FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 22-23, 2008
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, October 22, 2008

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Farrell, Jackson, Patton, Reid, Schumacher, Steinberg and Werfel. The executive director, Ms. Payne, and general counsel, Mr. Dymond, were also present throughout the meeting.

- **Approval of Minutes**

The minutes were approved electronically in advance of the meeting.

- **Update and Clippings**

Ms. Payne provided a brief update regarding fiscal sustainability outreach and staff liaison with IPSASB and GASB.

Mr. Steinberg suggested that staff pursue (1) the business community, (2) an appearance by Tom Allen on the IBM radio show, and (3) transition efforts.

Mr. Schumacher asked about CBO's publicized view that Fannie and Freddie should be "on-budget." Mr. Torregrosa noted that the CBO director believed that prior to the conservatorship the GSEs were a grey area regarding federal activities. With respect to the new arrangement, the warrants represent 80% ownership and that dilution has already been reflected through the market price. It's hard to argue that 80% ownership – via the warrants – is not control.

Mr. Werfel indicated that the warrants have not been exercised. He pointed out that there was precedent through the FDIC's treatment of failed banks to not consolidate. He acknowledged that the decision to not consolidate would be monitored.

Mr. Reid indicated that there was no intent that this arrangement be long-term. One would not want to consolidate now and then un-consolidate in the near-term when the arrangement changes.

Mr. Patton asked if putting these entities on-budget and consolidated are the same decisions – that is, do the same criteria apply. Mr. Werfel noted that the FASAB concepts put heavy emphasis on whether the activities are included in the budget. It is clear that if an activity is in the budget it should be consolidated for financial reporting purposes. He also emphasized that if the arrangement – conservatorship or ownership – is intended to be temporary then the reader of the financial report may be confused by consolidation since that implies a permanent relationship.

Mr. Werfel noted that there are about $1.5 trillion of assets and liabilities at the GSEs. The liabilities do not have the full faith and credit of the US government standing behind them. This would be a large category of liabilities added that are different than the existing liabilities.

Mr. Farrell asked how we can defer decision making when reports are to be issued within 45 days of September 30th. Mr. Reid responded that what has happened up through year end is immaterial. The intent of the larger TARP program has changed significantly just in the few weeks since discussion began.

Mr. Werfel indicated that the activity prior to year end will be fully disclosed in the financial report. He stated that a liability would be recognized. However, discussions are on-going regarding the actual recognition and disclosure.

Mr. Farrell asked whether there was a need for FASAB to be involved at this phase. Mr. Werfel indicated that he would appreciate day to day help but that due process was needed for FASAB to respond and time did not permit it. He believes that the hierarchy is being used with a strong preference to apply FASAB standards where possible.

Mr. Jackson noted that outside of the federal sector there is strong precedence that liabilities without the full faith and credit of the government are reported on the balance sheet. He believes that it is essential that FASAB step up to address the issues. He believes if FASB standards are considered appropriate, it would be helpful to have FASAB review the circumstances and approve application of FASB standards. He would like to show that the Board could be responsive.

Mr. Steinberg asked if Mr. Patton's question about on-budget versus on-books was answered. Mr. Reid indicated that an example of off-budget activity is the post retirement benefits for employees – these are not budgeted but are recognized "on-the-books."

Mr. Werfel indicated that they approached the question from an entity perspective.

Mr. Farrell suggested that this transaction was not envisioned when SFFAC 2 consolidation guidance was written. Mr. Reid indicated that the guidance for investments and guarantees does exist. Thus, the exposures created through our relationship with the GSEs can be addressed through the existing standards. The big issue is really what the exposure is – how do you value it.

Mr. Werfel indicated that his team found very few gaps in the literature for the transactions that occurred before the year end. He is open to looking at the standards to see if there are improvements that can be made.

Mr. Farrell asked whether the GSEs third quarter reports would help answer some of the measurement questions. He asked if there was an excess of liabilities over assets would Treasury recognize a liability. Messrs. Reid and Werfel indicated that it would. Mr. Werfel indicated that the model would also look further into the future to assess the long term cash flows. That is, the model would consider what would come back to Treasury over the long-term.

Mr. Dacey alerted the members to the many studies being undertaken regarding the usefulness of fair value accounting including studies directed due to the interest of Congress.

Agenda Topics

- **Social Insurance**

The objective of the social insurance session was to review and approve the social insurance exposure draft for publication. At the August FASAB meeting the Board approved the staff's plan to e-mail members a pre-ballot draft of the proposed standard *Accounting for Social Insurance, Revised* for final comments, after which a ballot draft was to be prepared for the October meeting. Staff explained that a pre-ballot draft of the exposure draft (ED) was sent to members September 16, that comments from several members were received during September, and that Tab A-1 in the briefing book contain a new "track changes" version of the ED for final review and balloting.

The staff began the session by noting that Mr. Patton objected to the "in order to" preface for most Questions for Respondents. Mr. Patton said such prefaces seemed to be overly focused on one aspect when the Board wants the reader to consider the broader implications. The Board decided to delete the "in order to" statements.

Mr. Steinberg commented that the proposed standard seemed too prescriptive when it specified exactly where in the MD&A the preparer should discuss key measures. He said the Board should say <u>what</u> should be disclosed; he said the <u>how</u> to disclose it is up to the preparer. He said the preparer might decide to call it something other than the "highlights section," e.g., they might call it a summary section. He noted that the staff said that the reference to the highlights section would be dropped, but he noted that the Question for Respondents on this subject mentioned the highlights section of the MD&A.

The staff agreed and explained that the reference to the "highlights section" in the Question for Respondents should have been deleted. However, staff explained that the Board had intended the discussion of key financial measures to be in the financial statement analysis section rather than being spread out over a potentially lengthy MD&A.

The Board considered this point. Mr. Steinberg said it should not matter in what section the discussion takes place. Staff responded that SFFAS 15 requires three sections, including a financial statement analysis section. Mr. Steinberg said the SFFAS 15 also requires a section on forward-looking information and this may qualify as forward-looking. Messrs. Allen and Patton said they understood the rationale for the requirement to include having the discussion in one place.

Mr. Allen called for a vote:

	Should the Discussion of Key Financial Measures Be in a Specific MD&A Section?	
	Yes	No
Mr. Patton	Yes, people should not have to search through the MD&A	
Mr. Schumacher	Agrees with Mr. Patton	
Mr. Dacey		No. Agrees with the objective of making the discussion easy to find, but would vote "no" because SFFAS 15 does not establish 4 distinct MD&A sections, at least in practice.
Mr. Werfel		No. Agrees with Mr. Steinberg that the standards should not get be too prescriptive about display.
Mr. Allen	Agrees with Mr. Patton	
Mr. Reid		Agrees with Mr. Werfel
Mr. Torregrosa		Agrees with Mr. Steinberg
Mr. Steinberg		[Agrees with Mr. Steinberg]
Mr. Farrell	Yes. The reference to sections in paragraph 26 of the ED should not be taken literally. There should be an area within MD&A that discusses financial statement analysis.	
Mr. Jackson	Yes. ED paragraph 26 merely says the section	

	Should the Discussion of Key Financial Measures Be in a Specific MD&A Section?	
	Yes	No
	"devoted to financial statement analysis." He suggested leaving paragraph 26 as is and changing the Question for Respondents to agree with it.	

Since the vote was five to five, the Board continued to discuss options. In conclusion, the Board decided to require the discussion of key financial measures to be in the section of the MD&A "devoted to financial statement analysis" wherever it might occur in the MD&A.

Mr. Werfel provided an outline of the alternative view he will be submitting.

Mr. Patton mentioned the possibility of a Board response to Mr. Werfel's alternative view. Staff noted that the recently submitted alternative view outline seemed straight-forward and succinct and may not need a response. Mr. Patton responded that, if that were the case, then he would offer an alternative view as well, while voting to put the document out, to take up some of the issues mentioned in Mr. Werfel's alternative view.

The Board discussed procedure in this regard. Mr. Steinberg mentioned consistency. He said he had had some additional proposals with respect to fiscal sustainability for which staff had put together a "Board's response" regarding why his additions were not taken up. So his question was: are all of Mr. Werfel's points appropriately addressed in the ED as to why they were not taken up by the Board.

Ms. Payne said the distinction is that, with Mr. Steinberg's submission relative to fiscal sustainability, Mr. Steinberg wanted additional reporting—reporting that was not addressed by the majority unless they responded to his view. She said Mr. Werfel is opposing the Board's proposed reporting. She said in theory the basis for conclusions lays out why the majority supports what they are proposing, and then Mr. Werfel is saying why he does not support it—resulting in both points of view being addressed.

Mr. Patton said the foundation of his alternative view is why there ought to be a liability. His alternative view would be submitted not to rebut Mr. Werfel but to offer the other side, which would be inconsistent with both what is being proposed by the majority and with Mr. Werfel.

Mr. Patton then asked Mr. Werfel about a statement in footnote #1 of the outline that he read as follows: “given the government’s ability to change the laws relating to social insurance programs and the unsustainability of current benefit payments with current financing, amounts of benefits payments are uncertain and not reliably estimable.” He said he recalled the Board’s *Elements* document saying that the ability of the government to change the law is not a barrier to liability recognition and therefore it seemed to him that Mr. Werfel’s appeal to this notion might not be based on the concepts the Board has passed, although he noted that OMB abstained.

Mr. Werfel said he had not thought of it that way and may need to re-consider the point. However, the point he wanted to emphasize here is that there are different degrees of certainty involved in these projections. But commitment values are not typically disclosed on the balance sheet because the Board has concluded that commitments are not as probable and certain as liabilities. Footnote #1 of his alternative view is pointing out that commitments are uncertain enough; and, using the fact that the law can be changed as a parameter, show why it is uncertain. He would not put in commitments on the balance sheet where they would have equivalency with liabilities because that would potentially confuse readers about the nature of the government’s promise. He said it is better to keep them on separate statements where parameters are different.

Mr. Patton said Mr. Werfel’s argument would be stronger if Mr. Werfel left out the part about the changing of the law. It would be grounded in the Board’s conceptual framework.

Mr. Werfel said he understood the conceptual framework on elements to indicate that the fact that the law can be changed does not in and of itself disqualify something from being a liability. However, the conceptual framework allows that that fact might reduce the certainty of an event in certain situations and therefore the Board may not want to record a liability or may not want to describe it in the same level of certainty.

Mr. Dacey said he read the two points about the ability to change law and the unsustainability of payments in combination. Something will have to change, probably the law, because benefit payments are unsustainable, which makes the estimate uncertain.

Mr. Allen mentioned OPEB, which he noted was a liability even though it is as subject to future changes, including termination.

Mr. Jackson said that he also read the two conditions in combination and therefore not in conflict with the *Elements* statement.

Mr. Werfel continued. He said the salient point is that the Board has made a determination over time to keep the value of commitments off the balance sheet because the Board did not want to mix apples and oranges on the same statement. Including them on the same statement implies a sense that they share common characteristics in terms of the government's promise, commitment, and likelihood of payment. He said the proposed standard reversed that determination and raised questions about why other commitments are not being presented on the balance sheet.

Mr. Werfel said he was concerned about what precedent is being set. When the Board talks about dictating or prescribing what will be in the MD&A, it will be a summary, it will include these particular summary measures, etc., he questions whether that is the type of activity in which the Board should be involved? It could create an expectation that the Board is going to be managing not only what is reported but exactly and precisely how it is reported. He said here the precedent with respect to balance sheet disclosure is that the Board has found a value and an item of information in another statement that it feels is important and wants to put it in other statements as well even though those statements were not designed or intended or historically driven to include that information, otherwise they would have had it from the beginning. The Board created a separate statement with different rules and parameters and analyses to develop these conclusions. He did not know if it is a good precedent to set for the Board to be saying some of that other information should be on another statement just so that it is in more than one place.

Mr. Allen said he understood Mr. Werfel's argument and it is very good and the points he made he needs to make and Mr. Patton probably needs to make points the other way because both of these points represent 50 percent. Fifty percent of the respondents, 50 percent of the Board, wants that on the balance sheet and believes totally it is a liability, and 50 percent believes it does not. So the compromise was developed, as explained in the basis for conclusions.

Mr. Werfel said he understood that.

Mr. Farrell said that, in order to solve the problem of consistency, he would be happy to include other federal commitments within the number included on the balance sheet. He said, unfortunately, this document just deals solely with social insurance; but that is the largest commitment. He said the Board was discussing a unique entity, which is a point that keeps coming up; and the Board must get information out that helps people understand how the government operates.

Mr. Werfel said he thought Mr. Farrell was saying that the balance sheet is not meeting our needs as it is currently constituted. This is a question that Mr. Werfel said is very good and fair and one he has been asking and one he thought David Walker had asked. He said the position that his alternative view was posing is not to deal with the deficiencies of the balance sheet by adding things to an existing framework that might be flawed. We are just going to add things in regardless; it is kind of like the foundation is not good but we are going to build on top of it, and that creates some instability in the effectiveness of the presentation. Alternatively, the Board could go in and fix the balance sheet and how financial reporting is done, which is a longer term or wholesale change that he thinks would be exciting and interesting to delve into. What his alternative view is saying or would have said had he not taken the comment out right before he sent the electronic version to the Board is that maybe the Board should re-think the entire balance sheet; but he felt that would distract the reader.

Mr. Allen said the Reporting Model project allows the Board to do that. Mr. Farrell agreed that the Board could be doing that with some of the current projects; but the social insurance proposal would allow the Board to address one of the biggest numbers.

Mr. Werfel concluded saying that perhaps when his outline if fleshed out he could make the point better. He said the point is that, if the balance sheet is not meeting our needs and there is a sense that important financial statement information is not getting out clearly enough because it is not on the balance sheet – it might be on other financial statements but it is not on the balance sheet – then his alternative view is saying the way to address that is not to put them on the balance sheet in its existing form, because he thinks there is a certain awkwardness or incongruity to that, but that a different path would be more appropriate.

Mr. Patton asked whether Mr. Werfel would prefer recognizing a liability, if it were going to be on the balance sheet.

Mr. Werfel said no. He said the fiscal sustainability statement should be more of the primary statement and he did not know how to make that point.

Mr. Dacey added that maybe the Board would not want to make the balance sheet into something it is not, maybe it is fine for what it is; maybe the Board needs a different vehicle.

Staff mentioned that, based on this discussion, that perhaps when Mr. Werfel's alternative view is "fleshed out" the Board may want to include a response in the ED.

Mr. Allen said he thought the basis for conclusions presented both arguments adequately, but judgment could be reserved until the alternative views were submitted.

Mr. Torregrosa recalled that Mr. Werfel's predecessor in the FASAB OMB chair had suggested some kind of below-the-line treatment. Mr. Torregrosa said he could not tell whether the balance sheet reporting proposed in the ED was a new element or just putting some important information below the line. He said he has been describing it at CBO as an additional disclosure; there is no change in liability or expense, which seemed to be the "hot button" words. He said he did not think that the CBO Director had focused on this yet and the Director would be reading the alternative view with great interest. Mr. Torregrosa said he could see that whether you show open or closed group is going to matter. He said Mr. Murphy had gone along with the closed group and so for the time being CBO would stick with that but it is an open question.

Mr. Allen mentioned that one member had asked about voting. Mr. Allen said that for draft exposure documents, unlike final documents, a Board member could include an alternative view and still vote to issue the draft document for comment. Thus, for draft documents, the Board needs six votes to issue it but not necessarily six affirmative votes in favor of it. Mr. Allen said he would take a vote on that basis; that is, the members would be asked to vote to issue the document rather than to vote affirmatively or negatively on the proposal. He mentioned that this approach seemed to be unique to FASAB.

The Board accepted several other suggestions for minor changes in the standard. The Board discussed the need to see the changes that the staff would be making the ED before voting. Staff agreed to provide a "track changes" update for the next day.

Mr. Allen took a preliminary vote on whether to issue the ED, subject to review of the new "track change" edition at tomorrow's session and a formal vote at that time.

	Should the SI ED be Issued?

	Yes	No	Other
Mr. Patton	Send it out.		
Mr. Schumacher	Send it out.		
Mr. Dacey	Would like to get the document out because it is important to get the issues out and get comments; but is also evaluating an alternative view and evaluating whether he would join that.		
Mr. Werfel	Put the exposure draft out. He will vote against it in substance. He does not want to hold it up. He'd rather get it out there with the yes and no votes and an alternative view.		
Mr. Allen	Send it out.		
Mr. Reid	Send it out.		
Mr. Torregrosa			He would push for the compromise but will await the director's decision. Thinks Mr. Werfel's alternative view reflects the traditional budget view.
Mr. Steinberg	Agrees with Mr. Farrell but wants		

	to see the “track change” edition.		
Mr. Farrell	Send it out without going through the individual issues again.		
Mr. Jackson	Send it out without comment.		

Mr. Farrell asked about the timing for issuing the document.

Ms. Payne replied that each member is allowed a certain amount of time to submit an alternative view after the ballot is called. The ballot will be called tomorrow. Members will have until November 10th to submit ballots. She noted that Mr. Werfel is doing his best to get his alternative view before that. Members will get Mr. Werfel’s alternative view as soon as it is provided. Staff will provide advice on whether something should be added to the basis for conclusions in response to the alternative view. She noted that Mr. Patton is subject to the same deadlines for his alternative view. She said all members have an opportunity to join either alternative view.

Mr. Patton asked Mr. Werfel when he expected to submit his alternative view, saying he could meet that date. Mr. Werfel replied that he could have it by October 31st.

Mr. Allen said the Board had to be very careful it does not end up exposing a document and going right back to having a five-to-five situation.

Mr. Schumacher agreed that the Board would end up in the same position as in the *Preliminary Views*.

On Thursday, October 23, the Board considered the changes the staff made pursuant to the discussion on the previous day. The staff provided a “track changes” edition of the ED for this purpose and asked whether the Board was satisfied.

Mr. Steinberg noted that he had met with staff last evening and made changes as shown in the draft, but there were two issues he wanted to raise. One involved the ED requirement that the entity discuss the “fiscal gap” among other key measures in the MD&A. Mr. Steinberg said that the concept of “fiscal gap” was beyond the scope of a social insurance standard. The Board decided to retain the requirement. The other involved the discussion in paragraph A83-A86 of the basis for conclusions. Those paragraphs touch on the notion of the “liability-commitment-expectation continuum” that some members found helpful. Mr. Steinberg found the discussion inadequate because, for example, the concepts lacked definition. The Board decided to retain these paragraphs.

At the conclusion of the meeting the staff called for any written ballots the members were ready to submit. Five affirmative ballots and one negative ballot were submitted.

> **CONCLUSION:** The Board reviewed and approved the social insurance exposure draft for publication. Five affirmative ballots and one negative ballot were submitted. [A sixth affirmative ballot was received on October 29, 2008.] Alternatives Views were due by October 31st. The deadline for ballots is November 10th.

- **Distinguishing Basic Information, RSI and OAI**

The Board approved SFFAC 6 prior to the meeting and this agenda item was cancelled.

- **PP&E Valuation**

Ms. Valentine opened the discussion by noting that the Board had received a ballot draft of the *Estimating the Historical Cost of General Property, Plant, & Equipment -- Amending SFFAS 6 and 23* exposure draft in the Board binder. However, a subsequent draft containing member suggested edits since the binder distribution had been developed for the Board’s review along with a list of those member edits. Ms. Valentine informed the members that the edits were separated into those that staff believed were not substantive in that they did not change the context of the proposed standard and those that were more of a substantive nature. Ms. Valentine noted that the meeting objective is to go through the member edits, get Board member agreement, and to approve by ballot a final ED for release by November 15. The following are the edits were discussed during the meeting.

1. Mr. Jackson -- Throughout the document the use of the word existing could be interpreted to mean estimates only apply to PP&E existing on a given date. My understanding of the proposal is that reasonable estimates are appropriate for existing PP&E and future acquisitions. Elimination of the word “existing” would seem appropriate. The Board agreed to eliminate the word existing from the amendment.

2. Mr. Jackson – In those instances when the document referred to the amended standards as “guidance”, it was agreed to change the references to “amendments.”

3. Mr. Jackson – (Pg. 9 Par 4.) “The Board encourages those Federal entities that apply the guidance outlined in this standard to put into place processes and practices (i.e., adequate systems and internal control practices) that will sustain the adequate capture of the original transaction data historical cost values of their G-PP&E.” Mr. Jackson stressed that adding the word “capture” was important to the context of the point being emphasized in the paragraph. Mr. Farrell asked staff if the sentence implies that entities must have its “processes and practices” in place before being able to use the estimates. Other members explained that the sentence was an encouragement to those entities that choose to use estimates to work towards establishing “adequate processes and practices”. The Board agreed to further edit the sentence by adding “for future acquisitions” and removing “original” to better clarify its meaning. The paragraph was changed to read: “The Board encourages those Federal entities that use estimates to approximate the historical cost values of G-PP&E to establish processes and practices for future acquisitions (i.e., adequate systems and internal control practices) that will capture and sustain transaction based data that meet the G-PP&E historical cost valuation requirements.”

4. Mr. Steinberg – (Pg. 11 Par [40.]): “<u>Although the measurement basis for valuing general PP&E remains historical cost,</u> reasonable estimates may be used to establish the historical cost of existing general PP&E, in accordance with the asset recognition and measurement provisions herein.” Mr. Steinberg noted the importance of stressing in this amending paragraph that the basis for valuing G-PP&E remains historical cost (see add language underlined above).

5. Mr. Jackson suggested removing the phrase “original transaction data” throughout the document because it seemed to imply that one might need to obtain that data to confirm the reasonableness of the estimates. That would be an onerous requirement and render the proposal useless. Staff did not agree with the elimination of this phrase because it is used to distinguish historical cost valuation via original transaction data vs. historical cost valuation via an estimate. Ms. Payne pointed out that during the initial research phase of this project staff was frequently asked if the proposal changes the basis of accounting for the valuation of G-PP&E. Therefore that distinction between “original transaction based historical cost” and “other estimates of historical cost” needed to be made. Mr. Jackson also wanted to clarify that “original transaction based historical cost” data was not necessary in order to use estimates. After some discussion, the

Board did not agree to remove the phrase from the ED, except in the instance noted in number 3 above.

6. Mr. Jackson suggested revising the last sentence in the Executive Summary. [Original] “Absent such an acknowledgement, significant resources likely will be committed to developing precise estimates that remain a poor substitute for adequate systems and controls.” [Mr. Jackson’s suggested revisions] “Absent such an acknowledgement, significant resources likely will be committed to developing historical cost information in an environment in which systems and controls have not been established for this purpose.” Staff did not agree with this change because they believe this change deviates from the intended meaning. After some discussion the Board agreed that the sentence was not necessary and to remove the sentence from both the executive summary and the basis for conclusions.

7. Mr. Schumacher suggested revising paragraph 2 in the introduction. Mr. Schumacher noted that the “implementation period” notion no longer applied in this amendment. The Board agreed to revise the sentence to read, “This method is available to reporting entities that have not previously prepared financial reports but who may be required or elect to do so in the future and <u>do not yet have adequate controls or systems to capture these costs</u>.”

8. Mr. Allen asked if it was necessary to expose the ED for 90 days. The Board agreed to a 75 day exposure period due to the timing of the release. The comments will be due by January 30, giving staff time to provide those comments at the February Board meeting.

9. Mr. Dacey suggested revising the heading above SFFAS 6 amended paragraph [40] to eliminate the initial capitalization notion. The Board agreed to the change.

10. Mr. Dacey asked the Board if the notion of “reasonable approximation of historical cost” as noted in the BFC in paragraph A12 (“In this case, estimates should provide a reasonable approximation of historical cost; the measurement basis required for G-PP&E.”) should be carried into the actual standard. Mr. Reid stated that he did not agree with adding that notion to the actual standard because it may be assumed that original transaction based historical cost data would be necessary to substantiate the developed estimate. Mr. Dacey wanted to ensure that the Board was satisfied with “reasonable” as the sole qualifier for the use of estimates. The Board agreed to leave the language as is.

11. Mr. Dacey asked that SFFAS 23 amended paragraph [16] be clarified to only apply to entities previously reporting and not those upon initial capitalization. The

Board agreed to a revised sentence to read, "Initial application of this standard by an entity previously reporting should be treated as a correction of an error in accordance with SFFAS 21."

12. Mr. Dacey asked if the intent of the amendment is to require entities, in the financial statement disclosures, to describe the nature of the estimates every year the estimates are used as outlined in SFFAS 23 amended paragraph [18]. Mr. Farrell pointed out that entities are normally required to disclose their use of estimates in their significant accounting policies footnote. The Board agreed to clarify that the use and general basis of estimates should be disclosed when estimates are used.

13. Other minor wording changes were also agreed to by the Board.

CONCLUSION: The Board agreed to the revisions to the ED. Eight affirmative ballots were received to release the ED for comment.

- **Appropriate Source of GAAP and GAAP Hierarchy**

Mr. Simms and Ms. Ranagan presented the Generally Accepted Accounting Principles (GAAP) Hierarchy project. Mr. Simms introduced the project and explained that the objective for the meeting was to discuss the draft exposure draft (ED) entitled, *Hierarchy of Generally Accepted Accounting Principles, Including the Use of Standards Issued by the Financial Accounting Standards Board*. The draft ED discussed: (1) the GAAP hierarchy for federal entities; (2) guidance for entities currently preparing financial statements in conformity with the Financial Accounting Standards Board (FASB) standards; (3) guidance for newly created entities; and (4) a requirement for entities following FASB GAAP to provide FASAB information for the consolidated financial report of the U.S. Government. In addition, Appendix C: Examples of Federal Entities that Apply FASB Standards of the draft ED included a listing of federal entities that currently apply FASB standards and a listing of some of the areas where differences have been noted between FASAB and FASB accounting and reporting. The listings were intended to help respondents in preparing a response to the question of whether they agree or disagree with the board's position that federal entities that have applied FASB standards in the past may continue to do so. Accordingly, the appendix would not be a part of the final standard.

Members acknowledged that the American Institute of Certified Public Accountants (AICPA) plans to remove the hierarchy from its auditing standards and they are interested in the FASAB's timetable for incorporating the GAAP hierarchy into a statement of federal financial accounting standards. Along with the GAAP hierarchy, members discussed what additional proposals should be included in the ED. In particular, members discussed whether to include: (1) examples of federal entities applying FASB standards and differences between FASAB and FASB accounting and reporting (Appendix C of the ED); (2) a requirement for entities following FASB GAAP to provide FASAB information for the consolidated financial report of the U.S. Government (par. 12 of the draft ED); and (3) guidance for newly created entities (pars. 10 and 11 of the draft ED). Also, members discussed the need for guidance regarding how to apply the hierarchy to analogous transactions or events.

Considering the need to issue the ED timely, the Board agreed that it would not require changes in practice at this time and agreed that in conjunction with the GAAP hierarchy, the ED would include proposed standards regarding: (1) newly created entities; and (2) how to apply analogous transactions and events. Rather than proposing standards that could affect current practice, the Board determined that the ED would present issues to help gather information for a companion project, the Appropriate Source of GAAP. As a result, the Board agreed to remove the requirement for entities following FASB GAAP to provide FASAB information for the consolidated financial report of the U.S. Government and the issue could be addressed in the companion project.

In the Appropriate Source of GAAP project, for the standalone financial statements of entities following FASB GAAP, the Board plans to consider additional reporting that may be required to meet the federal reporting objectives. In addition, the Board plans to consider whether consolidated information should be on a FASAB basis. Consequently, the ED would include questions to gather information related to these issues. The ED would retain Appendix C: Examples of Federal Entities Applying FASB Standards to assist respondents in considering the issues. Members also provided comments to help clarify the proposals in the ED. The following paragraphs present the issues discussed regarding the document.

Examples of Federal Entities that Apply FASB Standards and Differences between FASAB and FASB Accounting and Reporting

Mr. Patton expressed concerns about the role of Appendix C: Examples of Federal Entities that Apply FASB Standards of the ED and the function it served. He noted that the “Description/Characteristics" column induces the reader to compare those entities to the criteria in paragraph 11 of the ED. Ms. Ranagan explained that the appendix was directed to respondents who may not have an understanding of what agencies are applying FASB standards. This would help them to provide a more substantive response. It was intended to be provided in the ED, but not in the final standard. Staff could clarify the role of Appendix C in the introduction to the Appendix. Mr. Jackson noted that the appendix was enlightening and would be helpful as the Board moved forward to develop a standard in the next project (Appropriate Source of GAAP). He said it would appear that there are at least three entities in the appendix that should be following the FASAB standards.

Mr. Patton stated that the focus of the ED is to move the GAAP Hierarchy from the auditing literature to the FASAB accounting standards. However, Appendix C seems to be the next step. Mr. Allen stated that the Board has decided to move the GAAP hierarchy to the accounting standards and that the entities following FASB standards may continue to do so. Mr. Patton responded that the companion project, the Appropriate Source of GAAP, seems to address the issue of whether entities may continue following FASB standards.

Mr. Allen agreed that the best use of Appendix C may be in the next project, the Appropriate Source of GAAP. However, the appendix has some use at this point - to enhance discussion of the Board's decision.

Mr. Patton noted that the ED also includes a discussion of differences between FASB and FASAB accounting and reporting. This discussion also seems out of place for transferring the GAAP hierarchy. Ms. Ranagan added that the title of the ED was revised to indicate that the document not only discussed moving the GAAP hierarchy into the FASAB accounting standards, but it included guidance for those entities currently following FASB standards and authoritative guidance regarding the information those entities need to provide for the consolidated financial report. Appendix C helps provide respondents with a basis for answering questions 2 and 3 posed in the ED.

Mr. Patton stated that the Board needs to indicate what it wants readers to do with the appendix. Mr. Jackson added that Appendix C provides information on the differences between FASAB and FASB standards that would be essential to respondents. He noted that it would be difficult for a respondent to answer the questions for respondents without an extensive search of FASAB literature.

Mr. Reid believed that the requirement to provide FASAB information is not new. He believed that the Treasury Financial Manual has required entities to provide FASAB information for quite a while. Mr. Jackson noted that the accounting literature has to prescribe the reporting requirements so that if the requirements are not met, it will affect the audit opinion on the entity's financial statements.

Requirement for FASB GAAP Entities to Provide Additional Information (par. 12 of the draft ED)

Ms. Payne clarified paragraph 12[1] of the draft ED. She noted that the paragraph is a requirement on the FASAB entity that consolidates an entity following FASB. Mr. Allen asked whether the Board was ready to say that every preparer has to deal with the FASAB standards listed in Appendix C of the draft ED. He believed that the Board was in a "holding pattern." Paragraph 12 of the draft ED would allow Mr. Reid to get the information he needed until the [Appropriate Source of GAAP] project was completed and we could inform entities whether or not they can follow FASB standards.

[1] Par. 12 of the draft ED states, "When financial information of entities that prepare separately issued (stand-alone) general purpose financial reports through the application of standards issued by the FASB is included in general purpose financial reports of another federal reporting entity (e.g., the CFR), any standards issued by the FASAB that call for additional reporting or supplementary information are applicable."

Mr. Dacey indicated that he thought that entities could include information in the consolidated report on a FASB basis as long as it did not cause a consolidation problem. If an entity is using fair value on a FASB basis, it can be rolled into the consolidated report. However, he believed the problem occurred when they valued intergovernmental transactions on a different basis from FASAB. In those instances, additional information would be needed to adjust those statements.

Mr. Werfel noted that paragraphs A4-A7 of the draft ED provided a history of the Board's discussion and the resulting decision. Ms. Payne indicated that paragraph 12 of the draft ED discusses additional reporting or supplementary information. It may not be clear whether differences in measurement may be reconciled. Mr. Reid noted that paragraph A7[2] and paragraph 12 are not consistent. Members believed that paragraph A7 should be included in the standard rather than in the basis for conclusions.

Mr. Dacey stated that he believed the FASB entities would then need to track the equivalent of FASAB reporting, which was a cost issue that the Board was considering. Disclosing material differences between FASB and FASAB standards would cause a lot more work. Mr. Reid believed that the additional work would cause the entities to convert to FASAB standards. Mr. Werfel stated that paragraphs 12 and A7 need to be reconciled so respondents know how to respond.

Ms. Payne noted that the paragraph 12 is aimed at the consolidating entity. It is not placing a GAAP requirement on the FASB reporting entity, which was the goal for this phase. In the subsequent project (Appropriate Source of GAAP), we would address the requirements for the standalone FASB reporting. Mr. Dacey noted that he thought the Board had previously discussed whether the consolidated financial statements should be on a FASAB basis and decided to allow both FASAB and FASB. The first step would be to get what information we needed and the second phase would involve more deliberation before placing additional requirements on entities. Based on the international community's experience, it would not be an inexpensive exercise for entities to reconcile differences.

Mr. Reid noted that if we want to maintain the status quo, paragraph 12 would need to be removed along with question 3 for respondents. Question 3 relates to paragraph 12.

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[2] Par. A7 of the draft ED states, "At the February 2008 meeting, the Board tentatively decided that no federal entities will be required to convert to FASAB standards for their standalone general purpose financial reports at this time. The Board is also comfortable with including two sources of GAAP in the CFR; however, the Board believes that information provided to the U.S. Department of the Treasury for inclusion in a consolidated financial report presented in accordance with FASAB GAAP should conform with accounting and reporting principles issued by the FASAB if material differences would exist as a result of application of standards issued by the two boards. The Board has initiated a separate project, Appropriate Source of GAAP, to assist the Board in determining whether additional reporting should be required in standalone general purpose financial reports of federal entities that are currently applying FASB accounting standards."

Mr. Jackson noted that the Board should remove paragraph 12 and let that be the subject of the next project. He stated that based on the discussion, the Board does not have enough information to determine how to proceed.

Mr. Reid noted that if the Board wants to say that we should make some adjustments in consolidation for those significant differences, then those significant differences need to be identified at the agency level. Mr. Schumacher stated that the question is how costly will it be to provide that information - should the Board have the entities incur the cost now or wait until the Board enters phase 2.

Mr. Jackson suggested that to expedite moving the GAAP hierarchy into the FASAB standards, the Board should consider removing proposals, such as paragraph 12, from the draft ED and asking questions that would allow the Board to collect information necessary to move to the next level - identifying entities that should be following FASAB standards. The Board could move forward with the status quo, but indicate that the Board is looking at the entities in Appendix C and, in the future, looking to set requirements that may require information necessary to prepare the consolidated financial statements on a FASAB basis.

Mr. Steinberg noted that there is a danger that an entity could look at the hierarchy and determine that because Level A does not address them – the FASAB standards are not applicable to their situation – the standard allows them to go ahead with preparing statements in conformity with the remaining levels. He noted that there are three issues to consider answering:

1. Should we use this standard to get FASB entities to provide the “additional” information needed to consolidate into a FASAB-based financial statement?
2. Do we want this to apply to just the CFR or all instances where a FASB entity is consolidated into a FASAB statement?
3. Do we want to put the requirement on the FASB entity to provide the information rather than leave it on the FASAB entity to obtain the information?

Mr. Allen noted that if the Board maintains the status quo, the answer now would be “no” to each question. The status quo is that the Board is not requiring the FASB entity to provide the additional information for consolidation. Mr. Steinberg stated that when consolidated statements are issued, the first question is whether the consolidated statements should be on one basis. If we say no, then the other questions are not relevant.

Mr. Dacey noted that the Board could focus on the standalone statements of an entity choosing FASB and be silent on what happens “upstream.” Then the Board could state and ask questions about the next phase, such as how does a consolidating entity report get this information. The Board started with a grandfather clause which focused on the standalone statements.

Mr. Farrell noted that the Board started with the purpose of incorporating the GAAP hierarchy into the accounting standards. Also, the Board noted that it did not want to change practice at this time. Combining the GAAP hierarchy with other issues is confusing. The Board has a separate project (Appropriate Source of GAAP) which could deal with the other issues.

Members generally agreed that the ED could be used to gather information about whether the consolidated financial statements should be on a FASAB basis. Mr. Jackson stated that the ED could have two objectives: (1) to provide a hierarchy in the accounting literature; and (2) to collect information to facilitate improvement of the hierarchy through a companion project. The discussion related to collecting information could be presented in an appendix that will not impede the issuance of a final standard. The purposes of the document need to be clearly stated.

<u>Guidance for Newly Created Entities (pars. 10 and 11 of the ED)</u>

Ms. Ranagan asked whether members had comments on paragraph 11. At the August 2008 meeting, the Board was evenly divided on whether to include characteristics for newly created entities and whether to allow newly created entities to follow FASB standards.

Mr. Allen noted that paragraph 11 is a companion to paragraph 10. Mr. Jackson stated that if paragraph 10 is retained, he would start paragraph 10 with, “except as provided in par. 11…” This would inform the reader of an exception. Regarding par. 11, the question is whether the criteria are sufficient.

Regarding par. 11, Mr. Allen expressed concern that the Board may develop different criteria in the next project, the Appropriate Source of GAAP. Mr. Reid noted that if the Board tentatively decided that it would prefer a report prepared in conformity with FASAB standards, par. 11 is consistent with that objective and he believed that paragraph 11 should be retained. Mr. Dacey noted that if context is added that the Board is considering another project, and this is not “the end,” the Board will receive comments on the criteria and entities can inform the Board of their views.

Mr. Patton stated that if the Board retains the criteria as a way to gather information, there should be a clear distinction between the standard and the research. The standard should be paragraphs 5-8, and the research would be any additional information. Also, the title should be revised to simply, “The Hierarchy of Accounting Principles.”

Mr. Reid believed that paragraph 10 is significant and it puts everyone on notice that FASAB standards are pre-eminent and this is the direction the Board is headed. Mr. Patton added that paragraph 5a says that the hierarchy starts with FASAB standards.

Mr. Dacey noted that he would like to get comments on the criteria in paragraph 11 and the Board is trying to resolve "grandfathering" FASB entities in the short term.

Mr. Patton noted that it would be a mistake to combine a transfer of the AICPA hierarchy and other information that may be useful for another standard. Mr. Reid noted that the Governmental Accounting Standards Board (GASB) may not be in favor of a hierarchy. The combined approach is consistent with that thinking – that the Board is focusing on the FASAB standards (paragraph 5a) and exceptions are rare.

Mr. Steinberg noted that if paragraph 10 is included, then paragraph 11 should be included for those rare instances and, if paragraph 11 is included, there may be some entities using FASB standards. If there are entities using FASB standards, then the Board needs to provide for those entities to submit information for preparing consolidated reports.

Ms. Ranagan asked members to clarify whether paragraph 9 should remain in the ED. She noted that the standard could "trump" the newsletter's grandfather provision for FASB entities and, if the paragraph were removed, auditors could interpret the ED as requiring all federal entities to follow FASAB standards. Members agreed to retain paragraph 9.

<u>Summary of Members' Votes on Issues</u>

The table below summarizes members' votes on whether to: (1) retain Appendix C: Examples of Federal Entities Applying FASB Standards; (2) remove par.12 (requirement for FASB GAAP entities to provide additional information), but include questions to collect information for the companion project, Appropriate Source of GAAP; and (3) retain pars. 10 & 11 regarding newly created entities.

Board Member (*Acting*)	**Retain Appendix C**	**Remove Par. 12 (but include questions to collect information for the companion project)**	**Retain Pars. 10 & 11 of ED**
Allen	Yes	Yes	Yes
Dacey	Yes	Yes	Yes
Farrell	Yes, but include expanded intro paragraph	Yes	Yes
Werfel	Yes	Yes	Yes
Jackson	Yes, but only the differences in FASB and FASAB section	Yes	Yes, but in a separate section to generate comments

Board Member (*Acting*)	**Retain Appendix C**	**Remove Par. 12 (but include questions to collect information for the companion project)**	**Retain Pars. 10 & 11 of ED**
Patton	No	Yes	No, but willing to have a standards section and a "looking for information section"
Reid	Yes	Yes	Yes
Schumacher	Yes	Yes	Yes
Steinberg	Yes, provided its purpose is defined in the text	Yes	Yes, in a separate section
(*Torregrosa*)	Yes, but drop the description/characteristics column; retain the listing of entities and the differences between FASB and FASAB standards.	Yes	No
Majority	**Yes**	**Yes**	**Yes**

Analogous Transactions and Events

Mr. Werfel noted that the second sentence in paragraph 7 needs some clarification. The sentence states,

> A federal reporting entity should not follow the accounting treatment specified in accounting principles for similar transactions or events in cases in which those accounting principles either prohibit the application of the accounting treatment to the particular transaction or event or indicate that the accounting treatment should not be applied by analogy.

In particular, Mr. Werfel noted that the phrase, "…should not be applied by analogy," was not clear. Also, Mr. Werfel noted that some language may be needed for instances such as if applying another accounting standard-setter's principles for a transaction is not going to lead to a materially different outcome, then FASAB standards should be applied. In other words, it would be helpful to have greater clarity on whether the top of the GAAP hierarchy, where there is an analogous situation, trumps the bottom of the GAAP hierarchy where the guidance is more on point. Mr. Dacey added that the ED needs a framework to clarify some of the responsibilities for analogizing. The language in Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, could help make it clear what one should consider when analogizing before going to other literature. Members agreed that the language for analogizing could be enhanced.

Additional Comments

Mr. Allen noted that the questions for respondents should be framed in a neutral fashion. For example, respondents should be asked whether they agree or disagree with a position and they should be asked to explain the reason for their position.

Mr. Jackson stated that paragraph 13 should be clarified. The last sentence appeared redundant.

Mr. Steinberg noted that every appendix should have a reference in the text.
Ms. Ranagan noted that Appendix C would help address question 2. Question 2 could include a reference to Appendix C.

Mr. Dacey believed that the phrase "newly created" may need to be changed to "entities preparing their first GAAP financial statements."

> **CONCLUSION:** Staff will incorporate members' comments and provide the Board with a revised draft ED for tomorrow's (October 23, 2008) discussions (see minutes from discussion of revised draft on page 53).

- **Measurement Attributes**

Ms. Wardlow presented a memo containing a staff analysis that (1) identified the measurement attributes required for assets or liabilities by SFFAS 2, Accounting for Direct Loans and Loan Guarantees; 3, Accounting for Inventory and Related Property; and 6, Accounting for Property, Plant, and Equipment, (2) discussed the Board's reasons for selecting those attributes, (3) assessed the relationship between those attributes and the FASAB Objectives of financial reporting (SFFAC 1), and (4) compared those attributes with the measurement bases identified in Milestone I of the FASB/IASB joint measurement project. She also gave the Board a handout with three alternatives (see later in the minutes) for the future course of the project and asked the Board to select one alternative, or a different alternative, at the end of the meeting. As an update on the FASB/IASB measurement project, Ms. Wardlow reported that at their joint meeting in October the two Boards had not discussed the possible new approach that a working group had been developing for their consideration. Therefore, the future course of the joint project continued to be uncertain.

Referring to information in the staff memo, Mr. Patton said he was impressed by the number of different attributes in FASAB standards and the ad hoc nature of their adoption over time. He hoped the Board would be able to simplify the structure and provide a conceptual rationale for various measurements in a multi-attribute model so that the Board would not have to create attributes as standards are developed.

Mr. Reid said the Board had discussed in June the possibility of appointing a task force. He thought that, instead, more progress would be made by directing the staff to try to rationalize the list of attributes (Table A in the staff memo). He thought a number of items on the list were conceptually either identical or very similar to each other and perhaps the list could be reduced to four or five attributes.

Mr. Allen asked Ms. Wardlow about the GASB's approach in their measurement project. She responded that the GASB is focusing on fair value and historical cost, although the Board will not necessarily use those terms.

Mr. Reid asked whether the list of attributes in Table A of staff's memo could be rationalized into either historical cost or fair value. Ms. Wardlow said she thought several of the attributes were basically historical cost, including some kinds of ancillary costs. Fair value and market value also are listed, but in the source standards they appear to mean the same thing. She believes some items in Table A are not measurement attributes although they are treated as such in the standards. However, in her memo she did not recommend items for elimination as attributes. The intent of the memo was to remind the Board of the number of attributes required in current standards and to ask for the Board's views on the number and kinds of attributes that should be considered in developing a concepts statement on measurement. She likes the simplicity of looking only at fair value and historical cost. However, there are different concepts within those two terms and breaking them out would lead to a more useful concepts statement. For example, some members are interested in replacement cost. Mr. Allen asked whether replacement cost is not simply a variation of fair value. Ms. Wardlow said it could be but there are different forms of replacement cost. If the concepts statement is to give guidance for future standard setting, then the Board might wish to break out and define the different forms of replacement cost. She thought the concepts statement would be less useful if the Board tried to collapse a number of different concepts into two terms.

Referring to Mr. Allen's question about whether replacement cost is fair value, Mr. Jackson asked Ms. Wardlow whether, for an existing asset, fair value would include an assessment of impairment. She said yes. Mr. Jackson agreed and said that means replacement cost is not necessarily fair value; an asset's fair value could be its impaired value. Ms. Wardlow said there are other attributes that also are not in Table A, such as value in use. That is an entity-specific concept, rather than one that applies to all entities, and may be more useful for managerial decision-making than for external financial reporting. She is unsure whether the Board would want to include that kind of concept. However, her point is that she believes there are a number of attributes that the Board would wish to consider before deciding whether to focus on fair value and historical cost or on a broader range of attributes.

Mr. Allen said he thinks the GASB must realize there are more attributes than fair value and historical cost. He thinks that what the FASAB starts with in the project may determine how fast it progresses. One could explore the whole range of possibilities and then decide where the Board should place its main focus, or one might decide there is an advantage to focusing on two attributes, acknowledging that there are variations but not treating them as separate attributes. He asked Ms. Reese, GASB project manager, to comment on why GASB is not addressing all of the variations of historical cost and fair value or market value.

Ms. Reese said that the GASB wished to stay at a conceptual level. The GASB believes that when one looks at more detailed levels one must consider specific assets and liabilities, which is closer to a standard-setting issue. She said she understood that, unlike the GASB's project, the scope of the FASAB project scope was limited to measurement at initial recognition. Ms. Wardlow said the project might start with that, but one also would have to look at subsequent measurement. Similarly, the initial focus would be on measurement in the financial statements and notes, but later in the project, or in a subsequent project, the Board might want to look at measurement in required supplementary information and other supplementary information where other attributes might be needed. Ms. Reese explained that the GASB is attempting to distill the essence of historical cost and fair value. Lately the Board has been using terms like "original transaction-based value," meaning historical cost and any adjustments or fair value of an asset at the donation date, versus what GASB staff recommends be called "re-measured value." That term means that each time a government prepares financial statements it takes an asset or liability and re-measures it, as opposed to continuing to carry the original transaction-based value and adjusting it as time progresses, as in principal repayments, amortization or depreciation. "Original transaction-based values" versus "re-measured values" would be the fundamental split, but there are different ways of doing it. For example, fair value is a way of re-measuring, but you also have replacement cost, value in use, and perhaps other ways. The GASB has not yet decided on the level of detail under the two broad umbrellas of historical cost and fair value. For historical cost, there are the variations of with or without associated costs. The GASB also acknowledges that fair value and historical cost are the same at the transaction date. The GASB assumes that for most transactions there is an exchange, or a value in kind for a non-exchange transaction, and the value of that exchange is the same as fair value at the exchange date. As time goes by, that value can change. The idea is to keep it fairly simple. Mr. Allen asked whether the GASB would address in statements of standards issues such as historical cost plus additional costs, such as shipping. Ms. Reese agreed, saying that sometimes the same principles do not apply to all kinds of assets and liabilities.

Mr. Patton asked Ms. Reese to define the word "re-measure" and compare it with "revalue." Ms. Reese said the GASB is using "re-measure" to indicate the value placed on an asset or liability at the date of the financial statements. It could be any of several ways of measuring—exchange value, entry or exit value, replacement cost—any of those valuations related to the financial statement date. Mr. Jackson asked whether "re-measurement" would include impaired value. Ms. Reese said that in some cases impairments are reported by writing down the asset to fair value, but the question is whether you continue to re-measure the asset at fair value or whether it is a one-time write-down. In the GASB standard on impairment of assets, all measures are based on the original transaction amount.

Mr. Steinberg, referring to accounts receivable, said they might be at net realizable value at the date of the transaction, but three months later, if they are not collected, one might decide to reserve fifty percent of the amount, so it is "re-measured" and keeps being re-measured until paid. Ms. Reese said she thinks that what is "net realizable value" is tricky. It could be considered a future value because it is what one expects to collect in the future; the collection does not occur at the date of the financial statements.

Mr. Steinberg responded that at the transaction date the entity sold something and gave up that much in exchange, so that is the fair value or historical cost at that date. Ms. Reese said one could also argue it is a future value because it is reported at the amount the entity expects to collect in the future. Mr. Steinberg agreed.

Ms. Wardlow said that a difference she thought might exist between the FASAB and GASB projects is that, to date, the FASAB does not intend to look at specific assets or liabilities. Instead, the Board will look at certain types of transactions or events and what would be the best way to measure them compared with the reporting objectives and the kinds of decisions the information might inform. In that way, the concepts statement will include the basic concepts for the choice of measurement attributes in future standards. At their joint meeting in August, both the GASB and the FASAB indicated that in different situations one might choose different attributes. Also, like the GASB, the FASAB does not want the concepts statement to turn into a type of standard by, for example, rank-ordering preferences for different attributes. Instead, the goal is to describe the pros and cons of different attributes either for meeting the reporting attributes or for particular kinds of decision making. Then in particular standards the Board would require particular attributes for particular types of transactions and explain the choice. She said she thinks that kind of concepts statement would be useful and would include discussion of more than two attributes. Whether ancillary costs—referred to in the FASB/IASB Milestone I definitions as “related prices” —would be included in the definitions of attributes might be a secondary consideration. The concepts underlying inclusion or exclusion could be explained in the concepts statement without having separate attributes to include or exclude ancillary costs. The reasoning would be that the inclusion or exclusion of ancillary costs might vary according to the focus of a particular standard.

Mr. Patton agreed that a concepts statement should not include rules for the measurement of particular assets. However, would it be possible to identify classes of assets, where the class, defined perhaps by the purpose for which it is held, might drive the kind of measurement attribute to be associated with it? One way of thinking about it would be: You might have one kind of measurement attribute if assets are held for the purpose of being used in the production of government services and another kind if the asset is held for symbolic purposes—a kind of stewardship. Or, if the government is holding the asset for possible resale, that would suggest another kind of attribute. Mr. Patton was not suggesting that those are necessarily the right three classes to look at, but he thinks it would be useful to aggregate assets in some way and to conclude, based on the FASAB’s reporting objectives, that these kinds of measurements would be useful for these kinds of objectives. Ms. Wardlow responded that staff could work with that approach.

Mr. Jackson said one could think of fair value on a continuum—on day one, what you paid for an asset or the value of a donated asset on the donation date. Along the continuum fair value means different things—remaining economic utility of an asset or something else with regard to a mortgage-backed security—what you could recover from it, for example. Fair value is simple on day one, but as you move forward with regard to different assets or accounts or liabilities it means something different—economic utility, recovery cost, or other things.

Referring to Mr. Patton's comment on the intended use of an asset, Mr. Steinberg said the federal government already looks at that—for example, treasury investments where the intent is to hold them until maturity and then use them for pensions and other benefits. He thinks the notion of intended use is important. Regarding mark-to-market, consideration should be given to whether there is intent to market; if not, mark-to-market may not be appropriate. Another issue is complexity. For example, in the recent financial difficulties, banks have said that the instruments in question are so complex that no one understands them. A third issue is measuring quantities, which are discussed in a FASAB standard (certain forfeited assets) and would not be measured in dollars. Fourth, he believes it would be better to have the staff develop an outline of the concepts statement for Board comment than to engage a task force at the beginning of the project. He suggested the research should start with the attributes required in FASAB standards and then look at any FASB/IASB attributes that the FASAB has not addressed but which could be useful in the federal environment.

Mr. Allen said he would like to identify the measurement attributes that would be most useful for meeting particular reporting objectives. He also would like to have answers from the Board's project on the meaning of the financial statements: who are the users and what kinds of questions are they trying to answer. For example, if people look at financial statements to assess intergenerational equity, one would argue that historical cost is irrelevant to how one should value an asset. Replacement cost is more relevant. He thinks the Board can make progress by just understanding what the attributes are, but he is struggling with whether it would be easier to start with historical cost and fair value, like GASB has, and go forward with identifying objectives or classes of assets for those measures, but acknowledging that they have many variations that the Board may want to consider, depending on the nature of the asset. He wondered how much progress can be made with the measurement project and whether the Board would want to stop somewhere and look at the progress in Mr. Simms's project, or whether the Board should proceed with the measurement project using the existing financial reporting objectives and take another look if those objectives change.

Mr. Dacey said the Board could work with what it has now. The staff memo demonstrates what happens in general standard setting. The GAO and others have found great inconsistencies in the auditing standards because no one really focused on clarity. He agrees with trying to put measurement attributes in a context by classes of assets, but he would not spend a lot of time on it. The FASB/IASB project may at some point have research results that would help the FASAB understand how we should change what we have and perhaps we should wait for that before changing the FASAB's approach. But, the FASAB project work would help crystallize what we currently have. Mr. Allen said the FASAB has a project on re-looking at existing standards and Mr. Dacey agreed that project has related issues.

Ms. Wardlow asked for any comments on a question in her memo about "cost." She said that in the three standards she examined, the term "cost" is used in many different ways and she found it very difficult to deal with that. She wondered whether the notion of "cost" should be clarified and defined in the concepts statement so that the term would be used consistently. Mr. Patton said he always told his students never to use the word "cost" without an adjective in front of it, because otherwise the meaning is not clear. Mr. Steinberg said the Accountants' Handbook has twenty-seven definitions of "cost." He would clarify where each of the meanings assigned to "cost" in FASAB standards falls in the FASB/IASB lexicon of attributes. Mr. Allen said Ms. Wardlow had done that in her memo and said that the examples could fall in three different places in the FASB/IASB list. Mr. Steinberg said the Board then should discuss the issue; he would not want any of the terms on pages 23 and 24 of staff's memo to be forgotten. The Board might decide in which classes certain terms fall and then arrive at a common term. He would not like to use some of the FASB/IASB terms, such as "past entry price."

Mr. Reid said he would reduce the FASAB list (Table A) as much as possible and if there are terms that could fit in various places the Board should discuss that at the next meeting. The Board may be able to make a decision or might need to wait until the FASB/IASB proposes something, or maybe the Board should just move forward. One of his concerns is whether the FASAB standards have terms that are misleading to preparers, because in different standards the same term is used differently or different terms are used for the same concept. He is more concerned about that than simply deciding there should be some uniformity and linkage to what other boards are doing. If FASAB standards did not have different terms meaning the same thing or terms meaning different things in different standards, then he would be more inclined to wait and see where the FASB/IASB project is going and decide whether that implies the FASAB should follow suit.

Mr. Allen said he had heard a couple of members refer to identifying classes of assets and deciding how the measurement attributes might apply to FASAB's current reporting objectives. Mr. Patton said when one starts to think about measurement attributes it is natural to think about various types of assets, but he assumed the Board also would discuss measurement attributes for liabilities. Ms. Wardlow agreed. Mr. Patton said he is unsure what kinds of classes liabilities would fall into—perhaps monetary and nonmonetary. Ms. Wardlow said she was unsure how to classify assets and liabilities, but she likes the approach. She thinks it ties in with Mr. Reid's comments, because in the concepts statement one would need to be broader than looking at particular definitions for particular transactions. The concepts statement would consider how certain measurement attributes meet the financial reporting objectives. She thinks Mr. Simms's project will be very useful but, for the moment, the Board will need to work with the current financial reporting objectives. Mr. Allen said he agrees that one should not look at particular definitions and transactions. However, the Board has a project to re-examine standards and it would be good to take the words used to support certain measurement attributes in current standards and realize that when there is a certain financial reporting objective, those are probably the words one should use. So, if the Board is re-examining one of those standards, the Board could perhaps make some corrections and be more specific in how the words are used.

Mr. Allen asked Ms. Wardlow to go through the three alternatives for proceeding with the project that are included in her handout, and then he would like to hear members' preferences individually. Ms. Wardlow read the alternatives and briefly described some pros and cons of each alternative. The alternatives are:

1. Proceed, with the aid of a small task force, to examine (i) the relationship between FASB/IASB proposed measurement attributes (Milestone 1) and SFFAC 1 financial reporting objectives and (ii) the decision-usefulness of the attributes.

2. Staff would develop an outline of the scope and content of a concepts statement on measurement attributes. Research would include the FASB/IASB Milestone I measurement attributes as well as certain attributes required by FASAB standards. The outline could be presented to a task force for discussion and recommendations before being presented to the Board.

3. Defer work on the measurement attributes project until the FASB and IASB have decided on their new approach.

Mr. Jackson asked whether it would make sense to focus on alternative 2 and give the Board a better understanding of the attributes. If the Board goes with alternative 3, the Board would be waiting and then sometime in the future would have to decide what to do, which could be start from scratch, adopt what the FASB and IASB do, or something else; we do not know at this stage. Alternative 2 would give the Board some insights that would position the Board to better evaluate what the FASB and IASB do later. He is not sure how well the Board is positioned currently to evaluate anything the two Boards do. He asked Ms. Wardlow how she would proceed. She said she would go with alternative 2. In her view alternative 3 is risky for the reasons Mr. Jackson stated. With regard to alternative 1, she thinks it is premature to use a task force at this stage. She agrees with Mr. Jackson’s comments about the usefulness of having an outline or skeleton of the concepts statement; it would help the Board evaluate what the FASB and IASB do and also what the GASB does.

Mr. Allen said he would like to hear briefly from each Board member and then take a vote. Mr. Steinberg said that under alternative 2 the outline could be presented to a task force for discussions and recommendations before being presented to the Board. He asked Ms. Wardlow what she expects the task force to tell us. She responded that the task force would see from the outline what the concepts statement would look like and assess how it would help the Board, preparers, and auditors. The task force could comment on the reasoning behind the proposal and on whether they think the ideas to be presented in the concepts statement would meet the financial reporting objectives, how well the attributes would fit their current work, and so on. The task force would have more to work with than just a list of measurement attributes and their definitions.

Mr. Reid said he would prefer alternative 2. He thinks it is premature to use a task force; he would look to the FASB and IASB to fill that role. He likes the idea of putting together what might be called a draft concepts statement as a place to start. It would give a sense that we are moving in the right direction and it would help him see the need for what we are doing and that it will have a tangible benefit.

Mr. Farrell said he favors alternative 2 and he likes Bob’s reference to a “draft concepts statement.” He thinks the Board knows where it is heading; members intuitively know the parameters, at least on the asset side, of cost versus fair value, and the draft would be putting the logic of why we got there all in the same place and filling in some of the in-betweens. He thinks it would help him understand the project better to have it fleshed out more as to where it is going and then be able to comment on whether the

Board has thought of this or that issue. He thinks that would work better than alternatives 1 and 3.

Mr. Torregrosa agreed with Mr. Reid and Mr. Farrell. He would not necessarily wait for a task force to comment before the Board received the draft. Mr. Reid agreed.

Mr. Allen would go with a fourth alternative, which he thinks probably is closest to alternative 2. He is not particularly interested in seeing the format of a document. He would like to see the list (Table A) reduced. He thinks the Board's task going forward will be simpler if the Board focuses on different and unique measurement attributes. The task would be twice as hard with eight attributes as with four, and four objectives would be twice as hard as two. He also would like an initial assessment against the FASAB's current financial reporting objectives. Assuming, for example, the list can be reduced to three attributes, he would like to see why one attribute would help meet one of the objectives better and why a different attribute would help meet another objective better. That could be in a draft statement, but he would like to be able to answer those questions in his own mind before deciding whether to spend a lot of time on the measurement project. The reporting model project is very important and he is not sure whether staff resources would not be better assigned to that project than the measurement project. He thinks reducing the number of attributes and seeing how they help meet the reporting objectives also would help the Board with its project to review current standards.

Ms. Hug, for Mr. Werfel, referred to alternative 2. She said she thinks starting from a white page with nothing on it would be hard, so she agrees with starting with a draft or strawman and filling out the Board's intent with the concept statement. The Board will not know what to do if it is not clear where it is going. She is not sure whether it is better to go with a task force first or not. The advantage of going to the Board first is if the parameters are not fully captured and the direction and scope of the project are not clear, that should be addressed by the Board and should not result in the task force going a different way. She thinks she would agree with alternative 2 modified.

Mr. Dacey said he might be closer to alternative 4 than to alternative 2. He referred to his earlier comments and said it would be good to have more research and analysis before starting to draft a statement. He was not quite ready to start drafting and that was his only concern with alternative 2. Ms. Wardlow clarified that, with alternative 2, she meant that the staff would do the necessary research to build certain areas of the concepts statement and she is not thinking of a draft at this stage. She thinks preparing a draft statement is further than she could go without receiving more feedback from the Board. Like Mr. Dacey, her thoughts are to build some pieces that would go beyond what the Board has been doing and halt the process of looking at different definitions for different things.

Mr. Schumacher said he is between alternatives 2 and 4 and would like to accomplish a bit of both. He thinks staff could start by trying to reduce the list of attributes from thirty items to three or four and then try to fit that into an outline. He thinks having a task force would be premature and the Board should see the staff results first.

Mr. Patton would start with the classifications of assets and liabilities and the rationales for them and look at the outcome. Mr. Allen asked whether "rationales" would be framed in terms of the current financial reporting objectives and Mr. Patton agreed.

Mr. Allen summarized that all members preferred some variation of alternative 2.

Mr. Steinberg said there should be an outline of the statement. Staff has indicated certain things that should be in the statement and there are a lot of decisions that the Board needs to make. An outline would help the staff identify the decisions that are needed and the Board could provide feedback on the issues that require decisions. He thinks the outline should be developed by staff without a task force. Mr. Allen agreed that sounded productive. Mr. Torregrosa said he liked the approach taken by Mr. Werfel in his outline of an alternative view for a different project, where it was not just "a, b, c" but more substantive. Mr. Jackson said it is useful to look at the FASB/IASB attributes in the context of the financial reporting objectives because the intent of the financial statements is to provide information to meet those objectives.

> **Conclusion:** Staff will work on developing classifications of assets and liabilities. Staff also will look further at how certain attributes compare with the financial reporting objectives and what the objectives say about what should be reported in the financial statements. This work should result in a reduction of the number of attributes in the list prepared from current standards and the candidates developed by FASB/IASB. Staff also will consider what an outline of a possible concepts statement should [contain].

Adjournment

The meeting adjourned at 4:00 PM.

Thursday, October 23, 2008

Agenda Topics

- **Natural Resources**

Participants from DOI

Department of Interior (DOI) representatives **Daniel Fletcher** (Director and DCFO, Office of Financial Management) and **David Horn** (Branch Chief Financial Reporting, Accounting Policy and Systems) appeared before the board to answer questions regarding DOI's comment letter on the May 2007 Exposure Draft (ED), *Accounting for Federal Oil and Gas Resources*, and the related field test questionnaires.

In addition, DOI's field test team representatives **Kelly West** (Senior Accountant, Administration and Budget Finance Division, Minerals Management Service (MMS), Denver), **Tom Farndon** (Petroleum Engineer, Minerals Revenue Management, MMS, Herndon), **Scott Mabry** (Division Chief / Finance Officer, MMS), and **Bill Gewecke**

(Senior Petroleum Engineer, Bureau of Land Management, Inspection and Enforcement) participated via conference line.

Opening Remarks from DOI

Staff member Julia Ranagan indicated that Mr. Fletcher would like to make a brief opening statement and then answer questions from the board members. Mr. Allen asked Ms. Ranagan to follow up on any of the written questions that were not adequately answered by DOI.

Mr. Fletcher thanked the board members for the opportunity to clarify and comment on the proposed standard. He said the representatives from the Minerals Management Service that are on the phone understand all of the burdens and details associated with it. He said he hoped that the answers that were provided gave the board members enough perspective and stated that they are prepared and fully ready to answer any other questions the members may have. Mr. Fletcher commented that DOI believes there is a lot of complexity involved and certainly one could see that based on what happens in the market, there are a lot of swings. Therefore, depending on the degree and frequency with which they report, the sophistication of the systems that they are required to have to deal with those fluctuations should be a consideration – not the primary factor, but certainly a consideration. Mr. Fletcher stated that DOI is ready to support the board in its efforts and is open to questions from the members.

Mr. Allen asked Ms. Ranagan how the questioning should proceed. Ms. Ranagan stated that there were two primary questions: (1) What are DOI's thoughts on a less detailed standard? (2) How would DOI's proposed asset valuation methodology stand up to auditor verification?

Less Detailed FASAB Standard / Principles-Based Approach

Ms. West responded that, in regards to the less prescriptive standard, based upon experience and the complexity of this issue, the team believes that for valuation purposes, a less prescriptive standard may make some sense in that some of the methodologies could be applied to other commodities or natural resources. However, the team believes that the accounting treatment should be fully documented, whether that is in the standard or in an implementation guide to prevent audit issues from arising and remaining unresolved.

Ms. Ranagan asked Ms. West if she believes that an implementation guide would need to include the level of detail that is contained in the current standard and provided for by the field test team in order to satisfy the auditors. Ms. West responded affirmatively.

Mr. Jackson said the purpose of having more detail would not be to satisfy the auditors but rather provide sufficient guidance so that the auditors would not challenge the methodology.

Mr. Allen responded that he believes that more detail will just subject the board to more questions and more challenges. He noted that much of accounting standards do not have any detailed guidance at all. For example, entities are required to capitalize and depreciate an asset over its useful life but there is no detailed guidance anywhere on that. Management applies their reasonable methods of valuing it, writing it off over its useful life whatever they decide that happens to be, and the auditors have some comfort with that which has developed over time.

Mr. Mabry agreed with Mr. Allen that sometimes it is easier with the auditors if the standard is less restrictive if it is an established process. However, they start running into issues where there needs to be a specialized treatment of items that are not widespread across government or the commercial world. If the guidance is less restrictive and DOI goes one route, they have no support to back them up when the auditors come in and say they should have gone a different route.

Mr. Allen said the auditors would need to have a reasonable basis to support their recommendation that DOI go a different route. Mr. Allen said in the end accounting does not ride on the accuracy of an initial assessment but rather the application of that methodology consistently from period to period so that one can measure changes over time.

Mr. Fletcher responded that such an approach may seem reasonable in the boardroom but once you get out of the boardroom and you are in the last three weeks of the fiscal year, that sense of back and forth between the auditors and the preparers is not realistic. Mr. Fletcher said he would say that the standard can be at a high level and principles-based; DOI has dealt with those many times. Mr. Fletcher used the example of heritage assets and stewardship land as an example where the standard was very high level and the technical guide was very helpful in getting them through this audit cycle. He noted that the board members developed the guiding principles and the auditor and preparer community developed the key elements needed to apply the guidance. Mr. Fletcher said that he sees the same need for detailed guidance here because of the complexity and sensitivity involved and the wild swings in value. Due to the resulting swings in the government's equity, DOI does not want its methodology to be subject to interpretation of the guiding principles.

Mr. Horn agreed that the heritage assets and stewardship land implementation guidance was a perfect example. With respect to condition reporting, DOI was able to apply the examples in the implementation guide, which was developed as part of a coordinated effort by auditors and preparers, and provide supportable justification for DOI's reporting treatment.

Mr. Jackson said he would like to look at what the ED proposes and look at what DOI and others have proposed and look at the implications of the differences with regards to what the board's objectives are. He said the board could develop a standard that is more principles-based while identifying particular areas with the assistance of the community where more explicit guidance may be needed, which could end up in a technical release or implementation guide. Mr. Jackson said he frequently loses sight of the question because the material is overwhelming; he would like to see the points summarized more succinctly.

Mr. Farrell said that he would like to get back to the bigger picture – the federal government has an asset. Can we value it net of the related liabilities? Mr. Farrell said the board has taken a very detailed approach, which is not working, and he would like to go back to a principles-based approach. He proposed giving the auditor and auditee a year to try to implement a more principles-based standard by saying audit this and if they believe it is auditable it can be included in the financial statements as audited information. If not, they can still get a clean opinion but just not audit it for the year. Mr. Farrell said he believes FASB has used this approach with some of its more complex standards by picking a few companies to run through it so it would not be an out-of-the-box idea. Mr. Farrell went on to say that after one year, if implementation guidance is needed, then FASAB could do it at that point in time as opposed to doing the implementation guidance going in when the board does not know what all the issues might be.

Mr. Farndon asked if Mr. Farrell was proposing something similar to what was done for national defense property, plant, and equipment. Mr. Farrell responded that DOI has said that they have a proposed methodology that they believe is fair and reasonable and they are worried about the auditor challenging it. Mr. Farrell said give it to the auditors and say "this is our methodology – audit it." To the extent that the auditors audit it and say it is fine, DOI puts includes it in their financial statements and gets a clean opinion. If the auditors say they cannot get there for the following reasons (X, Y, and Z...), then FASAB comes back in the next year and deals with implementation issues and writes some guidance to help DOI get there for the next year.

Mr. Dacey asked if the board has enough information on other natural resources (e.g., coal, grazing rights, timber) to apply a more general concept to all natural resources. Mr. Fletcher responded that if the concept is approached via an inventory/unit and pricing model (e.g., board feet estimates for forestry, acres for grazing, etc), then yes they can apply that model to other natural resources. However, if the board decides to use a discounted cash flow concept, DOI does not have the systems in place to capture cash flow for different types of resources. DOI has systems in place that maintain the inventory.

Mr. Dacey asked if there was a standard way to estimate board feet in the industry. Mr. Fletcher responded that DOI has forest management plans that estimate based on diameters and other factors; it is a "cruising estimate" that is done when the forest becomes available. The Forest Service does not sell timber right now and has not sold it for a while; DOI is currently selling timber, mostly from mills on Indian lands. Mr. Fletcher stated that there is a process and a method around doing that that we could apply.

Mr. Dacey asked Mr. Gewecke to provide a basic understanding about the process for estimating coal, including whether the federal government or someone else prepares those estimates, and the reliability of those estimates. Mr. Gewecke responded that he can speak generally about the process but has not worked with coal directly. He said the federal government has pretty good estimates of coal that are prepared by the federal government with the assistance of industry including some exploratory drilling.

Mr. Dacey asked if the estimates are for the complete population of resources that the government owns or only that portion which the government intends on making available for sale. Mr. Gewecke said he believes there are certain areas that have been closed off that have not been fully evaluated for coal resources. Mr. Dacey said it seems that the board is focusing in on valuing only those assets that the government intends to sell rather than all of the assets that it owns. Mr. Dacey said that may be the cutoff point for what shows up on the balance sheet; recognition of only those assets that the federal government will sell.

Mr. Schumacher asked if Mr. Fletcher was recommending that we take a step back to develop a general, principles-based standard that covers more than just oil and gas and can it be done? Mr. Schumacher said that with all of the different measurement attributes between the different resources, he finds it hard to believe that the board could lump everything together in a general standard and then leave everything up to DOI to calculate it.

Mr. Fletcher responded that he thought several of the board members proposed working solutions. First, get a principles-based standard, take them in order of succession, and provide a year "free" to go do it without sacrificing the audit opinion. He said that additional guidance could be codified in an implementation guide if necessary. Mr. Fletcher stated that there is a level of comfort around oil, gas, and coal, and the board could prioritize how to handle the other resources. Mr. Fletcher said once they had a good foundation in concepts and principles, they could move a little quicker on the succeeding ones. Mr. Fletcher said he would agree with a principles-based standard, set a prioritization to move out, do the field test (pilots), make a decision on that, let DOI do it for a year, have DOI come back and say what assistance they think they would need, and DOI would get moving.

Mr. Patton said that in its response to question 15, DOI mentioned disclosure as the appropriate approach rather than the formal booking of an asset. Mr. Patton asked Mr. Fletcher if, based on what he had just said, he would be okay with a booking as long as FASAB worked out some of the calculation issues. Mr. Fletcher said he could support booking an asset where there is reasonable certainty surrounding the number.

Lack of information from EIA

Ms. West stated that, in regards to the absence of information from the Energy Information Administration (EIA), the team developed a methodology that the subject matter experts, including Messrs. Farndon and Gewecke, have a comfort level that it is a good and meaningful methodology. It makes a number of assumptions but the valuation process by definition is an estimate so as long as a consistent methodology is applied, it would have validity.

Mr. Farndon stated that there have been difficulties communicating with EIA and getting a response in terms of adjusting its already public and published proved reserve estimates to a form that would more accommodate DOI's calculations or valuation. However, in the team's examples, it provided ways to work around the lack of response and get the detail it needed by relying on EIA's published estimates and making some adjustments on its own to make those estimates fit DOI's needs. He stated that the fact remains that the team is still relying on and recommends relying on EIA's proved reserves estimates as the most definitive and consistently prepared reserve estimates that represent the federal interests throughout and across the nation. It would be a much more onerous, difficult, and probably impossible task to generate those estimates on their own that would be as consistently prepared and as up-to-date as the EIA reserve estimates. Despite its lack of responsiveness, EIA still does publish those estimates, and DOI would like to rely on them at a minimum as the basis for the valuation.

Mr. Farrell questioned whether any information that EIA is supposed to prepare would be provided going forward. Ms. West responded that EIA is congressionally mandated to publish the nationwide reserve estimates on an annual basis among other things.

Mr. Steinberg asked if there is any sense as to why EIA is not responding to what they apparently agreed to do and we built the original ED on. Ms. West said her personal thinking on the matter is that they are heavily strapped in terms of the work that they do, the number of staff that they have, and the funding that they have. They operate on a reimbursable-type basis; it is more of a business model for the funding that is derived for the work that is done by EIA. To be required to break out federal reserves at the lease level would be a huge effort and would probably require congressional action of some sort and additional funding.

Asset Valuation Methodology / Estimate of Proved Reserves

Mr. Allen questioned why the estimate that the field test team came up with in their alternative view was 50 percent less than the estimate for the ED view. Mr. Dacey asked if the methodology that the team developed for estimating the portion of proved reserves that underlie federal lands is reliable.

Ms. West said that the field test team obtained the reserve estimate numbers directly from EIA's website, and implemented a fairly simplistic process whereby the field test team took the production that was reported to MMS on royalty reports for a 12-month period that coincided with the 12-month period from the EIA reporting. The EIA reporting breaks out by state and onshore and offshore, estimated proved reserves for the different commodity types. The field test team obtained the royalty reported production that was reported to MMS for the comparable commodity types for the corresponding timeframe. The field test team developed a ratio that compared federal production reported to MMS to nationwide production reported to EIA for onshore production. The field test team then applied that ratio to the onshore estimated proved reserves that were published by EIA.

Ms. West noted that a major assumption is that production on federal leases onshore would be comparable to production on nonfederal leases onshore and inherently there is an assumption that says the reserves could be presumed to be on a similar ratio. The team believes that methodology has a reasonable basis – it is repeatable, consistent, and can be reperformed from year to year. Ms. West said there is nothing to compare it to in order to verify accuracy because EIA does not publish onshore proved reserve estimates for that which is under federal domain only. Ms. West noted that this methodology was proposed by Mr. Farndon who is the valuation expert for MMS, which the team concurred was a reasonable and rational methodology, which does contain some assumptions, but which has a reasonable basis.

Mr. Allen asked Mr. Torregrosa what CBO uses for its estimates. Mr. Torregrosa responded that CBO has to rely on the numbers reported by EIA and what Ms. West described seems reasonable to him.

Mr. Farndon pointed out that the methodology described by Ms. West relates to the federal onshore portion, which is the smaller of the onshore and offshore components. He noted that EIA does publish separately proved reserve estimates for the federal offshore portion, which is the larger portion and has the most value. He noted that the team made some assumptions for the federal offshore portion regarding the royalty rates to be used.

Ms. West noted that there is an up to 21-month time lag between the end of a period and when EIA publishes the figures. Mr. Farndon developed a methodology that provides a factor for additions and depletions over the time period from when EIA last published to the end of the reporting period. The team believes that is an important aspect to ensuring the value of the estimated proved reserves would be as accurate as possible. The other thing that is done in the present value (PV) view is that the quantities are discounted to present value. These are some of the significant factors that depart from the ED view and result in the large disparity between the ED view and the PV view regarding asset values.

Mr. Farndon agreed that the present value discounting accounts for the majority of the difference that was questioned by Mr. Allen earlier. He stated that the lower value in the PV view is based on the same level of reserves but it is the discounted value.

Mr. Dacey asked if it is conceivable that we own oil that is offshore that is not included in the estimate because there are no leases. Mr. Farrell responded that they would not be proved. Ms. West agreed that it would not be a proved reserve if it were not under lease. Mr. Farndon added that it would be an undiscovered amount and they are not known for sure to exist as proved reserves are.

Mr. Dacey asked if DOI thinks there are significant quantities of oil that exist under federal domain that are not included in the estimate because they are not yet proved. Mr. Fletcher said there would be, but the estimate uses proved reserves only to lower the risk of misstatements.

Mr. Torregrosa asked Mr. Farndon about the 10% per year decline in production rate that was used in the field test. Mr. Farndon said that is typical of a decline rate of an established producing reservoir field. If one were taking a snapshot in time of reserves as of today, then production in total on that fixed amount of fields that are contributing to that production would decline approximately 10 percent per year from that. Attributing to that production would be some fields that are underdeveloped whereas proved reserves would not be indicative of reservoirs that are already drilled and contributing to that production so for awhile there would be additions to production from those sorts of fields. Then eventually all of the production would then decline over time. As the board had pointed out about the extensive amount of history that DOI has on things such as this, it can measure the fields with the proved reserve estimates and find their decline rate over time and that is how the 10% figure came about.

Mr. Torregrosa asked Mr. Farndon to clarify that is not 10% straight line; it would not mean that in 10 years it would be done. Mr. Farndon confirmed that it is a hyperbolic function that declines, not straight-line.

Private Sector Proved Reserves

Mr. Steinberg asked how the major oil companies figure their reserves. Ms. West responded that the treatment that is being proposed is unprecedented and is not being done by private industry. Mr. Steinberg clarified that he was asking, "What does private industry do now?" Ms. West responded that private industry does not book proved reserves; they disclose them in their SEC filings and elsewhere. Mr. Steinberg asked how private sector companies determine the quantities. Ms. West said private industry has teams of experts whose role is to go forth and use seismic data and the latest technology to have an accurate valuation.

Mr. Steinberg asked if the oil companies have people working for them that estimate what their quantities are through engineering techniques. Ms. West responded affirmatively. Mr. Steinberg asked if the federal government does not have that type of capability. Ms. West said that EIA requires mandatory reporting from the oil companies to report to EIA on those proved reserves so by default the proved reserves that are developed and reported in the SEC filings for private industry are reported to the EIA and are the basis for which the EIA proved reserve estimates are founded upon. Mr. Steinberg stated that it sounds like EIA has the numbers for the oil companies but they do not have the numbers for the federal government. Ms. West responded that they have nationwide proved reserve estimates as reported by the private industry for onshore and offshore by state (this includes federal and nonfederal proved reserves) but they do not break it out by that which could be deemed to be federal domain only.

Ms. West clarified that by default, offshore is federal domain only; the problem lies in the onshore estimates that are developed and provided to EIA on a nationwide basis.

Discounting Methodology

Mr. Dacey asked DOI to walk through the discounting methodology that seems to be causing the big difference between the ED and PV field test estimates. Mr. Farndon responded that the reason for discounting or using a present value approach is because, although the proved reserves is an estimate under today's technology and prices, the fact is that achieving that production immediately is not possible. The reserves emerge from the ground over a period of years, up to 30 or more years. The capitalization of those reserves cannot occur immediately and will occur over a period of many, many years. The driving force behind using a present value or discounted methodology is that the money will be received over time and the value of money changes over time.

Mr. Allen said it seems to him that discounting involves projecting price increases and then discounting them back to today's dollar. Mr. Farndon responded that they are using projected prices from an independent source such as OMB.

Mr. Jackson said DOI's response showed how out of sync OMB's estimated numbers were with reality recently (for example, OMB forecasts were around $20 a barrel while actuals were around $100 a barrel) which demonstrates that we have no clue what the markets are going to do in the future. Ms. West responded that is a really good reason why a more prescriptive standard with regard to things like that would be crucial because a consistent methodology would be developed that the preparers can utilize, that would stand up to audit and be codified in the standard or in an implementation guide. It would be crucial to have things like that included in the standard so that the preparers are not tossed out to the wind where the auditors disagree with some aspect of the methodology and another auditor comes along five years later and disagrees with what the first one thought. Ms. West said it puts the bureau, and the department, and the federal government as a whole in a very difficult position if that type of stuff is not captured in the standard.

Mr. Farndon pointed out that while the recent differences between OMB forecasted and actual prices have been dramatic, the ED relies on prices for the previous years [i.e., first purchase price or wellhead price] which are not necessarily indicative of the prices in the future so both methods are relying on a method that is unpredictable because of the fluctuating nature of these commodity prices.

Mr. Patton commented that it seems to him that the price volatility is real and ought to be reflected in either the disclosures or the items that might be booked. For quantity estimates, the board has gotten to the point where, with respect to proved reserves, it is pretty confident that there is at least that much out there. Therefore, the question for the board becomes how to measure the asset – would it be fair value, historical cost, or some type of conservative estimate that would at least result in something being recorded on the balance sheet and providing accountability for these assets? Recording something on the balance sheet that is at least a conservative estimate of the asset would increase accountability and provide useful information without requiring some estimate of fair value of what is out there.

Mr. Dacey asked the team to clarify that they are projecting cash flows by estimating when the reserves will be taken out of the ground and the price of the resource when it is taken out of the ground as part of their estimate and discounting those back. Assuming that is what the team is doing, Mr. Dacey noted that one of the issues that the board members debated was how reliably one could estimate the timing of those cash flows. The unpredictability of the timing of those flows was one of the concerns the board members had with using a present value approach. Mr. Dacey asked the team if the timing of the withdrawal of these reserves is reliably predictable.

Mr. Farndon responded that forecasts are forecasts and one is never going to be exactly right. He said that by limiting the projections to proved reserves, which are emanating from fields that most likely have an established production history and an established decline in production, one can be fairly accurate and have been proven to be fairly accurate on similar projections done in the past. Mr. Farndon noted that John Wood from EIA had stated in the past that reliability of estimated production is 100 percent when limited to proved reserves.

Proved Reserves, Unproved Reserves, and Undiscovered Resources

Mr. Reid said he has some serious concerns about the standard, including the lack of response from EIA. He noted that the proven reserves number does not change that much (e.g., page 71 from ED which shows 163,387 billion cubic feet of estimated proved reserves in 1994 as compared to 192,513 billion cubic feet in 2004 while 18,000 – 19,000 billion cubic feet were produced each year) and is clearly not the right number to use to value the asset. He said the number may be reliable but it is not accurate because it is not truly representative of what is out there in the ground. He noted that the proved reserves number is roughly the same from year to year after 10 percent of them are produced in all three categories.

Mr. Reid said he agrees with Mr. Farrell that we need to take a long step back from this and say to the agency – come up with reasonable estimates of what these assets are worth, select a methodology, and sell it to the auditors.

Mr. Farndon said there are three categories of resources – proved reserves, unproved reserves, and undiscovered resources – and the reason that proved reserves does not change much from year to year is because new discoveries are made and converted into proved reserves. He asked Mr. Reid what he thought was a better avenue to use. Mr. Reid responded that he would start with the revenues. He said he is not interested in just a number that can be readily obtained; he wants a reasonable number that is more representative of the total resources under the ground.

Mr. Fletcher pointed out that the financial statements would disclose the potential but less certain categories of resources – unproved reserves and undiscovered resources. He said he believes that recognizing only the reasonably certain estimate of proved reserves in the principal statements and disclosing the other less certain categories of unproved reserves and undiscovered resources would satisfy DOI's responsibility to the reader.

Mr. Reid stated that he could agree with that but he does not believe that proved reserves should be the stopping point for asset recognition. He went on to say that he does not understand why EIA is not working with them, but if the government agencies cannot work together to come up with an estimate, he would like DOI to develop an estimate that works for their agency. He said if he were auditing it, he would use the cash flows over a number of years to project a value.

Mr. Torregrosa said he agrees with Mr. Reid in principle that proven reserves is not the right number but he believes that it is better than what is on the books now, which is nothing.

Mr. Jackson said he is somewhat dumbfounded by the notion that FASAB would base the asset and liability estimates on that which is unknown. He asked if reserves that are there but you just cannot get to right now because of technology would be considered proved reserves. Mr. Farndon responded that reserves that are not currently economically or technologically recoverable would fall under the category of unproved reserves, which is a much smaller category than the category of proved reserves. He said the other level Mr. Jackson was referring to are undiscovered resources which are postulated or statistically thought to exist in geologic basins around the country but their existence is a lot less certain. He said the quantity and value of these resources could be statistically estimated using means and probability and other factors to provide some level of comfort but these are not measured in any way and are not known to exist, but undoubtedly will eventually be discovered and contribute to the estimates of proved reserves.

Mr. Farndon said that proved reserves are the fields and reservoirs that are owned, drilled, and contributing to the production and supply of oil and gas to the country. Mr. Jackson said the use of proved reserves would therefore generate a reasonably conservative number assuming we could tag the market price with some reasonable degree of precision and would be less susceptible to error. Mr. Farndon agreed, noting that even though it is the most conservative number, the estimate can vary dramatically from period to period based just on price.

Mr. Dacey noted that when the price changes, the quantity changes because producers can economically recover more or less resources based on price. Mr. Dacey wondered if one could isolate or estimate the change in proved reserves that has occurred because of rising prices to explain why the proved reserves number has been staying steady in recent years. Mr. Farndon replied that the effect on proved reserves attributed to price would be minor since most of these fields are already producing. The significant costs of development are behind them and they are just maintaining production. A few may stop producing sooner if prices are particularly low because they have reached their economic limits at that point, but that has a very minor effect on production and the proved reserve estimate.

Mr. Farndon noted that the EIA estimates of proved reserves are the only annual, timely, and consistent estimates that are available to DOI. There is no comparable information available for unproved reserves and undiscovered resources. In addition, Mr. Farndon noted that the estimates for undiscovered resources change very dramatically as technology changes and as time goes on. He stated that the uncertainty involved in those types of estimates is extremely volatile and would therefore not be reliable for a use such as this.

Mr. Allen asked if the auditors would be comfortable with the EIA report because it is published information even though it is not audited at its source. Mr. Dacey responded that the question would be whether it is a reasonable approximation of what it purports to be. He noted that since the data is coming from all of the different oil companies, the one thing it would be interesting to note is the process EIA is using to compile that information to make sure what EIA is receiving is what they summarize and report out. He said he believes the board specified the source of that information in the standard to avoid auditor concerns over the source.

Mr. Allen stated that expected cash flows is a very valid way to value things and is used to value many assets. In that case, we would care less whether the reserves are proved or unproved and what the number is, if one has a history of a revenue stream, what is the value discounted back of that revenue stream?

Mr. Dacey stated that it would be different if we said to base the estimate on "proved reserves, period" because then one could get into the argument of whether EIA meets that requirement, but if FASAB has made cost/benefit decisions and said we believe the information from EIA is sufficient for reporting this information, that would seem to limit the issues.

Mr. Jackson asked if projecting cash flows would not involve depletion of proved reserves. Mr. Farndon responded that projecting cash flows would involve projecting production over time of proved reserves. Mr. Jackson said it seems to him that proved reserves would come into the equation no matter what the approach is. Mr. Allen responded that, disregarding the last couple of years of craziness on the open market, the government would have been able to securitize and sell its expected cash flows on the open market at a discounted amount far greater than any reserve number the board is talking about. The buyers would have cared less about the proved reserve numbers; they would have looked back over a 30-year period of time and forward at technology with confidence.

Mr. Allen said he has some sympathy for the proved reserve number because even without audited information, that is such an absolute conservative number. There is a

99% chance it is understated but there is almost no chance that it is overstated. Mr. Reid responded that is why he thinks an auditor will come in and say that it is not a reasonable number; they would argue that it is clearly understated.

Mr. Dacey said he thinks it is different if FASAB says report proved reserves versus report the value of oil and gas under the ground. Mr. Jackson added that the standard has to have a starting point; it can start with proved reserves and then evolve over time as needed to make it a better standard. Mr. Jackson noted that the less certain quantities could be reported as RSI. That is the place to alert the readers to the potential unknown quantities and enhance the readers' understanding of the potential scope of the asset.

Mr. Reid said his concern is that Congress may very well look for ways to augment the treasury in the future and selling the assets at book value would have people lining up to buy them but would not be doing right by the citizens.

Mr. Farrell asked if it would be realistic to think that DOI would sell assets for whatever they were recorded at? He asked if DOI would not do a study and determine what they could reasonably get for the assets?

Mr. Horn said Congress did tell DOI to sell the land around Las Vegas but it didn't tell them for how much. Mr. Horn said it ended up being an extraordinary amount, way more than anyone had anticipated.

Future Royalty Streams Identified for Sale

Ms. Ranagan noted that the field test team did not test the concept related to future royalty streams identified for sale. The field test team noted in the field test as well as its response to the questions that experts indicated that this scenario was fiscally undesirable and therefore remote. Since CBO had raised the issue, Ms. Ranagan asked Mr. Torregrosa if anything DOI said had changed CBO's position on the issue or if he had any additional questions for DOI. Mr. Torregrosa responded that if they believe it is remote then it is not likely to cause them a problem. Mr. Torregrosa said he believes Congress will sell assets given budget constraints and in general, when the government is selling, you want to be buying. He said his concern remains but that is the least of the board's problems right now.

Last Questions for DOI Representatives

Mr. Allen asked if the board members had any other questions for the DOI representatives before they left. Mr. Torregrosa said he wanted to clarify that given a year or two to test the present value approach, as the field test team has laid it out, that DOI would be okay with that. Mr. Torregrosa said he is assuming that DOI would make an estimate for one year, the auditors would fiddle around with it, and then DOI would have another year to implement the auditor recommendations before the number becomes audited.

Mr. Horn indicated the need for FASAB to provide staff implementation guidance within that year if it were needed. Mr. Fletcher asked Ms. West if it would be reasonable to commit to that approach (meaning is it conceptually doable without respect to any additional resources that would be required to actually implement the approach). Ms. West responded that team had agreed that it was a reasonable approach and she likes the idea of the two-year implementation phase-in to deal with the serious issues and complexity that is involved (more than was even touched on in the field test questionnaires and responses previously provided).

Mr. Allen commented that the auditors should be brought in early on as a key player in the methodology. Mr. Horn responded that it is very difficult to engage them in such a conceptual discussion and receive any conclusion of merit. Mr. Farrell said that is why he proposed the trial period because the auditor/auditee relationship has changed in recent years such that the auditors have become very careful about what type of guidance they provide to the auditee outside of the formal audit.

Mr. Allen thanked the DOI representatives for their time and convened for a short break before returning to obtain the board members' views on how to proceed.

Member Preferences

Upon returning from the break, Mr. Allen asked the board members what they needed to see from staff at the December board meeting to decide how to proceed with a standard on natural resources.

Mr. Farrell said he is becoming more and more convinced that a principles-based standard is the way to go. Mr. Allen asked if the board members wanted staff to draft what a principles-based standard might look like. There was general support for having staff provide such a draft.

Mr. Schumacher said he would like to know from the staff's standpoint if they think it is even possible to put together a principles-based standard to cover more than oil and gas. Secondly, if that is not possible, then with just oil and gas, knowing that the board might have to put out a technical bulletin later, can a principles-based standard be developed without all of these specifications and laundry list of requirements?

Mr. Schumacher said his only fear is that if we continue down the path we have gone, and incorporate all of these new calculations, DOI may come back and have a problem with those at some point. He said he thought the board did this before, but the board does not know what circumstances are going to change or what information EIA may or may not provide. He said he would rather go to a principles-based approach and get out of all of the detail and let DOI do it.

Mr. Allen said staff could draft an outline and the board could provide additional input as to whether that is what they had in mind. Mr. Allen said there would be a lot of time devoted to natural resources at the next meeting and he would like the board to know at the end of the December meeting the direction it wants to go.

Mr. Farrell said one of the bases of a principles-based standard would be that some information would be coming from EIA to start their principles-based calculations and he questioned the likelihood of that continuing due to the unusual goings on at the EIA where they won't talk to anybody. Ms. Ranagan responded that DOI's proposal was based on EIA's report of nationwide proved reserves that DOI said is a congressionally mandated report.

Mr. Farrell questioned why it is two years behind. Ms Ranagan responded that it is not that they are two years behind but that the report is based on the survey data collected from the oil companies. All of that survey data must then be compiled so when the report is issued it is based on the most recent year for which data is available, sometimes up to 21 months prior to the reporting date.

Mr. Farrell questioned if anyone is concerned that EIA will disappear off the face of the radar screen. Mr. Allen responded that it does not seem so. He said they issue very valid information, including forward-looking reports. Mr. Allen said it seems as though EIA will be here, just not in the format they had promised FASAB in 2004.

Mr. Patton said he does not know if the board members all have the same idea of what a principles-based statement would look like but his would start with: (1) Is it an asset based on the elements concepts in SFFAC 5 and (2) is it reliably measurable? He said he would structure whatever document is produced along those principles then start dealing with the reliability of the measurement and start talking to Penny Wardlow about various measurement concepts. Then if one concluded that it was not reliably measurable for balance sheet presentation, one could go to another level of disclosure – notes, RSI, or something like that.

Mr. Jackson asked Mr. Patton if in that process, would he include a threshold of sorts as somewhat of a conservative principle (i.e., perhaps something could be reliably measured at this threshold, but not that threshold)? Mr. Patton responded that he is not sure FASAB has conservatism as a principle. Mr. Jackson said he uses that term only in the context that he does not like to value contingent assets for example.

Mr. Reid said he would propose that the preparer calculate the number for a specified period of years (e.g., four years) and report it as RSI, where they can talk about it, work it, and establish the procedures, and then after that specified period, move it into basic information in some way, whether that is disclosure in the footnotes or a recording on the balance sheet.

Mr. Reid said either way, you hopefully have a transition of more reliable data as you have a few years to work through what it is you are measuring. He said he thinks there are parts of this calculation that are very measurable in terms of cash flows and productions and other parts that are probably not very measurable.

Mr. Dacey said that is why he thinks perhaps the board may decide to book those assets that the government has plans to sell while the government has other assets that are there and are similar but it does not plan to sell (e.g., while the government has lots of trees, it does not plan to sell very many of them, only the ones that are in the management plan). However, we need to tell the reader that what is recorded is not the whole thing.

Mr. Reid said he would think we would want to value those things the government does not plan to sell, because one would be making a business decision and would need to quantify that decision.

Mr. Allen directed staff to develop a structure regarding the level of detail that staff envisions for a more conceptual statement and send it to the board members for comment.

> **CONCLUSIONS / NEXT STEPS:** At the October meeting, after hearing from the DOI representatives regarding their experience during field testing of the May 2007 exposure draft (ED), the board members directed staff to draft a principles-based ED.

- **Federal Troubled Asset Relief Program Status Report**

Mr. Werfel noted that the first action was to place Fannie Mae and Freddie Mac into conservatorship. The first question became whether to consolidate the entities in light of the control exercised by the conservator—they looked to the FDIC's treatment of banks in receivership and found that these were not consolidated. After also reviewing the SFFAC 2 guidance, they concluded that not consolidating was appropriate but would continue to monitor developments.

Mr. Werfel explained that the second aspect was the $200 billion guarantee. Treasury will provide an infusion of capital if the GSEs go into negative equity. The arrangement provides Treasury with preferred stock up front – one traunch of stock was issued at $1 billion par from each GSE initially and this par will be adjusted as money is provided through the guarantee. Treasury may also purchase mortgage backed securities issued by the GSEs. In addition, there is a warrant for 79.9% of the common stock of the GSEs.

Mr. Allen suggested that aspects of this arrangement go beyond a bank receivership arrangement. Mr. Reid noted that the FDIC values the assets and liabilities of failed banks and books a reserve for the difference—the FDIC's expected loss due to insurance. Over time, the bank is liquidated and the reserves adjusted. Mr. Werfel clarified that receiverships lead to liquidation while conservatorships do not. Mr. Reid agreed and noted that his point was that the banks are not consolidated but the liability for losses are recognized by FDIC.

Mr. Werfel explained that the control elements of a conservatorhsip are intended to put the institution back on its feet—not to liquidate it. The conservatorship would be terminated when the institution is on sound footing. However, the financial transaction—the exchange of preferred stock and warrants for the guarantee—complicate matters.

Mr. Allen indicated that there does not appear to be a separation between the GSEs and the government. The actions taken imply that the pattern could repeat itself – conservatorship could repeat in the future.

Mr. Werfel indicated that the intent at this time is that the control is intended to be temporary and the FASAB, FASB and GASB literature provide that temporary control should not lead to consolidation. The intent of Treasury is not to exercise the warrants that provide 79.9% ownership. The purpose of the warrants was to drive the stock price down to next to nothing. When the government steps in to aid a publicly traded entity it does not invite fair trading. The Treasury wished to freeze the market for this stock and the warrant accomplished that goal. They have no voting interest and only own an option to own the entities.

Mr. Farrell noted that the government seems to have absolute control of the GSEs even if the intent is temporary. He explained that the FASB literature regarding temporary control is designed to deal with a stepped transaction where you end up with control for a brief period. He does not read the reports of the GSE activity to be temporary.

Mr. Werfel noted that these arrangements lead to a very dynamic situation. There are steps in the future that would need to be taken to indicate that the intent is to permanently control the entities. The intent of Treasury has been clear that this is a temporary arrangement. If that changes, then the consolidation decision would be evaluated.

Mr. Steinberg said that with these GSEs having an implied guarantee for many years he wonders whether it is realistic to expect the GSEs to return to their former status.

Mr. Torregrosa indicated that CBO saw the relationship differently. The government has effective control. CBO agrees that receivership and conservatorship are different. The GSEs are being used to attain public goals. Therefore, CBO believes they should be on budget.

Mr. Allen indicated that FASAB can not affect the FY2008 reporting through new guidance. However, during the course of the year FASAB should review what was done and consider new guidance.

Mr. Steinberg requested a briefing on the final accounting treatment in the CFR at the December meeting.

Mr. Werfel noted that TARP had followed shortly after the GSE issues. This is a much larger and more complicated program. He explained that the purchase of mortgage backed securities is to be considered a direct loan; the TARP bill indicates that for budget purposes such purchases would be treated under Credit Reform. However, for preferred stock the team reached the conclusion that there was not required pay back of principal and that it was not in substance a direct loan.

- **Federal Entity**

Staff explained the primary objective for the October Board meeting was to discuss the summary of the most recent Federal Entity Task Force meeting and to seek Board approval on proposed next steps. In addition, staff would provide a brief summary of the results of the Survey on Boundaries of the Federal Reporting Entities and the Federally Funded Research and Development Centers (FFRDC) Survey.

Staff explained the two surveys were distributed over the summer. The Survey on Boundaries of the Federal Reporting Entities to the federal CFO and IG community was circulated to solicit feedback on organizations considered questionable or unique when assessed in determining the boundaries of reporting entities. Additionally, staff distributed an FFRDC Survey to gain a better understanding of FFRDCs' perspective of how they view their relationship with the federal government

Staff explained there was an excellent response to the survey to the CFOs and IGs with 30 responses received. 13 responses of the FFRDC survey were received, which was equivalent to one-third of the known FFRDCs. Staff indicated the briefing materials contained detailed responses as well as analysis of the surveys. Staff noted the transmittal contained general observations concluded by staff which included:

- The results of the survey demonstrated that much of the CFO and IG community does not rely on the current Concepts statement and there is a need for the boundaries of the reporting entity to be addressed in a Standard.
- The survey provided an opportunity to gather information on the current staff proposal. Most of the respondents agreed with the three general principles and suggested this would be a more comprehensive approach.

Staff explained the federal entity task force met to discuss the results of the surveys and to determine next actions. Based on the respondents agreeing with the general principles and approach, the task force agreed it would be best to move forward finalizing language in the proposed standard. It was agreed that two small workgroups would assist staff in drafting and reviewing control and ownership sections.

Staff also explained one issue the task force discussed in detail was the legislative and judicial branches not being required to report. The task force believes the best resolution may be to seek the appropriate congressional action to require all branches to report. The task force suggested that either FASAB or JFMIP could write a letter encouraging the branches to report or alternatively the letter could be directed to the appropriate committees encouraging legislation. The task force also suggested utilizing taxpayer groups such as the Peterson Foundation to bring attention to the issue. Staff explained that the task force believes the materiality issue is not as important as accountability, and financial statement audits should be required of all branches.

Chairman Allen noted the task force unanimously agreed the federal reporting entity should include all branches of the government. He asked how FASAB should proceed or if there was anything that FASAB can do within its charter to encourage required reporting of all branches. The general consensus was that it is not within FASAB's purview to make such a recommendation. The Board discussed the other options would be to request the sponsoring agencies to initiate something to address this concern or FASAB could simply do nothing.

Mr. Farrell asked if members could request the FASAB purview be expanded to include the branches. He suggested this would allow the Board's position to be on record. Staff explained that in essence FASAB does take a stand on the issue in the proposed ED. For example, if the proposal defines the federal entity to include all branches, then FASAB has taken a stance that all branches should be included and therefore report.

Mr. Jackson suggested that there may be some associates on the hill that might be able to provide advice on how to proceed or they may be able to find people to get support for the proposal. He suggested that it might be better to deal with this issue softly to see if there is support for such a proposal.

Mr. Allen asked if OMB sends requests to the legislative and judicial branch agencies for information and other requirements. Mr. Werfel explained that all of OMB directives are directed to executive branch agencies only.

It was agreed that FASAB does not want to interject or lobby for changes on this matter. Although the Board agrees all branches should be required to report, the Board would not aggressively seek legislation but instead would try to make others aware of the issue.

Staff explained the task force discussed the Federal Reserve and that it is currently excluded from the federal reporting entity in par. 47 of SFFAC 2. Staff explained the task force recommended the issue of whether the Federal Reserve System should be included or excluded should be revisited. Staff proposed researching the area further by providing background materials on the Federal Reserve and determining how other countries treat central banking systems.

Mr. Patton expressed concern with the fact the staff recommendations includes moving forward with finalizing language of the proposed standard while also revisiting other areas such as GSEs and the Federal Reserve, which are the more complex areas. Staff explained that it would be possible to work on them concurrently. Specifically the plan was to have the task force begin working on some of the parameters and definitions while staff researched some of the other noted areas such as the Federal Reserve. Staff also explained the goal of the project and proposed standard would be to capture any amendments to SAFFAC 2. Considering the Federal Reserve complexities, the Board agreed an educational session on Federal Reserve will be held at the December Board meeting.

Mr. Jackson explained considering the responses to the surveys, he believes this gives more reason for the GAAP Hierarchy project to be limited to strictly bringing the hierarchy into the accounting literature. He stated the ED contained reference to the term 'federal entity' and that it should be defined or footnoted. He explained going further in the GAAP Hierarchy project could have a much larger ripple effect than was intended.

Mr. Patton asked for clarification between Government Sponsored Entities (GSEs) and Government Business Enterprises (GBEs). He noted the Federal Entity paper referred to GSEs while the GAAP project noted GBEs in the analysis. Mr. Steinberg explained GSEs are not owned by the federal government but the government played a part in establishing them. He added GBEs is a term used to refer to any government activity involved in business like operations. Staff noted GBEs is a term used by other standard setters and it is not a term used by FASAB, but was considered for comparison in the GAAP project. Staff also directed the Board to Appendix 1 which explained in detail how GSEs are defined in legislation.

> **CONCLUSION:** Staff will provide background and educational materials on the Federal Reserve as well as how other countries treat central banking systems. In addition, staff and the task force will move forward with initial plans to draft language of the proposed standard.

- **Reporting Model Project**

Mr. Simms introduced the Financial Reporting Model project and explained that the objective for the meeting was to discuss the plan for the initial phase of the project - Phase I: Studying the Needs of Users of Federal Financial Information. He noted that the plan includes conducting focus group discussions with the users of financial reports identified in Statement of Federal Financial Accounting Concepts (SFFAC) 1, *Objectives of Federal Financial Reporting*. Those users include citizens, Congress, executives, and program managers. Also, because the citizens group consists of a broad range of users, and they are the primary audience for the consolidated financial report of the U.S. Government, staff planned to conduct two sessions for this group, while conducting one session for each of the other groups. The plan also includes a focus group discussion guide. The discussion guide provides questions for focus group participants and would assist a moderator in conducting the discussions.

Messrs. Allen, Reid, and Werfel noted that some focus groups, such as citizens, may need some specific topics, questions, or an overview of what information is available, such as sustainability information, to get the discussion started. Mr. Simms noted that the plan includes conducting a "test" focus group session to determine how well the discussion guide would work and determine the need for some "warm-up" questions to prompt discussion. Mr. Allen noted that testing the discussion guide would help staff learn whether more specific questions would be needed.

Members agreed that multiple focus group sessions should be conducted for each user group. Multiple focus group sessions are needed because of the diversity within the federal government. Mr. Jackson noted that there are multiple, complex programs in the federal government and we need to know what information they use to manage those programs. Some agencies have programs that produce assets that are visible or "hard," while others provide services which are not as tangible or "soft." There should be an understanding of the program manager's responsibilities before conducting the focus group to provide some perspective. Also, the Board needs to identify what information congressional staff may want to know about those programs, such as information about assets. Mr. Dacey stated that we need to identify any information that is being used but is not a part of our current reporting.

Ms. Payne reminded members that there are other FASAB projects designed to study specific topics such as cost accounting and property, plant, and equipment. The reporting model project is the pinnacle project.

Also, members noted that a Preparers focus group session should be added. Mr. Reid expressed that financial report preparers may be a good resource for views on what information may be useful. Also, Mr. Steinberg noted that preparing financial statements helps to build understanding and insights into operations.

Members discussed that internal users have noted significant benefits from the financial reporting and audit process. For instance, auditing the statement of budgetary resources helped improve budget information.

Members believed that the project should provide for a differentiation between government-wide and agency financial statements. One result of this project is that the financial statements of individual agencies may be different from those presented today. Those statements may need to have a more internal focus.

Mr. Farrell noted that citizens seem to get more concerned about a $150 million bridge than a $50 trillion liability. The issue is how to get citizens to focus on some of the bigger challenges facing the federal government. Mr. Simms noted that once we receive information from the user needs study, a later step in the plan calls for exploring how to present that information.

Mr. Werfel stated that given the transition to a new administration and, as the CFO Council looks to establish their priorities for the upcoming year, it would be a good idea to have some type of deliverable or position by next summer. He also noted that Jonathan Breul, Executive Director of the IBM Center for The Business of Government, and others in the federal financial reporting community have been dealing with accountability reporting issues such as what works well and what does not. There may be some benefit in discussing issues and convening focus groups with them.

CONCLUSION: Staff will plan to conduct multiple focus group discussions with each group of users and will conduct a discussion with financial report preparers.

Also, staff will test the discussion guide to learn whether enhancements are needed to facilitate discussion, and will incorporate member's comments into the plan. Staff will keep the Board informed as progress is made in conducting the study.

- **Appropriate Source of GAAP and GAAP Hierarchy (Cont. from October 22, 2008)**

Mr. Simms and Ms. Ranagan presented a revised draft ED based on the October 22, 2008 Board discussions and summarized the revisions. Rather than voting on whether to issue the ED at this time, the Board agreed to review the revisions and provide staff with comments. Essentially, the revised draft ED discussed moving the GAAP hierarchy to the accounting standards, providing guidance for entities following FASB standards, and providing guidance for entities preparing GAAP-based financial statements for the first time.

Mr. Dacey offered suggestions for the analogizing framework. He suggested language from the auditing standards that focuses on the substance of the transaction. Mr. Allen commented that it informs the preparer to consider substance over form. Ms. Payne added that this notion is not currently in the FASAB literature. Mr. Dacey also suggested language from SFFAC 5 that informs the preparer to analogize to existing standards before considering other literature. Members agreed with the concepts suggested and staff will work on the specific language.

Mr. Dacey suggested revising Question 5 to state that the Board is "considering whether" the information should conform to FASAB rather than the Board "believes that…" The Board discussed whether consolidated information should be on the FASAB basis, but did not vote on the issue. Ms. Ranagan clarified that questions 4, 5, and 6 of the revised ED were intended to address each of the objectives of the Appropriate Source of GAAP project. Question 4 concerns standalone statements and what additional reporting would be needed to meet federal reporting objectives. Question 5 concerns how the information is reported when consolidated, and question 6 concerns FASB entities and the conversion to international reporting standards. Mr. Scott Bell was concerned whether there was enough context to answer Question 6. Ms. Ranagan noted that paragraph A18 briefly references this issue; she anticipates that only individuals with an opinion and current knowledge on the topic will respond to that question. Members agreed that a reference should be added to the question.

CONCLUSION: Staff will incorporate member's comments and provide members with a pre-ballot ED before the December 2008 Board meeting.

- **Update on Project Plans**

This topic was deferred until the December meeting.

- **Steering Committee Meeting**

The Steering Committee met in closed session.

Adjournment

The meeting adjourned at 3:30 PM.