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Special Edition

June 1995

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

FASAB NEWS

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SPECIAL EDITION OF NEWSLETTER: REPORT ON STATUS OF BOARD'S WORK

BASIC STANDARDS NEARING COMPLETION

The Board has now reached the point that we believe the development of basic accounting and financial reporting standards will be completed by the fall of this year and available as the basis for required auditable agency financial reports beginning with fiscal year 1996. After completion of the basic standards, there will remain considerable work for FASAB, including advising on interpretation requests and updating of standards previously abolished.

The Board's ability to develop standards on an expedited schedule is a result of cooperation not only from the Board members but also from many others who have participated through task forces and individuals detailed by the agencies to assist our staff. As it carries out the highly complex process of the development of understandable and workable governmental accounting standards, the Board must balance this task with the needs of the agencies which must implement them.

By this fall, less than five years since the Board held its first meeting in January 1991, FASAB will have completed a body of accounting standards constituting "generally accepted accounting standards" for the federal government. This includes Objectives of Financial Reporting, a model for reporting information which is outlined in the Board's Entity and Display concept statement, cost accounting concepts and standards, and individual tailed accounting standards. By way of comparison, other standard-setting bodies have taken

much longer to make the progress FASAB has made. The Board believes that its work, when implemented, can result in substantial budgetary savings and improved management of federal programs.

SUMMARY OF THE STATUS OF FASAB CONCEPTS AND STANDARDS

Two concept statements, Objectives of Federal Financial Reporting (issued July, 1993) and Entity and Display, (approved by the FASAB in April, 1995) provide the basic framework for the work of the Board.

The cost accounting concepts and standards provide guidance needed to assure that departments and agencies establish systematic processes for calculating and analyzing the "full cost" of performing activities employed in delivering government services. The financial accounting standards already adopted and those currently in progress provide the specific guidance for recording, accumulating, and organizing and displaying information in financial reports for use by financial managers, budget analysts, policy makers and others.

1. Statement of Objectives of Federal Financial Reporting

This is a conceptual statement on the objectives of financial reporting by the federal government. It focuses on the uses, user needs, and objectives of such reporting. The objectives are designed to guide the Board in developing accounting standards to enhance the financial information reported by the

federal government to: (1) demonstrate its accountability (2) provide useful information, and (3) help users of financial information improve the government's management. The objectives may be summarized under four headings:

BUDGETARY INTEGRITY

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and with related laws and regulations.

OPERATING PERFORMANCE

Federal financial reporting should assist in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

STEWARDSHIP

Federal financial reporting should provide information to assist in assessing the impact on the nation of the federal 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.

SYSTEMS AND CONTROL

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purposes authorized, and recorded in accordance with federal accounting standards; assets are properly safeguarded to deter fraud, waste, and abuse; and

performance measurement information is adequately supported.

2. Approved Standards: Entity and Display

This conceptual statement provides guidance on what should be encompassed by a federal government entity's financial reports, establishes guidelines for defining the make-up of each type of reporting entity, identifies new types of financial reports for communicating the information for each type of reporting entity, and suggests the types of information each type of report should include. The financial reports provided for in this statement are a major departure from the traditional balance sheet and operating statement used in the private sector.

One statement is designed to report on the "net cost" to taxpayers of providing government goods and services. This will help in assessing the cost of service efforts and accomplishments. Another statement is designed to report on the operating assets and liabilities related to the delivery of goods and services of government programs. A third provides information on the changes in financial position from year to year and the causes of the change. A fourth presents information on the budgetary flows. Then, a fifth statement links budgetary information and cost information. Finally, other statements provide information about certain federally owned assets, investment-type expenditures, and claims on future resources (These are explained below under the heading of Stewardship Reporting.).

3. Exposure Draft: Managerial Cost Accounting Standards for the Federal Government

This proposed Statement of Recommended Standards proposes cost accounting concepts and standards for all federal reporting entities. Presently most federal entities do not have systematic cost accounting methods or procedures. The proposed standards will require cost information to help federal managers better understand the "full costs" of government

programs. Costs can be linked to outputs for performance measurement. This effort will help alert management to waste, inefficiency and highlight areas for possible improvements. Cost information will be useful to members of Congress, federal executives, and citizens in making decisions about resource allocation and program priorities. Also, cost information will be essential to accurately report on and evaluate performance.

The proposed statement of managerial cost standards contains both concepts and standards. Conceptually it emphasizes the need to relate cost information with budget and financial information. It proposes use of a common data base of information and requires the ability to reconcile cost information produced and reported for different purposes. It provides for five specific cost accounting standards. These standards will require that federal entities:

- (1) accumulate, manage, and report the cost of their activities on a regular basis;
- (2) establish responsibility segments for the accumulation of cost data;
- (3) determine the full costs of outputs of federal entities;
- (4) recognize non-reimbursed or under-reimbursed inter-entity costs in certain cases; and
- (5) use an appropriate costing methodology to assign costs to outputs by direct tracing, cause and effect assignment, or allocation on a reasonable and consistent basis.

The final recommended standards are expected to be approved by the principals by June 30, 1995.

4. Statement No. 1: Accounting for Selected Assets and Liabilities

Issued on Dec. 15, 1992 (OMB SFFAS #1). This was the Board's first Statement of Recommended Accounting Standards. With the issuance of this Statement, the Board intended to provide an initial set of accounting standards in some very basic areas. This statement provides standards for five asset categories: Cash, Fund Balance with Treasury, Accounts Receivable, Interest Receivable, and Advances and Prepayments; it also provides standards for four liability categories: Investments in Treasury Securities, Accounts Payable, Interest Payable, and Other Current Liabilities.

5. Statement No. 2: Accounting for Direct Loans and Loan Guarantees

Issued on July 15, 1993 (OMB SFFAS #2). This Statement of Recommended Accounting Standards responds to the Credit Reform Act of 1990. Prior to the Act, the total outlay for direct loans was reflected in the first year of the loan. Since repayment was not considered, a direct loan in the Budget looked expensive. Guaranteed loans were not reflected in the Budget until they were in default. Therefore, guaranteed loans looked inexpensive. The Credit Reform Act was designed to ensure that credit programs would be accurately reflected in the Budget by providing that the total estimated cost (subsidy) of both direct and guaranteed loans be reflected "up front" in the Budget. This Statement provides for accounting standards that would be in consonance with the Budget represents a break from traditional accounting valuation in that the net present value of the total federal subsidy for direct and guaranteed loans is accounted for at the time the loan is made.

6. Statement No. 3: Accounting for Inventory and Related Property

Issued on July 30, 1993 (OMB SFFAS #3). This Statement of Recommended Accounting Standards

provides standards for six asset categories: inventory (held for sale), operating materials and supplies, stockpiled materials, seized and forfeited assets, foreclosed property, and goods held under price support and stabilization programs. In developing these standards, the Board considered many unique issues and tailored the standards to provide information useful to managers. Some of the unique features of these standards are:

-(1) inventory and operating materials and supplies are to be divided among several categories to facilitate analysis of stock levels;

-(2) stockpiled materials are segregated from operating inventories;

-(3) seized and forfeited assets are to be valued giving consideration to past sales experience and ability to realize full market value;

-(4) foreclosed property is to be accounted for in a manner consistent with Credit Reform Act provisions; and

-(5) goods held under price support and stabilization programs (i.e., agricultural commodities) are to be valued at expected realizable value which will provide earlier recognition of losses on price support programs.

7. Exposure Draft: Accounting for Liabilities of the Federal Government

This proposed Statement of Recommended Standards contains six standards that address the accounting for liabilities of federal entities, as well as a definition and general principle for the recognition of liabilities. The statement recommends standards for reporting liabilities of the federal government in general purpose federal financial reports not covered in Statement of Federal Financial Accounting Standards Number 1, Accounting for Selected Assets and Liabilities and in Statement of Federal Financial

Accounting Standards (SFFAS) Number 2, Accounting for Direct Loans and Loan Guarantees. This statement defines a "liability" as a probable future outflow or other sacrifice of resources as a result of past transactions or events. In addition to discussing the general liability recognition principle, the proposed statement includes specific federal liability accounting standards, for contingencies, insurance and guarantee programs, social insurance programs, pensions, other retirement benefits, and other postemployment benefits; federal debt, and capital leases. The recommended standards would significantly affect the balance sheet, operating statement, and other aspects of general purpose financial reports of federal reporting entities.

For example, for the first time agencies would recognize the full normal cost of employee pensions and other retirement benefits as part of their compensation expense during the years the employees work. For the first time also, the government's consolidated financial statements would recognize, annually, an appropriate portion of the full liability arising from the government's promise to provide these benefits in the future in exchange for worker's services. Liabilities that arise in connection with other kinds of exchanges would also be recognized when they arise, rather than when cash payments are due.

Many government programs, however, such as disaster relief, grants to states and local governments, and certain entitlement programs such as medicaid, are not exchange transactions as are pensions. These liabilities would be recognized in the amount of any unpaid amounts due as of the reporting date. This includes amounts due from federal entities to pay for goods, services, or benefits provided under the terms of the program as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.

The recognition, measurement and display of obligations for social insurance programs presented the Board with significant theoretical and practical problems. From the theoretical perspective, the Board



considered whether social insurance programs resulted in exchange or nonexchange transactions, or whether they contained both exchange and nonexchange features. The Board also considered the difficulty of determining an appropriate measure of the obligation assumed, whether such a measure were to be presented on the face of the balance sheet or in the notes. The Board favored characterizing social insurance obligations as nonexchange transactions, and limiting recognition of a liability to any unpaid amounts due as of the reporting date. A significant majority of the ED respondents, however, agreed with an Alternative View, which expressed the notion that social insurance programs contained both exchange and nonexchange features, and that there was a need for recognizing a liability at least equal to the present value of future payments due to recipients currently eligible for benefits. Upon reconsideration of the issues, the Board discussed requiring several important measures of social insurance in notes to the financial statements. The Board decided that, given the sensitivity and magnitude of social insurance, the new position would receive additional exposure, to allow users to review and comment on it. The Board felt that the concepts and alternatives had not yet been presented to the user community in sufficient detail. Hence, the discussion of social insurance has been withdrawn from the Liability standard and consolidated in the Supplementary Stewardship Reporting Exposure Draft.

Insurance and guarantee programs other than loan guarantees (which are covered in FASAB Statement 2) and life insurance and social insurance (i.e. social security and medicare) would recognize liabilities arising from events that have occurred, following the practices of property and casualty insurance companies. Federal insurance and guarantee programs would also be required, however, to disclose in notes to the financial statements the amount of risk assumed in situations where the risk assumed differs from the liability for events that have occurred. Pension benefit insurance is an example of this kind of federal insurance program.

The Final Recommended Standards are expected to be completed in July, 1995.

8. Exposure Draft: Accounting for Property, Plant, and Equipment

This proposed Statement of Recommended Standards has been issued in exposure draft form. Final recommended standards are to be available in the fall of 1995. The standards would result in meaningful accounting for the diverse universe of property, plant, and equipment held by Federal agencies by dividing PP&E into four categories-- general PP&E, federal mission PP&E, heritage assets and stewardship land. The standard would provide capital consumption costs, through depreciation of all general PP&E, for federal operations producing general government goods and services. Ultimately, these costs would be tied to outputs and performance measures. For the remaining three categories, information on the cost of acquiring the assets would be provided. For these three categories of PP&E, period-by-period capital consumption costs would not be provided since the existence of the asset is often the output--not a measurable period-by-period output such as number of widgets produced. In addition to accounting standards for PP&E, the ED proposes accounting standards for deferred maintenance and cleanup costs. These categories of cost were considered important by the users of financial information because they are areas where significant costs associated with PP&E are often not reported.

The final recommended standards are expected to be completed by August 31, 1995.

9. Exposure Draft: Revenue and Other Financing Sources

This exposure draft will be issued for comment in July. The FASAB is in the process of final editing before releasing it. The proposed Statement of Recommended Standards deals with basic standards

for classifying, recognizing, and measuring resource inflows. The proposed standards will make federal proprietary accounting more comprehensible to those who work with the budget.

Revenue is defined as an inflow of resources that the government demands, earns, or receives by donation. Revenue comes from two sources: exchange transactions and nonexchange transactions. Exchange revenues arise when a governmental entity provides goods and services to the public or to another governmental entity for a price. Another term for "exchange revenue" is "earned revenue."

Nonexchange revenues arise primarily from exercise of the government's power to demand payments from the public, e.g., taxes, duties, fines, and penalties, but also from donations. The term "revenue" does not encompass all budgetary resources such as appropriations or other Congressional authorizations to spend money. These sources of financing do, however, provide resource inflows to agencies, so the ED also proposes standards to account for them.

Operations of an entity engaged in exchange transactions produce the revenue received as well as the cost incurred. Therefore, financial accounting should relate the revenue to the cost for these transactions. The net effect--the gross cost minus the revenue--generally determines the extent to which the cost of the operations is borne by the taxpayers.

Information about the net cost of exchange transactions serves other purposes as well. Net cost gives one indication of the extent to which people are willing to make voluntary payments to acquire the goods or services and thus judge the products to have economic value. Net cost can be used in evaluating and establishing an entity's pricing policy. Both net cost and gross cost can be compared with outputs and outcomes in assessing the effectiveness with which resources are used to achieve results.

The Exposure Draft is now in printing and will be sent out for comments shortly. A public hearing will be

held in September, and Final Recommended Standards are expected to be completed in October.

10. Exposure Draft: Stewardship Reporting

The Board has developed proposed standards for providing information about the federal government's stewardship over certain federal assets and regarding certain federal expenditures that are viewed as investment type expenditures to more fully satisfy its objective that the federal government should "report on the broad outcomes of its actions." (Objectives of Federal Financial Reporting, Statement of Recommended Accounting and Reporting Concepts, July 1993). Such reporting will provide information that will assist report users in assessing the impact of the Government's operations and investments for the period. In considering those broad outcomes, the Board recognizes that certain resources treated as expenses in the financial statements are intended to provide long-term benefit to the public. Therefore, in these proposed stewardship standards, the Board has proposed that data on these resources should be highlighted to show the long-term nature of these resources and to demonstrate accountability over them. Depending on the nature of the resources, data to be presented for stewardship purposes could consist of financial and non-financial data. Proposed stewardship standards also call for providing projections that will aid in assessing the sufficiency of future budgetary resources to sustain public services and meet obligations as they come due. The specific components of stewardship are as follows:

STEWARDSHIP INVESTMENTS

Human Capital and Research and Development Standards -- The Board researched certain federal expenses that benefit more than the current period, are not simply consumption expenditures, and represent Federal investments designed to maintain or increase national economic productive capacity or provide other future benefits. The Board is developing two

standards to address the accounting for these stewardship investments: Human Capital, which consists of federal education and training of the general public, and Research and Development, which consists of basic research, applied research, and development. The proposed standards provide that trend data will be reported on the investments and that categorizing expenses as investments for stewardship purposes will be predicated on demonstrated outputs and outcomes consistent with the intent of the program.

Non-Federal Physical Property - Federal investment in non-federal physical property refers to: 1) those expenses incurred by the federal government for the purchase, construction, or major renovation of physical property that is owned by State and local governments; and, 2) federally owned plant, property, and major equipment transferred to a State or local government in exchange for less than fair value. Information relating to these investments is designed to assist in assessing not only service efforts and accomplishments, but also in determining whether government operations have contributed to the nation's current and future well-being.

Stewardship PP&E relates to items whose physical properties resemble those of general property, plant, and equipment traditionally capitalized in financial statements. However, the nature of these federal physical assets that the Board has classified as stewardship PP&E differs from general PP&E in that their values are indeterminable or would have no meaning (e.g., museum collections, monuments, and assets acquired at the formation of the nation), or that allocating the cost of such assets to accounting periods that benefit from the ownership of such assets is not meaningful (e.g., military weapons systems and space

exploration hardware). However, the Board believes that the federal government should be able to demonstrate accountability for these stewardship PP&E by reporting on such events as the existence, maintenance, upkeep or condition of these assets. Stewardship PP&E would include: 1) stewardship land - land not acquired for or in combination with general property, plant, and equipment (e.g., parks and forests); 2) heritage assets - those assets possessing significant educational, cultural, or natural characteristics (National monuments, memorials, historically or culturally significant property); and 3) mission PP&E - PP&E that are an integral part of the output of certain unique federal government missions (weapons systems and space exploration equipment).

STEWARDSHIP RESPONSIBILITIES

The project on stewardship responsibilities is closely related to liabilities. The Board decided that some federal responsibilities do not meet the definition of a "liability," but do impose claims on future resources. The Board will require information on the government's responsibility to continue current services, including social security and medicare. The Board has tentatively decided on a projection of the government's total current services for the six years subsequent to the current year as governmentwide information, and to require 75-year forecasts for social security and medicare. This will be supplementary to the primary financial presentation.

The Exposure Draft has been approved by the Board. The document is being edited and will be released for comment in July. A public hearing will be held in September, and the Final Recommended Standards will be completed in October.

FASAB

Federal Accounting Standards Advisory Board

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