

**FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD**  
**September 19-20, 2007**  
**Room 7C13**  
**441 G Street NW**  
**Washington, DC 20548**

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***Wednesday, September 19, 2007***

**Administrative Matters**

• **Attendance**

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

- **Approval of Minutes**

The minutes were approved electronically before the meeting.

- **Board Member Evaluations**

Chairman Allen noted that the remaining issues were primarily process related. The evaluation form itself is substantially complete but the Steering Committee members will be considering process issues. The policies and procedures will be presented to the Board for discussion and adoption in December.

## **Agenda Topics**

- **Communication Methods (Conceptual Framework)**

### Overview

The objective for the communications methods topic was to discuss a proposed concepts statement that would provide guidance for choosing the appropriate level of assurance on information to be required by standards. This approach for the concepts statement was highlighted during the Board's July 2007 meeting, when members discussed the Management's Discussion and Analysis (MD&A). While members agreed that the MD&A was an important component of the financial report, they deliberated on whether the MD&A should be considered basic information subjected to audit or required supplemental information (RSI) which is not audited. The proposed concepts statement would provide criteria to assist the Board in choosing the appropriate assurance level in instances such as the MD&A.

Members discussed that the Board primarily focuses on determining what information should be reported and the means for reporting the required information. In determining the means for reporting required information, the Board considers various factors. One factor is assurance. The Board may discuss assurance and designate information as basic or RSI to help ensure that the information receives the intended level of audit scrutiny. Factors such as reliability and precision are also evaluated in determining the means for reporting required information. These and other factors were previously developed in the basis for conclusions of SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*. The discussion in SFFAS 25 focused on distinguishing between basic and RSI. In addition, members noted that, at times, the Board may encourage the reporting of information. Information that the Board encourages may be considered other accompanying information (OAI). These notions were incorporated into a framework that staff could use in developing the concepts statement. The concepts statement will include the various factors that the Board considers in determining the means for reporting required information and the

notion of encouraging information using OAI. Additional details of the discussion are as follows.

### Discussion

Mr. Jackson stated that the Board should focus on describing the characteristics of information rather than what level of assurance the auditors should provide. The Board should describe what information is essential for the fair presentation of financial statements which is basic financial information. RSI is information that is important to a reader, but not necessary for fair presentation. OAI can be described characteristically and is information that the Board may urge. However, OAI is also not required for fair presentation. Once the Board describes what is required for fair presentation and describes it as basic information, this will drive the level of assurance that will be obtained. Auditors are required to give an opinion on whether information is presented in accordance with generally accepted accounting principles (GAAP).

Mr. Patton noted that the assurance categories cannot simply be ignored. The Board often begins discussing vehicles for conveying information within the financial report that have a variety of characteristics. However, eventually, the Board winds up discussing whether the information should be basic, RSI, or OAI. Because the Board frequently ends up discussing the assurance categories, it seems easier to structure the statement from that point of view and then decide what vehicle within a given category of audit assurance would be appropriate. Historically, it seems that discussions have mixed up issues related to assurance levels and issues related to the content of various vehicles.

Mr. Steinberg stated that the three assurance categories (basic, RSI, and OAI) are defined by the American Institute of Certified Public Accountants (AICPA), not the FASAB. The FASAB has to decide what is necessary to present the financial position and results of operations of an entity. The Board may want to talk about performance or systems and control because that information is necessary to understand financial position and results of operation and the Board has said that such information is part of the objectives of financial reporting. The MD&A and OAI provide a way to talk about performance and systems and control. Because the assurance categories are already defined, the Board has to consider them as a given and decide what information do we need to communicate to meet the objectives.

Mr. Dacey stated that he likes the categories conceptually, but noted that assurance is a consideration for deciding among them, not the primary driver. Also, the proposed approach implies that you cannot have a set of financial statements that are not audited. However, this is not true. An entity can have a GAAP set of financial statements which are not audited. The chart in Appendix B of staff's materials shows factors for consideration. The chart was good because it had a lot of relevant considerations, and it did not overly focus on assurance. It noted credibility as a factor.

Mr. Reid stated that the approach should not focus on assurance and he did not want the Board to get prescriptive when trying to communicate the status of a given year.

Agencies may view standards as part of a compliance exercise. The more prescriptive the standards, the less likely we will get meaningful information. Agencies may simply “check the box” and say that they did what was required. If the Board says certain information is basic, which needs to be audited, we will get just what was required and not other useful information.

Mr. Allen noted that the FASAB cannot divorce itself from considering levels of assurance. The Board currently has a model in place that makes a decision regarding level of assurance – the MD&A. The MD&A is defined as RSI and auditors ensure that RSI is not inconsistent with basic information. However, the MD&A has information that is not found in basic financial statements, such as performance information.

The Board has the power to say that MD&A is a basic financial statement presentation and must have assurance beyond RSI. If the Board does not have authority to say that, the level of assurance will be below what a number of members expect. In addition, when the Board considers the statement of sustainability, members will need to take into account the level of assurance the Board intends the statement to have.

Mr. Jackson stated that there are no standards regarding a lot of the information in the MD&A. For example, while there are standards for deriving the basic financial statement information, there are no standards regarding the calculation of performance. There would also need to be notes to describe the basis for deriving the data used in reporting on performance.

Other examples of information that lacked standards to facilitate measurement and auditing include stewardship land and deferred maintenance. When the Board initially considered stewardship land, members knew that assessing the reliability of the information was going to be difficult so the Board determined that the information should be considered RSI.

Mr. Werfel noted that the Board should be aware that a substantial amount of assurance related guidance already exists from other sources such as Office of Management and Budget (OMB), American Institute of Certified Public Accountants (AICPA), and Government Accountability Office (GAO) and the financial reporting community must consider all this guidance in preparing and auditing financial reports. The Board should consider whether it is clear how this concepts statement on assurance categories relates to the other guidance. In addition, the conceptual framework may not be the best vehicle for this guidance. The guidance seems to be helpful for a broader audience than simply the FASAB. The information may be helpful to others as well.

Mr. Patton stated that the Board cannot suppress the audit aspect because it will become a part of decisions about what information the Board requires and where it should be presented. In addition, the Board cannot ignore the audit assurance categories in deciding which vehicles to use in communicating information.

Mr. Reid stated that the Board needs to first consider what is appropriate to communicate then decide how precise the information needs to be.

Mr. Dacey explained that management is responsible for the fair presentation of financial statements and they need criteria to assure themselves. The auditor decides whether management's judgments are appropriate.

Mr. Farrell stated that the AICPA recognized that some users will need assurance on information that is not presented in the financial statements and they developed the attestation standards for that purpose. The Board must consider what auditors can do given the criteria they are forced to report against.

Mr. Steinberg stated that first, the Board should determine what information should be communicated, then consider what precision is possible and what precision is desirable. Concepts guide the Board and the proposed concepts statement would help the Board decide where to categorize information. Attestation could be added as a level of assurance.

Mr. Farrell stated that during the deliberations on the statement of social insurance (SOSI), the Board listened to the comments from auditors who were trying to determine how to review this unique area. One of the approaches that the auditors considered was the attestation standards.

Mr. Schumacher stated that the Board needs to retain the ability to place information in the category necessary for a fair presentation. He added that the Board decided to remove the SOSI from RSI and placed the statement in basic information.

Mr. Jackson stated that assurance should not drive the Board. The Board should consider whether the information is essential for fair presentation and can be presented reliably. If it cannot be presented reliably for the time being, the information moves to RSI. The Board considers the ability of the auditor to audit the information and provide an opinion.

Mr. Patton noted that the Board has developed a set of criteria for choosing between categories. Criteria for choosing between basic and RSI are presented in the basis for conclusions in SFFAS 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment* (Figure 2). The criteria include several factors including those that members have been discussing, such as reliability and/or precision possible and reliability and/or precision needed.

Mr. Dacey added that the Board does not need to place an inordinate amount of emphasis on a particular factor. The Board determines basic and RSI and there are a number of factors to consider.

Members suggested changes to the chart in Attachment IV: *Overview of FASAB's Role in Establishing the Kind of Assurance Desired for Items of Information Reported in a General Purpose Federal Financial Report*, on page 28 of the staff materials. The first shaded box should only state, "FASAB determines the information that should be

reported.” This box would be followed by a box that states that FASAB standards describe the means that should be used to communicate information. The means would be based on the list of factors in Figure 2 of SFFAS 25. Next, the chart should reflect the basic, RSI, and OAI categories and attestation, followed by the type of information in each category. Staff could use this framework to develop the concepts statement.

Members discussed that unlike basic and RSI, the FASAB may want to encourage the presentation of information and OAI could be used for that purpose. Members believed that discussing OAI could help readers and the Board in better understanding of the category.

**CONCLUSIONS:** The Board agreed that there are a number of factors to consider when determining how to communicate required information and the FASAB may encourage other accompanying information. Members also suggested a framework to use in developing the proposed concepts statement. Staff will revise the proposed concepts statement using the suggested framework and incorporating the various factors presented in the basis for conclusions of SFFAS 25 and the comments provided by Board members.

- **Fiscal Sustainability**

At the September meeting, the Board discussed objectives for fiscal sustainability reporting and discussed issues relating policy assumptions for revenue and spending projections. Several of the Technical Experts from the Fiscal Sustainability Task Force were invited to the meeting to answer members’ technical questions:

**Jagadeesh Gokhale**, Senior Fellow, Cato Institute

**Thomas McCool**, Director, Center for Economics, Government Accountability Office

**Patrick Locke**, Chief, Budget Analysis Branch, Office of Management and Budget

**Robert B. Anderson**, Senior Economist, Office of Management and Budget

Objectives for Fiscal Sustainability Reporting

The Board discussed paragraph 6, which presented four questions that fiscal sustainability reporting should help the reader to assess:

- Will future budgetary resources of the U.S. Government likely be sufficient to sustain future public services and to meet obligations as they come due?
- Does the balance of future budgetary resources and future claims potentially lead to unsustainable increases on Federal borrowing?
- Are future generations of taxpayers likely to face higher taxes and/or more

- limited government services?
- Do current government operations and current trends shift costs of services for past and current generations to future generations?

Mr. Patton said that there appeared to be some overlap in the questions; other members noted that the questions appear to be logically linked together. Staff was asked to rearrange the questions so that related items appear together.

### *Concepts of “budgetary resources” and “current law”*

The Board discussed whether the term “budgetary” was too limiting in describing resources, and did not include, for example, the possibility of selling Federal assets to finance future expenses. Mr. Murphy said that the word “budgetary” should remain, because the word “budgetary resources” means what the Congress can come up with to fund the operations of the Federal government. Task Force member Dr. Gokhale said that sustainability focuses on “current law,” which would not include selling Federal assets. Task Force member Mr. Anderson noted that current law had certain limitations. Mr. Anderson also recommended that the term “budgetary” should be retained.

Staff also noted that the term “current law” should not appear in the objectives section because of limitation of current law that would be discussed later in the session under the topic of “assumptions.” Mr. Reid and FASAB general counsel Mr. Jacobson agreed that “current law” would not provide a useful measure, since, for example, current law limits spending on Social Security and some of Medicare to amounts available from the trust funds and earmarked revenues. Mr. Jackson agreed with Mr. Murphy, and said that by definition we are dealing with “budgetary resources” and that the objectives should retain the phrase “budgetary resources.”

Mr. Allen said that he believes that the objectives are fine as written, except that the use of the word “unsustainable” in the second bullet might force us to define “unsustainable.”

Mr. Murphy said that nobody has ever been able to pinpoint what amount of borrowing would be “unsustainable.” He said that the level of public debt does have an impact, and suggested that perhaps the second bullet be folded into the first, in order to avoid using the term “unsustainable.” Staff will re-word the question to avoid using the undefined term “unsustainable.”

Mr. Schumacher asked whether “future public services” indicated current level of services. Staff said that the word “future” had been added to language that otherwise parallels existing Sub-objective 3B. That sub-objective more clearly relates to the current level of services. Staff suggested that the word “future” should be deleted from the question. Mr. Schumacher agreed that the deletion of the word “future” would clarify the question.

Mr. Reid expressed concern about doing the projections only at a government-wide level, and suggested that the Federal agencies need to analyze sustainability at an agency level. Task force member Mr. Anderson said that Social Security and Medicare do long-range projections, but that for everything else, long-range projections are not done on an agency level. For this reason, the Office of Management and Budget (OMB) generates its long-range budget projections internally, except for Social Security and Medicare. Mr. Allen agreed that you need to focus on the Federal government as a whole.

Mr. Steinberg said that bullets 2 and 3 supported bullet 1, and that bullet 4 is a separate question. He said that if resources are insufficient, your choices are to borrow, to increase taxes, or to cut services.

Mr. Jackson said that perhaps it could be shown that bullets 2 and 3 describe alternatives, and perhaps that could be noted.

Mr. Farrell said that the introduction to the questions should not imply that a definite “answer” would be provided. Staff said that the introduction could be reworded, perhaps saying “address” rather than “answer” the question.

Mr. Farrell said that he also had some issues with Australia’s definition of fiscal sustainability. Staff suggested that Australia’s definition could be moved to the Basis for Conclusions as background information so that it would not be misinterpreted as a definition being offered by the Board.

Dr. Gokhale said that the objective should be a single question relating to the balance between future revenues and future expenses, and that the other questions should be portrayed as flowing from the single, primary question.

Mr. Allen disagreed with combining the bullets, and said that bullet 4 in particular is a separate question. He said that he doesn’t want to lose the concept in bullet 4, because it would help to maintain the interest of readers.

Mr. Allen said that he agrees with the concepts that were laid out in the objectives. He said that although there was not quite a consensus, perhaps staff could send revisions to the members for comments.

Mr. Patton said that it would be preferable to have a definition for “sustainable.” Mr. Allen said that at the last meeting, staff suggested and the Board agreed to draft objectives rather than a definition of “sustainable.” Staff noted that the Board agreed that a definition of “sustainable” would appear to set budgetary rules, which is outside of the FASAB’s mission. Staff said that the Board’s mission does include promoting helpful, understandable and useful reporting.

Mr. Reid said that in his opinion, the objective is to identify those programs that are growing faster than Gross Domestic Product (GDP). Mr. Allen disagreed, and said that the reporting being envisioned is more high-level. Staff noted that a huge amount of very detailed information is already available from numerous sources, including OMB,

Congressional Budget Office (CBO), and Government Accountability Office (GAO) reports and the Trustees Reports, but that the objective of this project is to try to make that information accessible, understandable and meaningful to the public by including high-level information and narrative in the Financial Report of the U.S. Government (CFR).

Mr. Werfel noted that there needs to be a balance between simplicity and accuracy, and that perhaps there could be tiers to the information provided where readers could find additional information. Staff agreed, and said that this tension between simplicity and technical rigor- including adequate treatment of uncertainties- will be a challenge throughout this project.

Mr. Reid asked if the Board has the authority to require a separate report that would not be a part of the CFR. Mr. Allen said it would be preferable for the Board to utilize and refer to existing reports. Mr. Murphy agreed, and said that, for example, CBO does a long-term outlook report—and the intermediate numbers come out virtually the same as the Trustees report- and that the CBO reports, OMB reports and GAO reports could be footnoted as a potential source of more detailed information.

Mr. Murphy said that regarding Mr. Reid's suggestion about looking at individual programs, he did not envision the Board going beyond the major programs and drivers, but that such information might be useful to have. Mr. Allen said that in order to report on long-term sustainability, you need to be focused on the big picture, the major drivers.

Mr. Reid said that all the other data in the CFR is based upon audited financial statements at the agency level, and said that a change in this area might be an audit issue. Mr. Dacey agreed that it would be a change, depending on where the reporting would be placed in the CFR. He said that GAO in fact is currently involved in auditing the Statement of Social Insurance, and noted that GAO is doing some original audit work at the Department of Health and Human Services rather than relying on the work of other auditors.

Mr. Allen asked what the members view as the proper level of reporting (agency versus government-wide).

Mr. Steinberg said that he originally envisioned government-wide, which would capture the impact of the social insurance programs, but perhaps there are other exposures, such as PBGC and a backlog of highway maintenance, that also need to be considered, so he is not sure.

Staff noted that the scope of the project, even focused only on government-wide is already very broad because of the number of decisions that need to be made, and asked if the Board wishes to broaden the scope to the agency-level, if this could be evaluated as a separate project.

Mr. Allen agreed that the original scope is for the government-wide level, but said that he would not object to some kind of general reporting at the agency level. Staff noted

that Statement of Federal Financial Accounting Standards 15 already requires agencies to do this.<sup>1</sup>

Mr. Anderson said that this reporting is for the government as a whole, and that it doesn't make sense to look at individual programs other than the major ones, such as Social Security, where there is a dedicated revenue source. The sustainability of other programs cannot be determined at the agency or program level because they rely on Treasury for their funding.

Mr. Allen asked Mr. Reid to explain what he was proposing. Mr. Reid said that he would require each agency to list the major programs that were increasing at a rate faster than inflation. Mr. Allen confirmed that Mr. Reid did not object to the government-wide focus, and was only proposing the agency level as an add-on. Mr. Reid agreed.

Mr. Steinberg said that the additional requirement could allow for flexibility for the agencies to add programs that were growing faster than GDP.

Mr. Farrell said that he is concerned that there are other things that would not be captured by this, such as deferred highway maintenance.

Staff noted that this would require defining what a "program" is, for example whether a "program" can encompass one or more sub-programs, Treasury accounts, and other factors. Mr. Anderson said that a detailed analysis by program is already done in the Budget, but only projected to the 10-year point.

Mr. Allen asked if the Board could vote to move forward on the reporting objectives, which address government-wide reporting only.

Mr. Dacey said that the government-wide reporting needs to be done using a consistent and meaningful model, which could not be done on an agency level. A majority of the members concurred.

### **Conclusions: Objectives**

Mr. Allen summarized the morning session: the Board indicated broad and general agreement for the reporting objectives.

Mr. Allen said that any Board members that favor a different approach- for example, expanding requirements for agency-level reporting beyond the existing requirements in SFFAS 15- should draft a proposal for the Board's consideration.

### **Assumptions for Fiscal Sustainability Reporting**

Staff's briefing paper presented several examples of situations where "current law" may not be a useful assumption.

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<sup>1</sup> SFFAS 15, par. 3. (Also see OMB Circular A-136, Section I.12.4)

The first example is the statutory limit on Federal debt: every single time that the limit has been approached or reached, Congress has passed legislation to increase the borrowing limit. Staff recommended that, in such situations, that the assumption would be that this pattern would continue. (That is the current practice of all the agencies that make long-range projections that might be affected by the debt limit.)

Mr. Allen said that he agreed with the concept, but would not want the standard to be too specific. For example, it should not specify how long it would take to establish an expected pattern.

Mr. Reid said that the discussion of departures from current law should be in the Basis for Conclusions, and that the language in the standard should simply allow the preparer discretion to depart from current law when deemed appropriate, assuming that this is properly disclosed.

Mr. Anderson said that he agrees with staff recommendation that current law should not be used when current law keeps getting changed, but he suggested that the point be made without using the label “reasonable expectations,” because the phrase “reasonable expectations” implies a broader category than the rather narrow situation being described. Mr. Allen agreed.

Mr. Allen asked the members if they approved the recommendation. Mr. Dacey and Mr. Reid agreed with the recommendation at a high level, and said that, at least on a trial basis, the wording should allow some flexibility, since there would likely be cases of “close calls” and the Board should not establish a strict, bright-line rule. Mr. Reid said that the flexibility issue could be re-examined if there were problems. He suggested that prototype reporting would be very helpful in identifying variables.

Mr. Werfel noted that SFFAS 17 allows the preparer and auditor to make the decisions regarding assumptions, and asked if this issue is within FASAB’s scope.

Mr. Allen said that several members felt that FASAB has an obligation to at least set the direction for assumptions, because this could be a politically-charged document.

Regarding the phrase “reasonable expectations,” staff asked if the members wished to retain that label for the situation described (consistent changes in current law). Mr. Murphy said that he would like to retain the label, but does not want to specify a minimum time period for the changes. He said that since “reasonable expectations” is broad, it should be used as a broader label. Staff asked if “reasonable expectations” should be used to describe all three categories described.<sup>2</sup> Mr. Murphy agreed.

Task force member Dr. Gokhale said that while current law should be the presumption, there should be a reasonable basis to assume that current law will not apply, and there

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<sup>2</sup> (1) The law has been changed in a consistent direction over a period of time, (2) the law does not extend far enough into the future, and (3) the law does not provide for events likely to occur, such as specific reductions in benefits or increases in taxes upon the exhaustion of social insurance trust funds

should be procedures as to how to comply. Mr. Allen suggested that the procedure could involve the preparer and auditor, rather than the reporting standards.

Mr. Dacey agreed. Mr. Patton asked if field testing would be a part of the project, and what the intended audit status would be.

Executive Director Ms. Payne said that for field testing, the Board is benefiting from the work of the technical experts and the numerous reports that currently present projections. However, she noted that some field testing could be considered as the project moves forward. Also, staff plans to present the issue of audit status for consideration by the Board. The Communications experts indicated that auditing assists credibility. However, Ms. Payne noted the variability of projections and alluded to the risk of suggesting a certain level of precision to users through audit assurance. Mr. Reid said that a lot of this is experimental- we should try this, and see what kind of results we get. Regarding audit status, staff mentioned that various presentations and accompanying narrative will be considered and audit status may vary among the presentations.

Mr. Allen asked the members about how broad or narrow the Board's treatment of assumptions should be. Mr. Patton said that in the end, he would want to see the requirement narrower, but he likes the idea of field testing, and supports flexibility if field testing would be done before the standards stage. Mr. Allen said that field testing before the issuance of a standard would probably add 6 to 9 months, and for that reason he was envisioning getting feedback more informally than having full-blown pilots or field tests, which would involve the preparer, the auditor and readers. Staff noted that the optimistic project plan, without field testing, would result in the issuance of a standard in 2009. Mr. Patton said that this area is outside the Board's comfort zone. Mr. Allen said the initial standard could be broader and could be narrowed or refined later. He said that perhaps field testing could be done between the issuance date and the effective date.

Mr. Dacey asked about projections that are currently being done. Mr. Anderson said that on the revenue side, OMB has in the past generally used current law as modified by the President's budget, and included bracket creep,<sup>3</sup> but without the expansion of the Alternative Minimum Tax (AMT) - but that other projections, which are prepared by CBO and GAO, have used a historical constant share of GDP. For the current Budget OMB also used a constant share of GDP assumption. He said that for discretionary spending, the problem is that current law only takes you a few years into the future, so you have to come up with some assumptions. The usual options include the current services assumptions, which grow programs with inflation, which is probably not realistic in the long run, since most people assume that in the long run, programs grow with GDP. He said that you could also do a projection where defense spending increases

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<sup>3</sup> "Bracket creep" occurs because individual income tax brackets are indexed for inflation rather than wage growth. When wages grow faster than inflation, the effective tax rate increases, which can increase revenues as a share of GDP.

with population growth and inflation without productivity adjustment that goes into GDP, and non-defense discretionary grows with GDP. Mandatory spending is projected at current benefit levels, ignoring the exhaustion of the trust funds.

Mr. Dacey said that many of the options are well-developed, and that this issue is not new- so it becomes a matter of deciding what is reasonable for the reporting that the Board is considering. He said that this should not require a lot of research or field testing. He said that in cases where there is a primary presentation, there will also be coverage of alternative assumptions, so that the alternatives will not be lost, simply subordinate.

Mr. Allen asked if the Board concurred with the staff recommendation for Situation 1,<sup>4</sup> broadening the term “reasonable expectations” instead of using it to describe only Situation 1. Except for Mr. Patton, who expressed a desire for field testing, the members concurred.

Staff introduced Situation 2, where current law does not extend far enough into the future to be used for long-term projections, which is typical of discretionary spending. Staff asked the Board to agree in principle that “current trends” should be used, and that staff could work with representatives from OMB, GAO, CBO and Treasury to see if there might be a consensus for more specific recommendations for a baseline.

Mr. Steinberg asked if there might be different baselines for different part of the projection, depending on the types of programs. Staff said this was likely, for example defense versus non-defense discretionary spending.

Mr. Jackson asked about the treatment of changes in assumptions- would past amounts be restated?

Mr. Dacey replied that there has been some discussion about this relating to the Statement of Social Insurance going into the second year of audit. He said that the tentative position is that the assumptions are based upon the assumptions at the time, and this is no different from, for example, accounting for pension plans- you don't go back and restate the prior year because you now think that things are different.

Staff asked if the Board agreed in principle to “current trends” and that staff should work with OMB, GAO, CBO and Treasury to explore the possibility of more detailed recommendations.

Mr. Locke asked if the standard would set out a particular formula or instead require disclosure of the assumptions used. Staff said that if there is a clear consensus, the standard could set out specific formula requirements. Staff noted that SFFAS 17 does not set out specific requirements for assumptions, and that the standards for fiscal sustainability reporting would do so only if a consensus can be reached. If a consensus

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<sup>4</sup> Staff recommended that when there is a consistent pattern of legislative changes, that the pattern of legislative changes, rather than current law, be used for the assumption.

cannot be reached, the standard can simply have broad guidance, such as a systematic continuation of current trends, with an explanation of the assumptions used.

Mr. Werfel indicated that in his opinion, the Board should allow the preparer and the auditor to determine a reasonable approach, and should only step in if problems occur. He said that getting into the specifics of assumption formulas would set a precedent and asked why the Board should do this. He said that he is concerned that the Board will get bogged down debating detailed recommendations and end up with something not much different from what would have been used had the Board said nothing.

Staff asked the members if they agreed with Mr. Werfel. Mr. Allen asked if Mr. Werfel would agree that there should be broad guidance referring to current trends. Mr. Werfel said that he was not in favor of detailed requirements for assumptions, but that he might agree with some general “do”s and “don’t”s. He said that, for example, he agrees with staff recommendation for Situation 1. He emphasized that he was concerned about devoting significant resources to exploring detailed assumptions.

Mr. Allen said that he would agree with broad guidance, with disclosure of assumptions and changes in assumptions.

Ms. Payne explained why SFFAS 17 does not address policy assumptions in detail and indicated that she shared Mr. Werfel’s concerns regarding the merits of detailed guidance on assumptions. Mr. Reid indicated agreement with Mr. Werfel about taking a step back from addressing assumptions in a detailed way.

Mr. Jackson said that although he is concerned about arbitrary changes in assumptions from year to year, he said that he agrees with Mr. Werfel in that the Board should not spend its time addressing specific details of formulas for assumptions.

Mr. Steinberg said that the standard should simply point out the kind of options available, and said that the preparer should select a trend for each kind of item, disclose the assumption and explain the reason. He said that staff should talk with the representatives of OMB, GAO, CBO and Treasury for informative reasons and perhaps some parameters, but not to select specific trends.

Mr. Murphy said that he would like the standard to provide examples of assumption formulas, but not a restricted list. Mr. Dacey agreed.

Staff asked the Board to discuss Situation 3, which focuses on the exhaustion of the trust fund. Staff noted that the SOSI is not limited to presenting the benefits available to be paid through the trust fund mechanism, and recommends that fiscal sustainability reporting also not be limited.

Mr. Farrell asked if Situation 3 would include the expiration of the tax cuts.

Mr. Dacey said that this was similar to Situation 1. Task force member Mr. Locke said that Situation 3 was where current law will be in conflict with itself: one piece of the law says “you must pay these benefits” but another piece of the law also says “no federal

manager shall pay those benefits” because of the lack of budgetary resources to cover them. He said that for fiscal sustainability reporting, it would make no sense to assume that those benefits won’t be paid. Referring to Mr. Farrell’s question, he said that there is no law extending the tax cuts, so that would require political judgment. Staff said that the expiring tax cuts would relate more to the issue of “current trends.” Mr. Locke agreed.

Mr. Werfel said that he would want to use language such as “conservative” or “reasonable” rather than set up prohibitions. He said that he approves of the language in the staff recommendation, which promotes the concept of conservatism, but does not say “Thou shalt not.”

Mr. Jackson suggested that assumptions should include the provision in current law that would require a reduction in Social Security outlays when the trust fund is exhausted. Mr. Reid disagreed, and said that the standard should tell the preparer to make reasonable assumptions that would continue the current levels of taxes and services. That would include continuing the current levels of benefits and also extending the tax cuts. Mr. Allen said that this would come to the same answer as the staff recommendation: conservatism. Mr. Reid agreed, and said that this would solve the problem.

Mr. Werfel said that he does not want to see the Board debating Mr. Jackson’s proposal versus Mr. Reid’s. He wants to see the standard recommend reasonableness and conservatism, but let the preparer and the auditor debate the specifics. Mr. Reid says that his intention was to support the concept of reasonableness and conservatism.

For economic assumptions, staff recommended that economic assumptions should simply be consistent with the economic assumptions used in the preparation of the SOSI.

Mr. Reid agreed, and said that we wouldn’t want two sets of numbers. Task force member Mr. Anderson agreed with the staff recommendation, and said that it will be important to disclose the significant element of uncertainty that always occurs in making economic assumptions. He also suggested that when the administration’s economic forecast differs from that of the trustees, it should be given adequate coverage.

## Q&As

Staff asked if there were any questions or comments about the draft Q&As, which staff envisions as being included for informational purposes in the potential exposure draft. Mr. Steinberg asked what the assumption would be for borrowing levels in a “fiscal gap”<sup>5</sup> measure. Staff noted that the assumption would be the borrowing level at the

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<sup>5</sup> The fiscal gap is the change in spending or revenue that would be necessary to maintain public debt as a constant percentage of GDP.

reporting date, although other nations have set specific rules relating to borrowing levels.

Task force member Dr. Gokhale said that it would be confusing to have two different bottom lines (fiscal imbalance<sup>6</sup> versus fiscal gap). Staff said that both concepts need to be presented to the Board as options. Mr. Steinberg said that he would tentatively favor reporting that does not imply that there can be borrowing without any limit.

### **Conclusions: Assumptions**

- 1) Staff will address the guidance regarding assumptions in the following way:
  - use the term “reasonable expectation” in a broader way, to encompass more than the narrow category described in Situation 1;
  - add emphasis on the concept of continuing services (and taxes) at current levels;
  - address assumptions broadly and provide - to the extent feasible - examples and alternatives for the preparer to consider.
  
- 2) Staff will meet with the representatives of OMB, GAO, CBO and Treasury to develop an expanded list of potential options for assumption baselines for discretionary spending (and expiring mandatory program spending) and non-earmarked revenues, but not to select specific options- simply expand the list.

### **Next Steps**

For the December meeting, the briefing materials will contain numerous alternatives for fiscal sustainability reporting (in addition to revised objectives and guidance on assumptions). The briefing materials will be presented in the format of a draft exposure draft (ED). Where options are presented for Board consideration, they will be presented in the context of the draft ED.

- **Natural Resources**

At the September 2007 Board meeting the Executive Director, Wendy Payne, stated that she had received a request from the Department of the Interior (DOI) for an extension to the oil and gas ED comment period. She explained that the DOI requested the comment period be extended until November 30, 2007. She also said that in discussions, some of the groups that staff works with also have indicated that either they can't respond in time or they don't have the expertise. She noted that only one comment letter had been received. The Executive Director suggested that the comment period for the oil and gas ED be formally extended until January 11, 2008. She explained that, because the DOI could not provide their comments until the end of

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<sup>6</sup> The fiscal imbalance is the total of existing debt plus future projected deficits, expressed in present value dollars.

November, the ED would not be discussed at the December meeting anyway. She added that by extending the comment period until January staff could also make a concerted effort to reach out to groups and experts to respond to the ED. She said the responses would then be discussed at the February 2008 meeting.

Mr. Steinberg asked if the Energy Department would be interested in the ED. The Executive Director responded that it would, specifically the Energy Information Administration (EIA). However, the EIA is extremely tapped for resources at this time and staff is having difficulty communicating with them.

Mr. Jackson asked if the oil companies would be interested. The Executive Director answered that instead of contacting individual oil companies; staff would contact oil and gas organizations, for example the Society of Petroleum Engineers (SPE).

Mr. Farrell asked if other agencies who might be affected as the Board continues through the process of developing standards for other natural resources had been contacted, for example, the Forest Service timber. The Executive Director explained that the staff tried to communicate that the oil and gas accounting standards was a precedent for other natural resource accounting standards. She also said that some agencies may need to establish an accounts receivable for their share of the estimated petroleum royalties and they may not have picked up on it. She added that staff will be contacting the appropriate agencies.

Mr. Steinberg suggested that when staff contacts the agencies it could also ask the agencies to contact the oil companies and explain that the FASB looks at the FASAB standards as closely as the FASAB looks at the FASB standards. He said this may increase the interest of the oil companies and they make look at the ED and respond to it. The Executive Director noted this and said staff would follow-up with phone calls to agencies.

Mr. Allen asked if any Board Members objected to the January 11, 2008 comment period extension for the oil and Gas ED. No Board members objected.

**CONCLUSION:** Staff will: 1) contact the appropriate Federal agencies and private sector organizations, which have oil and gas expertise; and 2) continue analysis and summarization of comments received on the oil and gas ED.

- **Social Insurance**

The staff explained that the overall objective of the session was to obtain the members' opinions regarding (1) the essential social insurance information to communicate and (2) the options for communicating it.

The staff's proposed framework for the session involved four board discussion questions and several pro forma exhibits. By way of background for this approach, the

staff explained that much had been learned via due process. Many respondents felt the word “liability” was inappropriate. Others said that a balance sheet purporting to report assets, liabilities, and net position would be misleading without something more than a “due and payable” liability. The staff concluded that, at this early stage in the Board’s deliberations, an open-ended session would be useful.

The staff mentioned the components of the current accounting and reporting model and that the social insurance proposals would have to be explained in this context eventually. New information and displays may or may not align with the current FASAB model. As alternatives narrow and the Board moves closer to a proposal, each alternative would be evaluated against the elements definitions, current concepts of recognition versus disclosure, and implications for other statements in the model.

The Board’s discussion focused on the first staff question (“SI-1”), which asked the members what distinguishes the “estimated economic cost of social insurance” incurred in each reporting period from the cost of other programs, given the objective of the Statement of Net Cost. The staff explained that an objective of the Primary View had been to convey (1) “estimated economic cost” and (2) the amount of such costs needing future financing. The Primary View held that economic costs are incurred when eligibility is substantially attained, which for Social Security occurs at 40 quarters of work in covered employment, and incrementally thereafter. Some respondents favored an earlier point when participants enter work in covered employment. The Alternative View agreed with SFFAS 17 that economic costs are the benefits paid during the period plus the change in the “due and payable” liability. The staff explained that “economic cost” would involve the notion of inter-period and inter-generational costs as well as solvency or liquidity. Staff noted that the question regarding economic cost was not intended to address specific financial statement display or measurement.

Mr. Allen said he would answer question SI-1 affirmatively. The economic cost is the change in the statement of social insurance (SOSI) amounts, which most likely would be reflected in the statement of sustainability.

For clarity, Mr. Werfel asked Mr. Allen if, for example, the net present value (NPV) of the social insurance commitment last year was \$44 trillion and this year it is \$45 trillion, would the economic cost be \$1 trillion. Mr. Allen answered that it would. Mr. Werfel said he understood but did not agree.

Mr. Reid noted that staff was saying that perhaps more granularity is needed. He said that if the change in the NPV of the SOSI was the economic cost, then perhaps it can be presented in two pieces. One piece would be the amount attributable to work already performed and the other to work to be performed in the future.

However, Mr. Reid said there was a more fundamental issue. He noted that the Social Security Administration (SSA) has created a way to do this computation. The Primary View presented another way. He suggested the Board would be better off if it went back and used a computation that was consistent with one or more of the existing measures in the Trustees’ Report. He said the Social Security Trustees’ use two

measures in their Report, the “unfunded obligation” and “maximum transition cost.” He mentioned that he was not sure of the differences between them or whether either one would suit the Board’s purposes. Mr. Reid said he understood them to be quasi liability numbers that one could look at in a way that would be similar to what the Primary View had as a calculation.

*[Staff Note: the Trustees’ Report contains closed and open group “unfunded obligations” but not the “maximum transition cost” (MTC). SSA does provide the MTC on its Web site as an “Actuarial Note” that is updated periodically. Staff memorandum dated February 18, 2005, Section III. “Liability and Cost Amounts,” provided definitions for these amounts as follows:*

#### *Maximum Transition Cost*

*The “maximum transition cost” (MTC) is similar to a pension-type liability measure. The MTC population is the current participants – workers and those on the rolls – only and it measures benefits “earned” or credited as of the reporting date. It is computed as the difference between (1) the present value of all future accrued benefit obligations<sup>2</sup> payable and (2) the value of the assets on the valuation date plus the present value of revenue from taxation of future accrued benefit obligations payable. ... Although staff is using it as a surrogate for a pension-type liability, the MTC is not calculated quite the same as either the accumulated benefit obligation (ABO) or projected benefit obligation (PBO) that a corporation would report pursuant to SFAS 87.... However, conceptually, it is the closest thing to the PBO that is officially computed and reported for Social Security. ...*

#### *Closed Group Transition Cost*

*Another measure provided by SSA is the “closed group transition cost,” which is similar to the “maximum transition cost” except that the future cost and future taxes for current participants are included in the calculations. SSA uses a 100-year projection period for the closed group transition cost in order to capture the lifetime of all the current participants.... The “closed group transition cost” is similar to the “premium deficiency” liability recognized in the insurance industry for future policy benefits relating to long-duration contracts. That liability represents the present value of future benefits to be paid to or on behalf of policyholders and related expenses less the present value of future net premiums and assets for the current ... policies in force. Changes in the liability for future policy benefits that result from its periodic estimation for financial reporting*

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<sup>2</sup> SSA defines the “accrued benefit obligation” as the “future benefit obligations based on past earnings as of the valuation date. Thus, these accrued benefit obligations are relevant only to current participants as of the valuation date. The accrued benefit obligations are based on the primary insurance amount (PIA), the early retirement or delayed retirement factors, and other rules of payment.” See Appendix B of February 18, 2005, staff memorandum that provided an SSA Actuarial Note and/or the SSA Web page <http://www.ssa.gov/OACT/NOTES/ran1/index.html>.

*purposes are recognized in income in the period in which the changes occur. [See SFAS 60, par. 21] ...*

#### *Open Group Unfunded Obligation*

*Another measure provided by SSA is the “open group unfunded obligation.” It includes all income and benefits to be paid for a specified time period, e.g., 75-years, for all who will participate in the program during that period. It is computed as the difference between:*

- a. The present value of the future cost of the program between the valuation date and the end of the specified time period, and*
- b. The sum of the assets in the trust fund as of the valuation date and the present value of the scheduled tax income of the program between the valuation date and the end of the specified time period. ...]*

Mr. Reid asked if the Board would be better served if it looked carefully at how those computations are made and judge whether it could compromise enough to use that. He added that it might achieve general acceptance, regardless of how the Board used these amounts. He suggested taking a step back and looking at whether such an approach would be useful, and then discuss the notion of economic cost. He said it is important to understand what the annual economic costs are and incorporate that into the result. He questioned whether the Board should be using a basis different from what the Trustees are doing, or if the Board already knows that.

Mr. Allen said he was arguing that the Board should not be doing it on a different basis.

Messrs. Allen and Reid agreed on this point.

Mr. Reid said the Board needs to go back and re-visit how the Board directed the 40 quarter computation.

Mr. Allen noted that question SI-1 was only a broad , general question about whether there is an economic cost. However, he agreed that there would be value in syncing up that economic cost with however it is being reported.

Mr. Jackson asked Mr. Allen whether the economic cost he envisioned would be a gross number representing the growth in the entitlement or net of revenue.

Mr. Allen said he envisioned it as a net number because that was consistent with his view of the SOSI.

Mr. Reid said he would not use a net number.

Mr. Jackson agreed.

Mr. Reid said he would define it as the change in future benefits from one period to the next and further refine that to say it is not the total change in benefits. It is the change in benefits attributed to work that has already been performed.

Mr. Reid said that there are separate benefit numbers. A portion of it that is attributed to the work participants have already done and a portion is an estimate of the work the participants will do. He would like to breakdown the economic cost and provide more granularity, which he viewed as helpful information because it answers some questions raised during the hearings about having access to some of other information, regardless of where it is reported.

Mr. Patton said he read question SI-1 to ask what the members think distinguishes the economic cost of social insurance from the cost of other programs, rather than the subject the Board was discussing.

Mr. Allen said that his answer to question SI-1 essentially was that nothing distinguishes social insurance cost from the cost of other programs, which means there is an economic cost; and he viewed it as the change in the SOSI during the period.

Mr. Patton said he agreed.

Mr. Dacey said he agreed with the premise of question SI-1, that the statement of net cost seeks to present the gross and net cost of goods and services provided. He agreed with that and believed that that should continue. He was concerned about referring to changes in the SOSI as "costs." He preferred calling the changes something else. He said the term "cost" conveys a certain meaning related to the provision of goods and services, but not to SOSI changes. In addition, Mr. Dacey said the SOSI does not purport to relate to that which will happen. He noted that the SOSI presents projected receipts and benefits, and that Social Security and Medicare Part A cannot pay benefits in excess of their resources. He said SOSI is not trying to show economic cost. Like a statement of sustainability, the SOSI is trying to show what would happen if the program continued as it is. He said the character of what is presented in the SOSI is different from what is shown elsewhere. The changes in the SOSI is a valuable measure as well. He said he did not know that he would equate that with a cost.

Mr. Allen said it was a change in the level of commitment.

Mr. Dacey agreed that it was a change in the estimated net commitment. He said that was a fair way to characterize it.

Mr. Jackson said that when he considers a cost to the government he thinks about something that benefits the government in the current period. If the government incurred a cost, it received a benefit. He said he does not necessarily believe that the growth in the social insurance benefits is something that benefits the government in the current period.

Ms. Payne noted that economists from around the world had been discussing how to treat pension costs in the Systems of National Accounts (SNA). Currently, the SNA only reports funded pensions, but that is changing. A proposal was accepted in March 2007 to create supplementary accounts to report the accumulated benefit obligation (ABO) arising in employer-employee relationships with voluntary supplementary reporting of the ABO for the social pension obligation. In observing their discussion, which she

viewed as paralleling the Board's debate about the nature of the government's programs, Ms. Payne said a lot of the same type of issues have come up – for example, the difference between public debt, which everyone views as enforceable, and these kinds of promises to citizens. She said what she found interesting in the discussion was that, because the discussion is international in context, there is concern that costs are distorted because some countries have purely employer-provided pensions while others have purely government-provided pensions to other than government employees. The economists were talking about the costs that were not captured in SNA due to the varying treatments. She explained that to some degree this is what drove the thinking behind question SI-1. She was searching for an answer to the question: Is there really a great difference between, for example, adding a benefit to Medicare versus adding a benefit for government employees.

Mr. Werfel said that there might be a piece missing from the question, understandably so given the potential for getting bogged down again. He said that, when he thinks about the Statement of Net Cost (SNC) and going back into the prior period and capturing how things changed, there are things that you can look at that you are sure are actual expenditures, and other things that are going to be owed in the future. He stated that the key filter for deciding whether an item should flow into the SNC or not is whether a liability was incurred. He said changes in values should rise to the level of liabilities if they are to affect the SNC. Some items are too uncertain to affect the SNC, for example, the prospect of an environmental disaster or military conflict. He concluded that the liability filter is the construct the Board has used to determine whether things belong on the SNC, and it comes back to that question.

Mr. Patton agreed and said that that is why he had said there was no difference between social insurance and these other costs. He said there is a social insurance liability.

Mr. Werfel said he would need to know the answer to the question of whether a liability is triggered in order to answer question SI-1. His answer to SI-1 would be different depending on the answer to the liability question.

[See more social insurance discussion immediately below under Thursday, September 20, 2007.]

## **Adjournment**

The meeting adjourned at 4:30 PM.

## ***Thursday, September 20, 2007***

### **Agenda Topics**

- **Social Insurance (continued)**

The Board considered the staff's pro forma exhibits.

Mr. Jackson noted that he has favored a display for some time that was not among the pro forma exhibits in the briefing books. The display would be a line item on the balance sheet without a dollar amount, much like the current "commitments and contingencies" line item, that would refer the reader to the SOSI. The reader could then see whatever the Board eventually determines the commitment amount is, and the full context of the program.

Mr. Allen said he had similar thoughts, although in a somewhat different format. He noted that one of the things the Board had talked about is the challenge of understanding multiple financial statements and the desirability of a highlights document. He said he has become more and more enamored with Table 1 (Exhibit F at Tab C). Regarding possible geography, he said he probably would start with a highlights document and refer to other sections of the report where more information would be available. The highlights document would capture, in one or two lines, (1) the exchange transactions (or whatever you call it), (2) net operating cost, and (3) the social commitments – without saying one is more important than the other. Other statements could be developed that would link back to the highlights statements. He said he thought that could be accomplished with appropriate headings and titling, and avoid saying "on balance sheet" or "off balance sheet," terms that he does not like. He said he would not call the document a balance sheet. He would call it, for example, the statement of net position, or perhaps do what they did at GASB and call it the statement of net assets. He said there was nothing sacred about the term "balance sheet."

Mr. Jackson said his thoughts were more in line with the notion of highlighting the enormous social insurance commitment. He believes that it is almost irresponsible not to call the attention of a reader of the federal government's financial statement to this enormous commitment. He favored a line item on the face of the statement of financial position, balance sheet, or whatever you want to call it, that would refer the reader to a calculation of that long-term commitment. He said he has felt strongly for a number of years that we simply cannot refrain from having some reference to at least a financial statement similar to SOSI, and he liked the very straightforward display [shown in Exhibit A1, a line item on the balance sheet] that carries the reader back to other material. He added that he could see explanatory notes as well.

Mr. Steinberg agreed with Mr. Jackson that all the exposures and responsibilities should be shown, but he was not sure the balance sheet was the place to show it. He favored showing the information in a statement of sustainability. The latter would be a forward-looking statement with different components. One component would be the liabilities, as we traditionally know liabilities, because that reflects things done in the past that are hard and fast. Another item would be the social insurance responsibilities. Another item would be our other exposures, e.g., PBGC and deferred maintenance. He did not think the balance sheet is the place to report it because the balance sheet is not the most important statement.

Mr. Steinberg said he was trying to focus on the question of essential information, what information is important. He said that the open group actuarial liability in each of the last five years resonated with him, to see that growth year after year. Also, the cross-over point and cash flow as a percent of GDP are good because economists can use them. He added that the only other essential piece of information he would like to know about social insurance programs is what is the cause and the amount of the changes in the actuarial liability from year to year. He noted four reasons why those amounts might change: (1) additional work done by participants, (2) additional participants, (3) policy changes, and (4) additional income. He said he would show the change related to each of these reasons.

Mr. Reid added that a fifth reason would be the change related to each new 75-year period. For example, as a year of surplus might be dropped off and be replaced by a deficit year. But, he agreed that identifying the change drivers would be important.

Mr. Allen said he struggled after yesterday's discussion with the notion of the budget deficit versus the true change in the overall economic position. The economic position is actually made to look better by surplus Social Security contributions; but in reality, since the General Fund borrows it from the Trust Fund, it really is not an improvement. He said something very interesting to highlight would be how much of the change in net position is actually attributable to the fact that we do have from a budgetary standpoint access to this money, which by law has to be repaid to the Trust Fund. That is the difference between a cash- and an accrual-basis of accounting.

Mr. Reid said that the statement of changes in net position in effect shows that number as the surplus for earmarked funds. He added that what is not shown is this other piece regarding the social insurance commitment and how much of the change in the sustainability calculation is being driven by things that would be attributed to the current period on an accrual basis.

The Board discussed Exhibit F, which is Table 1 from the FY 2006 Financial Report. Mr. Reid noted that some respondents had favored Table 1.

Mr. Dacey asked Mr. Allen whether he envisioned a Table 1 type display as part of MD&A.

Mr. Allen said he favored a pyramidal presentation where a Table 1 would be presented as a standalone statement. It would refer to all the other statements that support it, and it could be lifted and put in a popular report.

Mr. Dacey made the point that the Social Security actuaries currently report the reasons for changes in the actuarial present values as part of their current model. For example, the components are shown in the illustration in Exhibit E.

Mr. Torregrosa said that, consistent with the FASAB exposure draft on changes in assumptions, highlighting the changes in assumptions is very important.

Mr. Farrell said it was very important to show these numbers for social insurance responsibilities juxtaposed against other traditional accounting concepts like net operating costs, assets, and net position of the government. This would be similar to Table 1 at Exhibit F. He said he liked the presentations that staff has created thinking outside the box and saying, well, since we have a traditional balance sheet, let's present additional numbers, which happen to be some of the biggest numbers that impact our national government, juxtaposed against some of the numbers we traditionally look at. He granted that it would be a different presentation. He noted that at this point it is not being called a liability, which may help some other folks; but to him it is important to see these amounts next to numbers that people are used to looking at, and let people draw their own conclusions. He thought footnote references would be all right, but every line item on the balance sheet is referenced to a footnote. Footnote references would not draw much attention, and most people agree that drawing attention to these numbers is critical because they are not sustainable.

Mr. Werfel suggested something for the next iteration of the discussion. He said Mr. Steinberg's primary question regarding what information is important is the proper starting point. He asked whether the Board had determined what are the essential things to present and disclose. Also, he asked a corollary question regarding whether there are any things that are not currently disclosed that need to be disclosed. Once the key things that need to be disclosed are identified, the current model with the Financial Report, SOSI, balance sheet, etc. could be examined to determine what the gaps are. For example, it might be the statement of changes in social insurance. Once the Board has that information and has potential agreement on that, then the Board might be ready to talk about geography.

Mr. Werfel added that he had some concern that constraints would be placed on the preparer regarding the construction of a summary like Table 1. He noted that Table 1 came about because the preparer had flexibility to construct a user-friendly presentation. He recommended that the standard preserve this flexibility.

With respect to question of essential information, Mr. Allen said he thought that through the course of this project the Board had answered that question. He said he thought the Board has said that the SOSI is absolutely good. In addition, a statement of changes is needed, although the Board had not talked about formats yet. Also, the Board has talked about the need to explain the components of the change; that that is a key. Beyond that, he had not heard any discussion other than what Mr. Werfel had referred to as geography, although geography is important.

Mr. Steinberg said he had asked staff several times for the essential information that needs to be reported so he could consider where to report it, but staff had not told him yet.

Mr. Allen said he would ask staff to comment but he had listed areas of consensus – the statement of changes in the SOSI, explanation for those changes, some SOSI improvements. He said he had not heard anyone suggest anything besides that, other than what Mr. Farrell communicated; but that is a geography issue. For example, does

it matter if it is a separate statement as opposed to a line item at the bottom of a statement.

Staff mentioned that the Primary View had identified a piece of the social insurance projection, the accrued cost and accrued liability piece, as new information that needed to be displayed, in addition to the items that the members had mentioned.

Mr. Reid said it might be helpful to provide an example of a breakdown of the components driving the change, either in the statement of changes or within the SOSI, in order to move forward from an opening balance to a closing balance. Such an analysis might help the Board to see whether it had all the components identified that it wanted to consider displaying.

Mr. Werfel said that separating the question of what is essential information from geography is not as easy as it sounds. Geography can inter-relate with questions about what is the essential information that needs to be reported. Geography can help the reader along. The numbers can be merely displayed as separate pieces or related to each other and added together. Displaying the pieces may be insufficient. He said Mr. Allen had asked a question about what other information had been discussed, and he saw in the material in the Tab for this week a lot of stuff that he would argue is not essential, e.g., maximum transition cost. He would like the Board to deliberate on the question of what is the essential information and understand if there are things needed to help the reader derive a number, even though the pieces are there.

Mr. Reid said, to be clear, when he spoke yesterday of the maximum transition cost (MTC) or other measures, he was responding to a call at the hearings for disclosing, if not recording, what would be the liability number. The Trustees do the MTC and other computations, e.g., the unfunded obligation, which might be suitable for the Social Insurance Project as a surrogate liability number. One of the advantages of using those measures is that they are published and available in the Trustees' Report.

Mr. Reid then addressed the question of essential information. He said somewhere in the document the liability number needs to be provided to people who want to see what a liability number would be. He does not believe it needs to be on the balance sheet. The Board can craft the statements, whether they are reconciliation statements or the SOSI, to disclose, for example, information program by program and/or group by group, and then summarize it separately in a cover sheet. The information could be added together the way people are used to seeing them. He said that, if a summary is to be presented, one of the things that is very helpful is to explain somewhere in the report how the number is derived. He said it was fine to have pieces of information presented in various places, but the Board has an obligation to summarize it in a way that brings it together. He believes people should be told, first, what the cost increment is, the increment that would be the accrual increment to cost for the current year if you had an accrual pension plan calculation; and, second, they should be told what liability number would be to which cost increments add up. He concluded that the present value of benefits attributed to work already done needs to be presented separately from the present value of benefits attributed to work to be done in the future.

Mr. Jackson said that over the years the Board has discussed a lot of information about social insurance programs. He did not think any more attention is needed to other information, other than what is shown in the Primary and Alternative Views and various iterations of the material in the briefing books. He did not imagine there is much else to be displayed. To move the project along, he suggested that a succinct schedule be developed that presents a series of numbers that are important to users. He agreed with Mr. Reid and others regarding the need to present the real commitment on a present value basis to people who are currently eligible for participation in the program. He said the Board needs to come to a consensus expeditiously regarding the essential information to display. He suggested bringing together a small group of Board members to answer Mr. Steinberg's question rather than asking staff to tell the Board what information people need. He said the Board has sufficient public input to do this. He agreed with Mr. Farrell that there needs to be a place in the Sun for this commitment, whether that is in a separate section or statement of financial position or balance sheet or whatever you want to call it. He said every citizen of the United States recognizes that this government has a commitment to them, and that needs to be reported in a way that shows that this government acknowledges that commitment.

Mr. Schumacher agreed with Mr. Jackson. He also agreed with Mr. Farrell's point, which he characterized as a traditional approach. He said he needed to see whether the Board calls these numbers commitments or liabilities. Whatever term is used, it needs to resonate and somehow relate to the traditional assets and liabilities, whether it is the balance sheet, statement of financial position, or schedule like Table 1. He agreed with Mr. Jackson that the Board has gotten feedback from everyone it needs to, and it needs to analyze what it has heard and decide what it wants to disclose. He said he thought it would just come down to geography. He said it should be disclosed clearly to every citizen that there is a commitment here. Whether it is the closed group or open group or something else, it has to somehow relate to all the other commitments, liabilities, and responsibilities of the federal government.

Mr. Allen said how the Board does that is really the whole issue. He referred to the first testifier's comment that "words matter." This testifier said the reason the social insurance commitment is not a liability is that, if you call it a liability, Congress would be impeded in its efforts to change the law. That was the only reason the testifier gave for why they thought it should not be a liability. Mr. Allen concluded therefore that words matter and geography matters, and the Board needs to be careful as it goes forward to meet the needs of the users and not mislead.

Mr. Patton supported the idea that words matter and, related to that, that concepts matter. He said he thought this is still a liability and, if it is not on the balance sheet as a liability, the rest of it is not as important as that decision. Putting it some place in the Sun, as Mr. Jackson suggested, is okay and he would not quibble with that place, except to say that it should have been a liability on the balance sheet. He concluded that, if it is not going to be a liability on the balance sheet, its placement does not matter much to him as long as there is a bright light shining on it.

Mr. Steinberg said he was trying to “think outside the box.” The balance sheet is a traditional statement that has been around for centuries and is great for reporting assets and liabilities. However, the federal government is different from other organizations, e.g. corporations, non-profits, and state and local governments; it has responsibilities that are far greater. It has responsibilities for the general welfare, for national defense, the economy, etc., He fears the balance sheet is not going to do it. He noted that the Board seemed to be talking a lot about geography, about articulation. He put his hope in the sustainability project to get the social security amount out in the sun. He said that if the Board looks at the amount as a liability solely because that is a term that has been used over the years, the Board would be missing the boat.

Mr. Torregrosa said he has sympathy for Messrs. Farrell and Jackson’s view and CBO would certainly entertain something like Exhibit A1 and Table 1 at Exhibit F. He said that the CBO director said it is important to show both the future benefits and the future streams of revenue but not call it a liability. He noted that since both the closed and open group projections include all future benefits, disaggregating the present value of components related to past and to future work in covered employment looks doable to CBO.

Mr. Farrell asked what is next for the Social Insurance Project.

Mr. Allen said, based on what the Board members said at the last couple of meetings, as many resources as possible would be put into sustainability. He said the social insurance project would go as far as it could with sustainability being the primary focus. He said he envisioned the Social Insurance Project staff would at least come back with a list of what Board members have said is essential information and of potential displays. He said he did not know if that would take one meeting or three or five. He reiterated that the primary focus is sustainability. He noted that everyone has said that that needs to be done, and it would help educate the Board regarding what direction it ought to go regarding social insurance.

Mr. Farrell said that the Fiscal Sustainability Project staff had said yesterday that perhaps a draft accounting statement would be present by the December meeting, but perhaps there will be some drafts of what a sustainability financial picture or chart might look like.

Mr. Allen said that the focus for December would be drafts of sustainability reporting. He said the sustainability statement needs to out run the social insurance project.

Mr. Jackson requested that, if the Social Insurance Project staff submits a list of essential information, that it also provide brief explanations of why it is so.

Mr. Allen agreed.

**CONCLUSIONS:** The Board concluded that the next step for the Social Insurance Project is a list of essential information, brief explanation of why it is essential, and potential displays.

- **AAPC Exposure Drafts**

Staff member Monica Valentine presented the two AAPC (Committee) exposure drafts (ED) along with their related comment letters to the Board to determine if any of the members disagreed with the overall concepts outlined the proposed guidance. The EDs presented were 1) proposed implementation guidance for SFFAS 30 Inter-Entity Cost (IEC) Implementation Amending SFFAS 4, Managerial Cost Accounting Standards and Concepts and 2) proposed implementation guidance for SFFAS 29 Heritage Assets and Stewardship Land (HA/SL). Ms. Valentine noted that four comment letters and one Board member response were received for the HA/SL ED and fourteen comment letters and two Board member responses were received for the IEC ED.

Ms. Valentine mentioned that the AAPC would be meeting on September 27 to discuss in more detail what revisions need to be made to the implementation guides before they are released as final. Mr. Allen noted that based on his review of the comment letters there clearly was a call for more clarification in a couple of areas of the guides. He also stated that AAPC members were more capable of providing the type of detail needed by the users of the guides and the Board would only intervene if they felt the Committee was headed down a wrong path.

Mr. Steinberg asked how the Committee planned to address those conflicts noted in the comment letters, such as how entities view the check writing services provided by FMS. Ms. Valentine noted in those cases where conflicts are noted the task forces would contact the responding agencies for further clarification of their responses. Mr. Jackson noted that based on his review of the example broad and general items he suggested that some of those services could be subject to a central service allocation plan as is used in state and local governments. Mr. Steinberg asked Mr. Jackson if such an allocation plan is put into place at the Federal level wouldn't that change the guidance outlined in SFFAS 4. Mr. Dacey and Mr. Jackson both responded that the allocation of some of the broad and general services would not require a change in the standard, it would simply be adding to the current list of allocated costs developed by OMB in 1998. Mr. Dacey noted that the cost benefit factor has to be considered in determining whether or not overall cost allocations are mandated. Mr. Jackson noted that many of the costs may be integral to an entity's operations but may not be material.

Mr. Dacey noted that one of his concerns going forward would be in those instances when two or three entities determine that a service is significant and integral to their operations and have to rely on the providing entity to get the estimated costs associated with that service.

Mr. Schumacher asked about the IEC ED comment letter from Treasury's Bureau of Engraving and Printing (BEP) and wanted to know how the Committee planned to respond to their issue. Ms. Valentine informed the Board that staff had been in contact with BEP and advised them that we do not see their issue as an accounting question

but as a pricing policy matter. SFFAS 4 may help determine what cost is, but enforcing the OMB pricing policy is not an accounting issue.

Mr. Jackson asked what four inter-entity costs were currently allowed to be recognized by Federal entities. Mr. Steinberg responded with 1) pension costs, 2) other retirement benefits, 3) other post-employment benefits, and 4) Treasury judgment fund transactions.

Mr. Allen asked the members again if they had any objections to the direction taken by the AAPC on the two implementation guides. There were no objections.

- **Elements**

The Board received a ballot draft of Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* (SFFAC 5), and a ballot, with the request that signed ballots be turned in by the end of the September meeting. The ballot draft incorporated the changes requested by the Board at the July meeting as well as those resulting from Board members' review of the preballot draft provided to them in August.

The Board made the following changes at the September meeting:

**Par. 14:** The Board reversed the changes that had been made at Mr. Steinberg's request following the preballot draft. The changes had eliminated a previous statement that certain items reported by component entities are not elements of the federal government as a whole. Mr. Dacey, Mr. Jackson, and other members said it is important to make that statement. After the reversal, par. 14 reads:

14. While items that meet the definition of an element from the perspective of the federal government are assigned to component entities, some items recognized in the accrual-basis financial statements of component entities are not recognized in the consolidated financial statements of the federal government because they do not meet definitions of elements from the perspective of the federal government. Instead, they are items that would meet element definitions from the component entity perspective and are treated as such by the component entity. For example, component entities may exchange services for a fee and recognize the resulting intra-governmental assets, liabilities, and related elements in their financial statements. However, intra-governmental items offset each other when the government is viewed as a whole and are eliminated in preparing the government's consolidated financial statements.

**Par. A13d:** An additional reference to the "reporting date" was included in the last sentence at Mr. Patton's request to clarify par. A13d and make it more consistent with par. 45. As a result, par. A13d reads:

- d. *Clarification concerning settlement.* The Board believes that it is important to clarify, as an essential characteristic, that for a liability to exist at the reporting date, there must be a law or an agreement or understanding concerning settlement. If at the reporting date the government is free to decide whether and when to settle the obligation, the government does not have a liability.

**Par. A36:** At Mr. Reid's request, the Board added that unresolved litigation is an example of a circumstance when the settlement date of a liability might not be known. The revised paragraph reads as follows:

A36. Paragraph 46 indicates that both the timing and the amount of the settlement may be uncertain, but that "Uncertainty regarding the amount or timing of settlement is addressed through measurement of the liability." The Board does not believe that there is uncertainty about whether the government has a liability simply because the precise settlement date is unknown. For example, with respect to unresolved litigation, the date of settlement may be unknown. Based on these considerations, the Board reaffirmed its conclusion that an essential characteristic of a liability is that the government be legally required to make settlement with the other entity or the government and the other entity have an agreement or understanding concerning settlement.

The Board discussed Mr. Steinberg's wish to express his views on the scope and other aspects of the concepts statement following his explanation of his reason for deciding to abstain from voting. Responding to Mr. Patton's questions, Ms. Payne said there currently is no policy on members' adding comments to votes to abstain. To adopt such a policy would require a change in the FASAB's Rules of Procedure, with the approval of the Sponsors. Mr. Allen asked for a vote on whether members wished to add anything to the Basis for Conclusions as a result of Mr. Steinberg's written comments. Staff said that the topics of most of Mr. Steinberg's comments are addressed in pars. A37–A41 and that the scope of the project is addressed in par. 1, "Purpose of This Statement." All members voted not to require additional wording on the topics in Mr. Steinberg's written comments.

**CONCLUSIONS:** The Board adopted SFFAC 5, with the changes noted above, by the affirmative votes of eight members. Mr. Werfel and Mr. Steinberg abstained. Staff expected to forward the Statement to the Principals the following week for their 90-day review period.

- **Appropriate Source of GAAP**

Staff updated the members regarding the progress on the project since it was last on the agenda in May 2007. At that meeting, members had asked staff to meet with FASAB's sponsors to agree on the most pressing issue to be addressed related to the appropriate source of generally accepted accounting principles (GAAP) for federal entities. In July 2007, FASAB staff and representatives from each of the three sponsors formed a workgroup and jointly developed a recommendation that would address the

issues with the governmentwide consolidation. Staff noted that there was not widespread support for requiring full conversion to FASAB standards so the recommendation did not address primary reporting at the component entity level.

Staff noted that there are several potential options that the members have to address the issue. Staff referred to the three options contained in the paper:

- Option A – Take no action
- Option B – Implement workgroup recommendation
- Option C – Initiate FASAB project to address specific differences

Staff briefly summarized the workgroup's recommendation, which is to (1) permit entities currently following GAAP set by the Financial Accounting Standards Board (FASB) to continue to do so but require that they present in their individual financial statements an audited footnote reconciliation of the differences between FASB GAAP and FASAB GAAP that would support the numbers submitted to Treasury via the Governmentwide Financial Report System (GFRS) for the consolidated Financial Report of the U.S. Government (CFR); and (2) revoke the "grandfather authority" that allowed entities to comply with FASAB GAAP by continuing to directly follow the FASB hierarchy.

Staff's paper contained a discussion of the legal and professional considerations that continue to complicate the discussion, not the least of which is the fact that, while FASAB is the standard-setting body for federal entities as defined in SFFAC 2, neither FASAB nor its sponsors have legal jurisdiction over the legislative and judicial branches. Staff noted that regardless of which option the Board chooses (even if the Board takes no action), all federal entities that are newly created or begin preparing financial statements after October 1999 are required by AU Section 411 to follow the federal GAAP hierarchy if they wish to receive a GAAP opinion. If the grandfather authority were revoked, it would only have an effect on entities that were preparing FASB statements prior to October 1999.

Mr. Werfel inquired what impact revoking the "grandfather authority" would have on the judicial and legislative branches. Staff responded that there has been no detail level research in this area; however, it was staff's understanding that no one in the judicial branch was currently preparing financial statements and the material legislative branch entities that are preparing financial statements already comply with FASAB standards so the impact would be minimal. Mr. Dacey said there are some legislative branch entities that are preparing FASB statements. Staff will research the current status of the financial reporting by legislative and judicial branches and provide additional detail in the next briefing paper.

Mr. Dacey said that he would like to avoid imposing the reconciliation requirement on the legislative and judicial branches because neither FASAB nor its sponsors have the authority to enforce such a reconciliation. It is only by virtue of the AU Section 411 Federal GAAP Hierarchy that the legislative and judicial branches would need to prepare such a reconciliation in order to continue to receive a clean GAAP opinion.

Mr. Dacey said he also does not want to see any entities that are currently preparing FASAB statements be able to justify moving to FASB statements with a footnote reconciliation.

Mr. Reid said the Board could limit those instances from occurring by wording the statement such as “Entities that are currently not following FASAB have the option of preparing FASB statements with an audited footnote reconciliation to FASAB...”

Mr. Dacey said there are ways to solve that problem, e.g., declaring FASAB as “the preferable method” and FASB as “an acceptable method.” Entities could not justify moving to something less preferable. However, Mr. Dacey said he also believes that the Board could articulate certain characteristics that would allow government corporations and the legislative and judicial entities the option to follow FASB based on the character of what they do.

Mr. Dacey said his main concern is that the Board would be indirectly placing requirements [on the judicial and legislative branches] that it is not directly capable of doing.

Mr. Reid said there will also be some objections because there will be agencies that will have to keep two sets of books for certain things, if not for everything. Mr. Reid noted investments as an example; investments are classified and valued as available for sale under FASB and mainly as held to maturity under FASAB. These investments would have to be calculated as if they had been held to maturity from the beginning in order to report under FASAB.

Mr. Allen noted that the Board has argued that the federal government is different and has unique reporting requirements and questioned why wouldn't the Board feel that FASAB is the superior reporting and do whatever is necessary to get federal entities to either move to or reconcile to FASAB standards? He asked what would be the harm in pushing federal entities to report under FASAB requirements if the Board believes that is the most appropriate reporting for federal entities?

Mr. Dacey said he believes there is a difference between encouraging FASAB reporting and actually getting to the point where a federal entity receives an adverse opinion if it does not include a reconciliation to FASAB.

Mr. Werfel asked if the Board could get early input from the community on the reconciliation requirement. Staff responded that another survey could be sent to the FASB entities similar to the one that was attached to the May briefing paper that requested feedback and cost information on full conversion to FASAB.

Mr. Reid said we need to be clear exactly what the reconciliation would include, which statements would be required. Mr. Reid said he personally believes that getting away from more than one basis of accounting is preferable. However, some entities may object strenuously to the requirement.

Mr. Werfel responded that is why the Board needs to become informed whether the objection is justified or not, get a better sense of the burden that is imposed by this. He said we can clearly identify the benefits – e.g., consolidation – but he would argue that we should present options (e.g., factor out budgetary or prepare Statement of Budgetary Reconciliation) and solicit input on costs and burdens in providing the information.

Mr. Jackson said the Board’s primary focus should be on whether the needs of the principal users of the financial statements are being met. Mr. Jackson said he believes that first and foremost, an agency’s financial statements should satisfy the needs of the principal users of that agency’s financial statements, whether that comes from FASAB standards or FASB standards. Secondly, if additional information is needed for the consolidation, then that information should be provided to Treasury.

Mr. Jacobson asked for clarification about whether the reconciliation will apply to only those entities currently following FASAB and not open to new entries into federal reporting. He noted that Mr. Dacey and Mr. Reid seem to have opposing views. Mr. Allen said he would like staff to provide more information about that point.

Mr. Allen called for a polling of the members’ preferences with respect to the three options.

<b>Member</b>	<b>Preference</b>	<b>Additional Comments</b>
Allen	B	
Dacey	C	Would like to leave it open for new entities where there may be legitimate user needs-based reasons to follow FASB.
Farrell	B	Voting for the overall approach not necessarily for the format of the Export Import Bank reconciliation since it might not be providing all the information that is necessary (e.g., budgetary).
Jackson	B	Expand Option B to include making sure we are meeting the needs of the principal users of the agency’s financial statements as well as the needs of Treasury.
Murphy	B	
Patton	B	Would like to see more on costs, burdens and user needs assessment
Reid	B	Include restrictions on future entry into other forms of accounting
Schumacher	B	Would like to see a little bit more on costs and burdens on agencies.
Steinberg	B	
Werfel	B	Would like to have more certainty about what the reconciliation would look like and what the impact (good and bad) would be on the entities required

		to do the reconciliation
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Summary of member preferences:

- Option A – 0 votes
- Option B – 9 votes
- Option C – 1 vote

Based on the majority, staff will further develop option B and include additional information about the needs of the principal users of the federal financial statements prepared under FASB standards and whether they differ from other federal financial statements prepared under FASAB standards.

**CONCLUSIONS / NEXT STEPS:** The majority of the Board requested that staff further develop Option B (implement workgroup recommendation) but include additional information about financial statement user requirements for entities that are preparing FASB-based statements. Some members also requested to see a draft survey requesting cost information about the proposed changes to component level reporting. Staff plans to complete the following:

- Research the current status of the financial reporting by legislative and judicial branches and provide additional detail in the next briefing paper;
- Determine the needs of the principal users of federal financial statements currently being prepared in accordance with FASB standards and whether they justify different reporting outputs from the principal users of federal financial statements prepared in accordance with FASAB standards;
- Present more information on whether the FASB permission and reconciliation requirement would apply to only those currently preparing federal financial statements or if that option would be extended to new entrants; and,
- Prepare a draft survey for the Board’s review that includes options for what would be included in the audited reconciliation footnote (e.g., budgetary information vs. no budgetary information) and would be used to solicit input from the affected community on costs and burdens associated with the additional reporting requirements.

● **Federal Entity**

Staff member Melissa Loughan led the discussion on the Federal Entity Project. Ms. Loughan explained that at the July Board meeting, the Board discussed the approach for the Federal Entity project. It was agreed that staff would focus on developing proposed standards relating to the boundaries of the reporting entity and specific criteria for each. Ms. Loughan explained that the Board suggested the proposed standards should build upon what is currently in SFFAC 2 and any proposed changes could be incorporated in SFFAC 2 as needed.

Staff presented an issue paper at the September meeting that discussed general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity. Staff recommended the Federal Reporting Entity include entities, organizations, transactions, and activities for which:

- the federal government is financially accountable;
- the federal government exercises control over; and
- the nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete.

Staff also presented an outline of a proposed standards statement to assist with understanding how the general principles would be conveyed in a proposed standard. Ms. Loughan explained the general principles are consistent with the framework established in SFFAC 2. However, staff believes presenting the broad and general principles in the proposed standard would allow for an expansion of the detailed criteria that may go beyond what is in SFFAC 2 and resolve some of the outstanding issues.

Staff explained with the Board's approval (of the broad areas of the boundaries of the federal reporting entity), staff will develop detailed criteria for each. Staff also explained the intent to utilize a task force to assist with the criteria.

Ms. Loughan requested the Board's feedback on the general principles. Specifically, staff asked if the Board agreed with the staff recommendation for the general principles that will be relied upon in establishing the boundaries of the Federal Reporting Entity and if the Board had any comments on each of the three principles.

Chairman Allen explained that in conjunction with the project he would like to modify par. 38 of SFFAC 2, specifically the part that states "...FASAB's recommendations pertain only to the Executive Branch...." Mr. Reid suggested that FASAB should be very careful in what is said regarding the judicial and legislative branches. He explained that we will never know with certainty if all is being reported for the judicial branch as they are not compelled to provide the information. He further explained that we would be looking at a permanent disclaimer as it would be difficult to prove that the branch is immaterial without all of the information.

Mr. Reid further explained that there is a disconnect in that the CFO Act (amended by GMRA) directs the Administration to consolidate the Executive Branch while SFFAC 2 states the Federal Entity includes all branches of government. Mr. Reid explained because the law doesn't require it, there is not access to all the financial information for the other branches. Mr. Reid asked if FASAB should consider requiring that the Federal Entity only include the Executive Branch to be consistent with the requirements of the law and to alleviate the completeness concern with the Federal Entity. Mr. Reid explained that currently Treasury is picking up the receipts and outlays information for the judicial branch for use in preparing the consolidated statement. He explained that there is no way to fully consolidate the information. He reiterated that he would like to see this constitutional issue addressed and some acknowledgement that we may never get all of the information because of constitutional constraints. He added that this

should be considered okay if we disclose that fact and disclose what is not included and that we believe it is immaterial.

Chairman Allen explained that he would prefer to say that our standards apply to the Federal Government as a whole versus saying that they only pertain to the Executive Branch. Mr. Jackson explained that the authoritative source of GAAP is included in the auditing literature so it is not possible to disenfranchise FASAB from the legislative and judicial branches of government. He explained that GASB and FASB standards wouldn't apply to those branches, so naturally for a set of financial statements prepared by any branch of the Federal Government would have to be prepared in accordance with FASAB to be in accordance with GAAP. Mr. Jackson added that perhaps in a statutory sense FASAB does not set standards for the legislative and judicial branches, but in a professional or theoretical sense it does for GAAP based statements.

Mr. Jacobson explained that SFFAC 2 was written prior to Rule 203. He added that the wording in par. 38 simply was a means of saying that FASAB's authority is only over the Executive Branch because it is through its sponsor's authority over the Executive Branch. Mr. Allen suggested that perhaps that is all is meant and there is no reason to be alarmed by having the statement.

Mr. Patton explained that he did have some concern with the 3<sup>rd</sup> broad area (nature and significance of their relationship with the federal government are such that the exclusion would cause the government's financial statements to be misleading or incomplete) because it is so broad that it may difficult to be operational. However, at this early stage it would be hard to be against it but it is an area that will need to be addressed further. Staff agreed with Mr. Patton and explained that it does seem to be a catch-all for items that don't fit the first two areas, but staff hopes with the assistance of a task force, some specific examples and/or indicators will be developed. Mr. Patton suggested that it would be beneficial if the task force could come up with some sort of parameters as to what "misleading or incomplete" means.

Mr. Dacey stated that he supported the three areas but did question if ownership was left out intentionally. Staff explained that ownership would be addressed with control. Mr. Dacey explained that he believes the third area (relating to the significant relationship) would need some caveat that it does require judgment and that there are indicators but nothing definitive. Mr. Dacey suggested that it may be a helpful exercise to go through which organizations are included because of the indicative criteria and to take a closer look at the ones that are on the fringe and not presently included.

Mr. Reid explained that some of these decisions will affect lower levels of reporting below the consolidated federal entity. Staff explained that the proposed standard would also address the component levels. However, staff believes the same framework and criteria would apply at that level as well. Mr. Steinberg explained that he believes there are far more issues at the component level and that may require more focus.

**CONCLUSION:** Staff will move forward on developing detailed criteria for each of the general principles that will be relied upon in establishing the boundaries of

the Federal Reporting Entity. Staff will also form a task force to assist in more efficiently and effectively developing new standards related to the federal entity and consolidation. The task force will consist of representatives from the financial management community. The task force will be helpful when considering the consolidation of unique relationships and activities. Of particular importance will be relationships such as joint ventures, special-purpose entities, federally funded research and development centers, lease arrangements, and other financing arrangements (partnerships).

- **Agenda Setting/Convergence**

Ms. Payne noted that the first proposal was to add the following questions to the criteria for ranking projects:

- a. Would alternative solutions contribute to meeting primary near-term focus objectives of operating performance or stewardship?
  - i. If so, would an alternative also contribute directly or indirectly to a secondary near-term focus objective?
  - ii. If not, are contributions to secondary near-term focus objectives significant?

The Board approved the proposed addition.

Ms. Payne indicated that she intended to consult with members of the preparer and auditor communities regarding potential project proposals. She noted that the list included in the briefing materials was preliminary but asked for any additions or questions from the members.

Mr. Werfel asked if we would take up strategic planning in early 2008. Ms. Payne responded affirmatively. Mr. Patton asked whether a project to consider replacing the liability definition in SFFAS 5 with the new definition should be added. Ms. Payne noted that the project “application of the liability definition” would most likely include consideration of that action and would expand the text to make that clearer.

Mr. Steinberg noted that one liability issue that he sees in training relates to expenditure driven grants.

Mr. Jackson noted that the environmental liability standards are nonsensical. The liability amount is understated as soon as it is recognized. For example, when a nuclear submarine is put in service only a small portion of the liability is recognized even though the full cost of decommissioning is unavoidable.

Mr. Allen noted that the FASB approach overstates assets – by adding the cost of decommissioning to the asset’s value – in order to capture the full liability.

Mr. Werfel expressed interest in a project on valuation of assets at fair value. He believes the timing is right for a project on this due to the work at DoD to value items at historic value. If we find that estimating historical cost is less meaningful than a more current value that is useful to facility managers, the time to make that finding is before DoD devotes significant resources to estimating historical cost. His understanding is that historical cost is not the component of any decision making model but that fair value is.

Mr. Jackson responded that valuing weapons system stock – including weapons systems acquired since SFFAS 23 became effective – has become a nightmare. He noted that some believed that FASAB would need to provide assistance to DoD with respect to efforts to value existing stock because there is an expectation that items acquired since fiscal year 2003 would be very precisely costed – at full cost. He considers this an insurmountable task. He suggested that the Board discuss this issue sooner rather than later. He asked that the Board explore what the benefit of the precision is and ask if the benefit is worth the enormous cost. The valuation hurdle is significant.

Mr. Werfel indicated that the audit plan for DoD calls for investment of considerable resources in the next ten years on valuation. He likes the notion that we would evaluate all existing standards but he believes this area is especially timely.

Mr. Allen asked if the issue is a standards problem. He noted GASB's acknowledgement that estimation would be needed to implement its GASB 34 asset standards.

Mr. Steinberg noted that the Board has run the gauntlet with PP&E. He recalled that initially, SFFAS 6 exempted weapons systems from valuation. He noted that, next, DOD, with the Board's support, explored the inclusion of condition information since it was of great importance to DOD . He believes that had the Board gone fully down that path, DOD would have produced valuable information. The Board did not go down that path because DOD requested removing the exemption regarding weapons systems.

Mr. Farrell noted the difference between accounting and accountability. If one proposed an accounting solution then one would get hung up on accountability. The ability to report on "eaches" was viewed as essential to accountability. Building a system that addressed both accounting and accountability was insurmountable. His view is that DoD never got too far because such a system was impossible.

Mr. Jackson noted that determining existence of military equipment was a problem. He believes they should be able to do this. The language in SFFAS 23 has been interpreted to mean that assets acquired after the implementation date are subject to the full rigors of valuation and can not be valued under the initial capitalization guidance which provided not only for estimation but also for options regarding documentation. A technical release affirming that you have a period of time to implement SFFAS 23 so that people can take advantage of the initial capitalization flexibilities until they are capable of capturing actual cost.

Mr. Allen suggested that staff explore the issue.

Mr. Reid noted that this arose because DOD was unable to determine what cost of a prior acquisition of a system was when they were planning for a new acquisition of the same system. He noted that there was value in knowing what the systems cost and that management believed that the historical cost would be helpful to them.

Mr. Werfel suggested that the Board should consider the cost of the standards. He noted that when you look at condition, value is an important component of condition. If you look at functional replacement value you have captured the condition information.

Mr. Reid argued that we should only revisit when the department is able to comply because a great deal of flexibility was provided. When they can comply on a go forward basis then we should consider the legacy assets. Mr. Jackson indicated that a significant amount of money would be invested by then and he felt that would be irresponsible. Mr. Steinberg agreed. He noted that to capitalize at cost you must answer these questions:

1. What is a weapons system (is it the single unit or all the support items associated with it)?
2. What part of the Research Development Test and Evaluation (RDT&E) is a cost of the weapons systems?
3. During RDT&E, we lose some assets during testing; is this cost?
4. What about systems within systems (aircraft carrier with fire control systems)?
5. What about the cost of modifications?
6. What about losses in war time?
7. What about the times you are unable to verify existence?

Ms. Payne noted that some agencies had no implementation period because they were only recently required to have audited financial statements.

Mr. Reid noted that investments are sometimes carried at market value by the investing agency but carried by Treasury at historical cost. This causes elimination problems for Treasury. He asked that this be considered.

Mr. Dacey noted that cost of capital did not seem to be at the same level of importance as many of the others. He indicated that we have had significant differences of opinion about the meaning of "risk assumed." There is not a clear definition or measure of risk assumed. Is the right number total insurance in force or your probable losses? He is not sure who is using the information but it is clear that they are not getting consistent information.

Mr. Allen noted that the first meeting next year would focus on strategic planning. Historically, strategic planning includes agenda setting.

Mr. Jackson asked if we needed to offer explicit guidance on SFFAS 6, Accounting for PP&E, and its applicability to property in a war zone. He noted that there is some discussion of what accounting is appropriate for assets in a war zone. Mr. Dacey agreed but that he was not sure whether the issue was impairment or an ability to track the asset. Mr. Jackson indicated that often tanks are refurbished to the condition of a new tank. He suggested that there may be cohorts of assets to be addressed.

Mr. Farrell noted that he thought people went overboard. He thought we could add value by giving broad guidance such as “if you put something in theater, then write it off and if it comes back to service then consider restoring it to the books.” Mr. Steinberg noted that these items are not the same as non-governmental assets. He suggested writing the standard so that it addresses these unique items.

Mr. Allen noted that this issue is important and timely. He asked that we move on to convergence.

Ms. Payne noted that “convergence” means different things in different places. She asked for comments on benefits and barriers related to options beyond informed convergence. Also, she asked what stakeholders should be consulted if a decision was made to move beyond adaptation.

Mr. Werfel noted that the principals were interested because of the press coverage of convergence in the FASB/IASB arena. He asked Ms. Ranagan where she would place FASB/IASB on the spectrum. She responded that they are at convergence.

Mr. Allen noted that they envision a trade off of standards – that the better of the two approaches would be adopted. He commented that even state and local governments do not have the challenges we have. He suggested that we should be at the opposite end of the scale – that we should learn from what others have done and partner when it is beneficial. He noted that there was a real demand for convergence in an arena where you have cross border investing. He does not see the need in our environment. Mr. Torregrossa noted that Mr. Murphy agrees whole heartedly.

Mr. Jackson noted that the IASB is pursuing fair value and addresses issues such as componentization of assets. Programs are funded differently than ours. Things they dealt with are different and it would be helpful to know why they reached their conclusions. Mr. Allen noted that the staff papers provide that information but it doesn't mean that we ignore opportunities to collaborate.

Mr. Reid indicated that Treasury had done a comparison of IPSASB standards with FASAB standards and will provide it to the members.

Mr. Patton noted that he expects the notion of federal sovereignty would be a significant barrier to convergence. Mr. Reid agreed. With IPSASB, countries can elect to use cash or accrual standards. You do see countries moving from one to another. Typically, you

see more options in the IPSASB standards; these were necessary to get agreement. In the private sector, there is a huge incentive to get to a single set of standards. That incentive is not there in the government setting with the exception of countries relying on IMF or World Bank funding and the program requires a certain accounting.

Mr. Allen recalled that the IPSASB indicated that the social benefits project is an example of the state of standard setting. The IPSASB altered the scope of the project to address only display because liability recognition was not attainable.

Mr. Werfel suggested that he believes the issues faced would be common among national governments. He asked if the international work could leverage our work. He wonders if we could more quickly and effectively develop standards if we integrated IPSASB's efforts and had more fluid adoption of those things that work. If we trusted the IPSASB process and it had a maturity, then we could move more quickly.

Mr. Allen noted that we are well represented and attend meetings. We can address ways to improve in that area. Currently, staff tracks IPSASB projects and speaks with staff.

Mr. Dacey noted his belief that there is something in between adaptation and informed deliberations – such as collaboration. He believes there is a fundamental difference between staff collaboration and Board collaboration. He suggested we consider whether there are GASB or FASB pronouncements that we could incorporate. He noted that IPSASB is converging with IASB absent a government reason not to do so.

Mr. Allen indicated that there was some interest in exploring what more we could do in the area of relying on or collaborating with other standard setters but not a great deal of interest in pure convergence or adoption.

- **Steering Committee Meeting**

The Steering Committee met in closed session to discuss personnel matters.

## **Adjournment**

The meeting adjourned at 2:30 PM.