

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

# FASAB NEWS

LAW LIBRARY

Suite 1001 750 First St. NE Washington DC 20002 Telephone (202) 512-7350 Fax (202) 512-7366

## NATIONAL PERFORMANCE REVIEW

Vice President Gore's National Performance Review report Creating a Government that Works Better & Costs Less has placed a significant challenge before the Board. The report requires that by the end of 1994 the Board "issue a set of cost accounting standards for all federal activities. These standards will provide a method for identifying the true unit cost of all government activities." The Report further requires that within 18 months the Board "issue a comprehensive set of credible accounting standards for the federal government." The report places a high level of importance on accounting and accounting standards in helping improve the management of government. Although it will be a very difficult task, the Board looks forward to meeting the requirements of the National Performance Review.

## LIABILITIES AND FUTURE CLAIMS

At the September meeting, staff provided the Board with preliminary exposure draft language for liabilities. There was discussion on the need to modify the tentative definition of liabilities, which is a "probable and measurable outflow of resources arising from a past transaction or event." Some members felt that a liability can exist whether or not it is measurable. Others felt that "probable" and "measurable" should be a part of the criteria for recognition rather than a part of the definition. Based on the discussion, staff was asked to provide a revised definition for Board consideration.

The liabilities draft language provides that the actuarial values representing future payments for certain large social insurance programs such as social security would

not be considered liabilities but would be reported as future claims. The liability would consist of only those payments due at the end of the reporting period. The operating statement would include expenditures incurred during the reporting period adjusted for beginning and ending liability balances.

An alternative approach for reporting liabilities and expenses for social insurance programs was proposed by a board member. Under this alternative a minimum liability for the actuarial value of future payments for those individuals already receiving benefits and others which have been adjudicated to receive benefits would be recognized. Expenses appearing in the operating statement would be only the amount due and payable in the reporting period. Any other amounts necessary to account for the change in the actuarial liability would flow through equity or a separate part of the operating statement. This alternative permits the reporting of a minimum actuarial liability while eliminating the impact of large actuarial fluctuations on the operating statement. The Board agreed to include the alternative in the exposure draft and will consider the alternative after responses have been received.

Future claims, while not yet fully defined, generally consist of items that do not meet the definition of a liability but are expected to result in a claim against future budgetary resources. The Board is considering requiring that future claims be reported in a separate section of the financial report. However, some members are concerned that there is not a clear distinction between some types of future claims and contingent liabilities. Certain members believe that contingent liabilities would be more appropriately disclosed in the balance sheet.

**CAPITAL EXPENDITURE PROJECT**

As reported in the August edition of FASAB News, to better address the diverse issues on capital expenditures, working subgroups were established for the following categories of this project: 1) Physical Property, 2) Non-federal Physical Property Financed by the Federal Government, 3) Human Capital, and 4) Research and Development. All subgroups, except Research and Development, met over the last month. A summary of the progress by subgroup is provided in the following paragraphs:

**Physical Property** - The subgroup met twice to formulate issues and consider options for discussion by the Capital Expenditure task force. The task force reached consensus on a definition for assets and a general approach to accounting for asset consumption costs. Issues and options to account for physical property and the task force consensus were presented to the Board for discussion in September. The Board's reactions were as follows:

- There was general acceptance of the task force's proposed definition of assets as "tangible and identifiable intangible items having a useful life of greater than one year."

- Assets used in providing services would be considered capital resources and would have an associated charge for asset consumption. This capital consumption charge might be reflected as historical cost depreciation in the case of short-lived assets (e.g., vehicles). The capital consumption charge also might be reflected as something other than depreciation for assets with longer life. For example, assets that must be maintained in perpetuity or in a ready state for use may be accounted for renewals accounting.

In considering the issue of a capital consumption charge, the Board discussed the

emphasis placed on cost comparison by the National Performance Review (NPR). Board members discussed the importance of ensuring consistency of comparisons among governmental units. Members envision a consistent method for measuring the cost of consumption that would not be difficult or expensive to implement.

- For assets such as buildings, the Board will consider whether an asset use charge might be based on a comparable rent charge.

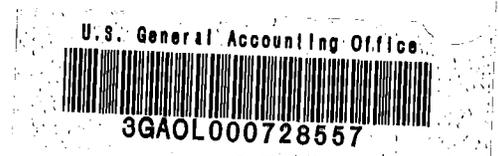
- The Board wants to ensure that deferred maintenance is addressed.

**Non-federal Physical Property Financed by the Federal Government** - There have been two meetings of this subgroup. The subgroup is addressing types of property to be included, sources of federal financing, methods of measuring expenditure flows, and the nature of financial and nonfinancial information to be reported.

**Human Capital** - This subgroup has met once. Discussion focused on the identification and measurement of human capital expenditure flows and the relation of human capital expenditures to economic productivity.

**Research and Development** - The potential issues for expenditures on research and development are still being developed by the FASAB staff. This subgroup will meet when the issues are formulated.

The FASAB staff will be meeting with the Physical Property subgroup and the Capital Expenditures task force in the next few weeks to discuss in greater detail the issues of capital consumption and deferred maintenance. After further development, these issues will be presented for the Board's consideration at its October meeting.



## COST ACCOUNTING

To begin board discussion of cost accounting at the September meeting, the Executive Director, Ron Young, reviewed the standards issued to date and how these standards and others under development provide much of the groundwork necessary for determining cost of performance. He emphasized that while most of the initial standards addressed balance sheet items, a parallel consideration was the effect that expenses associated with these items had on the operating statement.

He explained that many of the expenses (historical cost for the most part) associated with the cost of service delivery are addressed in Recommended Statements 1-3. For example, standards have been recommended on subsidy expenses of direct loans and loan guarantees and on expenses for the consumption of materials and supplies (the Inventory project). The ongoing capital expenditure project will provide for the capital consumption component of expense. These standards will provide (on a full accrual basis) the cost of service delivery and will permit the assignment of expenses to responsibility centers or activities and to their associated performance measures.

Mr. Young pointed out that standards need to be established for the assignment of cost to reporting units that are incurred outside the reporting unit in order to capture the "full cost" of service delivery. He also explained that the Board has tentatively agreed that payments to the public, such as transfer payments and grants, which are in effect the service itself, rather than the cost of delivering the service would be reported separately in the operating statement on an accrued expenditure basis (expenditures/outlays plus liabilities payable). Mr. Young also explained how data might be reported by activity in order to facilitate activity based accounting.

As an initial sub-project for cost accounting, the Board decided to work on the subject of inter-agency costs, which are costs paid by an agency on behalf of other agencies. Examples are federal employees' pension benefits and post-retirement health benefits paid by the Office of Personnel Management. The sub-project would result in a standard on the assignment of those costs to agencies that incur the costs.

Board members discussed a staff paper on the concepts of expenses and expenditures. As presented in the staff paper, expenses are the amounts of economic resources consumed in operations. The Board members generally agree that expenses should be recognized as they occur in government activities that produce and deliver goods and services and administer federal programs. Expenditures are amounts spent for the acquisition of goods and services; expenditures are also made for transfer payments.

Board members also heard presentation on cost accounting by Dr. Robert S. Kaplan of the Harvard Business School. Professor Kaplan discussed Activity-Based Costing (ABC). He described ABC as a more advanced cost accounting system than traditional cost allocation systems. Rather than allocating costs on some arbitrary basis to organization units, ABC assigns costs logically to activities in the process of producing goods and services. Dr. Kaplan explained how ABC helps identify the costs of specific products. He indicated that ABC has been successfully installed in numerous private sector organizations and that it can be implemented effectively in government. He cautioned that implementation should proceed carefully, after considering the capability and maturity of the underlying accounting system.

NEW ZEALAND FINANCIAL REFORMS

At the September Board meeting, Mr. Struan Little from New Zealand's Ministry of Finance, currently on assignment to the World Bank, discussed New Zealand's recent financial management reforms. Mr. Little pointed out that a key to the success of the reforms was cultural changes such as a strong focus on accountability, program outputs and empowerment of managers.

Later, in a separate session, Mr. Ian Ball, Central Financial Controller of the Treasury, New Zealand, discussed the reforms with several Board members and their staffs. Mr. Ball, who has primary responsibility for the financial management reform program, also emphasized the cultural changes and discussed more specific areas of accounting and

budgeting. Among his key points were the following:

- private sector accounting standards were adopted for government reporting,
- the budget is on an accrual basis,
- budgets are based on predetermined output units.
- cost accounting guidelines used to determine unit output costs are very general, and
- all costs must be assigned to some output measure.

Mr. Ball also pointed out that New Zealand currently prepares government-wide financial statements on a semi-annual basis and is planning to change to a monthly frequency.

