February 11, 2011

Memorandum

To: Members of the Board

From: Wendy M. Payne, Executive Director

Subj: **Technical Agenda – Tab F**[1]

## MEETING OBJECTIVES

- To review potential project options and prioritize potential projects

## BRIEFING MATERIAL

This memo reviews the Board's tentative priorities as discussed in February, 2010, and provides more detail about each potential project. The memo is accompanied by a timeline displaying 2010 goals for each current project (attachment 1).

## BACKGROUND

In August 2008, the Board considered potential projects including input from roundtables held early in 2008 and identified the following three new projects as its highest priorities:

a) federal entities primarily applying Financial Accounting Standards Board (FASB) GAAP,
b) evaluation of existing standards, and
c) deferred maintenance/asset impairment.

In December 2008, the Board reviewed progress on then active projects as well as project plans for each of the three priority projects. As a result of the discussion, the Board decided to continue the first project, "Federal Entities Primarily Applying FASB GAAP," but not to consider it a high priority and to retain the remaining projects as priorities.

For the evaluation of existing standards, the Board prioritized the following standards in the order shown:

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

1) Statement of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for PP&E*
2) SFFAS 15, *Management's Discussion and Analysis*
3) SFFAS 1, *Accounting for Selected Assets and Liabilities* as applied to grant accruals
4) SFFAS 27, *Identifying and Reporting Earmarked Funds*

At this time, progress has been made in the above areas as follows:

- SFFAS 6 implementation guidance is being developed by an AAPC task force (the efforts of the task force will inform the evaluation)
- SFFAS 15 evaluation has been completed and the AAPC is pursuing a best practices guide
- SFFAS 1 as it applies to grant accruals was addressed by a government-wide task force and the AAPC issued a technical release ED last month (a copy is provided in your briefing materials for this meeting)
- SFFAS 27 was evaluated by staff; problems and options are included at Tab H

At the December, 2009, meeting, the Board approved staff undertaking a review of managerial cost accounting and reporting standards as part of the existing reporting model project. Currently, a managerial cost accounting study has been added to the Reporting Model Project and a survey is underway (Tab I includes an update).

At the February, 2010, meeting, members discussed priorities very broadly, expressed some interest in the potential projects offered in the February briefing memo, and identified additional areas to consider. Projects presented by staff in February included:

1) Evaluating SFFAS 10, *Accounting for Internal Use Software*
2) Evaluating the cleanup costs provisions of SFFAS 6, *Accounting for Property, Plant, and Equipment*
3) Evaluating existing disclosure requirements

New potential projects were suggested in the following general areas:

4) Investments in non-federal securities
5) Electronic reporting including the potential for educational materials
6) Risk assumed (e.g., explicit assumption of risk through insurance programs but also implied assumption such as the GSEs and systemic risks)

These six projects are described further below. In addition to new potential projects, some suggested accelerating work on the entity and reporting model projects but acknowledged that additional staff resources may not accelerate decision making. At the meeting, I hope the Board will establish priorities from among the above alternatives. If members wish to consider projects other than the evaluation of existing standards or to pursue evaluation of standards that I have not identified, please let me know as soon as possible.

**POTENTIAL PROJECTS**

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## Evaluating SFFAS 10: Accounting for Internal Use Software

Issue

For internally-developed internal use software, Statement of Federal Financial Accounting Standards ('SFFAS") 10[2]requires capitalization of costs incurred during the **development phase**. Some assert that software is not built in "phases" as much as it was when the Federal Accounting Standards Advisory Board ("FASAB") issued SFFAS 10 and software development can be continuous, and therefore SFFAS 10 needs to be updated or revised to explicitly address instances where software development is a continuous process.

On the other hand, the term "development phase" would seem to be merely a very general term for a fundamental activity. The notion of software phases is used in other federal guidance. SFFAS 10 notes that it is consistent with (1) Office of Management and Budget ("OMB") Circular A-11, "Preparation, Submission, and Execution of the Budget", (2) various Government Accountability Office ("GAO") reports, and (3) American Institute of CPAs Standard Operating Procedure 98-1 (now included in the Financial Accounting Standards Board's Codification as section 350.40, "Internal Use Software"). SFFAS 10 mentions that there is no federal requirement regarding software phases, and that OMB Circular A-130, "Management of Federal Information Resources", states that there are only two phases for sure – a beginning and an ending phase.

The February 2010 FASAB minutes regarding the technical agenda contain the following:

> Mr. Jackson … indicated that the process of software development is an ongoing process rather than fitting … phases.
>
> Ms. Payne noted that some agencies are in the business of developing software continuously.
>
> Mr. Dacey agreed and indicated that the phases may need clarification.
>
> Mr. Jackson asked if there is continuous development, should anything be capitalized – the expenditures may be a good proxy for depreciation.
>
> Mr. Allen agreed – he noted that used to be the view and he has sympathy with it.
>
> Mr. Dacey noted that some ERP systems are so large that they are continuously modified.
>
> Mr. Allen asked if there was a need to clarify or modify standards. If we have progressed and it is impossible to segregate by phase, do we need to modify the standards.
>
> Mr. Jackson thought it deserved some time to assess whether there is such a need.
>
> Mr. Dacey does not believe it is an audit issue but agreed that it is becoming more complex. He thought information gathering was in order.
>
> Ms. Payne committed to researching the issue further.

[2] *Accounting for Internal Use Software*, June 1998.

Discussion

The federal government spent $76.1 billion on information technology ("IT") in FY 2009.[3] Although the budget publications do not report software costs separate from other IT costs, some ballpark estimates for software are possible. Using the breakout for "new IT and upgrades," the FY 2009 spending for this category shows $29.5 billion.[4] The balance sheet for FY 2009 for the Financial Report of the United States Government reports an internal use software asset of $24 billion and associated accumulated amortization of $13.1 billion, for a net asset of $10.9 billion.

Developing quality software within time and budget constraints is a perennial problem and developers have developed several approaches to try to control the process. One of the oldest software development tools is flowcharting, which has its roots in the 1920s, but software development methodologies per se started emerging in the 1960s. The "systems development life cycle" is considered the oldest formalized methodology for building information systems. The main idea of the systems development life cycle is a very deliberate, structured methodology requiring each phase or stage of the cycle to be carried out rigidly and sequentially. The target of this methodology in the 1960s was primarily large scale business systems. Circular A-11 and its associated *Capital Planning Guide* as well as GAO guidance focus on life cycle steps or phases. And even the literature dealing with continuous software development seems to focus on steps or phases in which cost is one of the metrics that is tracked and monitored.

The life cycle approach is sometimes described as a "waterfall." The "waterfall model" is a sequential software development process that is seen as flowing steadily downwards (like a waterfall) through the phases of conception, initiation, analysis, design, construction, testing and maintenance. The waterfall development model has its origins in the manufacturing and construction industries – highly structured physical environments in which after-the-fact changes are prohibitively costly, if not impossible.

Recently the complexity of software has gotten even more challenging. The multi-year software development project that necessitated a "big model up front" (BMUF) – especially with respect to requirements specification – has been criticized. Some say the BMUF approach does not reflect the realities of most modern application development efforts. Essentially, the "continuous development" or evolutionary approach starts with an approximate model and keeps perfecting it. One argument for this is that programmers do not find most bugs until late in development or after.

The "spiral model" of software development is another approach. It is an iterative process combining elements of both the structured life cycle and continuous approaches in an effort to

[3] See OMB's "E-gov" webpage for "Federal IT Spending for FY 2011," which leads to the "Report on Information Technology (IT) Spending for the Federal Government", and "summary" worksheet (http://www.whitehouse.gov/omb/assets/egov_docs/Agency53_Details_20100201.xls)

[4] The OMB webpage for "E-gov" reports on the IT spending category "**development, modernization, enhancement**," ("DME"), which is a cost category directly from "Exhibit 53" submitted annually by agencies as required by OMB. The enacted FY 2010 budget for DME was $15.4 billion, excluding DoD and EPA; data for DoD and EPA was not include in the table).[4] However, the new OMB "IT Dashboard," which also purportedly provides data from federal agencies' Exhibit 53, shows $29.5 billion for the similar IT cost category "**new/upgrades spending.** "See the IT Dashboard "data feeds" at http://it.usaspending.gov/?q=content/data-feeds

combine advantages of top-down and bottomup concepts. The spiral model is intended for large, expensive and complicated projects.

Immensely complex systems can be built via iterative or continuous development approaches. Some examples include communications systems (Internet and intra-nets), operating systems (Linux), social networks (Facebook), scripting languages (Javascript), search engines (Google, Safari), and designer built systems (E*bay, Amazon, Google).

If development is “continuous” and the associated cost is not segregate-able, then a question may be whether it is useful to analogize to Governmental Accounting Standards Board Statement 34, “Basic Financial Statements …,” regarding the expensing of infrastructure. One question would be whether such an approach, i.e., expensing costs instead of capitalization and amortization, result in loss of decision-useful information.

***Issues***

How much software development is continuous in the federal government?

Are Enterprise Resource Planning systems continuously modified?

Is “cloud computing” continuously developed and if so does it present problems for the accounting specified in SFFAS 10?

Is it impossible to segregate certain internally-developed software by phase?

Is continuously developed incompatible with SFFAS 10?

Do the phases in SFFAS 10 need clarification? Or is another chapter needed?

Other issues ….

***The Plan***

1) Review Software Development Guidance
    a) Federal
    b) OMB Circulars
    c) GAO
    d) GSA
    e) NIST
    f) Other?
2) Non-Federal Guidance
    a) SEI, Carnegie Mellon
    b) CMMI – “Software Development”
    c) Current IT literature regarding software development
    d) Other
3) Review Accounting Guidance
    a) GASB Statement 34 regarding expensing of infrastructure

b) FASB Codification regarding accounting for IU software

c) Other

4) Discuss with experts – federal and non-federal

a) GAO

*b)* OMB – Circular A-11 contains extensive material regarding budget formulation and reporting on budget execution for systems development – Section 53, Form 300, *Capital Planning Guide.*

c) Federal agencies

i) GSA

ii) Defense

iii) NASA

iv) Etc.

d) Software Engineers Institute, Carnegie Mellon University

e) CMMI

f) Others

5) Convene a FASAB working group to review results of research/consultation

*6) Make Staff Recommendation*

*a) Options:*

i) Update/enhance/revise SFFAS 10

ii) AAPC best practices/case studies guide

iii) No action

## Evaluating SFFAS 6 – Cleanup Costs Provisions

SFFAS 6, *Accounting for PP&E*– SFFAS 6 addresses three areas – cost of PP&E, cleanup costs, and deferred maintenance. While there is interaction among the three, I believe we could address cleanup costs in a separate evaluation. Issues include:

1) Whether the existing liability recognition provisions are consistent with newly issued element definitions.
   a) The liability may be understated because the obligation is to cleanup the entire hazardous waste but SFFAS 6 provides for a gradual build up of the liability balance as the related PP&E is consumed in service (the full cleanup cost is disclosed in a note).
   b) The cost of PP&E may be understated because the SFFAS 6 requirement is to capitalize its acquisition cost; the later cost to retire the asset is excluded.
   c) The scope of liability recognition is limited to costs to cleanup hazardous substances rather than the full asset retirement obligation.
2) Cost-benefit issues relating to the level of precision required for estimates and ongoing concerns regarding the timing of recognition of asbestos liabilities (generally when asbestos exists rather than when it is to be removed) have been raised.

Two agencies account for the vast majority of cleanup costs—Department of Defense and Department of Energy. Excerpts from the FY2009 annual financial reports are presented below.

Note that both Energy and DoD adopted an implementation option permitting them to book the entire cleanup cost as a liability upon implementation (however, the option was not available for PP&E used in business-type activities). At these departments, the full cleanup costs associated with pre-FY1998 PP&E have been recognized while the post-1997 PP&E cleanup costs for PP&E in use are building up gradual through recognition of annual expenses offset by cleanup costs liabilities. This affects both the reported expense (which does not include an annual cost of cleanup for any pre-FY1998 PP&E in use) and the liability (which some argue understates the post-FY1997 obligation). (Note that 89% of the Energy liability relates to legacy sites so no annual expense amount is affected by the election of the implementation option.)

<u>EXAMPLES OF AGENCY DISCLOSURES</u>

<u>Department of Energy, FY2009 Annual Financial Report – Note 15, Environmental Cleanup and Disposal Activities</u>

| 15. Environmental Cleanup and Disposal Liabilities | ($ in millions) FY 2009 | FY 2008 |
|---|---|---|
| Environmental Management Program | $ 180,071 | $ 185,503 |
| Other legacy environmental liabilities | 57,734 | 51,173 |
| Total legacy environmental liabilities | 237,805 | 236,676 |
| Active and surplus facilities | 29,852 | 29,405 |
| Total environmental cleanup and disposal liabilities | $ 267,657 | $ 266,081 |
| Amount funded by current appropriations | (4,905) | (2,451) |
| **Total unfunded environmental cleanup and disposal liabilities** | $ 262,752 | $ 263,630 |
| | | |
| *Changes in environmental cleanup and disposal liabilities* | | |
| Total environmental cleanup and disposal liabilities, beginning balance | $ 266,081 | $ 263,603 |
| Changes to environmental cleanup and disposal liability estimates | | |
| Environmental Management Program | 944 | 2,785 |
| Other legacy environmental liabilities | 7,244 | 6,108 |
| Active and surplus facilities | 502 | 307 |
| Total changes in estimates (Notes 23 and 24) | $ 8,690 | $ 9,200 |
| Costs applied to reduction of legacy environmental liabilities (Note 22) | (5,639) | (5,313) |
| Capital expenditures related to remediation activities | (1,475) | (1,409) |
| **Total environmental cleanup and disposal liabilities** | $ 267,657 | $ 266,081 |

"For facilities newly contaminated since FY 1997, cleanup costs allocated to future periods and not included in the liability amounted to $627 million at September 30, 2009, and $698 million at September 30, 2008."

## Department of Defense, FY2009 Annual Financial Report, Note 14. Environmental Liabilities and Disposal Liabilities

DoD's total environmental liabilities was $ 66,230.0 million for FY2009. The following text describes the methods used.

### *Methods for Assigning Total Cleanup Costs to Current Operating Periods*

The Department uses engineering estimates and independently validated models to estimate environmental costs. The models include the Remedial Action Cost Engineering Requirements (RACER) application and the Normalization of Data (NORM) System. The Department validates the models in accordance with DoD Instruction 5000.61 and uses the models to estimate the liabilities based on data received during a preliminary assessment and initial site investigation. The Department primarily uses engineering estimates after obtaining extensive data during the remedial investigation/feasibility phase of the environmental project.

Once the environmental cost estimates are complete, the Department complies with accounting standards to assign costs to current operating periods. The Department has already expensed the costs for cleanup associated with General PP&E placed into service before October 1, 1997, unless the costs are intended to be recovered through user charges. If the costs are to be recovered through user charges, the Department expenses cleanup costs associated with that portion of the asset life that has passed since the General PP&E was placed into service. The Department systematically recognizes the remaining cost over the remaining life of the asset.

For General PP&E placed into service after September 30, 1997, the Department expenses associated environmental costs systematically over the life of the asset using two methods: physical capacity for operating landfills and life expectancy in years for all other assets. The Department expenses the full cost to clean up contamination for Stewardship PP&E at the time the asset is placed into service.

## Evaluating Existing Disclosure Requirements

Some have suggested that disclosures are too detailed. A general review of disclosure requirements to determine if any should be augmented, reduced, or eliminated could be undertaken. FASAB has not compiled a list of note disclosures required by standards. In addition, some note disclosures derive from prevalent practice such as the disclosure of significant accounting policies.

The following data may give you a sense of the number and burden of note disclosures:

- OMB's Form and Content Guidance (Circ. A-136) gives guidance for 42 notes (some will have multiple items of information disclosed under the same general topic).
- GAO's Financial Audit Manual includes a checklist of 202 items to be disclosed.
- The average number of pages devoted to notes in a random selection of 11 CFO Act agencies was 57. The high number was 110 (for a complex department) and the low 39 (for a single mission entity).

To evaluate disclosures, staff would develop a survey instrument and seek input from preparers and auditors regarding the usefulness and burden of selected disclosures. Not all items would be surveyed—for example, clearly essential elements such as a summary of significant accounting policies would be excluded.

Based on the survey results, staff would identify the most likely candidates for amendment and convene user groups to evaluate the usefulness of the disclosures from selected reports. In addition to suggestions for eliminating disclosures, staff would seek input regarding ways to improve the usefulness or clarity of existing disclosures.

## Investments in Non-federal Securities

Federal standards address only two types of investments – investments in federal securities (excluding those available for sale or early redemption) and direct loans. These standards are summarized on the following page in Table 1.

Long-standing practice has been for agencies to rely on analogies to existing FASAB standards or to other literature to fill this void.

Treasury's FY2009 note disclosure regarding significant accounting policies relating to investments provides an example of current practice:

C. INVESTMENTS

Investments – Credit Reform

Troubled Asset Relief Program (TARP) equity investments, including investments in preferred and common stock and warrants of public companies are accounted for pursuant to the provisions of the Federal Credit Reform Act (FCRA) and the associated FASAB accounting standard SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees, as amended. As consideration for investments made, Treasury received common stock warrants, preferred shares (referred to as warrant preferred shares) or additional notes. Treasury concluded that GAAP accounting for such investments using SFFAS No. 2 was appropriate analogous accounting guidance based on the similarity between the equity investments made by Treasury and direct loans. Consequently, TARP equity investments, including investments in preferred and common stock and warrants of public companies are accounted for by Treasury using credit reform accounting in accordance with SFFAS No. 2, as amended, and reported in accordance with FCRA in these financial statements. Treasury calculates and accounts for equity investments using a market risk adjusted discount rate. In addition, the inclusion of market risk required by EESA in the valuation calculation results in accounting for these investments at estimated fair value, which is consistent with the accounting for other equity investments held by Treasury (i.e., Investments in GSEs). Treasury recognizes dividend revenue associated with equity investments when declared by the entity in which Treasury has invested and when received in relation to any repurchases and restructuring. Treasury reflects changes in the present value of the projected cost value of direct loans, equity investments, and asset guarantees in the subsidy cost on the Statement of Net Cost annually, as required by FCRA. The estimated values associated with these additional instruments are disclosed in Note 8.

Investments in Government Sponsored Enterprises

The senior preferred stock liquidity preference (preferred stock) and associated common stock warrant (warrant(s)) in GSEs are presented at their fair value as permitted by OMB Circular No. A-136. This Circular includes language that generally requires agencies to

value non-federal investments at acquisition cost, and also permits the use of other measurement basis, such as fair value, in certain situations. OMB issued guidance to the Department of the Treasury on October 7, 2009, noting that while OMB Circular No. A-136 focuses primarily on federal securities, which are normally accounted for at amortized cost, it is reasonable to interpret OMB Circular No. A-136 to permit non-federal investments, on an instrument by instrument election, to be reported on a basis other than cost. OMB's guidance allows the use of fair value accounting for non-federal securities beginning with reporting for fiscal year 2009. OMB Circular No. A-136 also directs agencies with non-federal securities to consult FASB's Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, for additional guidance. The Investments in GSEs disclosed as of September 30, 2008, were recorded at acquisition cost at the date of purchase with disclosure of fair values as of fiscal year end 2008. Treasury performs annual valuations, as of September 30th, of the preferred stock and warrants. Any changes in valuation, including impairment, is recorded and disclosed in accordance with SFFAS No. 7, Accounting for Revenue and Other Financing Sources. Since the valuation is an annual process, the changes in valuation of the preferred stock and warrants are deemed usual and recurring. Accordingly, changes in valuation are recorded as an exchange transaction that is either an expense or revenue. Since the costs of preferred stock and warrants are exchange transactions, any change in valuation is also recorded as an exchange transaction. In addition, the preferred stock, warrants, and related dividends, and changes in valuation are accounted for as non-entity transactions. Furthermore, any related revenue, gains, or losses to the preferred stock or warrants are reported as non-entity exchange revenue. Dividends are accrued when declared; therefore, no accrual is made for future dividends. Increases in the non-entity preferred stock liquidity preference occur when quarterly payments to the GSEs are made pursuant to the preferred stock purchase agreements (i.e., when a GSE's liabilities exceed its assets at the end of any quarter). These quarterly payments (liquidity commitments) are made from funds appropriated directly to the Treasury Department. Therefore, quarterly liquidity payments are recorded as costs in the Treasury Department's entity accounts and appear as costs on the Statement of Net Cost economic program section.

Investments in International Financial Institutions

The Treasury Department invests in Multilateral Development Banks (MDB) to support poverty reduction, private sector development, and transition to market economies and sustainable economic growth and development, thereby advancing the United States' economic, political, and commercial interests broad. These investments are non-marketable equity investments valued at cost.

Other Investments and Related Interest

The ESF holds most of the Treasury Department's other investments. Securities that the Treasury Department has both the intent and ability to hold to maturity are classified as investment securities held to maturity and are carried at historical cost, adjusted for amortization of premiums and accretion of discounts, in accordance with OMB Circular No. A-136. The GSE securities held by ESF are in this category. "Other Foreign Currency

Denominated Assets” are considered “available for sale” securities and recorded at fair value as permitted by OMB Circular No. A-136 beginning in fiscal year 2009. (Prior to fiscal year 2009, A-136 required reporting at cost.) These holdings are normally invested in interest bearing securities issued or held through foreign governments or monetary authorities.

Table 1: Summary of Investment Standards

| SFFAS | Definition of Investment or Class of Investment | Measurement Basis (including options) | Recognition of Gains/Losses (e.g., what triggers recognition) |
|---|---|---|---|
| **SFFAS 1 Accounting for Selected Assets and Liabilities** | Treasury securities, including (a) nonmarketable par value Treasury securities, (b) market-based Treasury securities expected to be held to maturity, and (c) marketable Treasury securities expected to be held to maturity. Does not apply to investments in securities (debt and equity) and other financial instruments issued by other than the U.S. Treasury. | Upon acquisition, valued at their acquisition cost Subsequently, carried at their acquisition cost, adjusted for amortization, if appropriate | In rare instances, significant unforeseeable circumstances may cause a change in an entity's intent or ability to hold to maturity certain securities that are initially classified as expected to be held to maturity. In these circumstances, the affected securities should be reclassified as securities available for sale or early redemption (redemption before the security's maturity). Once a security is reclassified it is no longer subject to this standard. |
| **SFFAS 2 Accounting for Direct Loan and Loan Guarantees (as amended)**<br><br>Note: The scope of SFFAS 2 is defined by Credit Reform Act of 1990 as amended (PL 101-508), and covers most direct loans obligated and loan guarantees committed after September 30, 1991. | Direct loan: a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. The term includes the purchase of, or participation in, a loan made by another lender. | Present value of estimated cash flows for the life cycle of the direct loan or loan guarantee.<br><br>Annual re-estimates are required. | Disbursement of direct loans; modification of direct loans; re-estimates of present value of cash flows; acquisition of property at foreclosure. |

## Electronic Reporting

Electronic reporting is increasingly viewed as a means to convey financial information about government. This is evidenced not only by sites such as Recovery.gov but also by the universal practice of posting annual financial reports to federal websites and the emerging practice of providing a written highlights document accompanied by a soft copy of the full report.

Benefits of electronic reporting include:

1) Reducing the production and distribution costs associated with hard copy reports
2) Ability to provide information more quickly and to provide specific information rather than general information
   a) Users may access the specific portion of the report in which they are interested
   b) Printing and distribution delays are avoided
   c) Information may be assembled in a manner that allows transfer to analytical tools (avoiding data entry)
   d) Search features may speed access for the user
   e) Non-sequential access is possible
3) Unrestricted access for the approximately 80% of the US population with Internet access
4) Ability to provide access to related non-financial data (strategic plans and performance reports) and more current financial data (budget requests)

(adapted from Seetharaman, Subramanian, and Shyong. "Internet Financial Reporting: Problems and Prospects," *Corporate Financial Review*, July/Aug 2005.)

The absence of guidelines for electronic financial reporting has been noted by many. I reviewed several journal articles covering reporting concerns from the perspective of the users as well as emerging audit issues. One author summed up his views as follows:

> The same standards of reporting and disclosure that apply in the "hard copy" environment should apply on corporate websites. If websites are to be credible and provide definitive, accurate, complete and timely sources of information to investors, the same level of information that would apply for example in an offer document like a prospectus should be available on the website. … Arguably, companies should use independent professional third parties to "audit" the websites for accuracy and completeness, in the same manner external financial auditors "sign off" on a company's annual

accounts. Source: David Hurburcg, "The Web: Where Financial Information Belongs" *JASSA*, Winter 2000.

A summary of the concerns/practices that might be addressed through guidelines follows. This is not a staff proposal—instead, it is as comprehensive as possible a list of concerns/practices for your consideration and discussion.[5]

1) Financial information should be complete even when reported electronically.
   a) Boundaries of an electronic report should be clear.
      i) A warning message showing when you are leaving the financial report
      ii) Information provided outside of the GAAP basis financial report should be clearly marked as such and any departure from the principles established for the financial report should be disclosed.
   b) Any excerpts from a GAAP basis financial report should provide a reference to the complete financial report.
   c) Accounting principles should be explained (whether GAAP or another basis).
   d) The audit status (and possibly information regarding quality controls over unaudited information) of each "Web page" should be clearly indicated.
   e) Internet reporting beyond GAAP basis financial reports should supplement or complement these reports.
      i) Explanations of differences in principles should be provided.
      ii) Non-GAAP basis pages should include a link to GAAP basis financial reports.
2) Web pages should be clearly dated and timely.
3) Communication with users (Interactive websites)
   a) Is adequate announcement of the availability of electronic financial reports made?
   b) Can financial reports be easily located (3 clicks rule)?
      i) Search features may need to be enhanced to help users locate the e-report
      ii) A common "portal" to access all financial reports may be useful. For example, the Financial Report of the US Government could serve as the portal to component reports.
   c) Automated e-mail alerts to interested users
   d) A single point of contact at each entity to respond to questions
   e) What constitutes good practice regarding posting of relevant links for the interested user? (considering both benefits and drawbacks of links)
   f) Many technology related issues emerge such as
      i) Speed of download
      ii) Use of pictures (thumbnails)
      iii) When should "plug-ins" be used?
4) Accessibility issues to consider include:

[5] Note that it is not suggested that each of these is a matter of concern that FASAB should address through standards. For example, some members suggested educational materials such as best practices.

a) Is the data downloadable to facilitate analysis?
b) Are appropriate historical data available?
c) Are internal and external links maintained (no broken links)?

5) Are security/control measures adequate?
   a) Process of posting data prevents errors
   b) Appropriate authorization to edit data
   c) Controls to prevent unauthorized access (both internally and externally)
   d) Hyperlinks to unaudited data – is adequate disclosure in place and does security extend to the unaudited data? Is the user able to differentiate between complete and incomplete data?
   e) Auditor relationship with electronically published data
      i) Relationship with existing GAAP based financial reports
      ii) Assurance over real-time electronic reporting?
   f) Quality assurance over unaudited data
      i) Source of data (e.g., financial systems, procurement data base, cuff records)
      ii) Controls
      iii) Reconciliation to other data sources

Sources:


Iqbal Khadaroo. (2005). Corporate reporting on the internet: some implications for the auditing profession. *Managerial Auditing Journal*, 20(6), 578-591.

Arumugam Seetharaman, Ramaiyer Subramaniam, & Seow Yuan Shyong. (2005). Internet Financial Reporting: Problems and Prospects (PART II). *Corporate Finance Review*, 10(2), 23-34.

Hurburgh, D.. (2000). The Web: Where financial information belongs. *JASSA*,(2), 16-20.

Richard Fisher, Peter Oyelere, & Fawzi Laswad. (2004). Corporate reporting on the Internet: Audit issues and content analysis of practices. *Managerial Auditing Journal*, 19(3), 412-439.

Barry Smith. (2005) An Investigation of the Integrity of Internet Financial Reporting. *The International Journal of Digital Accounting Research*, 5(9), 47-48.

## Risk Assumed

SFFAS 5, *Accounting for Liabilities of the Federal Government,* (as amended by SFFAS 25) requires risk assumed information to be reported as RSI for explicit insurance and guarantee programs. It describes risk assumed briefly as "Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force." (SFFAS 5, par. 105)

The Board envisioned returning to this topic to provide additional guidance on measurement. In addition, the Board considered the merits of measuring the liability (and expense) associated with such programs using the expected value approach. Instead, the following recognition guidance was provided:

> …should recognize a liability for unpaid claims incurred, resulting from insured events that have occurred as of the reporting date. The standard requires recognition of the liability that is known with certainty plus an accrual for a contingent liability recognized when an existing condition, situation, or set of circumstances involving uncertainty as to possible loss exists and the uncertainty will ultimately be resolved when one or more probable future events occur or fail to occur; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is measurable. (SFFAS 5, par. 104) [Note: Life insurance programs recognize future policy benefits as well.}

The Board discussed risk assumed in the basis for conclusions:

> Conclusion on Insurance And Guarantees
> 185. The Board considered two possible bases for recognizing the liability of federal insurance programs. One would recognize as a liability the unpaid expected present value (PV) cost of insured events that had occurred. The second would recognize as a liability the unpaid expected PV cost of risks that had been assumed (i.e., the unpaid expected PV cost inherent in insurance extended or in force). This second approach would be similar to that taken by the Congress in budgeting for direct loans and loan guarantees and by FASAB in accounting for these transactions. (See Statement of Federal Financial Accounting Standards Number 2, Accounting for Direct Loans and Loan Guarantees).
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> 186. Several Board members believe that this second approach has merit from a conceptual standpoint. However, the Board has concerns about the measurability of the risk assumed, particularly in the context of pension guarantees. There may also be some question as to the exact nature or categorization of some assumed risks in the absence of written contracts. The Board concluded that it would continue the traditional practice of recognizing the effect of events that had occurred on the face of the financial statements. However, it also decided to require reporting as RSSI the estimated PV cost of the risk assumed for all programs, except social insurance, life insurance, and loan guarantee programs.
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> 187. Accrual accounting for insurance programs attempts to report the expenses of operations for each period and the unpaid liability at the end of the period. Projections of future claims, including renewed, expanded, and new business, also provide important information for policy decisions about what rates should be charged to cover all expected future losses, what additional insurance should be extended, and similar decisions.

Management of reporting entities may wish to include such projections in financial reports as other accompanying information, and may do so on a voluntary basis, but the Board is not presently making any specific recommendations about this, beyond those required by this Statement and those to be further considered in Supplementary Stewardship Reporting.

188. During the Exposure Draft stage of the Liability Standard, the Board asked respondents whether the Standard provided sufficient guidance on how the risk assumed amount should be measured. Two of the fifty five respondents asked for additional guidance but did not mention measurement possibilities.

189. At the discussion stages of the final Statement the Board contemplated two possible measurement perspectives for reporting the risk assumed. The Statement requires that all federal insurance programs (except social insurance, life insurance, and loan guarantee programs) report the risk assumed amount as supplementary information. The risk assumed calculation as presented in the Exposure Draft measured the cost of the coverage outstanding during the reporting year. For annual term insurance programs, under this approach the risk assumed amount might not be significantly different from the sum of recognized liabilities and contingent liabilities reported on the Balance Sheet. However, the Board believes that requiring disclosure or supplementary reporting of a risk assumed number that is similar in concept and amount to the liability recognized could be confusing and would not add informational value.

190. In the second perspective, the risk assumed amount would be a broader and longer term measure of the government's potential cost for on-going insurance programs. Under some measures, this second approach to risk assumed could be regarded as an indicator of the "fair" or "full cost" premium that should be charged if taxpayers are not to subsidize the program. This measure would be a probabilistic estimate of the expected cost under certain assumed economic factors. The Board found merits in this calculation, and believes it can provide important additional information beyond that contained in the accrual. Although they believe the measure to be important, proponents of this approach acknowledge that the measure may be difficult to measure precisely. Accordingly, they would treat it as RSSI. The Board currently has a project at the Exposure Draft stage, Supplementary Stewardship Reporting, that will provide further details on the measurement and reporting of "risk assumed" in its final statement.

At the February Board meeting, some members expressed interest in reporting information regarding implied guarantees. This was viewed as particularly important in light of the financial crisis and actions to restore financial stability. In the past, particularly in the context of the federal reporting entity, members have expressed concerns regarding the risk associated with entities such as Government Sponsored Enterprises (GSEs) where there is implied federal support. While the article presented as Attachment 1[6] was directed to budgetary accounting and reporting, I believe it provides a helpful overview of considerations in the risk assumed area.

A project on risk assumed would address both explicit and implied guarantees. This represents a major project and a project plan would be developed after consulting with experts in this area.

[6]Phaup, Marvin. "Federal Use of Implied Guarantees: Some Preliminary Lessons from the Current Financial Distress." *Public Administration Review.* July/August 2009. p. 651.