FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 26-27, 2011
Room 7C13
441 G Street NW
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Wednesday, October 26, 2011

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Granof, Jackson, Reger, Schumacher, Showalter, and Steinberg. Ms. Bond was present for most of the meeting and represented by Ms. Kearney during any absences. The executive director, Ms. Payne, and general counsel, Ms. Hamilton, were present throughout the meeting.

- **Approval of Minutes**

The minutes of the August meeting were approved electronically before the meeting.

- **Financial Reporting in France**

Chairman Allen welcomed Michel Prada, chairman, and Marie-Pierre Calmel, secretary general, of the French standards-setting council. Mr. Prada updated the board regarding efforts in France (see attached presentation). He also shared thoughts regarding the challenges of moving beyond historical data, the relationships between national and international standards-setters in the public sector, and differences between private and public sector organizations. The Board greatly appreciated the opportunity to learn more about developments in France and to discuss challenges common to public sector standards-setters. Chairman Allen invited Mr. Prada and Ms. Calmel to continue the exchange of ideas in the future.

Agenda Topics

- **Draft Annual Report**

Ms. Payne noted that some members provided comments on the October 7th version of the draft annual report for fiscal year 2011. A revised draft showing those changes was provided to members at the meeting. While acknowledging the edits improved the document, she did not believe the edits were substantive. Her plan was to receive any further member suggestions during the current session and bring a revised draft for approval the next day.

Mr. Reger inquired about the paragraph entitled “resources.” He wondered if the detail aligned with the actual process. He thought the technical agenda was set and then the budget was set to support the planned projects. As he recalled, the agenda setting came first and then the budget was considered.

Mr. Allen recalled them being parallel. He suggested edits to resolve the concern. The tone he believes appropriate is that we have made some adjustments in our resources and the changes do not pose a problem for us now but future changes may.

Mr. Showalter thought it would be unrealistic to suggest that the budget did not impact the technical agenda. Mr. Reger thought it was important to convey that we have not delayed or deferred an urgent project as a result of the budget. Mr. Showalter did not agree. His perception is that the timeline for projects has been extended and a balanced message was important.

Ms. Bond agreed with Mr. Reger’s view. She did not recall a nonfederal member expressing the view that the budget was preventing the Board from addressing an urgent need.

Mr. Reger agreed that he did not hear nonfederal members express that view. If he had heard that view, he would have conveyed that concern to his agency.

Mr. Allen suggested a separate paragraph on the technical agenda process that would state the fact that the agenda was set and that we can meet the agenda with present resources. Mr. Reger preferred that this come before the assertion that adjustments were made due to resources. His point was that the planning process occurred prior to the agenda setting process. Some nonfederal members noted that they were not part of the discussion of resources – they simply ranked projects. Mr. Dacey explained that the process has not changed over time; the norm is to assign one staff member to each project. He believes elongated project timelines did not result because the norm of one staff member per project has been maintained.

Mr. Jackson noted that we are confronted with the challenge of budget reductions. The point is that these reductions have not yet had a negative effect on the board's ability to address priority projects.

Mr. Schumacher suggested changing "negative" to "significant." Mr. Granof agreed and explained that saying it had no negative impact implies we had excess resources in the past. Ms. Bond believes, to the contrary, that it reflects how the workload has changed over time. There is a substantial body of standards at this time. It is logical that we needed more staffing in the early years in comparison to now.

Mr. Allen suggested that we have a general framework for the edits and will receive a revised version at the meeting tomorrow.

- **Federal Entity – Government-wide**

Staff member Ms. Loughan explained the objective for the federal entity session was to approve the revised language for the government-wide reporting entity open issues and obtain member feedback on the completed government-wide portion of the Exposure Draft (ED). Specifically, the Board was asked to approve the revised language for the consolidation of FASB-based information without conversion and the revised language for non-core entity disclosures.

However, Chairman Allen noted that before addressing the issues in the staff memo, he recognized staff had sent additional materials (dated October 14, 2011) that expressed concerns by Board member Mr. Steinberg, which also included proposed alternate wording for intervention activities. Mr. Steinberg's view is that intervention activities should not be considered non-core entities because this implies they are federal entities.

Staff explained that in transmitting Mr. Steinberg's proposed language, staff also provided additional background and staff views on the over-arching issue. Staff believes the current draft provides that the non-core entities are included in GPFFR rather than being included in the entity. Staff explained care had been taken throughout the document to avoid stating that non-core entities are included in the federal entity. The document explains why non-core entities should be included in GPFFR.

Staff recognized the document could be further clarified by (1) revising the title (presently “Government-wide and Component Reporting Entities”) to a more descriptive option such as “Identifying Organizations to Include in Federal Financial Reports and Related Disclosure Requirements” and (2) acknowledging in the executive summary and basis for conclusions the continuum among non-core entities.

Staff also explained the Board had previously considered an exception approach and Appendix 1 to the October 14th memo documents that discussion.

Chairman Allen suggested that the Board discuss this issue as it may have a bearing on the other items for discussion as it appears the overall question may relate to the scope of the project and how it is defined. Chairman Allen explained gathering feedback from the Board on whether we are trying to define the federal entity or what organizations would be included in the report is important. He added that this would help determine if the Board would want to consider further some of the other issues raised by Mr. Steinberg.

Chairman Allen explained that Mr. Steinberg appropriately asked what the scope of the project is and if the Board could pause for a moment to ensure it is in agreement, it seems like a good approach.

Mr. Steinberg explained that if we change the title as staff has suggested, then he views it as a change in scope. He explained he thought the scope was to define the federal entity but now it appears it is to define those organizations that must be included in the financial reports. He added that both are valid, but he wanted to be sure the Board agreed on the scope. Mr. Steinberg explained if the scope is what organizations are included, then the standard could be much easier. He added it could be more streamlined and there might not be a need for the core and non-core. He explained that under the latter approach, the results would end up being   similar to the existing CFR, which uses related parties for the Federal Reserve, bail outs, etc. Therefore, the question is what does the Board see this standard as doing—defining the federal government entity or identifying the various entities that must be included in the federal government’s financial statements.

Chairman Allen explained he didn’t view the standard as trying to define the federal entity, but instead define the federal reporting entity. He added that by saying federal reporting entity, it allows for organizations that may be considered federal or not. He noted this may be close to the second option, but he considers it a reporting entity.

Mr. Showalter agreed he viewed it as the reporting entity as well. He doesn’t view it as within FASAB’s purview to determine what a federal entity is. He does view it within FASAB’s charter to determine what should be included in the federal government’s financial statements. Therefore, he noted he is in agreement with Chairman Allen.

Mr. Granof explained the approach has been to define the federal reporting entity and not legal entities or define the legal status of any particular entity. The question has been what information should be reported.

Mr. Dacey noted part of the challenge is Rule 203 relies on FASAB SFFAC 2 to determine which entities are federal entities. His view was that core entities could equate to federal entities. SFFAC 2 covers it now but he believed the issue should be addressed in a standard. In summary, he thought we needed to define federal entity for purposes of GAAP within the standard and he believes that equates to the concept of core entities as presented in the ED. Mr. Dacey explained he doesn't have any problem with the standard also addressing other entity disclosures beyond core entities, such as non-core or related parties.

Ms. Payne explained that the notion that the core are federal entities while non-core are included in the federal reporting entity could be incorporated in the ED. Mr. Dacey agreed.

Mr. Jackson noted that he struggles with the term 'non-core.' Mr. Dacey explained he viewed 'non-core' as what some have traditionally viewed related party, though he acknowledged some other members may not agree.

Ms. Bond explained she believed we had deliberated this issue and did not want to reopen to discuss new terminology. She added the Board had worked with this for quite some time to get the ED to where it is. Therefore, she was surprised by the question of the intent and scope being brought up.

Mr. Dacey explained he agreed we worked hard to get to where we are and he is in agreement with the results; he just had some concern with the term 'non-core.' He noted there had been several discussions on whether non-core was the best term.

Mr. Jackson asked if we continued down this path but used component units and related units or entities. He stated component units would represent core entities and related entities would represent those currently meeting the definition of non-core. Mr. Jackson explained he has issue with the terms 'core' and 'non-core.' He is uncertain how this would address Mr. Steinberg's concerns, but he does agree with some of his views. Mr. Jackson explained he would like to suggest component units would represent components of the federal government and would be considered part of the federal entity and related entities would be other entities the federal government has a relationship with, whether it be the Federal Reserve or other entities.

Chairman Allen explained the scope of non-core was broad enough so it could encompass many organizations. Mr. Steinberg explained that is what caused issue for him. He believes when one reviews the criteria for core and non-core and compares it to the entities in the CFR, there may be instances where an entity that was consolidated may be considered non-core—such as TVA or the Postal Service. Therefore, he was trying to envision what the financial statement would look like.

Staff explained it was staff's view there may not be material changes in what was consolidated under the proposal. There will be potential for differences; particularly when one gets to the component entity level.

Mr. Steinberg explained we should be looking at this further especially if we are going to be changing current practice. Mr. Reger agreed it is important to consider how the criteria are going to affect the current presentation and display. Ms. Bond noted as a technical response, TVA is part of the budget so it would still meet the core so she doesn't believe the application would change. Mr. Steinberg agreed but noted Postal Service is not in the budget.

Ms. Bond explained she thought we were trying to set up a principles-based standard and that is why she is a little frustrated. She didn't believe we were going to make adjudication against every existing entity as they exist today, especially given the federal government changes over time. She added that was the main reason for having principle based standards.

Ms. Payne explained that staff did not believe the objective was to write a standard that resulted in no changes and agreed that we could not evaluate every existing entity.

Mr. Showalter explained he views this as a problem with terminology. He noted that Mr. Steinberg doesn't believe intervention activities belong in the federal entity; however they absolutely belong in the federal reporting entity. He added it may go back to the fundamental question, and what members believe. He believes that disclosures make an entity part of the federal reporting entity. We aren't defining the federal entity; we are defining the federal reporting entity. Mr. Showalter added that we may need to be clearer or crisper in stating that.

Mr. Jackson explained he agreed that the intervention activities and receiverships are not part of the federal government. He wanted to make certain that was clear as well. He explained the federal government may do things as part of our responsibilities to and with other entities, but that doesn't make them part of the federal government.

The Board agreed a change in title was necessary as described by staff in the October 14th memo.

However, Mr. Jackson noted he still had issue with the terms 'core' and 'non-core.' Ms. Payne explained 'core' is used by entities such as IMF and in statistical accounts. She added that it was similar to general government such that the terms are often used interchangeably to refer to things that are considered governmental. 'Non-core' was selected because there is no other meaning than simply it is not part of the general or core government. Staff noted that several options were presented to the Board which included terms like affiliated, discrete etc. and the Board voted and agreed on the term non-core. Staff noted that other terms (such as affiliated and related) have other meanings where non-core was not an established term that could be confused with other known meanings. Ms. Payne noted further that the word 'accountable' was dropped from 'non-core' because it had certain connotations.

Ms. Bond explained she agreed with Ms. Payne and is very sympathetic to the fact the Board voted on this and gave staff direction to move forward, so she is uncertain in the value of tackling the term agreed upon. Ms. Bond added that she thought the Board was in agreement with the principles established. She believes we should be moving forward.

Mr. Jackson agreed with Ms. Bond but explained he wanted to ensure interventions are not viewed as part of the federal government as a result of the standard. He added that it would be misleading. Chairman Allen noted staff plans to address the title among other things to ensure this is clear.

Mr. Schumacher asked Mr. Dacey if there was an obligation under Rule 203 to define federal entity in a standard. Mr. Dacey explained that one of the challenges when the AICPA recognized FASAB as a Rule 203 body was how one defines federal entity. A federal entity is supposed to follow the GAAP prescribed by FASAB. The AICPA agreed to rely on the definitions in SFFAC 2. He noted this is also reflected in the ethics guidance for the auditors. It needs to be clear what entities are federal entities as that drives what GAAP is applied. Mr. Dacey explained he believes in this process we should define core as being equivalent to federal entities for purposes of applying the correct source of GAAP. He believes this would satisfy all the requirements while allowing intervention and other non-core entities to follow their respective GAAP.

Mr. Schumacher explained he is in agreement with Ms. Bond and he believed the Board was heading in the right direction and in general agreement and close to moving on to the component entity phase. He believes a title change is needed but other than that he is comfortable with the document as long as we address the issue brought up by Mr. Dacey.

Mr. Dacey explained his concern could be addressed with a small note or sentence that equates core to federal entity.

Mr. Reger explained if we change the title to the reporting entity it may help but we still need to define who it applies to. He reiterated that the standard should be clear that intervention activities are not core and are not part of the federal entity. He explained it was never the intent to integrate General Motors into the financial statements.

Chairman Allen agreed and noted the standard incorporated language that dealt with such temporary arrangements. Mr. Steinberg explained that having the intervention activities as non-core can be confusing especially considering the proposed disclosures. Ms. Payne noted that is one of the questions for the Board regarding the proposed disclosures in relation to the objectives at the last meeting.

Chairman Allen suggested that the Board walk through the questions proposed by staff at this time. The Board agreed. Before moving on, it was agreed staff would address the title issue as discussed as well Mr. Dacey's concern by addressing the GAAP issue with a narrow clarification that only core entities are federal entities.

Staff directed the Board to the issue *Consolidation of FASB-based Information without Conversion* at page 4 of the October 7 staff memo. Staff noted the Board previously agreed consolidation of FASB and FASAB based information was acceptable, line items would reference disclosures breaking out the numbers and describing the accounting policies used, and no reconciliation between the two GAAP based amounts would be included. Upon reviewing draft language in August, the Board requested revisions so the focus would be on information about material FASB amounts that contributed significantly to separately reported amounts. The materials presented revised language for the Board's consideration and approval.

Mr. Dacey noted it wasn't clear that we needed to have both FASB and FASAB amounts in a line item. He thought page 5 of the memo which starts "Users may be confused by the presentation…" that was for the basis for conclusions was clearer and should somehow be incorporated into the standard. He noted he didn't have exact wording at this time, but it should be clearer.

Chairman Allen noted he was struggling with the language as well. He explained he didn't care if there was a difference in accounting principles; he was more concerned if there was a difference in the amounts. Staff noted that in an earlier version we did condition the requirements on whether the FASB basis resulted in a different amount than the FASAB basis would have, but that required the preparer to produce FASAB based numbers and the Board noted concern with that cost. Therefore, the Board requested staff to revise the language. Mr. Reger explained the preparer would have to know how to run the numbers under both sets of rules to know the difference and they wouldn't have the data to do that.

Mr. Dacey explained the purpose of this was that if there is a difference in accounting principles in a particular line item, it should be explained. We just should tell the reader that there are different bases of accounting that are included in the number. Mr. Reger explained that almost every line item has a combination of the two, so would it be required for all. Also, there are some that are FASB line items that do not have FASAB amounts—such as cash equivalents and he questioned how those should be handled.

Mr. Dacey noted there has to be a material amount of FASB based information to trigger the disclosure. He agrees they are included, but there are not a lot of significant amounts reported by FASB based entities that would merit disclosure because they are not significant to that line item. Staff noted that was the intent of adding the caveat that disclosures are required 'where the amounts prepared to FASB standards are material to the line item.' Mr. Dacey agreed there are amounts that are just FASB based amounts such as Securities and Investments and it is fine the way it is—it is only where you have a difference in accounting principles within a line item that this is an issue and the amounts are material. Mr. Reger agreed and explained it would be a matter of breaking that information in the notes and showing the FASAB amounts and FASB amounts for those. Mr. Dacey explained if the FASB amounts are not material to the line item, then no further disclosure are required.

Mr. Showalter noted he also struggled with the sentence before the disclosures. He had sent staff suggested wording for a re-write such as "The following disclosures are required where the amounts presented within a line item pursuant to FASB standards result in a material difference between FASAB and FASB accounting principles or standards."

Mr. Jackson suggested the following: "The following disclosures are required when (1) there is a difference between the accounting principles issued by FASB and FASAB and (2) the effect on a line item is material."

Mr. Dacey explained he had concern with measuring effect. Mr. Dacey noted the conditions should be that the line item includes both FASB and FASAB amounts, both, the FASB and FASAB amounts are material to the line item, and there is a difference between the accounting principles for FASB and FASAB. Mr. Dacey explained there is some judgment involved in determining whether or not the principles are sufficiently the same that they can be combined in the basis of accounting description in determining whether the reader needs to be notified. He doesn't want to measure the effect.

The Board agreed a line item must have material FASB and FASAB amounts to trigger disclosures. Mr. Jackson explained we could leave material out as any standard has the materiality provision in it. He explained if there is a difference between FASB and FASAB then there is a disclosure requirement, materiality kicks in anyway. Mr. Showalter suggested it was safer to put in to deter the need of disclosing all instances.

Mr. Dacey explained the next question for the auditor is if they really are different accounting principle as they may use different words but they may be so close they are the same and this is where judgment comes in. For example, in describing them in the notes, the reader may accept them as being virtually the same.

Chairman Allen noted that there may be instances where different methods may result in little difference. What would expect to be said about the different methods or principles in those instances? Would we rather simply state included in this line item are two ways to calculate the values. He noted this is a fundamental question the Board should determine.

Mr. Jackson explained he thought what was worded here in a.) and b.) on page 6 was what the Board properly agreed upon. He explained it appears the problem is with the sentence before that, and if we simply state there is a difference in the accounting principles between the two Boards, it may solve the problem. Mr. Dacey agreed with that and noted some judgment would be involved if there is a difference. Chairman Allen explained the conundrum is there may be no difference between the two bases or principles though we don't want to require them to go through the process to figure that out. For example, Mr. Dacey explained he envisioned the disclosure saying there is $10 at cost (FASAB) and $20 at fair value (FASB) to be meaningful. Chairman Allen explained otherwise, we would just offer the amount.

Mr. Showalter explained when one reviews private financial statements that simply explain the method; they don't provide amounts by method. Therefore, one should consider the burden when you consider putting the amount with the method. Ms. Bond agreed with Mr. Showalter's point. Mr. Jackson noted we are deliberating over the largest entity, so that it is a valid point. Therefore, one can't imagine these methods having a material difference to begin with. Chairman Allen agreed he didn't foresee a disclosure at the government-wide level, but this would be driving guidance for the component level.

Mr. Dacey explained he had less concern about merging accounting methodologies than he does about merging accounting principles or bases. Mr. Showalter explained once you add numbers to it, you have moved past basis of accounting.

Mr. Granof noted that it appears this relates to trivial entities. Mr. Dacey explained it would affect entities such as Labor, USPS, PBGC, TVA, etc. He noted we effectively accomplish many of these things already.

Chairman Allen noted he would like to vote on this issue. Ms. Payne suggested the word "or standards" be dropped from the end of the last sentence in par. 3. The Board agreed with this suggestion.

Mr. Jackson explained he was sorting this as we have a summary of significant accounting principles in the notes and now we are trying to determine if we want to have a related amount associated with certain ones. Ms. Payne explained we don't have a FASAB standard about the Summary of Significant Policies. She added it is clearly convention and based upon everyone doing the right thing and if it is a FASB line item, one expected it to be described in the summary. Ms. Payne explained the staff proposal is written the way it is so that disclosures could be provided for material line items in a disaggregated fashion among FASB and FASAB amounts. Basically staff wrote this so that FASB material line items would drive detailed disclosures related to the line items. She believed some information was probably already required in the summary of significant policies before you get to the point of specific line items of the financial statements. Staff explained the focus on the FASB line items was based on decisions at the last Board meeting.

Mr. Jackson requested a better understanding about what the Board would be voting on. First it is whether a description would be required of the accounting policies, second it is whether a breakout of the different amounts included in the line items for each FASB and FASAB,

Mr. Showalter explained it appears we are spending a lot of time about information that isn't that material or important at the government-wide. However, if we want to do that then we can capture something along the lines of what Mr. Jackson suggested.

Mr. Granof suggested Mr. Jackson's wording was very similar to the staff proposal so it appears we are quibbling over small wording issues. He explained if there is a difference in standards and it is material to the line item then it should be disclosed. Chairman Allen explained we are not concerned with the difference in the amount.

Mr. Jackson explained he doesn’t want to get into a huge materiality discussion. The options before the Board are as follows:

1. Simply put the amounts for FASAB and FASB and nothing more.
2. Management option—determines if it is material. If so, disclose more.

Mr. Jackson explained our requirements should be for the minimum which is for the related amounts, but if the FASB amount isn’t material nothing more needs to be disclosed regarding policies.

Mr. Dacey explained in practice the FASB amounts and FASAB amounts are being consolidated in one of two ways. One, the FASB based amounts (such as Securities and Investments) are presented in separate line items. Two, the amounts are presented in a single line item and then split in the note into the FASAB and FASB component parts. He explained from that standpoint the consolidated financial statements have been doing what is proposed in the draft. Mr. Dacey added that it appears the Board agrees with what is drafted as well as with what is being done.

Chairman Allen asked if it needs to be articulated in the standard or can professional judgment be relied upon to lead to the same result. It appears so fundamental to explain the basis of accounting for your line items that working so long on the wording may be unnecessary. Mr. Dacey explained that financial statement readers should not be confused as to which basis of accounting is being used. He added that perhaps we do not need to go into detail in the standard.

Mr. Showalter suggested based on the discussion, the Board is saying preparers and auditors would come to agreement and do the right thing. Therefore, it might be better to eliminate from “The following disclosures are required…” Paragraph 3 would remain to permit consolidating component entity financial statements for core government entities prepared in accordance with SFFAS 34 without conversion for any differences in accounting policies among the entities.

The Board agreed with removing the sentences from par. 3. Mr. Granof suggested the language removed be summarized and included in the basis for conclusion as explanation. The Board agreed with this suggestion.

~LUNCH BREAK~

Due to the fact there were visitors from the Federal Reserve attending the meeting; the Board decided to start with the issue ‘Addressing the Federal Reserve’ after the lunch break.

Staff directed the Board to page 10 of the staff memo which explained that par. 47 of SFFAC 2, *Entity and Display,* provides that the Federal Reserve System would be excluded from the government-wide reporting entity. It was agreed that as part of the federal entity project, the exclusion would be reconsidered.

Staff explained that although it has been staff's position not to address *specific* entities in the standards or Basis for Conclusion, staff believes the Federal Reserve System will have to be addressed specifically because:

1. Paragraph 47 in SFFAC 2 should be rescinded and

2. There is <u>one</u> Federal Reserve System so it would be impossible to explain why the SFFAC 2 language is being deleted without some mention of the Federal Reserve System.

Staff explained the options to address the Federal Reserve which are detailed in the staff paper include:

1. Rescind par. 47 (along with other sections of SFFAC 2). Brief explanation would be provided in the basis for conclusions.

2. Rescind par. 47 (along with other sections of SFFAC 2). Federal Reserve System would be provided as a potential example of a *Quasi Governmental and/or Financially Independent Entity* and explanation would be provided in the basis for conclusions.

3. Address Federal Reserve System by incorporating the conclusion of option 1 or option 2 above into the <u>standard language so that the Federal Reserve System is explicitly identified as a non-core entity.</u> Also, rescind par. 47 (along with other sections of SFFAC 2).

Staff believes OPTION 2 most adequately addresses not only why the paragraphs within SFFAC 2 were rescinded but also shows how one might analyze the Federal Reserve System against the principles articulated within the standard at a very high level.

Ms. Payne added that the additional language in Option 2 was included to also facilitate responses if we were to include the proposed question to respondents. It doesn't necessarily have to be preserved in the final standard. Language in the basis for conclusions for an exposure draft does not have to remain in the final.

Mr. Jackson explained his fundamental problem with Option 2 is that we reached a decision as to how the Federal Reserve would be accounted for and that should not be included anywhere in the document. His specific concern is with the last sentence that states "Therefore, based on present circumstances, the Federal Reserve System should be included in the government-wide report and disclosures consistent with the non-core entity provisions in the Statement should be provided." Mr. Jackson stated that draws a conclusion and should not be included in a principles-based standard; the Board should not reach that conclusion regarding any entity.

Chairman Allen explained he adjusted the wording slightly to be that "one would likely conclude" or something along those lines. However, he asked if Mr. Jackson preferred option 1? Mr. Jackson stated he preferred Option 1.

Mr. Dacey explained he envisioned par. 39-50 of SFFAC 2 to be superseded. Therefore, he was questioning why we needed to explain the change for only one paragraph. He asked whether it was accurate to state that we want the principles-based structure in place and it would apply to all the superseded paragraphs. Staff explained that is accurate, however; where certain issues or entities were presented and articulated in the Concepts statements it was our thinking we ought to be clear in the exposure draft as to the reasons for changing.

Ms. Bond explained she was in agreement with Mr. Jackson and she supports Option 1. She added we are establishing a principles-based standard and should provide a brief explanation as to why the change is being made. It provides clarity and ensures the reader understands.

Mr. Showalter explained he was supportive of Option 1 as well. Although we can hi-light the information in option 2 in the exposure draft in some fashion, he views the basis for conclusion as extending forward. Ultimately, he is more comfortable with option 1.

Staff asked the Board if there is something they would like to say regarding the ramifications but not a complete assertion regarding the Federal Reserve. Mr. Showalter suggested just pointing it out that it was previously in the SFFAC 2 and now must be assessed against the principles.

Chairman Allen explained Option 1 is the most principles-based approach. He thought we were trying to be sensitive to some of the concerns raised regarding the Federal Reserve.

Mr. Granof explained he is in favor of option 3 because we are dealing with trillions of dollars of assets for a very specific entity. He added the way the Federal Reserve is handled overwhelms everything else in the standard. He explained this is sufficiently important that it goes in the front of the standard, and not in the back of the book.

Chairman Allen asked if he had concern with the fact it wouldn't be principles-based to do that. Mr. Granof acknowledged that. He thought, given a particular paragraph is to be rescinded from the Concepts statement and the magnitude of the entity involved, we should be clear about the desired result.

Mr. Steinberg explained he agreed with Mr. Granof's views. He said his views are with Option 2 but listening to other member comments, they closely align with Mr. Granof. He explained he doesn't agree that we must make this principles-based and not address the Federal Reserve. Because the Federal Reserve is so important (that it was addressed in SFFAC 2 due to its uniqueness and size), it should be clearly addressed. Therefore, he believes Option 2 is best.

Mr. Shumacher asked if we went with Option 2 and the additional language, would it require re-exposure to drop that language in the final standard. Ms. Payne said no as it wouldn't change the final language in the standard; simply the basis for conclusions.

Mr. Reger explained he agreed with Mr. Steinberg. He added another issue is do we want to solicit questions on the treatment of the Federal Reserve in the ED or not? If the Board wants feedback on whether the Federal Reserve should be included or whether they should be core or non-core, then we request information on that. If the Board has already reached a decision on that and doesn't want information, then perhaps it isn't necessary.

Ms. Bond explained this is a slippery slope to say this is a principles-based standard yet we are somehow dismissing all that work and trying to do except for clauses. Option 1 meets the intent of the standard.

Mr. Showalter explained we are rescinding paragraphs of SFFAC 2, not necessarily because they are wrong but because we are replacing them with a standard. He agreed with Mr. Jackson's comment earlier that as standards-setter's we shouldn't telegraph what we think the answers should be. We may all have our own personal views on certain entities, but we don't have the same information available to us as the entity. Further, the public wouldn't be in a position to comment if the Federal Reserve should be included or not, as they would have even less information.

Chairman Allen requested a vote on the issue.

Mr. Showalter explained he is for Option 1.

Mr. Schumacher explained he is fine with Option 2, but after hearing the Board comments he would also be comfortable with Option 1.

Mr. Dacey noted his preference would be Option 1.

Ms. Bond expressed her choice was Option 1.

Chairman Allen explained he was fine with Option 2 (with the revised wording he noted earlier) but he is okay with Option 1.

Mr. Reger explained his preference is for Option 3 as we should be clear.

Mr. Steinberg explained he is for Option 2.

Mr. Jackson explained he is for Option 1.

Mr. Granof votes for Option 3 because the Federal Reserve is unique.

Based on the above votes Option 1 was selected for addressing the Federal Reserve.

Mr. Steinberg noted the Federal Reserve System is made up of the Board of Governors and Reserve Banks and he questioned how that would be applied. Staff noted based on the discussions, that question is not something the Board believes it should deliberate. Mr. Reger noted they would have to have discussions with the Federal Reserve in making those determinations and how they interpret the statute. Mr. Steinberg noted the language in Option 2 made the distinction between the two but Option 1 does not.

Mr. Steinberg noted concern that we may not be asking the right questions to get information about the Federal Reserve banks which is where the trillions of dollars are located. Mr. Granof noted just including the Board of Governors is trivial information, if we don't include information about the banks. Chairman Allen explained we are establishing principles and leaving this up to the preparers, auditors, and consolidators. Mr. Steinberg explained in voting for Option 1 we left if very vague about what we are referring to when we speak about the Federal Reserve.

Chairman Allen directed the Board to staff question 3- "Should a listing of non-core entities be incorporated into the Disclosures for Non-core Entities?" on page 9 of the staff memo. Staff explained that previously certain members had suggested that a listing of the non-core entities in a note disclosure would be meaningful because it would explicitly state in one place which entities are core (consolidated) versus non-core (disclosed). There appeared to be some resistance by other members because there was a question regarding the cost versus benefit of providing such information since there might be numerous entities for consideration, though materiality provisions would apply.

Ms. Bond view was not to require a list because it would be lengthy and cumbersome. Mr. Dacey explained the existing proposed disclosures are for significant entities or significant aggregate entities so this would provide disclosure and he doesn't see the value of a separate list.

Chairman Allen explained he thought it would be helpful in light of materiality provisions. Chairman Allen asked Mr. Dacey what assurances are there that readers will be made aware of the material non-core. Mr. Dacey explained the proposal is worded for significant non-core entities or aggregate non-core entities to provide disclosures. He added the threshold we have described in the non-core disclosures is good, and to require a separate listing would not add value to the process.

Mr. Schumacher explained he didn't see the need for a list if the disclosures already cover significant non-core entities. Mr. Granof, Mr. Jackson, Mr. Steinberg and Mr. Reger agreed that the list is not necessary.

The Board agreed that a listing of non-core entities would not be incorporated into the disclosures.

Chairman Allen explained the Board would discuss the issue of *Revised disclosures for non-core entities.* Staff directed the Board to page 7 of the staff memo. At the August meeting, staff had presented revised disclosures incorporating an example for referring to separately published financial statements and also clarifying that examples provided in the standard were strictly examples of information and not specific requirements or required disclosures. In August, the Board requested that the non-core entity disclosures be revised to reflect 3 broad objectives (the nature of the relationship, nature and magnitude of the activity during the period and balances at the end of the period, and future risks and exposures to gains and losses) and the examples presented as types of information that could fulfill the three broad objectives.

Staff asked for the Board's feedback on the revised language for Disclosures for Non-core Entities—specifically if the objectives were articulated as expected and the examples of disclosures satisfactory.

Chairman Allen noted that earlier it was brought up that one of the most important pieces of information we are concerned in conveying is the risks and rewards regarding the non-core entities. He noted concern that this was listed as the third objective. He explained in reviewing the proposal wording which states:

> For each significant entity and aggregation of entities disclose information to meet the following objectives:
>
> a. ***Relationship:*** The nature of the federal government's relationship with the non-core entity.
>
> b. ***Relevant Activity:*** Nature and magnitude of relevant activity during the period and balances at the end of the period.
>
> c. ***Future exposures:*** A description and, if possible, quantification, of the federal government's exposure to gains and losses from the future operations of the non-core entity.

Chairman Allen noted concern because he didn't see how a. and b. were as important as the information from c. He suggested revising so c. is primary, and the others are below it. He realized that background information was necessary, so that is why one might explain the relationship but the goal is to provide the information on the gains and losses.

Mr. Dacey explained he viewed a. through c. as objectives that must be met, and not a prioritization of objectives. Chairman Allen explained he viewed the information from c. as the most important while a. and b. are more background to help understand c. Chairman Allen offered that if there is no risk, he may not care about a. and b. Mr. Dacey explained he believes they are all important. For example, it is very important to disclose how much money we provided to Fannie and Freddie this year, which is accomplished through b.

Mr. Showalter explained that it is much easier to do a. and b. than it is to do c. Therefore, we may need to offer more information about this. Mr. Showalter explained he is supporting Chairman Allen's comments.

Mr. Jackson explained he was unclear what was meant by relevant activity as it seemed like it was an open ended statement and open for interpretation. Though based on the conversation regarding the Fannie and Freddie payments, it is clearer. He believes we should be clear what relevant activity is in the standard so people understand.

Mr. Granof explained he was comfortable with the three objectives, for example when considering the Federal Reserve-wouldn't one want to know the activities they engaged in throughout the year. He added there are a lot of transfers back and forth, and that seems very relevant.

Mr. Jackson explained it should be clear that we are referring to relevant activity between the federal government and the non-core entity.

Mr. Steinberg explained when he considers the disclosures; he views the different relationships and the types of disclosures. There are relationships due to the fact we had to bail entities out. There are relationships because the organizations are set up in a quasi-governmental fashion; therefore there might be relevant activity that should be disclosed.

Mr. Reger agreed and explained one might want a different level of explanation or disclosure for the different types of relationships.

Mr. Reger noted the word "may" prefaces the list of examples, but he was concerned with the exhaustive list. He noted we started with risk and relationship, so he wasn't sure if all the information included in the list of the types of information to be disclosed helps.

Mr. Dacey explained he is comfortable with the staff proposed wording. He believes we currently meet the three objectives in the consolidated financial report. It is important to understand why we are in a relationship with the non-core entity. He added the balances and activity between the government and the non-core entities are critically important to understand what is going on. Naturally, exposures are very important. Mr. Dacey explained he thought they were pulled together in a nice and concise way. Further, based on the current notes to the financial statements, he believes the objectives would be met.

Mr. Shumacher explained he was comfortable with the three objectives. He noted that although he understood Chairman Allen's concern regarding c., he viewed them as presented in the order they would be found in the financial statements and not prioritized in any way.

Mr. Showalter explained he was comfortable with the three objectives. However he noted we need to be clear with the lead in to the examples to ensure we don't get more than the relevant information in the footnote.

Mr. Dacey noted that materiality is always an important consideration regarding what gets reported and disclosed. Further, the ED offers guidance and other factors for consideration in determining what should be disclosed for non-core entities.

Chairman Allen asked if there should be any revisions to the language.

The Board approved the language as proposed by staff for the disclosures for non-core entities.

Staff directed the Board to page 15 to discuss the Basis for Conclusions language. Staff explained this project to date has a long history and the decision regarding what to capture in the basis for conclusions can be a difficult one. Further, this has been a fluid project and many of the final decisions have only just been solidified; enabling staff to draft a basis for conclusions (BfC).

Therefore, staff found decisions about the level of detail and what should be related regarding the history, a bit challenging. However, as the title indicates the basis for conclusions should capture the rationale for those decisions of the Board that led to proposed standards. The details of the minutes will remain as a permanent record and further detail of deliberations and other ideas considered by the Board throughout the federal entity project.

Staff requested Board input if the BfC is at the level of detail expected and covered all the notions the Board believed pertinent to be included in the BfC. Staff noted that editorial comments may be directed to staff after the meeting. Staff is seeking approval of the overall structure, detail, and rationale proposed.

Mr. Steinberg noted there had been changes in what the Federal Reserve does since SFFAC 2 was written. The Federal Reserve now makes loans and participates in other activities it did not do before. They are not the same Federal Reserve that existed in 1991, and he believes this should be put in the basis for conclusion.

Mr. Reger stated the fact we are rescinding the Federal Reserve paragraph has nothing to do with their suggested change in activities, we are rescinding because we are going to a principles-based standard. The Board has not deliberated on the functions or activities of the Federal Reserve.

Mr. Steinberg explained there might be some push-back if we don't offer some explanation. He added if it was good enough to not report them in 1991, why isn't that good enough now.

Mr. Jackson noted we didn't make a decision regarding how the Federal Reserve would be reported.

Chairman Allen suggested the Board go to a vote on the Basis for Conclusions.

Ms. Bond explained she is fine with the basis for conclusions, as long as it is updated and reflects decisions made by the Board today—for example, Federal Reserve paragraphs would be consistent with option 1.

Ms. Payne explained the document would be updated to reflect today's decisions. Mainly staff was looking for any major issues with the rationale offered. Editorial suggestions can be provided to staff for incorporation.

Mr. Dacey and Ms. Bond stated they had edits to provide.

The Board approved the basis for conclusions language subject to substantive changes agreed at the meeting and editorial comments from members.

Chairman Allen directed the Board to the next issue-*Questions for Respondents.* Staff developed an initial list of Questions for Respondents for the Board's consideration. Staff believes the questions address the main provisions of the Statement and requested the Board's input.

Chairman Allen noted there were 13 questions and some of them were multiple part questions. He doesn't like requesting respondents to write a thesis. He explained he went back through the questions trying to determine which ones could possibly be eliminated. In doing so, he wasn't sure if the misleading to exclude question was necessary, but he wishes there were more that could be taken off.

Mr. Dacey explained the questions related to the inclusion principles could be condensed to one question and ask if the respondent agrees with them. Mr. Granof agreed, the fewer the number of questions the better and it looks less imposing. The respondents will find a way to let you know what they think.

Chairman Allen suggested that Board members provide any other suggestions to staff on ways to reduce the questions so it doesn't look so burdensome. However, the Board agreed there were no questions to be added.

Chairman Allen directed the Board to the last issue regarding Next Steps on page 16 of the staff paper. Staff explained the Board may wish to consider if a Preliminary Views (PV) document or a Discussion Memorandum (DM) should be issued to solicit input on the government-wide portion as the Board will be spending some time on the component reporting entity piece. Staff explained it would be beneficial as the Board would be working on the component entity portion during the time the PV or DM is out for comment and the feedback may have an impact and perhaps assist with developing the more detailed options for the component reporting entity section.

Chairman Allen stated his view was absolutely no, a DM or PV should not be issued because it extends the due process by about a year. He believes the Board has spent extensive time deliberating the issues. He added he doesn't see the topic as so controversial that it is required.

Chairman Allen asked if any members supported issuing a PV or DM. No members supported.

CONLUSION: The Board decided the following at the October meeting:

- The Board agreed the document could be clarified by staff (1) revising the title (presently "Government-wide and Component Reporting Entities") to a more descriptive option such as "Identifying Organizations to Include in Federal Financial Reports and Related Disclosure Requirements" and (2) acknowledging in the executive summary and basis for conclusions the continuum among non-core entities. [Note: Staff will present title options at the next meeting that align with the revised structure]
- Staff will address the GAAP issue with a narrow clarification that core entities are federal entities.
- The Board approved the revised language to address the consolidation of FASB Statements with the following change: the last sentence in par. 3 "The following disclosures are required…." Will be removed and summarized in the basis for conclusion as explanation.
- The Board approved the revised language for Disclosures for Non-core entities.
- The Board agreed a listing of non-core entities would <u>not</u> be incorporated into the Disclosures for Non-core Entities.
- The Board voted Option 1 for addressing the Federal Reserve in the ED (rescind par. 47 and certain other sections of SFFAC 2 with a brief explanation in the basis for conclusions).
- The Board approved the draft Basis for Conclusions (overall structure, detail, and rationale proposed) with the understanding changes would be incorporated for decisions made at the October meeting. In addition, certain members plan to forward editorial comments after the meeting.
- The Board generally agreed with the proposed Questions for Respondents for the government-wide portion of the ED and there was <u>not</u> a request for additional questions. However, the Board did request staff to reduce the number or combine the questions so it doesn't look so burdensome to respondents.
- The Board will <u>not</u> issue a Preliminary Views document or a Discussion Memorandum to solicit input on the government-wide portion

- **Federal Entity – Component Entity**

The discussion of component entity was deferred due to time constraints.

- **Reporting Model**

<u>Overview</u>

During the reporting model project session the Board discussed the report entitled, *The Chief Financial Officers Act of 1990 – 20 Years Later: Report to the Congress and the*

Comptroller General (CFO Act Report); and discussed a project plan for reviewing the reporting model for component level entities. Attending the meeting to discuss the CFO Act Report were:

- Danny Werfel, Controller, Office of Federal Financial Management, Office of Management and Budget
- James L. Taylor, Chief Financial Officer, Department of Labor
- Jon T. Rymer, Inspector General, Federal Deposit Insurance Corporation

The CFO Act Report identified the lessons learned since the CFO Act of 1990 was enacted and offered the following recommendations:

1. The Congress should consider enhancing the role of the CFO by standardizing the CFO's portfolio to include leadership responsibility for budget formulation and execution, planning and performance, risk management and internal controls, financial systems, and accounting. To provide continuity during the often lengthy period between appointments of agency CFOs, the Congress should also consider providing Deputy CFOs with the same breadth of responsibilities as their respective CFOs.
2. The Congress should consider directing OMB, GAO, and the Federal Accounting Standards Advisory Board (FASAB), in consultation with CIGIE, to evolve the financial reporting model by examining the entire process with an eye toward how to further improve and streamline current reporting requirements and to better meet the needs of all stakeholders.

Also, FASAB discussed next steps for the reporting model project. The Board determined that staff should begin by conducting discussions with CFOs and representatives from various groups to help the Board better determine what information is of value to users. Details of the meeting are as follows.

<u>CFO Act Report</u>

In conducting their study, Mr. Rymer noted that they met with about 250 individuals and received a variety of perspectives. The individuals were from various organizations including the CFO and IG communities, accounting firms, academia, and trade associations. They focused their research on federal financial management, internal controls, financial systems, and financial accountability and reporting.

Mr. Taylor noted that with respect to the recommendations, Congress does not necessarily need to pass a law, but they should take a look at the areas recommended and state their intent. Regarding the first recommendation, they believed that there should be more consistency in the portfolio of responsibilities of CFOs.

The CFO Act envisioned that CFOs would have a Boardroom role rather than a back office accounting type of function as in the past. The idea of the Act seemed to be to provide a CFO type of function similar to the private sector; someone that could provide management with the information they need to make decisions. Different agencies have evolved the CFO function differently; therefore there is no commonality across government. There are ways that the CFO could be more valuable to management and, to provide the most value to management, performance, budget formulation, and risk assessment activities are functions that the CFO should have.

Also, the CFO Act intended for the deputy CFO to provide continuity. However, in most cases, the deputy CFO does not have the same responsibilities as the CFO and rarely acts on behalf of the CFO when the CFO is gone.

The CFO measure of success is not the readership of the reports. The success of the CFO Act comes from the systems, processes, and the discipline involved. Providing information to management is the intent of the CFO Act. CFO's endorse the process, but the focus could be reconsidered – how much depth should we go into on certain issues as opposed to other issues. CFOs are concerned that they do not have the insight on data being made available. Different groups within an agency may place data on the agency website, but the CFO may not have insight on whether the data are valid. Also, what has changed over time is the speed at which information is required.

Mr. Taylor noted that he was encouraged by looking at the FASAB staff recommendation to review the reporting model; however, he believed the project could be conducted more timely, because the research has been conducted and CFOs know what the issues are. He believes that he and other CFO resources could be better expended in a manner that gives management the information they need.

Mr. Werfel noted that he sees a narrowing of the usability of the core financial reporting activities versus emerging risks. The CFO's responsibilities concerning reporting have shrunk relative to their other responsibilities. He noted that he wished that the reporting infrastructure would be a more diverse and helpful toolbox to the CFO, now that they are at this critical point in government's history. Because it cannot be changed overnight, we need to start to define phases and percentage improvements with the usability of our core infrastructure to address emerging risks.

The Board could consider its agenda and priorities and determine whether they advance the reporting model in a way that has a positive return on the investment. Regarding projects and determining solutions to problems, involve more practitioner expertise, like CFOs and business leaders, who can look more holistically at the challenges we face today and can help articulate how financial reporting and audit can fit into a larger framework of improving government performance going forward.

Also, we need to learn about emerging risks and how financial reporting, internal control, and audit can be better positioned to support and reinforce the government's response to those risks. Additionally, we may need to rethink the risk parameters of the reporting model. It may be less important to validate the completeness or value of our inventory and relying on a larger error variance on those areas if the efforts we are undertaking are more central to the bottom line risks that the government is facing. Also, CFO's are being asked questions regarding budgetary amounts, cash flow, and management of financial resources, rather than the reporting of those resources, and internal control over performance, program, and mission.

Mr. Allen noted that the FASAB is open to changes and that the Board works best when it knows what is needed. He asked the participants for their views on how FASAB could contribute to the recommendations discussed in the CFO Act Report.

Mr. Taylor noted that the first step is that the Board needs to understand the intent of the reporting effort. For most agencies, the main purpose of the reporting effort is to get a clean opinion. After the clean opinion is obtained the report is not reviewed.

Mr. Rymer noted, somewhat in jest, that in response to his inquiries, the IG community said, "don't let them touch the financial statements." In that regard, the IG community expressed some resistance to changing the financial reporting model and process. Some felt that if the "traditional" format of the financial statements were changed it could appear as if certain information formerly captured was no longer being disclosed. He also noted that some agencies do rely on the financial statements, but that level varies from agency to agency. There are some things that the IG community could do to help. For example, the community could look at best practices in managing independent auditor relationships. At times it may be difficult for agency management to ask questions of the auditor's methods. The IG may be better positioned to ask those questions.

Mr. Werfel noted that the question is whether audited financial statements could produce more "bang for the buck." Also, is there some aspect of the financial reporting process that could address program integrity? The Board could help the community understand the difference between public and corporate finance.

Mr. Steinberg noted that the kinds of information that constituents need are outside the accountant's traditional domain. For example, the Board is spending time on developing guidance for reporting on the value of assets when managers do not normally look at values. They need information on performance and program spending, budget comparisons, cost accounting, and the future. They also are using the Internet more for reporting.

Mr. Allen noted that when the Board develops its technical agenda, the Board seeks input from CFOs. To some agencies, the area that the Board chooses to address may be viewed as an additional burden, while to other agencies; the information may be considered useful.

Mr. Jackson noted that the CFO and CIGIE report is presented at a high level and engenders further thought. He urged the participants to identify what information is needed to facilitate the management of resources and provide some illustrations of that information. That feedback would be helpful in identifying if there are gaps in the standards. Currently, managers have a substantial amount of information available to them. We may need to simply educate them on how to use the information they have now.

Mr. Werfel noted that the Board should consider where new standards and requirements would have an impact on key decisions and information requests that are coming on a daily basis. Because agencies would need to install processes to address those standards, they would likely be better able to extract the more granular data being sought by program, project, and activity.

Mr. Allen noted that the Board takes in issues from the community, and then prioritizes how resources should be allocated. He noted that we may need a better method of communication if an issue is of concern to the community, but is not a priority of the Board.

Mr. Jackson noted that information may be useful to management but, in some cases, less precision may be needed. Also, the Board may deliberate why an item such as deferred maintenance should be a priority and decide that the item may be important for making long-term budgetary decisions.

Mr. Taylor noted that there is a danger in focusing on an example or anecdote because the anecdote becomes the strawman. Also, asking the community about issues for Board consideration may be a challenge because some believe that the result will simply be more requirements. However, with the impetus of the requirement for the CFO Act Report, everyone has gotten more focused on the issues and the environment is conducive for more discussion. To address the question regarding what more could be done, we need to start with the attitude that everything is on the table, rather than asking, "What more do we need to look at?"

Mr. Reger noted that it is time to say what we want the model to look like 20 years from now and do we want the model to simply be a refinement of the existing model or do we want executives to be able to rely on a system that can provide decision-making information more timely and accurately. There has to be a way to shrink the amount of resources used to provide audited financial statements while maintaining our diligence in demonstrating accountability. The focus should be on the information needed for agency leaders to make decisions and a lot of times that is budgetary information, but the question is how we get from the current model to the new one.

In response to a question regarding whether agencies need a full set of statements, Mr. Taylor noted that from a CFO standpoint, the set of financial statements are not needed and financial statements for individual agencies are not needed. The information is not used on a day-to-day management basis. However, department-wide statements are needed, but we need to determine what information we need an auditor to opine on. Once it has been demonstrated that internal controls are adequate and functioning, we could be flexible regarding whether audited financial statements are needed.

Regarding what areas of risk and forward-looking information are needed, Mr. Taylor noted that they received a lot of concerns but not a lot of specifics. He noted that there are budgetary risks, program risks, risks for rising costs, and improper payments. With respect to improper payments, the agency may have little control over the delivery of the service and the states set the requirements for measuring improper payments. Also, management might want to look at some prospective analyses to determine what needs to be done to ensure a going concern. In addition, managers may want cost information to compare one field office to another. CFOs may want to provide these analyses but may not have time because of other requirements.

Mr. Rymer noted that there are so many disparate government activities going on, but we are trying to measure and report using one model. Also, we may need common cost standards to compare similar functions.

Mr. Jackson noted that it might be helpful if management could walk through an illustration and develop a proposal regarding what kind of changes might be needed, conceptually or in an accounting standard.

Mr. Dacey asked the participants to consider how the Board could work with the CFO community to develop more clearly some of the ideas for improving the model. Mr. Taylor noted that CFOs are interested in working with the Board and that they would maintain a level of interest as long as they believe that something is going to happen. Ms. Bond also noted that they would be glad to bring together the CFOs to have conversations with the Board. Additionally, the Board would need to consider whether its priorities agree with the current needs of the community.

Mr. Granof noted that the CFO Act Report discussed linking financial and performance information and he asked Mr. Taylor whether he was satisfied with the information he has been receiving and whether budget reports are performance-based. If they are, the next step would be linking those reports to accounting reports. Mr. Taylor noted that his organization does not have combined financial and performance data. His organization has a very structured, performance-based environment and the budget represents their core values. However, they are not satisfied with the kind of information they are getting. They are currently looking at better program evaluation tools. Although linking performance and financial information would be a good area for the Board, it is a challenging area to establish standards.

Next Steps

Mr. Allen noted that the Board's agenda includes a project to review the reporting model for component entities and, upon completion of the project; the Board will consider how the results affect the government-wide model.

Mr. Dacey noted that the Board needs to better understand what the CFOs believe is potentially valuable information that is not currently reported, particularly considering the information needs of program managers. It appears that we have a significant amount of feedback from other users. However, the group that has been most illusive has been the managers.

Mr. Allen noted that citizens want cost information, but not in the structure that it is currently provided. They seem to want cost information by program, such as the cost of the war in Iraq.

Mr. Granof noted that he supports asking users what information they need, but that is not the way to develop something really creative. He noted that if Thomas Edison asked people what they needed, we would simply have brighter candles today. He believes that it would be better if the Board developed a proposed model, and then conducted testing.

Mr. Steinberg noted that citizens and appropriators do not use the reports. He believed that the preparers are the biggest users of the reports. He suggested that staff meet with Mr. Taylor and CFO Council representatives and develop a list of items that they believe the Board should be addressing to improve the usefulness of the component level financial reports. Next, CFOs, not CFO staff, can review the list and prioritize the items.

Mr. Reger noted that, from a CFO's perspective, they do not use the financial statements; instead, the financial statements are an indicator of the rigor you have in the processes used to generate other reports. Mr. Allen noted that the Board should focus on building the base of users.

Ms. Kearney noted that meeting with the CFOs could result in something creative. They may be able to help provide ideas on how to shift the process to focus more on information that is used for decision-making.

Mr. Reger noted that he would like to see the budgetary reports that CFOs are providing to their program managers and would like to see if there is a way that we could do that kind of reporting on a grander scale. Those reports are useful. Also, we need to bring program managers to the table as well. Perhaps, we could select five programs around the government and ask the managers what information they would need to run their programs. CFOs may inform us on what they can produce, but that may be different from what managers want.

Mr. Jackson noted that external readers may simply be interested in knowing that the financial statements are reliable or may be seeking a general level of comfort with regard to the financial information being produced. The audit opinion is not intended to be a decision useful tool.

Ms. Kearney noted that we want to maintain the discipline and clean audit opinions, but the opinion should be on information that is meaningful. Some questions to consider may include: is the current balance sheet reflective of a sovereign nation; should the balance sheet include assets that would never have a market value as if we were going to sell them; is reporting asset values the most effective way to help manage assets?

Mr. Allen noted he believes the Board is open to making significant changes to the reporting model. He noted from reading the 20 year CFO report it seemed what is being sought are refinements rather than significant changes. However he believes the Board is open to any changes that would make financial reporting more useful and cost effective.

Mr. Showalter noted that most people view financial statements through analysts. Analysts are making decisions on what people want to see. We need to talk to those individuals. Also, it would be helpful to talk to the International Monetary Fund (IMF) or World Bank to determine what they would expect a sovereign nation to present. We could decide to take information out of the statements, but then that could affect the credit rating of the federal government because global bond markets would expect to see that information.

Mr. Reger noted that, for the first time, the U.S. was thrown into the mix of looking at the financial position of governments, and this is continuing. If we want to consider what should be on the balance sheet of the U.S., we may need to look at the financial statements of states because they have been issuing bonds for years. We could think about what we show versus what states show.

Mr. Jackson noted that we may need to reconsider our objectives with regard to property, plant, and equipment (PP&E). For example, if we do not capitalize items, we cannot amortize them and measure cost. Ms. Kearney was concerned whether, given our objectives, is amortization the best approach to determine cost. Mr. Allen noted that it may be a matter of determining what level of precision is needed.

Ms. Payne noted that the reporting model project was not pursued as a project that would evaluate each line item of the financial statements. Other projects would address that perspective. For instance, we had a project to evaluate existing standards and the Accounting and Auditing Policy Committee has active committees evaluating PP&E standards. Also, during its last effort to prioritize projects, the Board determined that PP&E was not a priority and evaluating PP&E standards was taken off the agenda.

Members noted that before organizing a task force, staff should focus on discussions with CFOs. However, members recognized that financial reports are due on November 15, 2011, and CFOs may not be available for discussions before that time. Also, members noted that staff should conduct discussions with program managers and citizen intermediaries (analysts).

> **CONCLUSION:** Staff will begin the project by conducting discussions with CFOs and representatives from various groups to help the Board better determine what information is of value to users.

- **Steering Committee Meeting**

Members of the steering committee indicated that there was no new information regarding the budget.

Adjournment

The Board meeting adjourned for the day at 5:00 PM.

Thursday, October 27, 2011

Agenda Topics

- **Earmarked Funds**

Ms. Parlow began the discussion by introducing three issues on which she needed Board decisions in order to move forward with a preliminary draft SFFAS:

- Reporting on the face of the financial statements versus option to report in the notes
- Board member's suggestion to delete the option for alternative format
- Effective date

Ms. Parlow asked the Board to consider permitting component entities to report earmarked funds information other than net position in the notes. She said that at one time, the Board had supported a move to note-only reporting, and that a majority of respondents supported note-only reporting. She noted that a primary objective of earmarked funds reporting is to show the extent to which the rest of government has borrowed from earmarked funds. She said that the disaggregated reporting for net position on the face of the balance sheet would accomplish this. Accordingly staff recommended a compromise for component entity reporting: that net position should continue to be disaggregated on the face of the balance sheet, but that component entities should have the option to report the disaggregated amounts for earmarked funds related to the Statement of Changes in Net Position (SCNP) in the notes instead of on the face of the SCNP.

Initially, a majority of the members indicated support for giving component entities the option to report data relating to the SCNP in the notes.

However, Mr. Dacey said that for certain component entities, the flows are also important, especially for agencies with very large inflows of dedicated collections. He said that activity relating to earmarked funds is quite substantial. He suggested that component entities which receive a significant portion of their funding from dedicated collections should be required to continue to report disaggregated data on the face of the SCNP, but that other component entities could opt to report in the notes.

Mr. Allen said that in his opinion, the balance sheet data answers the primary question about these funds, which is the extent to which there is accumulated borrowing from earmarked funds that needs to be repaid. He asked what question would be answered by the SCNP. Mr. Dacey replied that on the government-wide level, approximately half of the federal government's inflows are dedicated collections. Ms. Parlow noted that staff was not recommending any changes to the government-wide reporting of flows because this information is very important on the government-wide level. She said that there was also basically universal agreement that the balance sheet should be disaggregated on both the government-wide and the component entity reporting.

Mr. Showalter said the respondents to the ED prefer to see consistency throughout the government, and therefore he prefers not to allow numerous options.

Mr. Allen confirmed that a majority of the members supported the staff proposal to permit reporting on earmarked funds relating to the SCNP in the notes.

Ms. Parlow said that Mr. Showalter wanted to discuss the alternative format.

Mr. Showalter said that only a slight majority of respondents agreed with the option of the alternative format, and of those none indicated that they even plan to use it. Accordingly, he wanted the Board to reconsider whether it should be included in the final standard.

Ms. Allen said that some have argued that agencies know best how to report on their activities to their stakeholders – which may override the concept of consistency. He said that it does not appear that harm would be done by allowing the alternative format.

Mr. Showalter said that if the Board believes that this information is important, it should be in the same place across the government.

Mr. Reger said he can see both sides of this issue. He said that for example, although the notes are considered to be an integral part of the financial statements, if an agency gets over 50% of its revenue from dedicated collections, should this information be relegated to the notes, which might not even be read? Or should they put something parenthetical? He said that the respondents were all over the board on this question, because this is a difficult issue but is one of the more important items.

Several of the members indicated that staff should develop options for encouraging component entities with very material amounts of dedicated collections to continue to report on the face of the SCNP. For example, Mr. Jackson suggested that there could be language in the Basis for Conclusions indicating the Board's intent or preference that agencies with very material dedicated collections should continue to report on the face of the SCNP.

Mr. Schumacher suggested that another option could be to require agencies with over 50% of their funding from dedicated collections to continue to report on the face of the SCNP.

Mr. Dacey suggested that there could be language in the standard with items for agencies to consider when making decisions about placement.

Moving to the issue of the alternative placement, Mr. Showalter said that because there was not strong support from respondents on the alternative format that perhaps it should be dropped from the proposed standard. Several of the members indicated that this issue should be postponed until the first issue was resolved.

Ms. Parlow asked the members to confirm that it would be acceptable to have an effective date of FY 2012 even though the statement would be issued during FY 2012. She said that the intent of the proposed amendments to SFFAS 27 is to make reporting easier for preparers and improve the reporting by excluding funds that should not be included in earmarked funds reporting. However, she said that some respondents had noted that by the time the statement is issued, there will have been quarterly reports sent to OMB for FY 2012. For example, the first quarter reporting is due to OMB in mid-January. She said that staff would be interested in hearing OMB's comments on this issue.

Mr., Allen said that generally FASAB has focused on year-end reporting and the standards have been silent on quarterly reporting.

Mr. Jackson asked if there is OMB guidance on quarterly reporting. Ms. Kearney said that OMB has guidelines on quarterly reporting in a separate section of Circular A-136. She said that quarterly reporting to OMB is unaudited. The quarterly reporting includes some analysis but no notes, and it is reported only to OMB.

Mr. Reger said that agencies might feel some concern because agencies often use their March quarterly drafts to scope the work with their auditors. Ms. Kearney said that at this point it may be premature to discuss the effective date until the Board has made a decision on what to do about the alternative format.

Mr. Dacey said that the alternative format would be optional and not mandatory, so there should be no additional burden on agencies, who could continue to use the existing formats.

Mr. Jackson said that the real issue is that some funds would no longer meet the definition of the standard. Mr. Dacey said that it should not take a great deal of time for agencies to address the new exclusions.

Mr. Allen recommended that due to time constraints, further discussion of the effective date should be postponed to a later date.

> **Conclusion:** As a result of the discussion at the October 2011 meeting, the Board agreed that staff should develop the following options for Board discussion:

1) An addition to the Basis for Conclusions (BfC) to encourage agencies with majority earmarked funding to report on the face of the SCNP

2) An addition to the standard providing factors for agencies to consider when deciding among alternatives for SCNP reporting on earmarked funds
3) A 50% rule in the standard regarding options for SCNP reporting for component entities

In addition, the Board agreed that staff should develop a draft rule that component entities should have a reference to the earmarked funds note on one or more line items of the SCNP if not reporting on the face of the SCNP. Such a rule could be combined with any of the three options above.

- **Deferred Maintenance and Repairs**

Mr. Allen introduced the project by referring members to TAB G and asking Mr. Savini to begin the discussion. Mr. Savini began the presentation by acknowledging and thanking those task force members that were present for the meeting. Staff noted that the exposure draft was very well received as reflected by the 22 responses. In particular, the majority of the responses were from the CFO and preparer community reflecting a good balance and check on the task force's work which was primarily reflecting a technical user's (i.e., asset custodians, engineers, facilities management personnel, architects, etc.) concerns and point of view.

As a result, because of the favorable nature of the responses, staff asked the board to address two questions: (1) whether or not a public hearing should be scheduled and (2) if there were individual respondents from whom members wanted staff to seek further clarification.

The Chairman stated that in deciding whether a public hearing should be scheduled, the board tries to identify areas of potential controversy or significant impact or change. In his opinion, he did not see a reason for a public hearing and asked members for their thoughts. Mr. Allen noted that all responses should be weighted equally and collectively. Members agreed that no public hearing would be required.

However, Mr. Showalter inquired about a NASA response that disagreed with many of the board questions (respondent # 8) noting that although he did not see a compelling need for a public hearing, it would be informative for the board to better understand the rationale behind this response.

Mr. Reger asked if a NASA representative was present and Mr. Savini noted that although no one from NASA was present, we actually received three responses from NASA including the IG (respondent # 11) and CFO (respondent # 18) letters. Staff explained that the NASA response in question came from a task force representative who is concerned that FASAB requirements might interfere or be redundant with existing real property reporting requirements. However, the other two NASA responses have taken a different position.

Mr. Reger then asked if staff had noted any respondent concerns or issues that might have arisen that needed to be addressed by a broader community. In his opinion, he did not see such a need. Although staff concurred with Mr. Reger, there were three respondent suggestions within the board's remit that staff recommended be adopted.

Members then discussed the following three suggestions:

1. Respondents #3 and #15 – in addition to cyclical methods, include in footnote 7 on page 12 a reference to a methodical risk-based assessment method. There were no objections to staff's recommendation in this regard.

2. Respondent #20 – articulating in the basis for conclusions at A17b on page 25 that preparers could consider providing information concerning the amount of the ending DM&R balance that would need to be incurred in the near term. Staff does not advise inclusion within the standard because (1) it would be overly prescriptive and difficult for agencies to do and (2) inconsistent with board actions to-date that acknowledge the imprecise nature of DM&R estimates and the task force's goal to focus on a singular estimate. There were no objections to staff's recommendation in this regard.

3. Respondent #13 – because of eliminating the term "condition" from SFFAS 29, include the definition of this term, currently in the FASAB Appendix E glossary within this proposed standard. There were no objections to staff's recommendation in this regard.

Members agreed to review a revised document reflecting the above changes prior to pre-balloting in December. Mr. Allen then concluded this portion of the meeting by thanking members of the Deferred Maintenance – Asset Impairment Task Force noting that they have been an incredibly productive group and stated that there names would be memorialized in the final standard.

Conclusion: A draft SFFAS will be developed for the Board's consideration.

- **Asset Impairment**

Staff provided an overview of the questions in the transmittal memo and proceeded to discuss a typographical error in one of the illustrations on page 46; the deflated of depreciated current cost amount should read $2,138,640 and not $2,128,640. Staff apologized for this error and reassured members that the arithmetic and calculations in all of the illustrations have been more than triple-checked and that this was a last minute change due to rounding the deflation factor decimal from four places to two places. Staff then proceeded to the flowchart on page 27.

Mr. Dacey noted that the flowchart on page 27 meets with his expectation and written notes. He then deferred to other members for their consultation.

Mr. Granof then turned to page 28 to review the continuation of the flowchart and questioned the decision diamond concerning materiality. Even if an amount is immaterial and might still require an adjustment, this is not a board concern. Accounting would necessitate that immaterial items still need to be adjusted. Immateriality does not give management the right not to adjust an amount.

Mr. Reger noted that in essence Mr. Granof questioned the inclusion of the entire decision diamond.

Mr. Showalter then responded by noting that staff attempted to correlate the decision process to the paragraphs and that this decision diamond relates to paragraph 19 on page 16. If members felt the decision diamond should not be included, then they would need to address the requirement in paragraph 19 concerning G-PP&E that do not meet the impairment test.

Mr. Allen asked Mr. Granof if he was suggesting that materiality is a determination made prior to even following this process flowchart. Meaning this, that one would not even begin the process unless they thought that the impairment amount would be material.

Mr. Granof responded in the negative by stating that whether or not something is material is of no consequence to the board per se. That is, preparers should still follow the same accounting rules and that the only point he is making is that the board need not worry about immaterial items.

Mr. Jackson then noted that he agreed with Mr. Granof after reading paragraphs 18 and 19. No mention of materiality needs to be included because it goes without saying that if something is immaterial it would not rise to being a reportable item on the statement of net costs.

Mr. Dacey in referring to paragraph 4 on page 8 that discusses materiality noted that the provisions of any FASAB statement need not be applied to immaterial items. However, it does not say that a preparer cannot apply the standard to immaterial items. If an item is immaterial, one does not have to apply the provisions of the standard and he believes the chart fairly reflects that point. In addition, the process box on page 28 does say that this is subject to management's discretion.

Mr. Granof stated that he does not like referencing materiality in standards.

To which Mr. Dacey responded that materiality is in fact embedded in all FASAB standards by again referring to paragraph 4 on page 8.

Mr. Showalter observed that paragraph 19 does not refer to materiality but rather the overall decision concerning impairment and asked staff to consider using an alternate word choice.

Staff noted that the reason the decision diamond is included is to ensure that practitioners do not misinterpret the board's intent. Specifically, the fact that an item is immaterial to report can also be interpreted as being immaterial to adjust in the entity's books and records, thus adversely affecting the statement of net costs. Staff believes that practitioners often view reporting and accounting as being distinctly different from one another.

Addressing Mr. Savini's concern and Mr. Showalter's observation, Mr. Dacey suggested that we change the question in the decision diamond to read, "Is there an impairment to be recognized"?

Messrs. Showalter, Schumacher, and Allen concurred with Mr. Dacey's suggestion. No objections were noted.

Referring members back to paragraph 7 on page 10, staff proceeded to address the notion of significant events, and how the board at the last meeting wanted to broaden the scope of what could potentially become an impairment by focusing on impairment indicators and not necessarily just significant events. Staff asked the board if paragraph 7 as revised meets with its expectations and that any forthcoming member edits would be incorporated into the next draft version.

Apart from the standard's intent, Mr. Allen noted his concern that unintended consequences could arise by agencies applying the standard to immaterial items. The way the standard is written and the manner in which the illustrations are portrayed, one could easily misinterpret the board's intentions and apply this standard to immaterial items. Have we done everything we can to make clear that we are asking preparers to "look upward" by keeping an eye on materiality and not process? Noting no other member suggestions other than what had been submitted, the Chairman turned to OMB for help in communicating the board's intent to the agencies. OMB acknowledged Mr. Allen's request.

Mr. Schumacher suggested that we ask a question in the exposure draft as to whether this proposed standard would place an undue burden on the agencies.

Mr. Allen replied that as opposed to referencing undue burden, could we frame Mr. Schumacher's suggestion to say, "Do you see a significant amount of effort from this requirement?"

Mr. Jackson reminded the members concerning one of the reasons the board decided to initiate this project. Both auditors and practitioners have been raising this issue by saying that because there is no FASAB impairment standard, there is no effective way for agencies to deal with impairments apart from following FASB guidance. Because this board has not addressed impairment apart from internal use software, auditors are requiring management to go through an impairment analysis without any applicable guidance. Further complicating the issue is that the FASB standard uses a cash flow approach, which is not germane to Federal PP&E.

Mr. Allen then endorsed Mr. Schumacher's suggestion to ask the community-at-large what their thoughts were in this regard.

Mr. Steinberg reaffirmed Mr. Jackson's reminder by suggesting that the board should consider explaining why it perceives benefits to outweigh costs as opposed to asking the community-at-large if there is a burden brought about by the proposed standard.

Mr. Jackson replied by saying the board should assess burden before issuing the standard.

Mr. Allen replied that the board has carefully worded the standard in a manner that users should understand that they are not required to search out impairments or to apply the standard to immaterial items. He noted his concern that in the Federal environment it appears to him that accounting matters are executed in a much more detailed or exacting manner than they are in either the commercial or state/local venues.

Staff noted that if materiality is considered in the context of project-based management or a cost allocation environment where unit costs or service fees are paramount, the materiality discussion changes.

Mr. Jackson noted that we are advising agencies to use their current and existing processes in a manner that considers this standard. In essence, we are asking agencies to consider impairment in the context of their existing practices and to only run the calculations when there is an indicator of significant impairment present.

Mr. Dacey stated that we should not reference costs, but rather state in the basis for conclusions what we consider to be the level of effort and then ask the community if they perceive it to be any different. The question should be more about our assumption concerning the relative benefits in light of costs.

Mr. Allen said that we are asking whether they perceive the impact of the standard in the same way we do.

Mr. Steinberg added that we should reference that SFFAS 34 would require them to look to the FASB for guidance. As a result, does providing a federal alternative place additional burden on the user?

Ms. Payne clarified that the hierarchy would not directly require them to first go to FASB because the GASB and IPSASB are tailored to cover government entities. The board can add these caveats in the proposed language. Each exposure draft has a request that respondents address the perceived costs versus benefits. Although it would be helpful to add a question, we will need language in the basis for conclusions to explain why we are drawing attention to this matter. Staff will include something in the next draft for the board's consideration.

Staff then noted that paragraph 7 no longer focused solely on significant events. The standard has been broadened to include changes in circumstances, deferred maintenance and repair costs, etc. The paragraph makes clear that the entity is not required to conduct surveys and that they are to use existing processes. As a result, subsequent paragraphs (11 through13) have been realigned incorporating member edits.

Mr. Dacey noted that in paragraph 11 the two-step process was referred to twice and he asked whether staff could collapse it to one reference to clarify the paragraph.

Staff acknowledged Mr. Dacey's request and will propose edits in the next draft.

Concerning paragraph 12, Mr. Jackson pointed to language on page 12, line 2, that ends with "the media." In his opinion, this sentence that also includes oversight and senior management or the media is limiting. He would recommend that we cite the media as an "or others (e.g. the media)" category.

Mr. Granof then asked what does the board mean by "prompted discussion?" He objects to this terminology. What do we mean by discuss?

Staff noted that this is identical to the GASB language and referred to footnote 7 on page 12.

Mr. Allen noted that the GASB also struggled with this concept. They concluded that "prompted discussion" means that one is aware of the impairment for some other reason besides going out and looking for the impairment.

Mr. Dacey replied that "discuss" infers that the impairment indicator is important enough to talk about, for example, at senior levels or within oversight agencies.

In reply to Mr. Dacey, Mr. Granof stated that discussions are not accounting approaches.

Mr. Allen concluded this portion of the discussion by asking Mr. Granof to further consider this issue and provide staff with suggestions concerning this language.

Staff then turned to paragraph 16a on page 13 beginning on line 10, which addresses magnitude of the decline in service utility. Concerning this issue, staff consulted with the GASB representative who worked on GASB 42 and with Mr. Steinberg who provided the language beginning on line 10 and ending on line 12. According to the GASB representative, the magnitude issue was another concept they struggled with but they did not want to give specific guidance in this area; instead leaving it up to management. Staff endorses Mr. Steinberg's suggested language because it is clear and straightforward.

Mr. Steinberg asked the board if the phrase, "expected service utility" should be changed to "expected service outputs or use?"

Mr. Allen replied that because service utility is used throughout the document, in order to be consistent he would advise that we retain this language and not change it. Members agreed and there were no objections.

Mr. Savini suggested that members take time to reflect over Mr. Steinberg's language and provide staff with any comments or ideas concerning the magnitude issue while keeping in mind that GASB also struggled with this and did not want to be overly prescriptive in this regard.

Mr. Jackson then inquired about paragraph 16b and specifically the term on line 23, "set aside." In the Federal space we do not necessarily set monies aside, therefore he suggested referring to "develop plans" or "obligated funding" as acceptable substitutes.

Staff agreed with Mr. Jackson and then noted that members had satisfactorily addressed all the paragraph issues in Question 1 on page 5 of the transmittal memo and then proceeded to Question 2 on page 6. Because this question dealt with the flowcharts on pages 27 and 28 of the draft document previously discussed, staff then proceeded to Question 3 and asked members to look at the edits made to the decision table on page 29. Staff reviewed the two substantive changes on the table concerning the use of the measurement methods and illustrations.

Mr. Allen noted that he struggled with "some acceptable measurement methods" and although he was comfortable with the last column that referred to "Illustrations that may be appropriate", the first column concerned him. For example, when it comes to construction stoppage or contract terminations, is it true that practitioners can use any of these methods?

Mr. Dacey said that he would replace "some acceptable" with "examples of" measurement methods.

Mr. Jackson noted that nothing needs to be added to the term "measurement methods" because the footnote clearly says that the use of other industry-accepted methods may be appropriate.

Staff acknowledged that members agreed with Mr. Jackson and that no objections were noted concerning his recommendation for staff action.

Conceptually speaking, Mr. Dacey asked if the service units approach could be used broadly across most of the categories. His concern is that the board should not tie any particular method to a specific indicator.

Staff replied in the negative stating that the service units approach actually over estimates impairment losses because it does not consider the latent service utility that might exist in an asset. The board is familiar with Illustration 1d on page 35 that deals with the two top floors of a five-story building being totally closed off and in that case, using the service units approach would be an acceptable method and two-fifths of the building would be impaired. However, if only the walls of the top two floors were impaired due to mold contamination, but the floors or any of the restrooms provided utility then the service units approach would be inappropriate as it would overestimate the loss and not consider the benefit from the use of the floors or restrooms. In such cases where there is so-to-speak residual service utility, the replacement or restoration cost approaches are superior to the service units approach and would be most appropriate and conceptually sound. It is important to note that the GASB came to this conclusion in its deliberations.

Mr. Allen noted that the service units approach may not be appropriate for situations such as wall remediation or building damage; however, in cases involving equipment such an approach would be beneficial to use because one can measure discreetly identifiable units such as number of hours, units produced, etc. Mr. Allen suggested that the table could be reconfigured to list methods in a bullet form or narrative style. However, he believes that the current tabular format is preferable. The real question is how do we ensure that readers not misinterpret this guidance as being prescriptive? He noted that the footnote should help in this regard.

In addition to the footnote, staff reminded members that they previously asked for the Text Box above the table. The box states that methods are to reasonably represent diminished service utility and that if more than one method is reasonable, practitioners should select the most efficient and practicable method available.

Mr. Allen agreed that the text box and footnote satisfactorily address his concerns. No other member comments or objections were noted.

Staff then turned to Question 4 in the transmittal memo on page 6 that dealt with the revised illustrations. Each of the listed illustrations and their related changes and edits were briefly reviewed and staff further noted the elimination of Illustration 4b as per prior board instruction. Staff noted that Mr. Granof assisted him with illustration 1c and he further noted a typo in the first paragraph where the $24 million amount should read $2 million. In this illustration, as a result of an earthquake we had non-specific damage spread throughout the building and as stated before, this change better reflects the use of the replacement method as opposed to the service units method that can be seen in Illustration 1d.

Mr. Dacey said he had 2 minor points to raise. First, “mold remediation” remained in the first paragraph of the revised text and it should be deleted. Second, the nature of the impairment is not stated. He noted that the building does not appear to be impaired because it is continuing to be used.

Staff noted it had drafted the language to read this way to allow the reader to infer what the impairment was that brought about reduced performance objectives. If there are suggestions, staff offered to incorporate them into the next revision.

Mr. Dacey said that the illustration should be clarified to state that there is a decline in service utility.

Staff then turned to Illustration 1d on page 35 noting that this example illustrates a choice among methods where the service units approach is deemed preferable over the replacement approach.

Mr. Showalter suggested that one of the reasons given was that "time is of the essence." He questioned this as a consideration in selecting a method because it is a non-technical reason.

Mr. Dacey shared in this concern.

Staff noted that it would delete that specific non-technical rationale from the illustration.

Consistent with his prior comments, Mr. Granof asked that references to the phrase "if material", be deleted in all illustrations.

Staff noted that it would delete all such references.

Staff then turned to Illustration 2b on page 38 and noted that the Department of Interior also provided clarifying language in the second paragraph. In addition, Mr. Jackson's previous suggestion to delete references in the fourth paragraph to "set aside" would be incorporated in the next revision.

Ms. Hamilton noted that OMB might have another term, however, when monies are set-aside they are in essence "committed."

Mr. Jackson acknowledged that "committed" was a very good term to use. In his mind, he was also thinking about plans that occur before commitments arise. Changing the term to committed makes it better because it is more formal.

Staff then turned to Illustration 4a on page 46 and noted the typographical/math error on the bottom of page 47; the deflated depreciated current cost amount should read $2,138,640 and not $2,128,640. As previously stated in staff's opening remarks, this was a last minute error brought about by changing the deflation factor percentage of 0.6667 to 0.67.

Staff continued to Illustration 7a on page 52 and asked Mr. Jackson if his suggestion to provide additional background information was appropriately addressed by staff.

At this point, Mr. Granof stated that he believed the use of the undiscounted cash flow approach was conceptually incorrect. He acknowledged that using undiscounted cash flow information is done to simplify and ease administrative burden, however, simplifying or easing administrative burden is not an adequate defense of a method that is conceptually incorrect because it does not consider the time value of money. Another invalid defense is that other standard setters have adopted this method. Nevertheless, this too is an inadequate defense of the method because we should make our decisions based on what we believe is correct.

Staff noted the conceptual concern raised by Mr. Granof and reminded the board that this language or concept comes directly from the FASB 144 standard that uses the undiscounted cash flow in its test of recoverability. Staff then asked Mr. Granof if he was suggesting that we should adopt the use of present value discounting techniques. Mr. Granof replied in the affirmative saying that it was more conceptually appropriate to do so.

Ms. Payne clarified that that term was deleted from the titles, however, the procedure of its use still remains part of these illustrations that deal with revenue or cash generating assets. The clarity is that the two cash flows are not both undiscounted amounts.

Messrs. Allen and Granof discussed the impact of the earnings rate versus inflation rate and the term or period for which the cash flows would be generated. Mr. Granof noted that using a discount rate would inherently consider inflation. Mr. Allen introduced the applicability of this concept to both investments and pension standards. Mr. Allen then deferred to others for opinions concerning this matter.

Mr. Dacey took a counter position to Mr. Granof. If the asset is not impaired, the historical cost will be amortized over the future remaining life of the asset with no time value of money adjustment, as will future cash flows. The impairment process ensures that we are not going to defer recognizing losses. In his opinion, there is some benefit to using undiscounted cash flows.

Mr. Granof articulated that the problem is that when using the undiscounted cash flow method, the board is ignoring when cash is received.

Mr. Dacey replied that conversely, depreciation costs related to the capital asset will be allocated into the future. The future depreciation dollars will be allocated at a current amount and not a present value amount.

Mr. Granof stated that Mr. Dacey's explanation mitigates the impact but does not resolve the conceptual problem.

Staff then asked Mr. Granof if one would have to take the historical cost of the asset's remaining net book value and escalate it to today's dollars in order to have a comparable comparison to the discounted cash flow dollars?

Mr. Granof replied that he would have to think about that notion. He noted that these problems arise whenever assets are valued at historical cost.

Mr. Jackson said that he too would think that if one were going to adjust the cash flows, they would have to also look at adjusting the related asset values for comparison purposes.

Mr. Granof acknowledged that for practical purposes members might retain this concept in the draft standard, however, he still believes the conceptual issue remains.

At this point, staff turned to Illustration 7d on page 62 where he noted the title change that Mr. Dacey requested at the last board meeting to better explain that the illustration deals with calculating “value-in-use.”

Mr. Dacey stated that the change was satisfactory. However, he noted that on page 63 in the second calculation box that the third item down, which reads, “excess of recoverable value over net book value”, should have the two elements in that phrase reversed so that it reads “excess of net book value over value-in-use.” Overall the wording improved and the clarity was much better; however he deferred to Mr. Jackson’s thoughts.

Mr. Jackson noted that his primary concern was that the original title included undiscounted cash flows but the illustration displayed discounted cash flow information. The staff changes appear to be satisfactory.

Staff thanked Mr. Dacey for the correction and then proceeded to the last question in the memorandum on page 7, Question 5 that deals with internal use software. Staff conducted additional research at the board’s request by contacting various federal managers, IT managers, and IT contractors. In addition, staff pointed to Appendix B that provides analytical information culled from the FY2010 financial statements of the 24 CFO agencies. Staff advised the board that in his opinion, this issue warrants additional work in another project. Staff noted that the way IT is developed and maintained has changed since the 1990’s and as a result, impairment of software has also changed. Staff does not believe that the proposed impairment standard should be applied to internal use software.

Mr. Allen stated that in his opinion, internal use software should be treated as a period expense.

Mr. Jackson said he generally agreed with the staff recommendation, but was not certain as to what the unintended consequences could be of not making this current standard apply to internal use software. However, he does not want to overly complicate the current situation.

Mr. Showalter noted that the consequences quite simply are that agencies will continue doing what they are currently doing. Staff has clearly stated that it has not done enough research in this area to best advise the board.

Ms. Kearney noted that per the staff analysis, internal use software is a very small portion of the total G-PP&E.

Mr. Jackson noted that what he likes about the draft standard the board is currently working on is that it does not require a rigorous exercise to identify impairments as SFSAS 10 does on internal use software. Mr. Jackson wondered if in any way practitioners would infer that because we are exempting internal use software from this proposed standard, that SFFAS 10 would then require them to rigorously search and identify impairments.

Mr. Allen noted that the staff recommendation is that there should be a future project to address this issue.

Mr. Showalter replied to Mr. Jackson's concern that for most agencies, internal use software is immaterial.

Mr. Granof then asked members to turn to page 12, paragraph 14 that discusses reduced demand. He wondered why reduced demand should not be considered a discrete or sole indicator of impairment.

Mr. Allen replied that we are looking to tie the reduced demand to a reason apart from, for example, the manner in which a hospital might market or advertise its services.

Mr. Steinberg, in clarifying Mr. Allen's remarks stated that if a hospital had reduced demand due to poor advertising, it still has the ability to perform. As a result, there would be no impairment.

Echoing Messrs Allen and Steinberg, Mr. Jackson stated that what we are measuring is not the reduced demand but the reduced service utility.

Mr. Allen asked Mr. Granof if he wanted to call for a vote concerning this matter to which Mr. Granof respectfully declined.

Mr. Dacey raised an unrelated point concerning the conceptual basis for the replacement and restoration approaches within the draft standard. His concern is whether they represent the extent of impairment in an asset. If no other members think this is a significant issue, he would be willing to speak off-line with staff concerning this matter.

Mr. Allen asked Mr. Dacey to send an e-mail to the members explaining what his concerns are concerning these methods.

Mr. Granof stated that staff had semi-convinced him to the applicability of these approaches.

Mr. Allen concluded this portion of the meeting thanking staff and members.

- **Statement of Changes in Social Insurance Amounts**

Ms. Payne directed the members to Tab I for information about questions posed by an independent public accounting firm. The firm inquired whether over time more than one statement of changes in social insurance amounts (SCSIA) should be presented. Ms. Payne explained that she reviewed the wording and realized that it could be interpreted differently. So, she asked the views of two members and received different responses. For that reason she was seeking guidance from the Board as to whether one, two or four Statements of Changes in Social Insurance Amounts (SCSIA) following the initial year of implementation of Statement of Federal Financial Accounting Standards (SFFAS) 37 was required.

Mr. Dacey confirmed that only one SCSIA is expected in fiscal year 2011—the first year of implementation.

Mr. Allen indicated that he believes multi-year information is very important. It shows trend information. However, to explain changes, he believes preparers and auditors only have an obligation to explain one year of changes. The responsibility does not extend beyond the current year.

Mr. Showalter noted that he re-read SFFAS 17 and 37. He does not necessarily disagree with Mr. Allen, but found a strong connection between the SCSIA and the SOSI. He believes the wording implies the need for an explanation for the changes from each year presented in the SOSI.

Mr. Dacey explained that FASAB does not require comparative statements in the accounting standards. He also questioned whether we needed five years of SOSIs. He asked how much information would be needed to meet the requirement. For example, with regard to assumptions, a decision was made to not present a separate table for each year. Instead, a table for the most recent year is presented and an explanation about where to locate prior year assumptions is included. In this case, he thought the Board should discuss options and select the best. He also questioned the timing of guidance; that is, when would guidance be needed.

Ms. Payne explained that she believed that if either the single- or two-year option was selected, that decision could be documented in the minutes. The chairman could then write a letter to OMB conveying the preference of the Board. OMB could then include guidance in its Circular A-136. When asked, the project manager, who is now retired, expressed the view that only one statement was intended. She believed that if the four-year option was preferred then an opportunity to consider comments ought to be provided. She conveyed that informal comments she received so far indicated opposition to the four-year option as excessive, cluttered, confusing and burdensome.

Mr. Dacey suggested that with the four-year option, there could be flexibility in how to provide the four years of information. He wondered what due process should be followed. He appreciated the burden issue but thought it could be challenging to write an audit opinion covering statements for five, two and one years.

Mr. Allen said he wasn't aware of any other requirements that did not align with the period covered by the financial statements. For example, GASB moved long-term information to RSI so that the auditor would not have to opine.

Mr. Allen thought that due process should be required if the Board believes it is changing the intent of the prior Board. He was comforted by the project manager's thoughts.

Mr. Dacey felt that a minimum of two years would be needed in a comparative set of statements.

Ms. Kearney expressed reservations about more than a single SCSIA. She noted the extent of material within the current reports that focus on a single type of program—social insurance. She did not see value in having more than one SCSIA.

Mr. Dacey selected two-years because it should be in tandem with the other financial statements and, particularly, with the fiscal sustainability information.

Mr. Allen noted that the usual requirement is a single year but that many organizations provide two years. He asked what you expect people to focus on when they pick up an annual report for a year. He would argue that there is no difference between the two- and four-year options. If you want to explain changes in every column, then do so. He has simply focused on the current year in a report and that the prior year is provided to reveal trends. He did not believe there was a justification for two-years; if you believe you need two then you should believe you need four.

Mr. Dacey indicated that if comparatives are provided for everything else, then you would need comparatives for SCSIA. Mr. Allen indicated that the SCSIA was reporting changes and the focus was on the immediate year's changes. Mr. Showalter asked if you might want to know how those changes compared to the prior year's changes.

Mr. Allen believed that, as a practical matter, Congress is different from year to year and you would not see similar changes from year to year.

Mr. Reger noted that he prefers one but acknowledges the argument for two. However, this is not a traditional statement. He thinks an entire page would be needed to display one year. So, it will be confusing to look at a two-page statement. He thought referring readers to where they can find prior year SCSIA was preferred. Ms. Kearney agreed—you can always go back to prior years' reports to compare. She does acknowledge that OMB requires comparative statements but she does not see a compelling argument for this statement to be comparative.

Mr. Allen noted that multiple years of reconciliation would not mean anything to him and that the explanation of changes from the prior year end to the current year end covers two years. Mr. Reger agreed and added that explanatory line items would differ from year to year. Mr. Showalter disagreed; he thought the differences among explanatory line items would be meaningful.

Mr. Granof preferred 2 years but would not be greatly disturbed by one year.

Mr. Jackson preferred 2 years.

Mr. Steinberg preferred 2 years and agreed with Mr. Granof's thoughts on one year.

Mr. Reger preferred 1 year.

Mr. Allen preferred one year

Ms. Kearney preferred one year

Mr. Dacey preferred two years.

Mr. Schumacher preferred two years.

Mr. Showalter preferred two years.

Mr. Allen asked if an exposure document was needed. Ms. Payne indicated that she did not believe it was necessary because two years of statements was within the traditional meaning of 'reporting period.' Mr. Allen asked if anyone was uncomfortable with the proposed process—documenting the discussion in the minutes and conveying the Board's views to OMB. No one expressed reservations.

> **Conclusion:** The Board believes SFFAS 37 requires presentation of two Statements of Changes in Social Insurance Amounts when comparative financial statements are presented. The chairman will convey this decision to the Office of Management and Budget.

- **Final Approval of Revised Annual Report**

Members were asked whether anyone objected to issuance of the revised draft annual report. Hearing no objections, Mr. Allen indicated that the draft was approved.

Adjournment

The meeting adjourned at 2:15 PM.