs and to vet the issues.

Mr. Webster noted that as mentioned earlier by another individual testifying, the Library does not believe that a flat five percent threshold would be appropriate. Instead, Mr. Webster explained that the Library suggests that different thresholds for materiality may apply depending upon which of the three factors for materiality seem most relevant. He added that for example, perhaps higher materiality thresholds may apply for inter-entity costs that seem administrative and infrastructure-related. Mr. Webster explained that the Library recognized the Architect's costs because the costs are so large and management and other stakeholders would not be adequately informed about the Library full costs without including how much it costs to operate the Library's building and grounds. Mr. Webster explained that lower materiality thresholds may apply for inter-entity costs that seem to be mission-related, which is why the Library recognizes GPO costs.

Mr. Webster explained an even more complicated example--costs for security services. He explained that the Library has a dedicated police force whose annual costs exceed 11 million dollars. He noted that the Library's police force has jurisdiction over its buildings, grounds, and collections, but the Library also receives security and policing services from the U.S. Capitol Police.

Mr. Webster explained that the U.S. Capitol Police is a separate, independent legislative branch agency with broad jurisdiction over a number of agencies. The Capitol Police provides security to primarily the Capitol Hill complex, which includes the Library's three major buildings. Mr. Webster explained that currently, the Library does not recognize inter-entity costs for the security services provided by the Capitol Police. Mr. Webster explained that the Congress is deliberating on a merger of the Library's police force with the Capitol Police, including a corresponding transfer of the Library Police budget to the Capitol Police budget. If this merger occurs, the Library will have to consider whether the security services of the Capitol Police should be an inter-entity cost and the Library may encounter difficulty in splitting the services provided to the Library from the total services provided by the Capitol Police.

Mr. Webster explained that to the best of his knowledge, no legislative branch agency recognizes inter-entity costs for the Capitol Police on its financial statements (this includes the Congressional Budget Office, Architect, and the House of Representatives). He explained that the Library suggests that the AAPC consider security costs in its implementation guidance, perhaps even as a cost considered broad and general in nature. Inter-entity security costs may meet the first factor of significance, but the other two factors of directness to entity's operations or identifiably may not be applicable.

Mr. Webster explained that the next example is partnering relationships between agencies. The Library administers a free national reading program for the blind in partnership with state and local governments and the U.S. Postal Service [the program is called the National Library Service for the Blind and Physically Handicapped]. He explained that Braille and audio materials are circulated to eligible borrowers in the United States by postage-free mail. Mr. Webster explained that the partnership works as follows: First, the Library provides the machines and reading materials to the State and Local governments. Second, the State and Local governments administer the program by determining eligibility and loaning out the machines and the materials to the program recipients. Third, the U.S. Postal Service provides free postage for the machines and materials between all parties, for which it receives a separate appropriation from the Congress for this and other blind related mailings. The Library considers the State and Local governments and the Postal Service as its partners in implementing this program and does not consider their costs as inter-entity costs. Mr. Webster explained that the Library suggests that the AAPC consider providing implementation guidance to distinguish between situations where in one case an agency provides goods and services to another agency and in another case where two agencies partner together to implement a program.

Finally, he added that the Library requests that the FASAB provide implementation guidance on the use of cost data provided by agencies who follow GAAP, other than that promulgated by FASAB. Mr. Webster explained that the House of Representatives, GPO, and the Postal Service all follow GAAP promulgated by the Financial Accounting Standards Board. He explained that he believed implementation guidance should include all requirements for reconciliation, disclosure, and documentation of non-FASAB cost data.

Mr. Webster stated that both he and Mr. Miller would welcome any questions the members might have.

Board Discussion/Questions to LOC

Mr. Mosso asked Mr. Webster if the Library would be willing to voluntarily follow the arrangement that is being set up to go through the AAPC and OMB for the vetting of inter-entity cost issues. Mr. Webster replied that the Library would be willing to take the suggested resolutions as a point of reference to be discussed with management and the auditors. Mr. Webster noted that because of the separation of powers the Library could not just say that it would follow whatever guidance OMB has the final say on.

Mr. Farrell asked Mr. Webster about the Architect providing $37.2 million of support for Library buildings and grounds. He asked if the $37.2 million represented costs in lieu of rental costs or did they represent actual costs for support? Mr. Webster replied that the amount represented actual unreimbursed costs to the Architect, less any costs that are capitalized. Mr. Webster explained that the Library is recognizing an imputed cost for these unreimbursed support services provided by the Architect. In addition, the Library recognizes an imputed depreciation cost for one of the buildings built by the Architect in 1980, along with imputed amortization on improvements made by the Architect. He noted that their auditors do not have a problem with their recognition of these imputed costs.

Mr. Anania asked Mr. Webster about his comment that the Library requests that the FASAB provide implementation guidance on the use of cost data provided by agencies who follow GAAP other than that promulgated by FASAB, i.e, the Postal Service. Mr. Anania stated that it would not be realistic to believe that the FASAB could provide that type of guidance. He went on to say that the Board's goal is to be certain that the Federal entities following FASAB standards are given proper guidance. Mr. Webster explained that he is looking for guidance from the Board when there are two different bases of reporting between an entity following FASB guidance versus an entity following FASAB guidance. Mr. Mosso asked Mr. Reid how this situation is handled during consolidation. Mr. Reid replied that Treasury requests that the entities using FASB convert their statements to FASAB guidance.

Ms. Comes noted that SFFAS 4 does not require that the exact figures from inter-entity cost transactions be reported. She further noted that the receiving entity is allowed to make estimates of the costs being provided by another entity and there are ways to facilitate the eliminations.

With no other questions, Mr. Mosso thanked Mr. Webster and Mr. Miller for addressing the Board.

Summary of Testimony Provided by Anna D. Gowans Miller, Technical Manager and Director of Research, Association of Government Accountants (AGA)

Ms. Miller thanked the Board for allowing her to address the Board on behalf of the Association of Government Accountants (AGA) Financial Management Standards Board (FMSB). She explained to the Board that her testimony was to support the letter previously submitted by the FMSB. Ms. Miller explained that the FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members.

Ms. Miller noted that a majority of the members agreed with the concepts of the exposure draft and that all material costs should be included in full cost measures. Inter-entity costs need to be accounted for, and their inclusion results in a truer picture of the actual costs of services being provided by federal departments. She added that it also allows for comparability between federal services and private providers. However, she explained that one also needs to consider the costs associated with compiling and reporting this information, and whether it simply adds another layer of bureaucracy to the process.

Ms. Miller explained that several members suggested that an even earlier date should be considered because the members believe that each federal agency should take responsibility for the accuracy and completeness of its financial information rather than relying on other parties such as the FASAB to deal with agency-specific issues or dictate which costs should be included.

Ms. Miller noted that one member of the FMSB thought that Mr. Reid made a valid point about the potential differences of opinion between auditors and preparers on what is material. Ms. Miller also commented that a flat five percent materiality level would not be appropriate, but that significance to the entities should be considered. She explained that this becomes a matter of "professional judgment." Ms. Miller added that currently, the two groups (auditors and preparers) have disagreements on many other items related to financial statement preparation and "professional judgment" and it would be unfortunate if this proposal were to add inter-departmental costs to the areas for potential disagreement.

Ms. Miller explained that on the question of reimbursable agreements, the FMSB thought it was possible, or even probable, that agencies would alter their agreements so as to capture the costs and recover them appropriately, if this new requirement identifies under or over charges. She added that the proposed requirement does allow entities time to develop internal guidance on recognizing inter-entity costs, seek implementation guidance, or establish reimbursable agreements.

Ms. Miller explained that the FMSB believes that the AAPC should be the entity to give any additional guidance on the standards and that FASAB should monitor agency implementation and be prepared to answer issues as they arise. She added that it might be useful to develop a list of activities that would fall under this category to assist agencies in understanding this issue.

Ms. Miller completed her remarks and asked if the members had any questions.

Board Discussion/Questions to AGA FMSB

Mr. Mosso asked Ms. Miller to elaborate on the anti-deficiency act issues mentioned in the comment letter. She replied that this issue was a concern that a retired federal member had. For example, if agency A provides non-reimbursed services valued at $1 million to agency B, those funds are included in the appropriation for agency A. If agency B now has to pay for those services, the $1 million should be appropriated to agency B; otherwise it will run into the anti-deficiency issue or will be required to reduce other mission related activities. She explained that agencies should alter their agreements in order to avoid any of these types of issues. Ms. Robinson mentioned that Congress is not very fond of agency reimbursable agreements.

Mr. Reid expressed his concern about the actual funding of reimbursable agreements. He believes that agencies are unlikely to give up budget authority for these activities and that agencies will look more closely at the costs and start billing more for the activities and in turn the agencies being billed would not have enough funds to meet the payments.

Mr. Anania asked about the make up of the FMSB membership. Ms. Miller stated that there are approximately eight current and retired federal members.

Mr. Mosso thanked Ms. Miller for addressing the Board.

Board Discussion after the Public Hearing

Mr. Mosso explained that the agenda had allowed additional time for Board discussion after the public hearing. Staff explained that the goal was to determine next actions on the project to finalize the standard for issuance.

Mr. Mosso asked the Board to consider if the Board still wished to go forward with the proposal and the suggested staff draft guidance plan.

Mr. Anania explained that he is trying to get a handle on whether the inter-agency agreements would in some way affect the budget process. He explained that it was his understanding that the proposal does not deal with the budgetary aspects. He added that it might be helpful to state that the document does not deal with the budgetary aspects at all.

Ms. Robinson explained that her concern was that if the ultimate goal is to have a financial accounting system that also feeds a budgetary accounting system, then it would have to be an extremely flexible system. She added that you could potentially have a full cost financial accounting system that may be different then the full cost for the performance matrix or budgetary accounting system.

Mr. Anania suggested that it may be helpful to include a discussion in the basis for conclusion that explicitly states that the Board is not dealing with the budgetary system. Mr. Anania explained that perhaps the Board should alert the reader to this so they are aware that it may require consideration. Mr. Zavada stated that he did not believe that would be necessary. Mr. Zavada stated that he was a bit confused by the budgetary concerns that were raised. He added that he did not believe there was a need for the Board to clarify.

Ms. Robinson suggested that perhaps the Board can take advantage of the fact that the budget and performance information integration system is still at such an early stage for full cost accounting. She added that the Board could lead and then that system could follow as she is concerned that ultimately there could be different costs reported in the systems. Mr. Zavada explained that there is already a difference because appropriations do not line up with the programs. Ms. Robinson agreed, but added that the goal is for the information to be the same and performance indicators include full cost accounting information.

Mr. Anania explained that Interior mentioned that they believed a more direct relationship with OMB on approval of costs was necessary. He noted that Mr. Reid's alternative view cited a 1998 OMB memorandum that stated which inter-entity costs should be imputed and recognized and further stated that no other inter-entity costs should be recognized. Mr. Anania asked if there has been any other guidance from OMB since that memorandum or any follow-on communication from OMB on the subject of inter-entity costs. Mr. Zavada stated that he is not aware of any other communication sent broadly or to specific agencies on the identification of inter-entity costs.

Mr. Anania noted that based on the OMB memorandum, there is more or less a restriction on agencies from recognizing costs other than those included in the memorandum. He added that if there is this restriction, then it should be lifted. Staff explained that the restriction and the language in the memo is a result from the language in SFFAS 4. Staff further explained that the language in par. 110—which is what the current proposal would rescind—is the platform on which the OMB memorandum stands.

Specifically, par. 110 reads "Implementation of this standard on inter-entity costing should be accomplished in a practical and consistent manner by the various federal entities. Therefore, the Office of Management and Budget [OMB], with assistance from the FASAB staff, should identify the specific inter-entity costs for entities to begin recognizing. OMB should then issue guidance identifying these costs. These particular inter-entity costs should be specified in accordance with this standard including the recognition criteria presented below. The OMB should consider information and advice from Treasury, GAO, and other agencies in developing the implementation guidance. It is anticipated that the largest and most important inter-entity costs will be identified first. As entities gain experience in the application of the standard, recognition of other inter-entity costs may be specified in future guidance or required by future standards."

Mr. Anania asked if OMB would be required to issue something as well to rescind the guidance in the memorandum after the Board eliminates par. 110. Staff explained that the Draft Guidance Plan does include forthcoming guidance from OMB on certain issues. Staff also added that OMB does update their form and content guidance periodically, which references the OMB memorandum on the inter-entity costs. Thus, we could expect for OMB to update it accordingly. Mr. Zavada stated that OMB would update the guidance to reflect the new standard, as OMB would not be inconsistent.

Mr. Farrell asked if there has been consideration as to how the auditors would react to the cost information from the providing entity. He explained that when considering the imputed costs that are currently being recognized, there are procedures done—for example, OPM annually sends out information to all agencies detailing rates that should be used to recognize pension benefits, which is accompanied by a letter from the auditor stating the information has been audited.

Mr. Farrell asked how GAO would react when auditing an agency with an allocation coming in from another agency—would GAO send a group of auditors to the other agency as well? Mr. Dacey explained that there are similar situations now and the auditor would typically request audit reports from the other agency since they are subject to audit as well. Mr. Dacey explained that auditors would try to satisfy themselves with the work already done. He added that if the costs are material, it may warrant certain procedures by the auditor to ensure the reasonableness of amounts.

Mr. Mosso asked staff to summarize the proposed draft implementation guidance. Staff explained that the draft guidance details that the Accounting and Auditing Policy Committee (AAPC) Inter-Entity Task Force will continue its work in this area by developing a Technical Release (TR) that will address various areas raised by respondents and that certain operational guidance to be issued by the Office of Management and Budget (OMB). Staff also explained that the guidance does offer a venue for agencies to direct agency-specific questions.

Staff explained that the guidance details that the AAPC Task Force will collect individual inter-entity requests for guidance on specific cases and determine if general guidance in the area can be provided on the issue, and if so, the Technical Release will provide such clarifying guidance. Staff explained that the actual cases will be forwarded to OMB with the Task Force's recommendation, which will reference the general guidance in the Technical Release. However, the final disposition of the individual entity-specific cases will be determined by OMB.

Ms. Robinson commented that she has been concerned about whether the Board is requiring reporting this information at all levels and would the value of this type of information at the entity level be as important at the bureau level. Ms. Robinson suggested that perhaps the information may not be as important at the bureau level as the bureau may not have control over the costs and it may be more important at the entity level for comparisons. Mr. Mosso explained that he thought it was just as important at all levels.

Mr. Dacey requested clarification on whether SFFAS 4 applied to the entity level or below that. Ms. Comes explained that SFFAS 4 is part of GAAP and therefore applies to any entity preparing financial statements, which may include bureaus. Ms. Comes added that Interpretation 6 dealt with this very issue and whether par. 110 precluded bureaus within a department from recognizing imputed costs for goods or services provided by other bureaus within the same department. She added that Interpretation 6 details that imputed intra-departmental inter-entity costs should be recognized. She explained that Interpretation 6 went into effect in FY 2005. She added that through the comments received, she believes that agencies may have lost sight of that implementation date. Ms. Comes explained that the FASAB Newsletter will now contain a reminder regarding which standards will become effective in the fiscal year since there is often a delay between when the Board approves something and its effective date.

Ms. Robinson asked if bureaus would be imputing costs such as the Office of the Secretary. Staff explained that the same provisions exist in the Interpretation as in SFFAS 4 and entities may determine that the costs are broad and general in nature.

Mr. Patton asked what the advantage would be to send the individual case studies or questions to the AAPC when OMB has final disposition. Ms. Comes explained that the AAPC would offer some consistency in reviewing the cases and with the issuance of a Technical Release, any framework developed would be in the GAAP hierarchy. She added that if OMB finds that the AAPC does not move fast enough, they can request the case studies directly. Mr. Zavada explained that it would be helpful to see the case studies, as there is the possibility that agencies will work it out or otherwise the cases need to be elevated so they can be resolved.

Staff pointed out that at the most recent AAPC meeting, staff shared the draft guidance with the AAPC and there were no major concerns or comments.

Mr. Mosso asked if the Board does vote to move forward, would staff come back with a pre-ballot and final implementation guidance plan. Staff agreed with Mr. Mosso. Mr. Mosso then polled the Board for their vote to move forward and for any comments on the draft implementation guidance.

All the Board members except for Mr. Reid agreed with moving forward and the draft guidance.

Mr. Farrell asked why the date for the Draft Technical Release (June 2006) was so far into the future. Staff explained that it was to allow time for entities to come forward with their issues or case studies. Staff explained that potentially the AAPC could issue two Technical Releases—the first being earlier that would address the issues other than case studies—such as the listing Broad and General and additional guidance on the criteria factors. The second technical release could address the case studies, if warranted. The Board agreed that it would be good to issue something early on.

Mr. Farrell asked if SFFAS 4 includes a discussion of what should be done if the cost information is not received from the providing entity. Staff explained that there is language in SFFAS4 that states the receiving entity should estimate the cost when the information is not received. Mr. Anania suggested that if possible, language should be added to emphasize that the guidance in SFFAS 4 as it relates to estimates should be included. Staff explained that something similar was done in Interpretation 6 that referred to the accounting and implementation guidance in SFFAS 4 and that it still applies. The Board agreed that similar language should be added to the basis for conclusion in this proposed standard.

> **CONCLUSION:** Staff will work towards finalizing the proposed standard for issuance and finalizing the implementation guidance plan.

- **Heritage Assets and Stewardship Land**

Staff member Ms. Loughan led the discussion on the Heritage Assets and Stewardship Land project by directing the Board members to Tab F in the Board Binders. Ms. Loughan explained that during the October meeting the Board had discussed an issues paper that addressed stewardship and accountability considerations, categorization and unitization, materiality, and potential phased-in implementation methods. Staff explained that the Board had also tentatively decided upon several staff recommendations that were to be incorporated into the proposed standard *Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information.*

Staff explained that the Binder materials included a revised proposed standard for the Board's consideration and comment. Staff elaborated that the binders included a clean version, as well as a marked version that showed all changes from the exposure draft.

Staff explained that the goal for the meeting would be to determine what comments the Board had on the revised standard and determine other actions necessary to finalize the standard for issuance.

Staff distributed a handout that contained some other proposed changes to the standard. Staff explained that there were certain other proposed changes that had been suggested since the distribution of the board binders. The Board began by discussing those suggested changes.

Staff explained that one of the major items included on the handout was additional language regarding materiality. Staff explained that at the October Board meeting, staff had distributed an excerpt from SFFAS 3 that explained the Board's position on materiality. Staff explained that the Board had expressed an interest in including the language in the proposed Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information.

The specific language included on the handout for consideration was as follows:

> In preparing the standards, the Board intended that their application be limited to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. The Board proposes relying on the Financial Accounting Standards Board's (FASB) concept as modified by certain concepts expressed in governmental auditing standards. Presented below is the Board's position on the issue of materiality at this time.
>
> The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.
>
> FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered qualitatively material if it would influence or change the judgment of the financial statement user.
>
> The Board believes that FASB's definition of materiality is generally appropriate for use in applying the accounting and reporting provisions of the Board's accounting standards. In the federal government environment, however, the definition is extended to apply to all financial information included in the annual financial report and, therefore, is not limited to the principal schedules and related notes.
>
> In applying the concept of materiality, the needs of the users of the annual financial report should also be considered. In the federal government environment, such needs generally differ from those of users of commercial entity financial statements. For example, federal government financial statement user needs extend to having the ability to assess the efficiency and the effectiveness of the entity's programs. Further, compliance with budget and other finance-related laws, rules, and regulations is also a significant consideration of such users.

> This is expressed well in the "Government Auditing Standards" (the "Yellow Book"): "Auditors may need to set lower materiality levels than in audits in the private sector because of the public accountability of the audited entity, various legal and regulatory requirements, and the visibility and sensitivity of government programs."
>
> While this standard applies to an auditor's evaluation of materiality rather than a preparer's, it does provide insight into the factors affecting materiality in the federal government.
>
> Therefore, the accounting and reporting provisions of the Board's recommended standards should be applied to all items that would influence or change the users' judgments of the entity's efficiency and the effectiveness and its compliance with laws and regulations in a material manner.

Mr. Schumacher asked where the additional language would be included in the proposed standard. Staff explained that at the previous meeting the Board discussed three alternatives, which included incorporating the language with a footnote to the standard materiality box, including the language in the Basis for Conclusion, or including the full language in the standard.

Ms. Comes explained that when the language was included in SFFAS 3, it was not part of the authoritative portion of the standard. Instead, it was part of the Introduction to the standard. Ms. Comes confirmed that it was in the introduction by pulling SFFAS 3 on the overhead for members to view.

Mr. Reid asked if the language would be persuasive to auditors, considering auditors would always rely on their professional judgment. Mr. Mosso explained that the language was broad enough that he didn't believe it would violate any professional judgment. Mr. Reid explained that his view was that he did not believe the additional language would change an auditor's thought process.

Mr. Mosso explained that the Board is constantly being questioned about materiality issues when respondents comment on proposed standards and with this proposal, there were many concerns identified. He further added that it may be in the Board's interest to some how incorporate the language in all standards.

Mr. Anania noted that the Board had done this recently in another standard and he thought it was perhaps in the Earmarked Funds standards. Staff explained that it had been elaborated on slightly in the Earmarked Funds standard with the following language:

> "The preparer should consider both quantitative and qualitative criteria…"

Staff explained that the language was actually included in the Earmarked standard itself. Mr. Anania asked if there was a more lengthy discussion in the basis for conclusion. Staff noted that there was not a more detailed discussion in the basis for conclusion.

Mr. Mosso confirmed with the Board that they believed it was a good idea to add some language regarding materiality to the proposal. Mr. Reid asked if this was a policy decision that the Board would be including the language in all future standards. Mr. Mosso explained that the immediate decision would be whether to include it in this standard, but he thought the Board should discuss if perhaps it would be a good idea to include something similar in future standards. Mr. Mosso explained that the materiality box could be footnoted and then additional explanation could be included in the basis for conclusion.

Mr. Dacey explained that he did believe the issue was important enough to discuss whether it should be incorporated in future standards. He suggested that the Board may need to deliberate the issue further to agree on the specific wording if the goal is to include in future standards. Mr. Mosso agreed with Mr. Dacey's remarks and stated that he did not want the Board to decide on the spur of the moment that the language needed to be added to all standards and the focus for now should be just on whether to add it to the heritage assets and stewardship land standard. Mr. Mosso also suggested that it should go in a non-authoritative section of the standard. Mr. Dacey agreed that it should be in a non-authoritative section. Mr. Dacey explained that the implications of putting it in this standard should be considered, as he believes that it would be applicable to all standards.

Mr. Mosso asked Ms. Comes what the procedure would be if at a later date the Board issued something broader on materiality. Ms. Comes explained that normally one would expect to see this type of policy statement in a concepts statement. Ms. Comes suggested that it could perhaps be included in the current concepts project, but that would not preclude the Board from including something in the standards.

Ms. Comes suggested that perhaps the language could be incorporated in the basis for conclusion, which would also allow the Board to explain why they are expanding upon it in this particular standard.

Mr. Patton asked if the language was verbatim with SFFAS 3. Staff explained that it was, except for the yellow book reference, which was updated. Mr. Patton asked what the Board would gain by including the additional language.

Ms. Comes explained that SFFAS 3 was an odd place for the Board to include this materiality language that basically explained the Board's position. Staff explained that it appears that users need constant reminding about this issue. Mr. Patton suggested that the materiality box could be footnoted to reference the paragraphs in SFFAS 3. Mr. Patton explained that he believes including the language here would in essence require this Board to vote on it and he would not be prepared to do that. Staff explained that footnoting the box was an option presented to the Board.

Mr. Anania explained that he thought the proposal would include a truncated version of the language from SFFAS 3, similar to what was done in the Earmarked standard. Staff explained that a truncated version could be another option, but then there is still the question of whether it would be in the authoritative standard section as was done in the Earmarked standard.

Mr. Mosso explained that he thought the more detailed language would be helpful in this standard as there were concerns raised by respondents.

Ms. Comes explained that staff would work on language to be included in the basis for conclusion and include it in the next version. The Board agreed that some additional language should be included in the basis for conclusion.

Ms. Robinson explained that she is still concerned with what direction the Board is going with respect to internal controls. She added that in the absence of issuing anything on internal controls, one could see the value of producing the category and unit information as required by the standard. Ms. Robinson explained that several agencies identified that there was more value in asserting to the internal controls and having those audited versus actually counting items to be reported. Ms. Robinson asked if the Board intended to do anything in internal controls and if an assertion on controls would ever be considered.

Mr. Mosso explained that the issue of the system and controls objective would be considered further in the white paper being developed in the concepts project. Mr. Mosso explained that the Board will deliberate the systems and control objective further as the project progresses. Mr. Mosso explained that an assertion might eliminate the need for some of the required information, but it is his opinion that the category and unit information provides important information about the nature and type of assets the entity is responsible for.

Mr. Zavada explained that although the revised standard language does appear to offer flexibility, but when considering that the Library of Congress (LOC) prefers to have an audit of internal controls which is very extensive, he wonders if the standard is as flexible as the Board believes. Ms. Comes stated that she wanted to explain that the LOC is already required to have an assertion and audit of internal controls. However, based on discussions with LOC, the LOC believes that the assertion is separate and apart from the financial statements and the LOC would not support an audited assertion in the notes to the financial statements.

Ms. Robinson explained that she does consider the Board to be requiring non-financial information to be audited. Mr. Mosso explained that may be true looking at it in the strictest sense, but he believes that the information is more of a substitute for the financial information as it is intended to elaborate upon the assets because there isn’t a reasonable measure for recognition of the assets.

Mr. Zavada explained that the OMB is on the verge of issuing guidance to agencies on assessing the internal controls over financial reporting. He added that the assessment would be similar to Sarbanes-Oxley and that it would apply to the 24 CFO Act agencies. Mr. Mosso asked if the assertion would be audited. Mr. Zavada explained that the guidance is just for the management assertion. He added that he believes the government already addresses audits of internal controls and the goal of the new guidance is to strengthen management's assessments.

Mr. Mosso explained that many say the federal government has many regulations on internal controls (more than Sarbanes-Oxley) yet most would say that they are not effective. Mr. Mosso suggested that perhaps the audit coverage may be the key to making it effective.

Mr. Dacey explained that he agrees that the controls are very important, but he also believes that the information the Board is requiring is very important and it would be difficult to take one over the other. He added that controls get separated into several buckets and the controls over these particular assets may not be considered financial reporting controls.

Mr. Farrell also pointed out that although management may soon be required to make a management assertion regarding financial reporting controls, it doesn't mean that there will be any consequence for entities that are not able to provide it. Mr. Zavada explained that the draft guidance does include a non-compliance clause. Ms. Robinson asked what where the consequences for non-compliance. Mr. Zavada explained that he would share that when the guidance was final. Mr. Anania asked if the Board could receive a copy when it was final and Mr. Zavada said yes and hopefully it would be finalized by the next Board meeting.

Staff then directed the Board to the next proposed change. Staff explained that the exposure draft contained the following:

> "A concise statement explaining how significant heritage assets are important to the overall mission of the entity."

Staff explained that the revised standard included new language that was added due to a comment from a respondent that suggested that entities may be responsible for assets that are not important to their mission. Specifically, the entity may be responsible simply because of mandates or that Congress has determined them to be nationally significant.

The revised standard included the following:

> "A concise statement explaining how significant heritage assets are important to the overall mission of the entity, or are pertinent due to mandates such as compliance with laws and regulations or that Congress has determined the heritage assets to be nationally significant."

Staff explained that the revised wording was considered to be lengthy and might actually result in much more information than the Board had intended. Staff explained that there was a suggestion to change the sentence to the following:

> "A concise statement explaining how significant heritage assets are important to the overall mission of the entity or to the nation as a whole."

Ms. Cohen explained that the underlying reason for adding the language was that certain agencies had heritage assets that did not relate to their mission and they wanted to be able to convey that.

Staff explained that the new suggested language will still satisfy the respondent's concern while also limiting the information reported to information that relates to the mission and nation as a whole. Staff explained that for instance, the Department of Defense may be responsible for certain heritage assets although they may not be directly related to their mission.

Mr. Patton explained that he had concern with the notion of "nation as whole" as the Board has focused on the federal government entity so he would prefer "government as whole." Ms. Cohen suggested use of "national significance." Mr. Anania explained that he would prefer not to use significant or significance again in the paragraph.

Mr. Patton elaborated that his concern with "nation as whole" has to do with the fact that he hopes the Board will eventually visit the measurement issue and potentially recognize these assets, which will bring in the concept of entity. He added that he has considered the entity to be the government, not the nation.

Mr. Dacey explained that it appeared the Board was adding a narrative disclosure about the assets that have already been determined to be significant and that require disclosure. He added that the language is not to be determinative but rather explanatory in nature. Staff agreed with Mr. Dacey's remarks.

Ms. Robinson noted that the definition for heritage assets does not include anything about being important to the mission. Staff explained that importance to the mission is not a criteria necessary to be a heritage asset, instead it is a required disclosure to offer more information about the asset.

Ms. Comes explained that perhaps adding the additional language confuses the matter more and it may be appropriate to keep the original language as exposed. Mr. Mosso asked if the Board preferred to keep the original language as exposed and the Board agreed.

Ms. Robinson suggested that the word "overall" should be removed as based on discussions, entities may be responsible for the assets and it may be part of their mission, but it may not relate to their "overall mission". Ms. Cohen also suggested that the word "relate" versus "important" be used so that it allows entities to explain that the assets may not relate to the mission of the entity, although they are important. Mr. Farrell suggested that "significant" be dropped. Staff concurred with this suggestion because the main paragraph in the disclosure section requires that entities with significant heritage assets disclose the additional information. Ms. Comes explained that the disclosure is to discuss how the heritage assets relate to the mission, not how they are important.

The Board agreed on the following wording:

> "A concise statement explaining how they relate to the mission of the entity."

Mr. Farrell asked about the use of the term significant at the beginning of the disclosure section and specifically, is it intended to be qualitative or quantitative. The Board agreed that it was both. Mr. Anania stated that he had concern as well but he noted that standard setters have been using the term "significant" forever and it is something that preparers and auditors will have to use judgment with. The Board agreed to keep the term significant in the lead in paragraph to the disclosures section.

LUNCH BREAK

Mr. Zavada explained that he had some concern over using the specific example of "acres" in the last sentence of paragraph 16 of the standard as it may lead individuals to believe that it is required. Paragraph 16 reads:

> "Some investments in heritage assets (e.g., national parks) will meet the definitions and be considered both heritage assets and stewardship land (see Stewardship Land below). Such reporting would not be considered duplication, as the type of information reported on an item would be different for each category of stewardship asset. **For example, the number of physical units identified as national parks would be in the heritage assets disclosures and the number of acres used as a park would be in the stewardship land disclosures.**"

Ms. Comes suggested that it could be reworded to say "the quantity of land" instead. Mr. Zavada stated that the standard could explicitly state that acres are not required.

Ms. Robinson asked if we are suggesting that entities have to come up with a quantity for land because she thought that the standard was flexible to allow number of parks versus amount of land. Staff explained that the number of parks would be reported as a heritage asset, but entities still have to report the amount of stewardship land. Staff further explained that the entity still has the flexibility in determining the aggregation for reporting land use as well as the unit for reporting the physical units (acres, square miles, etc.).

Mr. Zavada asked if it is the Board's intent to have the duplicate reporting as discussed in paragraph 16. Mr. Mosso explained that this has been reported in this manner for quite some time. Mr. Zavada explained that the associated audit cost with reporting the acres is a big concern. Ms. Robinson also noted that it was her understanding that footnote 23's intent was to not require reporting by acres. Ms. Comes explained that the footnote would need to be clarified to reflect the fact that land is a volume measure versus an item measure.

Mr. Mosso explained that SFFAS 8 has been in effect for quite some time and that entities have been reporting items such as parks in the heritage assets section and the stewardship land section. Mr. Zavada explained that the big difference is that the information is now subject to audit.

Mr. Farrell explained that in paragraph 39d., the standard suggests that the stewardship land be "quantified in terms of physical units." He suggested that most would consider reporting in acres or square miles, but some entity may come up with something different. Ms. Robinson explained that the Bureau of Land Management reports “tracts of land” and would that be considered a physical unit. Mr. Mosso explained that if they determine that to be the most meaningful unit of measure, then that is what they would report.

Mr. Anania suggested that the example sentence in paragraph 16 be removed so entities do not interpret it to mean that the Board requires the unit of reporting for land to be acres.

Ms. Robinson explained that at the public hearing, Interior explained that they know how many parks that they have but they do not necessarily know how many acres for each park. Mr. Anania added that Interior stated that they had boundaries in place but had not measured the amount of land. Mr. Reid explained that Interior does provide an estimate for the amount of acres as well as other calculations to the total land area of the country.

Mr. Zavada explained that the documentation required for audit will pose a problem. Mr. Reid added that the issue of ownership will be the biggest obstacle as a there are methods such as the use of satellites that will enable auditors to substantiate the measurement issue.

Ms. Robinson explained again that she believed it more important to know the boundaries and be able to protect the land versus to measure the land. Mr. Reid explained that there is the requirement to not allow another person to sell it while they protect it. Mr. Reid added that reporting the ending balances in essence explains to the public that the government did just that.

Mr. Zavada explained that it is more of a cost concern about having sufficient documentation to support an acres measure. Mr. Zavada explained that he believes the revised standard does offer some flexibility, but the references to acres may be misinterpreted. Mr. Mosso pointed out that the sentence does say “for example” but he would not oppose to revising the wording of paragraph 16 or dropping the sentence all together.

Mr. Zavada asked the Board again if it was the intent of the Board to have the information reported in both places as paragraph 16 details. Ms. Comes explained that it is a conceptual dilemma in the fact that the example detailed in paragraph 16 meets both the definition for heritage assets and stewardship land. Ms. Comes explained that if the entity presents a combined heritage assets and stewardship land report, there might be a way to present the information in such a way that it would not have to be repeated and instead it could be blended together.

Mr. Schumacher commented that it is not a new requirement. Ms. Comes explained that entities have been dealing with it in the past. Ms. Comes explained that when SFFAS 8 was exposed, the respondents specifically asked the Board how to handle this situation and where to report the assets. Staff explained that the language was added to clarify that it was okay to include it in both heritage assets and stewardship land and that although one might consider this to be duplicate, the Board did not consider it double-counting.

Mr. Mosso explained that it was similar to the approach with multi-use heritage assets that are predominantly used in government operations. Staff explained that those assets were included in general PP&E (capitalized) as well as included in the heritage assets disclosures.

Mr. Mosso asked if the Board objected to removing the last sentence in par. 16 while saying that physical units are required in both heritage assets and stewardship land, without saying what type of physical unit.

Mr. Dacey suggested that the first sentence of paragraph 16 include “and reported as” after the word considered so it would read: “Some investments in heritage assets (e.g., national parks) will meet the definitions and be considered and reported as both heritage assets and stewardship land (see Stewardship Land below). Such reporting would not be considered duplication, as the type of information reported on an item would be different for each category of stewardship asset.” The Board agreed with the proposed wording.

Mr. Schumacher asked for clarification on the phased-in implementation detailed in paragraphs 42a-c. He asked if the main reason for just requiring the ending balances in 42 b is to establish a base year. Staff explained that is was to offer an additional year before requiring the additions and deletions to be subject to audit and that once the ending balances are substantiated in that year, those balances will become the beginning balances the following year. Staff explained that for years thereafter, all required information, including additions and withdrawals, would be basic information

Mr. Zavada asked if it was acceptable to use different physical unit measures or would an entity have to use the same physical unit measure for land. Staff explained that it could be different, but the standard does require that it be meaningful and based on how the agency manages the land. Mr. Reid commented that all entities had provided the land in acres the previous year.

Mr. Farrell added that when the entities determine the unit for audit, they may choose something different. Mr. Reid explained that this may make the aggregation for the consolidated report to be somewhat meaningless. Staff explained that the current proposal does not require unit information in the CFR, instead the proposal requires a reference to agency reports. Mr. Reid explained that he was just considering the impact on what he is currently reporting and that he would just have to wait and see what agencies choose to report. Mr. Mosso explained that he would not like to see the CFR lose information like that and he hoped that the CFR would still report it, perhaps in an unaudited section of the report.

Mr. Mosso added that he does not see the problem with auditing the number of acres of stewardship land. Mr. Dacey explained that this issue has been discussed quite a bit, but he does not believe that anyone has gotten to the point of saying what was reasonable or not reasonable. Mr. Farrell commented that ownership was a bigger issue. Mr. Dacey agreed that the documentation to support ownership would be a bigger obstacle for the auditor.

Mr. Reid explained that between FY 2002 and FY 2003, the CFR picked up approximately 12 million acres and he doesn't recall any appropriation for that. He added that it presumably occurred due to some refinement in measurement.

Ms. Robinson commented that isn't it a concern that entities will aggregate so much that we lose information. Mr. Mosso explained that we are in the accountability business and we do require meaningful presentation. Ms. Robinson asked if it was central to know the quantity as long as the entity is accountable for protecting the assets. Mr. Reid asked how can you protect something that you can't quantify the number that you have. Ms. Robinson stated that she did not necessarily agree with that.

Mr. Mosso explained that no matter how good your controls are, assets do get away. Mr. Mosso explained that reporting your balances is a way to ensure you still have what you took in and so forth, whereas an internal control assurance would not provide that. Mr. Reid explained that as a manager he believes it is important to report this type of information. He added that he would want those directly responsible for those individual areas to report to management on the area they are responsible for, so management is comfortable that the agency is doing its job.

Mr. Anania suggested that the Board may want to require some information about the agency policies for the stewardship assets. Staff commented that the proposal does require:

> "A brief description of the entity's stewardship policies for stewardship land. Stewardship policies for stewardship land are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of stewardship land consistent with statutory requirements, prohibitions, and limitations governing the entity and the stewardship land. While not all encompassing, the policies should address preserving and maintaining condition, providing public use or access, and enhancing the stewardship land's value over time. "

Mr. Mosso explained that he believed it was important to leave the physical units in the standard. He added that he believes that agencies want to do a good job and that they have gone to great lengths thus far to report meaningful information. He added that the agencies could come up with the best unit for presentation and that there have been several task forces that have worked on this. He believes that the work could be finalized.

Mr. Mosso asked if the changes discussed during the meeting were incorporated, would the Board be comfortable with moving forward. Staff explained that a revised pre-ballot would be distributed to the Board that reflects the changes discussed as well as other comments received Board members.

Mr. Mosso asked if the Board was comfortable with moving forward with the standard. The Board agreed to move forward with the standard.

CONCLUSION: Staff will move forward on finalizing the standard and provide the Board with a revised pre-ballot of the standard by incorporating the changes discussed at the meeting.

- **Natural Resources**

Staff, Rick Wascak and Monica Valentine, led the discussion. The objectives of the meeting were to get: 1) feedback on the meeting material provided to the Board, and 2) any comments or suggestions on the issues that were not addressed in the material.

Staff noted that at the August meeting, members raised various issues and asked staff to research them. Staff explained that it had addressed a large number of those issues. Responses to those identified issues were presented in the form of a Basis for Conclusions (BfC). Staff added that the BfC consisted of the following:

- Background
- Overview of Federal Oil and Gas Resources
- Conceptual Aspects of Oil and Gas Resources as a Federal Asset
- Oil and Gas Resources Meeting the Definition of Asset
- Oil and Gas Resources Recognized as a Federal Asset
- Measurement of the Federal Asset
- Existing and Proposed Accounting Entries for Oil and Gas Resources

The specific issues not addressed in the BfC would be dealt with in future staff work. The remaining issues consist of:

- Definition and description of the “average wellhead price”
- Support for the reliability of estimated EIA proved oil and gas reserve quantities
- Accounting entries at the agency level
- Proposed disclosures or information to be reported as required supplementary information (RSI)

Ms. Robinson commented that she did not believe the standard should be limited to proved reserves. She believes that the standard should include other oil and gas resources because they all have a future economic benefit. Staff explained that the standard only proposes to recognize proved reserves on the balance sheet. Information on other oil and gas resources (i.e., undiscovered recoverable resources, unproved reserves, and proved undeveloped reserves), which would also be considered assets, would not be recognized on the balance sheet. However, other information on these resources could also be presented in the financial statements. The reliability of the measurement of these resources would determine how and where this information is presented.

Ms. Robinson said she believes the reliability of the measurement for these other resources already exists for them to be recognized on the balance sheet. She suggested that staff contact the U.S. Geological Survey (USGS) to determine what information is available for these other resources (i.e., undiscovered recoverable resources, unproved reserves, and proved undeveloped reserves) and how reliable it was. Mr. Anania commented that he believes the answer to Ms. Robinson's question was how far does the Board want to push the envelope in regard to reliability when it comes to measurement. Mr. Mosso asked if there is information available for proved undeveloped reserves. Staff responded that information may be available to the producer; however, the producer is not required to report the information to any government agency. Ms. Robinson asked if the producer was required to report proved undeveloped reserves to the Security and Exchange Commission (SEC). Staff responded they would get the answer from the SEC. Ms. Robinson also suggested that staff include the SEC as another government entity involved in the Federal oil and gas resource activities.

Mr. Mosso noted that additional information gathered by staff for these other resources would assist the Board in deciding if more resources could be recognized; or, if some other kind of information can be presented about them in the financial statements.

Mr. Patton indicated that the document provided for the December Board meeting rules out the use of historical cost for valuing the asset. He suggested that a fuller discussion on historical cost be provided, including its positive and negative aspects. Ms. Comes remarked that she believes a discussion of this nature should be contained in a conceptual framework document. She suggested that the sentence stating it was irrelevant be deleted, and to simply rule out the use of historical cost measurement on the basis that it was not available. Mr. Patton agreed.

Mr. Anania stated he was not close to a decision on using the "average wellhead price" or not. He said he believes discounting the asset should be looked at more closely, including a discussion on the pros and cons of using the discounted cash flow methodology and whether there is an estimated average period of time over which the oil and gas is extracted from a well. Mr. Anania also noted that staff should explain more clearly why the average wellhead price would be usable and why other methodologies would not be usable.

Mr. Patton commented that he believes the value of the asset to be recognized on the balance sheet should be proportionate to the winning bonus bid for a lease. Mr.

Jacobson noted that bonus bids are relatively low. Staff was asked to review bonus bids and determine if bonus bids were proportionate to the value of the asset.

Ms. Robinson asked if there are leases signed with no intention to ever produce oil and gas. She also asked if leases are terminated for any reason. Staff responded they would research these two matters. Mr. Mosso noted that he remembered a newspaper article relating to oil and gas leases, in which there was limited or no production from leases for oil and gas. He asked staff to locate this article again and provide it to the Board. Mr. Mosso also asked staff to make a comparison between the FASB 69 oil and gas accounting standards and the SEC Rule on oil and gas activities, and to provide the similarities and differences between the two.

Ms. Robinson stated that at the end of a lease, there are costs to the government for reclamation of the land. Staff noted it would look into who has responsibility for the reclamation of Federal lands on which oil and gas was explored and extracted.

CONCLUSION: For the March 2005 Board meeting, staff will work to:

- Provide a detailed definition and description of the term “average wellhead price”.
- Provide supporting information in regard to the reliability of estimated EIA proved oil and gas reserve quantities.
- Provide accounting entries at the agency level.
- Identify proposed disclosures or information to be reported as required supplementary information (RSI).
- Contact the U.S. Geological Survey (USGS) to determine what information is available for undiscovered recoverable resources, unproved reserves, and proved undeveloped reserves; and, how reliable the information is.
- Determine if lessees, who are authorized to extract oil and gas reserves on lands under the control of the Federal government, are required to report proved undeveloped reserves to the Security and Exchange Commission (SEC).
- Provide a discussion on the pros and cons of using the discounted cash flow methodology to value the Federal governments royalty share of proved oil and gas reserves as of the end of a fiscal year reporting period.
- Determine if there is an estimated average period of time over which oil and gas is extracted from a producing well.
- Review the amount of the bonus bids on oil and gas leases to determine if the bids are proportionate to the value of the Federal governments royalty share of proved oil and gas reserves.

- Provide the newspaper article relating to oil and gas leases in which there was limited or no production from the leases.

- Make a comparison between the FASB 69 oil and gas accounting standards and the SEC Rule on oil and gas accounting standards, and to provide the similarities and differences between the two.

- Research what organization has the responsibility for the reclamation of Federal lands on which oil and gas are produced.

- **Steering Committee Meeting**

Steering Committee members did not alter the plan presented regarding the Appointment Panel's recruitment strategy.

Adjournment

The meeting adjourned at 3:00 PM

Attachment 1

SPENT FUEL LITIGATION

As background, in accordance with the Nuclear Waste Policy Act (NWPA), the Department [of Energy] entered into contracts with more than 45 utilities in which, in return for payment of fees into the Nuclear Waste Fund, the Department agreed to begin disposal of spent nuclear fuel (SNF) by January 31, 1998. Because the Department still has no facility available to receive SNF under the NWPA and does not anticipate such a facility until at least 2010, the Department has been unable to begin disposal of the utilities' SNF as required by the contracts. Significant litigation has ensued as a result of this delay.

To date, the spent fuel litigation has conclusively established that DOEn's obligation to begin disposal of SNF is legally binding notwithstanding the lack of a facility to receive SNF, Indiana Michigan Power Co. v. Department of Energy, 88 F.3d 1272 (D.C. Cir. 1996); that the utilities' remedies for DOEn's failure to begin disposal of their SNF are to be determined as a matter of contract law, Northern States Power Co. v. U.S., 128 F.3d 754 (D.C. Cir. 1997), cert. denied, 119 S.Ct. 540 (1998); and that DOEn cannot deny liability on the ground that its delay was unavoidable. Ibid. In addition, the Court of Appeals for the Federal Circuit has held that DOEn is in partial breach of its contracts and that utilities are entitled to recover damages for that breach. Maine Yankee Atomic Power Company v. United States, 225 F.3d 1336 (Fed. Cir. 2000); Northern States Power Co. v. U.S., 224 F.3d 1361 (Fed. Cir. 2000).

Court of Federal Claims

While four suits have been settled (see discussion of Exelon Settlement below), 60 suits remain pending in the Court of Federal Claims for breach of contract in which they collectively seek in excess of $6.18 billion. The industry is reported to estimate that damages for all utilities with which DOEn has contracts will be at least $50 billion. The Department believes that the industry estimate is highly inflated and that, if DOEn prevails on some key disputed issues, the actual total damages suffered by all utilities as a result of the delay in beginning SNF disposal is more likely to be in the range of between $2 billion and $3 billion.

In the first case tried to judgment, Indiana Michigan v. United States, No. 98-486C (Fed. Cl. May 21, 2004), the court adopted the Government's position that in a partial breach of contract action, damages are limited to those attributable to DOEn's breach from the date of the breach, January 31, 1998, through the date of trial and concluded that Indiana Michigan had not proved it incurred any damages during that six years that were attributable to DOEn's delay. While this ruling may affect damage awards in other spent fuel cases, the various trial courts are not required to apply it. This judgment is not final and has been appealed to the U.S. Court of Appeals for the Federal Circuit. Additionally, the specific facts of each case and individual rulings by the seventeen trial court judges handling these spent fuel cases will determine the amount of any damages awarded in individual cases. It is also important to note that prior to the Indiana Michigan decision, various trial courts had issued several rulings adverse to the Government on dispositive motions. If those rulings accurately reflect how those issues will ultimately be resolved, the Government's damages prediction could increase significantly.

Liability is certain in this matter and, in most of the pending cases, orders have been entered affirming the Government's liability. Other than ascertaining the actual amount of damages, the only other outstanding issue is how that liability is to be satisfied. At this time, it is uncertain whether damages would be paid from the Judgment Fund, the Nuclear Waste Fund or some other source. However, in Alabama Power v. U.S. Department of Energy, 307 F.3d 1300 (11th Cir. 2002), the Court found that the Department is not authorized to spend Nuclear Waste Fund monies on settlement agreements aimed at compensating utilities for their on-site storage costs that result from the Department's breach of their Standard Contracts, which suggests that the Nuclear Waste Fund would not be an appropriate source for paying damages.

Exelon Settlement

The government resolved four pending spent nuclear fuel cases in a settlement agreement with Exelon and its subsidiaries Exelon Generation Company, Commonwealth Edison Company and AmerGen Energy Company, which collectively produce about one-fifth of the nuclear energy in the United States. Under the terms of the settlement agreement, the government will reimburse Exelon for the actual incurred costs of spent fuel storage that are directly attributable to the government's delay in beginning fuel acceptance on January 31, 1998. The agreement provides for an initial payment from the Judgment Fund of approximately $80 million to cover the actual costs of additional spent fuel storage already incurred by Exelon. All future reimbursements will be made only after the actual costs incurred have been verified by the Department of Energy and all future payments will be paid by the Judgment Fund. Under current law, these payments from the Judgment Fund are not required to be reimbursed by the Nuclear Waste Fund or the Department of Energy. Future actual costs incurred by Exelon as a result of the Department's delay will be reimbursed on an annual basis. The Department has estimated that this settlement could approach a total cost of $280 million assuming it achieves a steady state acceptance rate of 3000 MTU's per year.

YUCCA MOUNTAIN LITIGATION

Nuclear Energy Institute, Inc. v. Environmental Protection Agency, U.S. Court of Appeals for the District of Columbia Circuit, case nos. 01-1258, consolidated with 01-1268, 01-

1295, 01-1425, 1-1426, 01-1516, 02-1036, 02-10, 02-1116, 02-1179, 02-1196, 03-1009, 03-1058.

Four challenges by the State of Nevada to the Department's activities regarding the Yucca Mountain site have been declared complex litigation and consolidated in the U.S. Court of Appeals for the D.C. Circuit. These challenges are to: 1) the site recommendations by the Secretary of Energy to the President and the President to the Congress; 2) the Final Environmental Impact Statement; 3) the Department's Yucca Mountain Site Suitability Guidelines (10 C.F.R. Part 963) alleging that the Department's reliance on engineered barriers rather than geologic barriers to contain radiation is unlawful; and 4) the constitutionality of Congress' passage of a resolution approving Yucca Mountain as the site for a repository. A three judge panel of the court of appeals dismissed or denied all challenges brought against the Secretary's and the President's actions as well as challenges to the constitutionality of Congress Joint Resolution approving the Yucca Mountain site. The panel also rejected all of the challenges to the constitutionality of Congress' Joint Resolution approving the Yucca Mountain site. The panel also rejected all of the challenges to EPA's and NRC's rules, with one exception: it vacated the 10,000 year compliance period in the EPA rule and the corresponding section of the NRC rule and remanded the matter to the EPA. The court found that the 10,000 year compliance period was not consistent with the requirement of Section 801(a) of the Energy Policy Act that EPA's rule be "based on and consistent with" the recommendation of the National Academy of Sciences (NAS), since NAS had recommended that compliance be measured at the time of peak radiation release, which is estimated to occur after several hundred thousand years. Petitioner Nuclear Energy Institute (NEI) sought panel rehearing or rehearing en banc, but the court denied both those petitions on September 1, 2004. On September 9, 2004, NEI moved to stay the issuance of the mandate pending the disposition of a petition for writ of certiorari. The court denied NEI's motion to stay the mandate on October 8, 2004. None of the parties filed for certiorari, so the judgment is final. These cases do not seek any damages and, therefore, any impact they may have on the Nuclear Waste Fund would be indirect.

Additional FASAB Staff Explanation:

DOEn staff also notes that Section 302(e)(2) of the Nuclear Waste Policy Act provides that the "Secretary may make expenditures from the Waste Fund, subject to appropriations which shall remain available until expended." In other words, unlike most other funds, the Department needs an appropriation to spend money from the Waste Fund. As the spent nuclear fuel cases are in litigation, the Department of Justice has the authority to settle cases in litigation if DOEn recommends the settlement, presumably using the Treasury Judge Fund, which was established by Congress in the 1950's to pay in whole or in part the court judgments and settlement agreements negotiated by the Justice Department on behalf of agencies, as well as certain types of administrative awards. The Congress established the Judgment Fund as a permanent, indefinite appropriation. [See FASAB Interpretation 2, *Interpretation of Federal Financial Accounting Standards No. 2: Accounting for Treasury Judgment Fund Transactions: An Interpretation of SFFAS No. 4 and SFFAS* 2.]