

Memorandum Reexamination

June 10, 2021

To: Members of the Board
From: Monica R. Valentine, Executive Director
Subject: **Reexamination of Existing Standards** (Topic C)

INTRODUCTION

Staff has begun preliminary discussions on potential approaches to conduct a project to reexamine FASAB's existing standards. The Board has not previously taken on a specific project with the sole purpose of exploring opportunities to reexamine existing guidance.

For this topic discussion, staff is seeking the Board's feedback on potential approaches to advance the reexamination of existing standards project.

REQUEST FOR FEEDBACK BY JUNE 17

Prior to the Board's June meeting, please review the attached staff recommendations and analyses and respond to the ensuing questions by June 17.

Please submit responses to me at ValentineM@fasab.gov.

NEXT STEPS

Staff is not currently requesting the Board to approve any approach at this time. However, the Board should be prepared to further consider this project during the August technical agenda deliberations. The Board's feedback will assist staff in continuing to advance the reexamination of existing standards project.

ATTACHMENTS

1. Staff Recommendations and Analyses
2. 2005 FASAB Invitation to Comment

Staff Analysis

Reexamination

June 10, 2021

CONTEXT

The Board has previously stated that it should periodically reexamine the accounting standards to assess their current applicability and to eliminate or revise unnecessary requirements. For example, FASAB may need to reexamine existing standards while considering enhancements made to the Board's conceptual framework, as well as the issuance of additional pronouncements.

The project objective would be to reexamine FASAB's existing standards to assess their current relevance and to identify opportunities to streamline authoritative guidance.

BACKGROUND

At the December 2020 meeting, the Board approved the technical plan for the reexamination of existing standards research topic. The research topic will address issues related to (1) inconsistencies with current practice, (2) confusion or difficulties applying requirements, (3) the need for clarifications, and (4) the usefulness of disclosures and other required information.

Since 1993, the Board has promulgated 27 new topic standards, 6 add-on standards, 17 amending standards, 1 omnibus, and 7 deferrals – 7 of those 58 standards have also been rescinded. These numbers demonstrate that the Board has addressed many issues in a relatively piecemeal manner by amending, expanding, and even rescinding standards. Additionally, there are concepts statements, 10 Interpretations, and other lower-level pronouncements. Therefore, it is advisable that the Board consider a project to specifically and comprehensively review its guidance.

Other standard-setters also have a process to reexamine existing guidance. For example, the Governmental Accounting Standards Board (GASB) generally reexamines its existing standards statement by statement, as opposed to on a broad topic basis. The standards that GASB reviews for reexamination have been in effect for more than five years. GASB consults with the Governmental Accounting Standards Advisory Council (GASAC), state and local government stakeholders, and financial statement users on potential standards for reexamination. GASB does plan to eventually reexamine all of its standards/topics.

In February 2021, staff provided the Board with an educational briefing regarding the codification of the standards.

Some of the discussion points raised by staff during the education session included:

- Does the current generally accepted accounting principles (GAAP) hierarchy need to be reassessed to determine if the four-level hierarchy is still necessary and if the concepts statements should continue to be excluded from authoritative guidance?
- What options are available to ensure the *FASAB Handbook* is serving the needs of the federal financial management community?
- Should the Board seek feedback from the federal financial management community on the potential benefits of codification?

Although the Board has made no decisions on or commitments to a codification project, staff notes that work in the two areas is similar and a collaborative approach should be considered. For example, if there were a firm commitment from the Board and resources available to prepare a codification of the standards, this would assist with assessing the full set of standards and identify gaps, inconsistencies, and ways to streamline the standards that would be helpful in the reexamination of the guidance. Alternatively, if there is not a firm commitment or there are no available resources for a codification of the standards at the present time, staff notes that the reexamination of existing standards project should continue while being mindful that a codification of the standards is planned.

RECOMMENDATIONS AND ANALYSES OF POTENTIAL APPROACHES

Reexamination of existing standards can be approached many different ways, including a one-by-one approach starting with the oldest standards and working through the full set of standards, addressing the standards on a broad topic basis (for example, assets, liabilities, revenue, and expenses, etc.), targeting the guidance most in need of revision, or combining these as well as other approaches. Staff is very aware that identifying an optimal approach is essential to the success of the project. Therefore, staff believes it is best to take the necessary time and fully vet all options prior to committing significant resources to this effort.

Staff, in consultation with the chair, has identified a few potential approaches to effectively manage a comprehensive reexamination project.

RECOMMENDATION

Reassessing the GAAP Hierarchy

Staff recommends conducting further research to determine both the benefits of and concerns with FASAB's current GAAP hierarchy. Staff believes conducting the research will better inform the Board if the current GAAP hierarchy needs to be updated.

ANALYSIS

SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles for Federal Entities, Including the Application of Standards Issued by the Financial Accounting Standards Board* incorporates the hierarchy of GAAP into FASAB's authoritative literature. SFFAS 34, paragraph 5 states:

The hierarchy of generally accepted accounting principles, hereafter referred to as the GAAP hierarchy, governs what constitutes GAAP for federal reporting entities. It lists the priority sequence of pronouncements that a federal reporting entity should look to for accounting and financial reporting authoritative guidance. The sources of accounting principles that are generally accepted are categorized in descending order of authority as follows:

Level A. Officially established accounting principles consist of FASAB Statements of Federal Financial Accounting Standards (Standards) and Interpretations. FASAB Standards and Interpretations will be periodically incorporated in a publication by the FASAB.

Level B. FASAB Technical Bulletins and, if specifically made applicable to federal reporting entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides.

Level C. Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

Level D. Implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

Staff has consistently found that many members of the financial management community do not have a working understanding of the GAAP hierarchy. This means there is some confusion about the pronouncements' order of authority, as well as the authority of the concepts statements. Staff notes that FASAB issued SFFAS 34 in 2009 after representatives of the American Institute of Certified Public Accountants requested that the U.S. accounting standard-setters consider adopting certain guidance for accounting and financial reporting issues that now reside in the professional auditing literature. The structure presented in SFFAS 34 generally carried forward the hierarchy as set forth in Statement of Auditing Standards 91, *Federal GAAP Hierarchy*, and the Office of Management and Budget A-136, *Financial Reporting Requirements*, at the time.

If a goal is to make the standards more user-friendly, the current GAAP hierarchy may need to be reassessed prior to reexamination to determine if the four-level hierarchy is effective. In assessing the hierarchy, GAAP levels B (Technical Bulletins), C (Technical Releases), and D (staff implementation guides) would need to be reviewed.

For example, several years ago GASB updated its GAAP hierarchy in GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*:¹

This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

The requirements in this Statement improve financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in nonauthoritative literature. As a result, governments will apply financial reporting guidance with less variation, which will improve the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.”

Question for the Board:

1. Do Board members agree with further researching both the benefits of and concerns with FASAB’s current GAAP hierarchy?

RECOMMENDATION

Seeking Input from the Public

Staff recommends, as a first step, the Board consider soliciting feedback through the use of an invitation to comment (ITC).

ANALYSIS

Given the potential extent of a reexamination project and significant use of staff resources to research the Board’s approach, staff believes that seeking input from the public is an essential step. FASAB could solicit input from the public in many different

¹ Please note that GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* has two GAAP hierarchy levels: authoritative and implementation guidance. However, only the standards are codified.

forms. Staff could conduct round tables, form a task force, conduct outreach to various organizations, or seek feedback in a formal Board publication. Staff agrees that all of these mediums would be both beneficial and useful to the Board as it establishes an approach to the reexamination project. However, initially gaining widespread feedback on potential approaches would be advantageous to the project's success.

The Board can issue a publication that has rarely been used by FASAB – an Invitation to Comment (ITC). An ITC could be used to invite the public to comment on a variety of alternative approaches to reexamination, as well as potentially generate additional alternatives for the Board to consider. It could also be used as a means to gain general feedback on broad issues. For example, the Board may consider including a specific question regarding a topic such as the GAAP hierarchy.

The Board used an ITC in 2005 to solicit feedback on four potential projects that the Board was considering for its technical agenda (see attachment 2).

Question for the Board:

2. Do Board members agree with staff's recommendation to consider soliciting feedback through the use of an ITC as a first step to the reexamination project?

Technical Agenda Options

Invitation to Comment

Written comments are requested by September 9, 2005

July 22, 2005

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Federal Accounting Standards Advisory Board (FASAB or "the Board") was established by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General in October 1990. It is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standard is published in an exposure draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."*
- "Mission Statement: Federal Accounting Standards Advisory Board."*

*Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mailstop 6K17V
Washington, DC 20548
Telephone (202) 512-7350
Fax (202) 512-7366
www.fasab.gov*

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July 22, 2005

TO: HEADS OF FEDERAL AGENCIES AND ALL OTHERS WHO USE, PREPARE,
AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (the Board) is seeking your input regarding its Technical Agenda. The Board believes that resources can be devoted to one or two new areas before the end of 2005. We believe that you can offer a valuable perspective to the Board in considering the best use of our resources.

We have provided descriptions of four potential projects considered priorities. In addition, we offer criteria for ranking projects (see appendix 2 at page 34) which you may find useful in your assessment of the potential projects.

Comments are requested by September 9. We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to comesw@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. If you wish to mail your comments, please send them to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW
Washington, DC 20548

Your response should include a ranking of projects from one to four as well as an indication of the reasons for your ranking. If you wish to suggest a project that is not listed, please feel free to do so. It would be most helpful if you provided a brief project description indicating the issue, specific cases where the issue arises, and a point of contact for staff to follow-up with questions regarding your proposal.

If you have questions regarding this request, please contact Ms. Comes at 202 512-7350 or comesw@fasab.gov.

Sincerely,

David Mosso, Chairman

QUESTIONS FOR RESPONDENTS

- 1) Please indicate the rank you would assign to the following projects with one being your highest priority and four being your lowest priority:

_____The Federal Entity (see page 8)

_____Leases (see page 15)

_____Conceptual Framework Acceleration (see page 18)

_____Appropriate Source for GAAP (see page 20)

If you consider another potential project a higher priority than any of the above named projects, please provide a description of the project(s) you wish to propose. In addition, indicate what rank you would assign to the project(s). (Omit that ranking from the ranks assigned to the above named projects.)

- 2) The Conceptual Framework Acceleration project is described beginning at page 18. The project envisions a comprehensive conceptual framework and numerous issue areas will be addressed. In addition to considering the priority of the conceptual framework project in relation to the other potential agenda items, please identify the most important phases or individual issues within phases (such as issues 3 and 4 of Phase 2 found on page 31) of the framework project on which you would like the Board to place a higher priority. See Appendix 1 for information on the issues being addressed in the framework.
- 3) What are your views concerning consideration of the adequacy of the current set of financial statements to achieve or meet the current stewardship reporting objective?

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POTENTIAL PROJECT DESCRIPTIONS

THE FEDERAL ENTITY

FASAB addresses the entity issue in its Statement of Federal Financial Accounting Concepts (SFFAC) 2, *Entity and Display*. Figure 1 presents a summary of the SFFAC 2 guidance as well as the requirements of the two other United States Generally Accepted Accounting Principles (GAAP) bodies. Figure 2 presents a summary of selected international requirements on the subject. The most apparent short-coming in the FASAB literature is that it resides in a concepts statement. Thus, it may be considered by preparers and auditors but is not equivalent in force to level A GAAP literature. Of the references provided in Figures 1 and 2, FASAB is the only standard setter that has not included in its standards requirements for consolidation.

Figure 1: Comparison of U.S. Standards

Country	Document	Scope	Consolidation Requirement	Definition / Criteria
United States of America	FASAB Statement of Federal Financial Accounting Concepts No. 2, <i>Entity and Display</i>	Federal Sector	Financial Accountability and existence of a Significant Relationship where exclusion would cause the financial statements to be misleading or incomplete. (§ 38)	<p>Conclusive criterion</p> <ul style="list-style-type: none"> Any organization, program, or budget account, including off-budget accounts and government corporations, included in the Federal budget section currently entitled "Federal Programs by Agency and Account." <p>Indicative criteria</p> <ul style="list-style-type: none"> It exercises any sovereign power of the government to carry out Federal functions. It is owned by the Federal Government It is subject to the direct or continuing administrative control of the reporting entity. It carries out Federal missions and objectives. It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides. It has a fiduciary relationship with a reporting entity.

	GASB Statement No. 14, <i>The Financial Reporting Entity</i>	State and Local Government Entities	Financial Accountability	<p>A primary government is financially accountable for legally separate components under either of the following circumstances:</p> <ul style="list-style-type: none"> a. The primary government appoints a voting majority of the organization's governing board and (1) it is able to impose its will on that organization or (2) there is potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the primary government. b. If an organization is fiscally dependent on the primary government. (§ 20)
	FASB Statement of Financial Accounting Standards No. 96	Private Sector Entities	Controlling Financial Interest	<p>The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one company, directly or indirectly, of over fifty percent of the outstanding voting shares of another company is a condition pointing toward consolidation. (§ 13)</p>

Figure 2: Comparison of National and International Standards

Country	Document	Scope	Consolidation Requirement	Definition / Criteria
Australia	Australian Accounting Standard AAS 24, <i>Consolidated Financial Reports</i>	Private and public sector entities, excluding those at the “whole-of-government” level for each State, Territory and the Federal Government	Control	Control means the capacity of an entity to dominate decision making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity. (¶ 18)
Canada	CICA Handbook Section 1590, <i>Subsidiaries</i>	Profit-oriented enterprises	Control	Control of an enterprise is the continuing power to determine its strategic operating investing and financing policies without the co-operation of others. (¶ .03)
	Public Sector Accounting Recommendations, Section PS 1300, <i>Government Reporting Entity</i>	Federal, provincial, territorial and local governments	Control	Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization’s activities. (¶ .08)
International Accounting Standards Board	International Accounting Standard IAS 27, <i>Consolidated Financial Statements and Accounting for Investments in Subsidiaries</i>	Private sector parent entities	Control	Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. (¶ 6)
International Federation of Accountants	International Public Sector Accounting Standard 6, <i>Consolidated Financial Statements and Accounting for Controlled Entities</i>	Public sector entities other than Government Business Enterprises	Control	Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities. (¶ 8)

In SFFAC 2, FASAB established concepts for identifying reporting entities as well as for identifying what components to include in reporting entities. With respect to the consolidated financial report (CFR) of the US Government, SFFAC 2 states the following overall objective of consolidation:

38. The ultimate aggregation of entities is into the entire Federal Government which, in reality, is the only independent economic entity—although some would say the entire country is the ultimate economic entity. The Federal Government entity would encompass all of the resources and responsibilities existing within the component entities, whether they are part of the Executive, Legislative, or Judicial branches (although, as noted in paragraph 5, FASAB’s recommendations pertain only to the Executive Branch). The aggregation would include organizations for which the Federal Government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government (see paragraphs 39 through 50) are such that their exclusion would cause the Federal Government’s financial statements to be misleading or incomplete. (emphasis added)

The following issues regarding SFFAC 2 and entities being considered for consolidation should be addressed through the project:

1. Are the conclusive and indicative criteria necessary and sufficient?
 - a. Are they resulting in consistent and appropriate consolidated practices?
 - b. Are they sufficient to address evolving entity models? (See text below for examples of new types of entities.)
 - c. Is each criterion necessary?
 - d. Is there a need for explanatory language regarding:
 - i. the meaning of each criterion, or
 - ii. when sufficient criteria are met and consolidation is required?
2. Is guidance needed to address component entity¹ issues? Such as:
 - a. Determining whether to consolidate a separate entity first in a component entity financial statement.
 - b. Determining which component entity among two or more component entities having roles and responsibilities related to the entity in question should consolidate that entity.

¹ The term “component entity” is used to distinguish between the U.S. Federal Government and its components. The U.S. Federal Government as a whole is composed of organizations that manage resources and are responsible for operations, i.e., delivering services. These include major departments and independent agencies, which are generally divided into suborganizations, i.e., smaller organizational units with a wide variety of titles, including bureaus, administrations, agencies, and corporations. (SFFAC No. 2, Entity and Display, pars. 11-12).

3. Should the guidance regarding consolidation be included in standards instead of concepts? For example, in the absence of a standard on consolidation are component entities able to avoid application of the conclusive and indicative criteria?
4. Should standards address disclosures relative to those entities not qualifying for consolidation but presenting significant financial or other accountability issues for the federal government? For example, should disclosure be required where there is:
 - a. risk associated with entities having an implied federal guarantee?
 - b. substantial support offered by non-government entities which share a common mission with a federal entity and collaborate on service delivery?
 - c. Federal property used by non-federal entities?

To put these questions in context, a series of examples² of what may be considered “special purpose entities” is presented below:

- d. The National Railroad Retirement Investment Trust was established pursuant to Section 105 of the Railroad Retirement and Survivors' Improvement Act (RRSIA). The sole purpose of the trust is to manage and invest railroad retirement assets. The RRSIA authorizes the trust to invest assets of the Railroad Retirement Account in a diversified portfolio in the same manner as those of private sector retirement plans, including investments in non-government securities. Prior to the RRSIA, investment of Railroad Retirement Account assets was limited to US Government securities. The trust is a tax-exempt entity independent of the Federal Government. It is domiciled in and subject to the laws of the District of Columbia.
- e. The Public Company Accounting Oversight Board (PCAOB) was established by the Sarbanes Oxley Act subject to these provisions:
SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.
(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.
(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

² Inclusion on this list is not based on an assessment of the entity for consolidation or awareness of whether the entity is or is not consolidated at this time. These are purely illustrative of the types of entities created.

- f. A new federal funded research and development center (FFRDC) was created on April 23, 2004. The Department of Homeland Security (DHS) selected Analytic Services Inc to establish and operate the Homeland Security Institute (HSI) as a new Federally Funded Research and Development Center. The HSI will assist DHS in formulating and addressing important homeland security issues, particularly those involving policy and security where scientific, technical and analytical expertise is required. Creation of the HSI was recommended by the National Research Council's 2002 report "Making the Nation Safer," and subsequently mandated by statute in the Homeland Security Act of 2002.
- g. Public Private Partnerships (Source: GAO-03-1011 entitled 'Budget Issues: Alternative Approaches to Finance Federal Capital' which was released on August 21, 2003.):

Given today's budget constraints, evolving private sector markets and the expansion of creative real property development alternatives, several agencies have established public private partnerships as a means of leveraging the intrinsic equity value of real property. Ideally, the partnerships are designed such that each participant makes complementary contributions that offer benefits to all parties. Public private partnerships tap the capital and expertise of the private sector to improve or redevelop federal real property assets.[Footnote 11] They are considered most appropriate where excess capacity exists within the asset and where existing government facilities do not adequately satisfy the current or potential future needs.

OMB Circular A-76 describes the federal government's longstanding policy to rely on the private sector for needed commercial services. Public private partnerships are consistent with this policy so long as the product or service provided by the private partner cannot be procured more economically by the federal government. Partnerships raise questions about what functions are most appropriately performed by the federal government.

Proponents of public private partnerships argue that this approach provides a realistic, less costly alternative to leasing when planning and budgeting for real property needs. Proponents also note that federal partners benefit from improved, modernized, and/or new facilities plus a minority share of the income stream generated by the partnership or use of the asset at a lower cost than a commercial lease.

Critics of public private partnerships caution that these ventures are not the least expensive means of meeting capital needs, although they may appear to be in the short-term. They remind decisionmakers that up-front payment of appropriated funds is the least expensive way to obtain assets. Although partnerships may

be more costly, it is possible that they could make sense from a mission perspective. However, the full costs should be transparent to decisionmakers through inclusion in primary budget data.

LEASES

Current FASAB standards addressing leasing transactions include SFFAS 5, “Accounting for Liabilities of the Federal Government” and SFFAS 6, “Accounting for Property, Plant, and Equipment.” This guidance broadly defines capital and operating leases, outlines the four criteria for capital lease classification, and requires the recognition of liabilities and assets related to capital leases. The criteria on distinguishing between capital and operating leases have been criticized as ineffective because they do not make meaningful distinctions regarding the substance of lease transactions. Some argue that all leases convey rights and obligations which create assets and liabilities.

This view of leasing and the objective of accounting for arrangements with similar economic substance in a similar manner are receiving increasing attention from standard setters. The “New Approach” proposed by a working group consisting of Board members and senior staff members of the standard-setting bodies of Australia, Canada, New Zealand, the United Kingdom, and the United States³ suggests major changes are needed in lease accounting.

The New Approach would eliminate the “arbitrary” determinants of whether a lease is a financial (capital) or operating lease. Instead, all leases of more than one year would be recognized at their present value. Material assets and liabilities arising from all leases would be recognized at the beginning of the lease term on lessees’ balance sheets. Reporting on leases by lessors would change also. They would report financial assets (representing amounts receivable from the lessee) and residual interests as separate assets without regard to classification as capital or operating lease.

In addition, a project consistent with the New Approach is currently an active long-term project of the International Accounting Standards Board (IASB) and was last discussed at their November 2004 meeting. The primary objective of the IASB project is to ensure recognition of assets and liabilities arising under leases that are consistent with the IASB Conceptual Framework definitions. The IASB has tentatively agreed that accounting for leases should be based on the analysis of the assets and liabilities that arise from contractual rights and obligations. Conceptually speaking, the IASB tentatively agrees that the recognition of assets and liabilities should not be limited to contracts that convey rights that are economically similar to outright ownership. Rather the focus should be on the conveyance of rights to future

³ McGregor, Warren, Accounting for Leases: A New Approach (Recognition by Lessees of Assets and Liabilities Arising Under Lease Contracts), Financial Accounting Standards Board, 1996.
Nailor, Hans and Lennard, Andrew, Leases: Implementation of a New Approach, Financial Accounting Standards Board, 2000.

economic benefits (such as the right of use). The model is described briefly as follows:

- (a) A lessor would recognize:
 - 1) assets that include:
 - a) its contractual rights to receive cash
 - b) its residual rights in the leased property
 - 2) liabilities that include its contractual obligations under the lease
- (b) A lessee would recognize:
 - 3) assets that include its right of use (i.e. unconditional rights to use leased property subject to any restrictions on its use imposed under the lease)
 - 4) liabilities that include its contractual obligations under the lease

A FASAB project on leases would address all leasing transactions of the Federal government. According to a GAO report "Budget Issues: Alternative Approaches to Finance Federal Capital" (August 2003 GAO-03-1011) the following are some of the financing approaches involving leases that Federal entities are using to finance capital purchases.

- Operating leases
- Sale-Leaseback*
- Lease-Leaseback
- Public Private Partnerships*
- Outleases

*Note that the issue of consolidation of any special purpose entities resulting from these types of leases could be addressed in this project or in a broader project on consolidation.

Leasing transactions entered into by Federal entities have drastically changed in the years since SFFAS 5 and 6 were adopted and recognition of lease transactions in a consistent manner requires either the New Approach as envisioned by the working group or updated guidance. Staff proposes to begin the research phase of the project with a thorough review of the New Approach and the progress made by the IASB in its project as well as current leasing activities of Federal entities.

The following issues would be addressed:

1. Should the New Approach be adopted for federal financial reporting?
2. If so, various technical issues must be addressed include but are not limited to:
 - a. Point of initial recognition (e.g., lease signing or delivery)
 - b. Measurement of the lease assets and liabilities including residuals
 - i. Treatment of optional or contingent lease payments

- ii. Valuation of residual and/or reversionary interests
 - c. Identification of any exceptions to the general provisions (e.g, granting of access to intangibles such as the results of research)
 - d. Treatment by lessees versus lessors
3. If not, the Board would consider what – if any – modifications to the operating and capital lease model currently in place are needed. The Board may also consider what – if any - implementation guidance is required to ensure consistent application of the standards.

CONCEPTUAL FRAMEWORK ACCELERATION

An alternative to adding another major project would be to assign additional resources to developing the FASAB Conceptual Framework (the framework). Work on the framework project has been underway for approximately 2 years. The Board's plan for the framework project is presented as Appendix 1. The overall framework is expected to be a multi-year effort in excess of five years. Phases 1, Objectives including qualitative characteristics, and 2, Elements and Recognition Criteria, of the plan are currently active with approximately one and a third staff members devoted to researching issues.

The plan includes a report on the Board's progress and near term plans for these phases. Assigning additional resources – in both staff and Board time – may accelerate progress by completing earlier phases sooner or running more phases concurrently.

Assigning additional resources to the Conceptual Framework project would be helpful because the Board is trying to resolve specific issues concerning the scope and content of federal financial statements and reports without having an adequate framework concerning the objectives, elements, recognition criteria, statements and measurements in federal financial reporting. Several members have expressed interest in accelerating phase 2 with respect to the adequacy of the current set of financial statements in achieving or meeting the stewardship reporting objective. These members are interested in advancing concepts and standards that would contribute to meeting the following objective and subobjectives:

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine:

3A. Whether the government's financial position improved or deteriorated over the period.

3B. Whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.

(From SFFAC 1, par. 132, 134 and 139, emphasis added)

Several aspects of sustainability of public services and long term financing needs could be addressed. These include but are not limited to:

- a set of measures related to the sustainability of national programs;
- forecasts of the government's long term financing needs; or
- reports or statements intended to inform consideration of inter-generational equity issues.

If additional resources were to be devoted to accelerating the framework, these members would support addressing the issue of sustainability from a government-wide perspective first. These members would expect a standard to be produced along with the concepts.

The Board has devoted substantial resources to the framework and continues to integrate ongoing standards efforts with the evolving framework. However, members are mindful that without a substantially complete framework, the Board may find it difficult to produce a sound, stable set of standards. Therefore, the Board is seeking input from respondents on these questions:

1. In addition to considering the priority of the conceptual framework project in relation to the other potential agenda items, please identify the most important phases or individual issues within phases (such as issues 3 and 4 of Phase 2 found on page 31) of the framework project on which you would like the Board to place a higher priority. See Appendix 1 for information on the issues being addressed in the framework.
2. What are your views concerning consideration of the adequacy of the current set of financial statements to achieve or meet the current stewardship reporting objective?

APPROPRIATE SOURCE FOR GAAP -- GOVERNMENT CORPORATIONS AND ENTITIES USING FASB GAAP PRIOR TO FY1999

Certain entities follow GAAP for non-government entities (FASB GAAP). Government corporations⁴, the US Postal Service, selected component entities of the Department of Treasury, and some smaller entities historically apply FASB GAAP. In early 2000 FASAB recognized this practice as acceptable for those entities that had been following FASB GAAP to avoid an immediate and unanticipated requirement that these “federal entities” follow “federal GAAP” after FASAB was recognized as the Rule 203 standard-setting body. This guidance was published in the January/March 2000 issue of *FASAB News*:

Use Of FASB Standards by Federal Reporting Entities

Another issue raised by the AICPA’s Rule 203 action is whether financial statements of Federal entities prepared in accordance with standards issued by the Financial Accounting Standards Board (FASB) may be considered prepared in accordance with GAAP. The Board has not deliberated that question and will not have time to do so before the fiscal year 1999 financial statements are issued. FASAB staff is providing this response as immediate guidance.

Question: May financial statements issued by Federal entities after October 19, 1999, and prepared in accordance with standards issued by FASB be considered prepared in accordance with generally accepted accounting principles for Federal entities, even in situations where material differences exist in amounts recognized or disclosed, or in the number, form, and content of required financial statements pursuant to FASB and FASAB standards?

Answer: The AICPA has designated FASAB as the source of GAAP for Federal entities. In general, therefore, any Federal entity financial statements prepared in accordance with principles that conflict with FASAB standards should not be regarded as being in accordance with GAAP. However, financial statements in accordance with accounting standards published by the FASB also may be regarded as in accordance with GAAP for those Federal entities that have in the past issued such financial statements.

Background: Federal financial reporting concepts and standards have recognized that certain Federal entities prepare financial statements in accordance with FASB standards. This practice developed before FASAB was established and has been widely recognized and prevalent in the Federal government. In SFFAC 2, *Entity and Display*, paragraph 78, and SFFAS 8, *Supplementary Stewardship Reporting*, paragraph 40, the Board speaks to this practice.

At its meeting on December 14, 1999, the Board did not object to the above response and expressed the view that further Board level action was not needed at this time.

⁴ In late 1999, there were approximately two-dozen government corporations. Selected examples of government corporations are Commodity Credit Corporation, Corporation for National and Community Service, Government National Mortgage Association, Legal Services Corporation, and Tennessee Valley Authority.

The action taken in early 2000 was intended as a temporary measure in light of the unanticipated consequences of Rule 203 recognition. The American Institute of CPAs has requested that FASAB clarify which entities from among the diverse entities currently applying FASB GAAP should be required to convert to FASAB standards in order to receive a GAAP opinion. Generally, the AICPA's objective is to ensure that like entities follow like accounting standards.

In addition to the AICPA's concerns, the US Department of the Treasury Acting Inspector General requests FASAB consider "requiring Federal GAAP for the general purpose financial statements of Federal entities, unless there is a statutory or regulatory requirement to report on a different basis of accounting." The full text of the letter making this request follows.



INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON
April 20, 2004

Ms. Wendy M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, D.C. 20548

Dear Ms. Comes:

I am writing to bring to your attention a matter of concern regarding the consistency of the application of generally accepted accounting principles for Federal financial reporting. The Federal Accounting Standards Advisory Board (FASAB) was recognized in October 1999 by the American Institute of Certified Public Accountants as the standards setting body for Federal governmental entities. This established generally accepted accounting principles for Federal governmental entities (Federal GAAP). However, FASAB has allowed Federal entities that had issued financial statements prior to October 1999 using standards issued by the Financial Accounting Standards Board, (private sector GAAP), to continue to do so.

The allowance for continued use of private sector GAAP has had a significant impact on financial reporting at the Department of the Treasury (Department). Ten (10) of the Department's component entities are required to issue stand-alone audited financial statements, and 6 of these entities have continued to report on a private sector GAAP basis. This has resulted in inconsistent and incomplete financial reporting by the Department's component entities, as well as complications in preparing and auditing the Department-wide financial statements. The effects of using two different bases of accounting at the Department are discussed in more detail in the enclosed excerpt from our management letter for the Fiscal Year 2003 audit of the Department's financial statements.

We understand the rationale for allowing certain Federal entities to continue using private sector GAAP for a limited transition period following the recognition of federal GAAP; however, we do not believe it is advisable to continue this practice indefinitely. Federal GAAP addresses the unique nature of Federal operations, and is designed to meet the particular

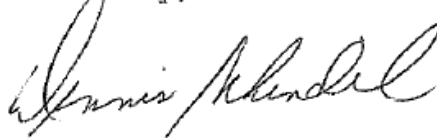
Page 2

needs of users of Federal financial statements. Accordingly, we believe it provides more comprehensive and informative reporting for Federal entities than private sector GAAP.

In order to strengthen and promote consistency in Federal financial reporting, we encourage the FASAB to consider requiring Federal GAAP for the general purpose financial statements of Federal entities, unless there is a statutory or regulatory requirement to report on a different basis of accounting.

If you have any questions, please contact me at (202) 622-1090 or Bill Pugh, Deputy Assistant Inspector General for Audit, at (202) 927-5400.

Sincerely,

A handwritten signature in cursive script, appearing to read "Dennis S. Schindel".

Dennis S. Schindel
Acting Inspector General

Enclosure

cc: Barry Hudson
Acting Chief Financial Officer

Excerpt from Audit Report OIG-04-022, Management Letter for the Fiscal Year 2003 Audit of the Department of the Treasury Financial Statements, dated February 18, 2004

Financial Reporting for Department of the Treasury (Department) Component Entities Should be Consistent

The Department's financial statements are prepared in conformity with accounting principles prescribed by the Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal government, as recognized by the American Institute of Certified Public Accountants in October 1999. However, certain Department component entities continue to prepare their financial statements in accordance with accounting standards prescribed by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. These entities include the Bureau of Engraving and Printing (BEP), the United States Mint (Mint), the Office of Thrift Supervision (OTS), the Exchange Stabilization Fund (ESF), the Federal Financing Bank (FFB), and the Community Development Financial Institution Fund (CDFI).

Although the FASAB has allowed entities that issued financial statements prior to October 1999 using FASB accounting principles to continue to do so, this has resulted in inconsistent and incomplete financial reporting by the Department's component entities. It has also inhibited preparation of consolidated Department statements, since, in order to consolidate entities reporting on a private sector GAAP basis, the additional information required for Federal GAAP reporting must be developed and crosswalked into the Department's consolidated financial statements. On occasion these crosswalks have been inaccurate, resulting in reporting errors by the Department. For example, the Department's FY 2002 consolidated statements had to be restated to properly record seigniorage related to circulating coins delivered by the Mint. This likely would not have been necessary if seigniorage had been reported in accordance with Federal GAAP in the Mint's financial statements.

The limitations of using private sector GAAP for Federal reporting entities are substantial. Private sector GAAP does not contemplate budgetary reporting and therefore components using this basis of accounting do not prepare statements of budgetary resources (SBR) or statements of financing (SOF), although these statements are an integral part of the Department's financial statements. Moreover, information reported in the Department's SBR must be reconciled to enacted amounts in the President's Budget and disclosed in the footnotes to the Department's financial statements. Considerable additional preparation and audit steps are required to develop and report this data at the Department level for components using private sector GAAP.

Another major limitation of private sector GAAP is that it does not provide adequate information regarding the costs of programs and activities, since costs are aggregated in the statement of operations to arrive at a single net income figure. The statement of net cost (SNC) required by Federal GAAP requires that costs and offsetting earned revenues be presented by responsibility segments, with net costs identified for each of the segments. This provides more meaningful information to evaluate the operating results of each of an entity's major activities.

Enclosure

There are also significant inconsistencies in how certain costs are reported by entities using private sector GAAP. For example, Federal GAAP requires that non-reimbursed costs paid by the Office of Personnel Management (OPM) for retirement plans be recognized by the receiving entity as an imputed cost in order to report the full cost of operations. The imputed cost should be reported in the SNC, with the related imputed financing reported in the SOF. Since private sector GAAP does not require either of these statements, this imputed cost is being reported inconsistently, or not at all, by the Department's component entities. For example, Mint and CDFI report offsetting amounts in their statements of operations; BEP discloses the amount of costs paid by OPM in the footnotes but does not include it in its statement of operations; and, OTS does not report the portion of these costs paid by OPM.

Finally, private sector GAAP does not require management's discussion and analysis (MD&A) of the information presented in the annual report. The MD&A is one of the most valuable aspects of an annual financial report, since it provides management's assessment of key trends, fluctuations, and unusual items. It should also link financial and performance information to provide meaningful analysis of the cost benefit relationships of program accomplishments. Several of the Department's component entities using private sector GAAP do not present an MD&A in their annual reports.

The continued use of private sector GAAP by certain component entities undermines the quality, consistency and usefulness of information reported by these entities. It also limits comparability with other component entities reporting on a Federal GAAP basis. In order to strengthen and standardize financial accounting and reporting throughout the Department, all component entities should be required to prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report on a different basis of accounting.

We note that one component entity, the Office of the Comptroller and the Currency (OCC) has already taken the initiative and changed its financial reporting basis from private sector GAAP to Federal GAAP. This has resulted in significantly more useful information for users of the OCC annual report.

Recommendations

We recommend that the Department research and determine whether component reporting entities reporting on a basis other than Federal GAAP are required to do so by statute. We further recommend that (1) all reporting entities within the Department prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report in accordance with a different basis of accounting, and (2) entities that are statutorily required to report on a basis of accounting other than Federal GAAP provide supplemental information in their annual reports that meets the reporting requirements of Federal GAAP, to include an MD&A.

The following issues may be considered in connection with this project:

1. What characteristics, if any, distinguish the entities currently applying FASB GAAP from those required to comply with FASAB GAAP?
2. Do these characteristics warrant application of standards other than those established by GAAP? For example,
 - a. Do the financing sources used by the entity (e.g., a preponderance of private donations and little or no appropriated funding) imply that FASB's reporting objectives are more relevant to users than FASAB's would be?
 - b. Do (1) the activities warrant or (2) an oversight body require a special level of comparability with other financial reports of entities operating similar activities?
 - c. Do other circumstances distinguish these entities from federal entities in a meaningful way?
3. For those entities required to apply FASAB GAAP:
 - a. Is transition guidance required?
 - b. Is guidance needed regarding any FASB standards directly applicable to transactions and events not addressed by FASAB standards? For example, placement of elements measured under FASB standards but reported within the federal model.
4. For those entities permitted to continue applying FASB GAAP:
 - a. Are supplemental disclosures warranted for any uniquely federal transactions or events (e.g., appropriations)?
 - b. Are any entities currently applying FASAB GAAP similar in nature to the entities permitted to apply FASB GAAP? If so, should these entities be required to change, permitted to change or prohibited from changing?

APPENDIX 1: CONCEPTUAL FRAMEWORK PLAN

The Board developed a core set of accounting standards and initial concepts statements on reporting objectives and entity and display early in its first six years of operation. Concepts were developed as initial standards were developed. At this time, the Board believes that it should review and add to or modify concepts statements.⁵ However, the Board does not believe that this effort should come at the expense of developing new standards that would enhance federal financial reports. Thus, the Board is undertaking a concepts project that (1) is linked to ongoing and future standards projects and (2) envisions phases so that incremental progress can be made. Active consideration of conceptual framework issues began in June 2003.

Key Terms Used in the Project Description:

Disclosures refers to notes and narrative that are an integral part of financial statements.

Financial Report refers generically to the annual report containing the entity's annual GAAP financial statements as well as information required by authorities other than FASAB. This report is referred to as a "Performance and Accountability Report" by most agencies.

Financial Reporting Objectives refers to objectives that should be attained through federal financial reports broadly.

Financial Statements refers to the basic financial statements required by generally accepted accounting principles. Disclosures are an integral part of financial statements.

Other Required Information refers to required supplemental information (including Management Discussion and Analysis) and required supplementary stewardship information.

Staff Action Items are presented under "related projects" for each phase. These action items flag required components of staff work on active projects other than the concepts projects. While not necessarily occurring sequentially or in conjunction with a concepts project issue, these action items should ensure that staff frame issues in terms of concepts and explicitly raise conceptual foundations they are relying on and concepts related issues. Staff will develop a standard outline and/or critical questions to be prepared and updated for each active project. This will (1) ensure that strong links to existing or evolving

⁵ The Board's desire to evaluate concepts after 12 years of substantial progress is stimulated by a perception that (1) some critical concepts that have been relied on are not yet included in a concepts statement, (2) certain aspects of the concepts – notably the liability definition – are not widely accepted, and (3) there is a need to communicate clearly to the growing community of federal financial report users, preparers and auditors.

concepts are maintained in standards projects and (2) speed progress on concepts by analyzing standards issues against conceptual foundations.

Primary Objective:

To ensure that the Federal Financial Accounting Standards are based on a sound framework of objectives and fundamental concepts regarding the nature of accounting, financial statements, and other communications methods. The framework should:

- provide structure by describing the nature and limits of federal financial reporting,⁶
- identify objectives that give direction to standard setters,
- define the elements critical to meeting financial reporting objectives and describe the statements used to present elements,
- identify means of communicating information necessary to meeting objectives and describe when a particular means should be used, and
- enable those affected by or interested in standards to understand better the purposes, content, and characteristics of information provided in federal financial reports.

Project Phases and Related Standards Projects:

For each phase of the overall project, a brief description including example issues, current status, related active projects and staff action items are identified. The efforts in related standards projects would not be limited by progress on the concepts project. Rather, as issues are identified in standards projects staff would explicitly relate the issues to the relevant concepts (both existing and developing concepts). The Board would consider the issue, how the concepts would help resolve the standards issue and decide whether and how to proceed on the standards project. The consideration of standards issues within the existing or evolving conceptual framework should inform the concepts project. Thus, the standards projects should advance while explicitly including some deliberation on concepts issues. (Staff notes that concepts are generally referenced in standards projects currently. This plan would increase the amount of effort devoted to explicit reference to concepts and open issues for debate in conjunction with standards. Thus, additional time may be required to complete standards.)

⁶ Federal financial reporting has changed dramatically since FASAB's inception. Some changes have been the result of FASAB's efforts and others have been the result of legislation, OMB directives or preparer enhancements. Today, most CFO Act agencies prepare a Performance and Accountability Report. This report includes many reports related to financial and program performance previously issued separately. Through the course of this concepts project, FASAB will attempt to be clear regarding the scope of its efforts. However, FASAB will need to refer broadly to "financial reporting" to assess how current objectives are or may be met. To prioritize its own efforts to meet financial reporting objectives, the Board will need to be explicit with respect to aspects of financial reporting that are the result of other requirements (e.g., components of the auditors report).

PHASE 1: Evaluate Objectives and Other Aspects of SFFAC 1

Concepts 1 identified reporting objectives. Some Board members have suggested that FASAB reporting objectives are broad in comparison to those of other standard setters. In fact, Concepts 1 indicates that “many information sources other than financial statements help to attain these objectives. The objectives relate to the management and financial reporting systems in the federal government in their entirety.” (par. 5) As the Board’s work has progressed, members have found it difficult to rely on these broad objectives to reach conclusions on specific standards issues.⁷

Phase 1 will address questions such as:

- 1.1. As drafted, are the objectives themselves clearly stated and complete?
- 1.2. Have any events or circumstances arisen since the objectives were drafted that would cause the Board to reconsider them?
- 1.3. Are certain objectives currently met by means other than GAAP financial statements? If so, how reliable (stable) are the means currently in place?
- 1.4. Does FASAB have a comparative advantage over other means of meeting certain objectives?
- 1.5. Are the objectives overly inclusive? Some have suggested that the objectives are so broad that they do not narrow the field of alternatives. Is it appropriate to determine “FASAB’s objectives” from among the current broad reporting objectives? Alternatively, is it appropriate to prioritize among the current objectives?
- 1.6. How does the current reporting model contribute to meeting each reporting objective? (Responding to this question may require the Board to express its views on element definitions and the purpose/meaning of individual statements. This discussion would serve as a building block for future projects.)
- 1.7. Concepts 1 established qualitative characteristics. Have these characteristics been useful? Is the list complete and clear? Should greater emphasis be placed on certain of the characteristics?
- 1.8. Based on the above issues, the board would consider whether an amendment of the objectives is needed. The Board may conclude that the objectives are appropriate and that issues may be resolved by increased reference to and explanation of the tradeoffs among objectives would be helpful in its deliberations.

Status of Phase 1: Since the inception of the project, the Board has (1) reviewed federal financial management legislation and regulations with an emphasis on changes since 1990, (2) considered the underlying reasons for SFFAC 1’s inclusion of internal users needs (the dual focus on internal and external users), (3) discussed specific ways prior standards contributed to meeting certain objectives and indirect contributions to improving systems and controls, and (4) the foundational objectives of accountability and decision usefulness.

At its March 2005 meeting, the Board approved an outline for a white paper on objectives of federal financial reporting. The white paper will address the nature and

⁷ Members note that the objectives do not lead them to narrow or choose among alternative solutions. As always, there are tradeoffs between meeting objectives as well as qualitative characteristics. Members wish to explore further the implications of our current objectives.

limitations of financial reporting, relationships between GAAP based financial reports and other sources of information, changes in the environment since FASAB was established, qualitative characteristics of information, and specific implications for the four reporting objectives identified in SFFAC 1 (budgetary integrity, operating performance, stewardship and systems and controls). The white paper is expected to be completed in late 2005. During summer 2005, staff will hold four roundtables, one on each reporting objective, to solicit constituents views on the role of the Board in meeting each reporting objective as well as contributions made by other professions (e.g., economists, actuaries, budget and policy analysts),

Related Active Projects:

For each standards project, the Board considers how accounting alternatives would contribute to meeting reporting objectives. For some standards, the Board has indicated that one or more objectives are “primary.” Thus, the Board may wish to consider whether explicitly speaking to the reporting objectives by narrowing or ranking the objectives for that specific project would enhance decision making on each active project.

Staff Action Items: For each active project, staff will (1) indicate which objectives are most relevant, explain why other objectives are not considered relevant, and, if applicable, explain barriers to consideration of those not considered relevant, (2) as policy alternatives are considered, describe how the alternatives contribute to meeting relevant objectives, and (3) identify any other means (i.e., other than GAAP financial statements but including certain reports mandated by law) of meeting the reporting objectives.

Phase 1 Product:

Following completion of the white paper, the Board may wish to develop a concepts statement that narrows or ranks the previously stated objectives⁸ and presents any clarifying language related to other fundamental topics covered in Concepts 1. The statement may address the current reporting environment (including non-GAAP reporting initiatives), how the original (broader) reporting objectives not retained (or no longer primary) are met, and the Board’s role in meeting the remaining or primary objectives. The phase 1 product should (1) enhance the Board’s selection of standards projects by making explicit the objectives attainable through GAAP financial reports and (2) communicate to users the Board’s objectives. In addition, the white paper will support a strategic planning effort expected to begin in 2006.

⁸ Note that the staff action items call for a ranking on a project by project basis, the ranking suggested here would be for overall reporting objectives. Thus, there would be a “default” ranking at the beginning of each project. Note that the ranking need not be a strict hierarchy – there could be Tier 1 objectives and Tier 2 objectives.

PHASE 2: Elements, Recognition and Statements

Definitions of some elements are currently found in the related standards (e.g., “liability” is defined in SFFAS 5 and “revenue” is defined in SFFAS 7). FASAB has not defined “asset.” For the Financial Accounting Standards Board (FASB) and many other standard setters, “asset” is considered the primary element definition because all other definitions refer to the asset definition.

Items meeting the definition of an element become candidates for recognition. Recognition decisions are made in accounting standards and are based on an assessment against recognition criteria. FASB’s recognition criteria are:

An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are:

- Definitions. The item meets the definition of an element of financial statements.
- Measurability. It has a relevant attribute measurable with sufficient reliability.
- Relevance. The information about it is capable of making a difference in user decisions.
- Reliability. The information is representationally faithful, verifiable, and neutral.

Source: FASB Concept Statement 5, Recognition and Measurement in Financial Statements of Business Enterprises

SFFAC 2, *Entity and Display*, describes the principal statements included in a federal financial report. These descriptions typically list specific elements and types of items included among elements (e.g., assets – cash, inventory, property). In addition, the 1996 Implementation Guide accompanying SFFAS 7 provides a more detail description of the role and structure of each statement. Some have suggested that SFFAC 2 does not adequately reveal the objective of each statement and the building blocks of the statements.

This phase of the project would consider the following questions:

Elements:

- 1) Do the current element definitions or working definitions support the reporting objectives as modified in phase 1?
 - a) Are the current definitions clearly stated?
 - b) Are key definitions missing?
 - c) Compare existing definitions to those in other domains (e.g., FASB, GASB, IFAC PSC) and consider the implications of each difference relative to meeting objectives.

Recognition Criteria:

- 2) Are there specific recognition criteria applicable to the federal domain?

Statements:

- 3) What constitutes a full set of financial statements?
- 4) Is each current statement effective in meeting reporting objectives? (This implies describing how statements meet objectives.)
- 5) Consider the effect of the existing element definitions on recognition in a statement:

- i) Does the definition result in omission of important information that does not meet an element definition but otherwise aligns with the goal of a principal statement? If so, is there another element definition needed or does the omission imply a need to revise the definition?
 - ii) If new definitions are needed, should all defined elements be part of an articulated set of principal statements? If not, should new non-articulated statements (such as the Statement of Social Insurance) be added to the principal statements for the federal model?
 - iii) To what extent is disclosure (in notes) of important information not meeting an element definition effective for meeting reporting objectives?
- 6) Do the existing concepts clearly explain the relationship between the elements and the purpose of each financial statement? Have we identified the “building blocks” for federal reporting?

Status of Phase 2: The Board has developed a working definition and characteristics of asset and a working list of characteristics of liability. This includes a discussion of the role of uncertainty in application of the definitions. At its upcoming meetings, the Board plans to consider recognition criteria. Work related to the asset and liability definitions and recognition criteria is expected to continue through the end of 2005. The Board will consider the remaining element definitions in 2006. Work on the financial statements is expected to begin upon completion of the elements and recognition criteria.

Related Active Projects:

For Balance Sheet Elements:

- Assets – Heritage Assets, Stewardship Land, Natural Resources, Fiduciary Activities
- Liabilities – Social Insurance, Research into the Application of the Liability Definition
- Net Position – Earmarked Funds

For Statement of Net Cost or Statement of Changes in Net Position Elements:

- Expense/Cost - Actuarial Changes in Social Insurance, Inter-entity cost
- Revenue and other financing sources– Natural Resources

Entity Issues that Affect Statements and Elements:

- Under what conditions do ‘special purpose enterprise’ operations get consolidated into the administrative entity’s statements?

Staff Action Items: For each active project, staff will present the relevant element definition and explain how the element definition is met or not met by the transactions or events under discussion.

Phase 2 Product:

A concept statement listing element definitions, establishing recognition criteria, describing statements and stating how they relate to meeting reporting objectives, and expressing the Board’s preferences for communication methods (e.g., when it is appropriate to use notes versus recognition and how to report on info that is not related to elements). The effect should be a stronger framework for addressing specific standards and a tool for preparers/auditors to consider specific situations not yet

addressed in standards. Interim steps – An asset definition could be developed (may be based on existing definitions) and exposed with any of several current projects.

PHASE 3: Measurement

Accounting standards include guidance for measuring items to be recognized and/or disclosed. Providing this guidance involves selecting among various measurement attributes. FASB identified five measurement attributes in its Concepts Statement No. 5, par. 67:

- a. Historical cost (historical proceeds)
- b. Current cost
- c. Current market value
- d. Net realizable (settlement) value
- e. Present (or discounted) value of future cash flows.

In addition, FASB published Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, which provides a framework for using future cash flows as the basis for accounting measurements at initial recognition or fresh-start measurements and for the interest method of amortization. It provides general principles that govern the use of present value, especially when the amount of future cash flows, their timing, or both are uncertain. It also provides a common understanding of the objective of present value in accounting measurements.

FASAB has not addressed measurement attributes⁹ but has used attributes other than historical cost in the existing standards. Thus, the federal model is described as a multi-attribute model. Concepts broadly addressing appropriate techniques for devising measures consistent with each attribute as well as when it is appropriate to select a particular measurement attribute would be useful. In standard setting, attributes would be assessed for relevance based on their potential contribution to meeting reporting objectives. In some cases, choices may be required between competing measurement attributes that contribute in varying degrees to meeting individual reporting objectives; that is, trade-offs may be required in selecting a measurement attribute.

Related Active Projects:

All current standards and projects include issues related to measurement. Of particular importance are the recently completed project on heritage assets, stewardship land, and ongoing projects on social insurance and natural resources. Each of these requires consideration of relevant measurement bases and the impact of reliability issues on the use

⁹ Attribute “refers to the traits or aspects of an element to be quantified or measured, such as historical cost/historical proceeds, current cost/current proceeds, etc.” Statement of Financial Accounting Concept 1, par. 2, footnote 2.

of relevant measures. Measurement bases are assessed for relevance in relation to meeting the reporting objectives.

Staff Action Items: For each relevant active project, staff will present a discussion of (1) why a previous FASAB standard did not require recognition, (2) how the information would be treated when the FASB recognition criteria are applied, and (3) what barriers staff sees to recognition and measurement. Staff will explicitly list potential measurement bases and describe how alternatives align with reporting objectives.

Phase 3 Product:

A concept statement defining various measurement bases and indicating circumstances when differing bases are appropriate would be published. The effect should be a resource for members in considering specific measurement guidance.

PHASE 4: Entity Issues

The Board is aware of a number of entity issues. While SFFAC 2 provides criteria for determining if an entity should be included as a federal entity, questions continue regarding whether certain activities should be included and whether certain entities should follow FASAB GAAP.

The Board will consider questions such as:

1. Criteria for including entities (SFFAC 2 provides these)
2. Criteria for consolidating entities
3. Reporting on joint ventures
4. What, if any, Federal entities using FASB standards should continue to do so?
5. Reporting on “national” vs “governmental” indicators

Related Active Projects:

Fiduciary activities introduces issues relating to inclusion of “non-federal” assets on the entity’s balance sheet.

There are government corporations, government sponsored entities and other federal entities currently producing FASB GAAP statements. The appropriateness of this should be evaluated. Federally Funded Research and Development Centers are currently either consolidated with the federal entity (e.g., Department of Energy) or excluded entirely from the principal financial statements (e.g., National Science Foundation). Issues relating to control and operational relevance should be addressed.

Joint Ventures relied on increasingly in meeting federal missions. This project could consider when consolidation would be appropriate.

Risk Assumed includes commitments or relationships that lead to an assumption of federal support. In addition to liability recognition, the Board may consider whether disclosures or other required information are warranted.

Staff Action Items: For each relevant active project, staff should explicitly identify any entity issues and discuss alternatives. Issues to consider are federal control of the entity, relevance to the federal entity that would consolidate the sub-entity, and contribution to meeting reporting objectives. Staff should provide the Board with any relevant standards/practices from other domains (e.g., FASB/GASB/IFAC PSC).

Phase 4 Products:

A concepts statement providing principles for determining (1) whether there are circumstances under which a federal entity should follow GAAP from another domain (as stated, this assumes all federal entities should follow FASAB and identifies exceptions), (2) what types of entities or activities should be included in a federal entity's report, and (3) when disclosures are warranted for "risk-assumed" through association/sponsorship of non-federal organizations.

APPENDIX 2: CRITERIA FOR RANKING PROJECTS

1. Significance of the issue relative to meeting reporting objectives

- a. With respect to meeting reporting objectives, are one or more alternative solutions likely to produce an improvement in information that is important to external, legislative, and executive branch users?
- b. Is the issue so egregious that not resolving it would damage the credibility of federal financial reporting?
- c. Is current practice diverse among federal entities and is comparability between federal entities important in this area?
- d. Is financial information that is relevant, reliable and comparable already available and likely to remain available?
- e. Is it likely that the project will clarify the federal reporting model or lead to concepts that provide a sound foundation for future projects?

2. Pervasiveness of the issue among federal entities

- a. Are many federal entities faced with this issue?
- b. Are significant dollar effects on federal financial reports likely?
- c. Is the issue raised by a single event unlikely to recur often and/or for which level A GAAP guidance could not be provided in a timely manner (e.g., major restructuring of departments)?
- d. Is there existing ambiguity, which contributes to divergence of practice or other difficulties for preparers, auditors and users?

3. Technical outlook and resource needs

- a. Have other standard setters done research or developed a standard(s) that could be useful to FASAB?
- b. Are other standard setters currently undertaking projects of potential significance to federal accounting such that a simultaneous project would be desirable?
- c. Are there sufficient resources available to research and resolve the question on a timely basis?
 - i. Would a task force of preparers, auditors and/or users be needed and available to assist?
 - ii. Are Board resources balanced appropriately between major projects and projects that offer technical guidance or fill voids in applying existing standards?
- d. Are there barriers to finding a solution that is likely to be accepted generally? (e.g., Would legislation be required to compel compliance? Would extensive changes to systems or the audit model be needed to successfully address the issue?)

FASAB Board Members

David Mosso, Chair

Claire Gorham Cohen

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James M. Patton

Robert N. Reid

Alan H. Schumacher

David Zavada

FASAB Staff

Wendy M. Comes, Executive Director

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX 202-512-7366
www.fasab.gov