



**Federal Accounting Standards Advisory Board**

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May 11, 2006

**TO:** Members of FASAB

**FROM:** Penny Wardlow, Consultant

**THROUGH:** Wendy Comes, Executive Director

**SUBJECT:** **Ballot Draft of a Proposed Concepts Statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements* – TAB B**

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

The objective of the May 2006 meeting on Elements is to obtain the Board's approval of a ballot draft of a proposed Concepts Statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements*. The following documents are attached:

- **Attachment 1:** A summary (with a brief cover memo) of the differences in GASB's proposals for a concepts statement on Elements compared with the FASAB's proposals. The Board requested the summary at the March 2006 meeting. Staff found very few substantive differences between the two drafts.
- **Attachment 2:** A ballot for the FASAB's ballot draft on Elements.
- **Attachment 3:** The ballot draft, showing the changes proposed to the preballot draft circulated to members on April 28, 2006. Those changes are:
  - Insertion of proposed dates: Issue date June 5, 2006, and comments requested by October 5, 2006--a 120-day comment period (Title page and pages 3 and 8)
  - Wording changes:
    - Page 3, letter from Chairman Mosso
    - Page 6, Executive Summary, penultimate paragraph
    - Page 9, Questions for Respondents, question 1b

**Does the Board approve these changes?**  
**Does the Board approve the ballot draft for issuance?**



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May 11, 2006

**TO:** Members of FASAB

**FROM:** Penny Wardlow, Consultant

**THROUGH:** Wendy Comes, Executive Director

**SUBJECT: Differences in GASB Draft of a Proposed Concepts Statement on Elements Compared With the FASAB Draft on Elements and Recognition**

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Attached is a memorandum that lists and briefly discusses differences in the most recent GASB draft on Elements compared with the FASAB's preballot draft. The differences are presented in the same order that the topics appear in the GASB draft. The memo is intended to be informative and not a critique of the GASB draft. It has been reviewed for accuracy by GASB staff.

The focus of the memo is on differences. However, a summary at the end of the memo briefly describes the similarities between the two documents as well as providing a list of the differences described in the memo. The staff's conclusion is that the two documents are very similar, except for differences that are due to the GASB's consideration of the existence of fund-based financial statements in state and local government reporting and applicability of the definitions to different measurement focuses and bases of accounting, as well as terminology, wording, and style differences. Overall, FASAB staff believes there are very few substantive differences between the GASB and FASAB drafts.

**DIFFERENCES BETWEEN THE GASB EXPOSURE DRAFT  
OF A CONCEPTS STATEMENT,  
*ELEMENTS OF FINANCIAL STATEMENTS,*  
AND THE FASAB EXPOSURE DRAFT OF A CONCEPTS  
STATEMENT,  
*DEFINITION AND RECOGNITION OF ELEMENTS OF  
ACCRUAL-BASIS FINANCIAL STATEMENTS***

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This memorandum has been prepared by FASAB staff. It is intended to identify differences between the GASB and FASAB drafts, but not to offer a critique of either document. The analysis is based on the GASB draft of April 4, 2006, a summary of the first principles of the GASB draft provided by GASB staff, and the FASAB preballot draft of April 21, 2006, which was circulated to FASAB members on April 28, 2006. FASAB staff obtained clarification from GASB staff on certain proposals in the GASB draft. Some of those issues are still under discussion. GASB currently projects issuance of the draft in August 2006, a public hearing in December 2006, and issuance of a final concepts statement in June 2007.

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## **SCOPE**

The GASB draft defines and discusses elements of financial statements but does not include recognition criteria. The current plan is to prepare a separate concepts statement on recognition and measurement attributes. Board deliberations on that project are scheduled to begin in October 2006.

Elements are defined in terms of a governmental unit, that is, a separate legal entity. Control over resources and the obligation to sacrifice resources (inherent characteristics of elements) are manifested only at the governmental unit level. However, elements may be assigned to a reporting unit, such as an activity, fund, or segment of a legally separate entity, for control, management, or financial reporting purposes. Transactions between reporting units should be reported as “interfund balances and transfers” (par. 35), which are not elements but should be reported in the reporting unit’s

financial statements, along with assigned elements. GASB staff indicates that the term “interfund” may be changed.

The FASAB is not proposing a different term for intra-governmental balances and activities. Provided they meet the definitions of elements of the government as a whole, intra-governmental balances and activities would be reported as elements in the component entities’ financial statements and eliminated in the preparation of government-wide statements (par. 14). The difference between GASB and FASAB on this issue is likely to be due to the different status of state and local government activities, funds, and segments compared with federal component entities.

## **GENERAL APPROACH TO DEFINING ELEMENTS**

Similar to the FASAB, the GASB’s approach is to define elements by their “inherent characteristics” (equivalent to “essential characteristics” or “fundamental characteristics” in the FASAB draft). Where the two Boards differ is that the GASB indicates that each of the elements it defines (except, presumably, net assets) has its own inherent characteristics. For example, the GASB refers to the “acquisition of net resources,” a phrase included in the definition of revenues,<sup>1</sup> as an inherent characteristic of revenues. In contrast, the FASAB indicates that assets and liabilities each have their own essential characteristics but net position, revenues, and expenses do not (pars. 3 and 49). Those definitions derive from the definitions of assets and liabilities and in assessing whether items meet the definitions of net position, revenues, and expenses readers are referred to the definitions of their underlying assets and liabilities (par. 49).

Another aspect of the FASAB’s approach to defining elements is to distinguish between definition and recognition and to indicate that an item that meets the definition of an element would not necessarily

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<sup>1</sup> As will be noted later, the GASB does not use the terms, revenue, expense, or expenditure. FASAB staff sometimes uses those terms for simplicity, when referring to the GASB draft.

be recognized in the financial statements (pars. 5 and 6). The GASB also indicates (par. 8) that for an item to be reported in a financial statement, it should meet all criteria for recognition, and that meeting the definition of an element is only one of those criteria. Recognition also is affected by the measurement focus and basis of accounting of a financial statement.<sup>2</sup> The GASB draft does not include recognition criteria.

## **RESOURCES AND ASSETS**

The GASB uses the term “resource” as a central feature of each of the definitions of elements (except net assets). In contrast, in the FASAB document, once assets have been defined, the term “asset,” rather than “resource,” is used in the other definitions.

The GASB states (par. 5) that the “essential characteristics of a resource in the government environment is its present capacity to provide, directly or indirectly, services.” In addition, a resource may be tangible or intangible. It remains a resource only so long as it is still capable of providing services. The term “services” incorporates economic benefits. The primary reason for describing the economic benefits feature of a resource as service capacity is to recognize that the mission of government is to provide services to citizens—not to generate cash flows. Also, not using the term “economic benefits” in the document is consistent with the GASB’s proposal (par. 34) that its definitions should be the same, regardless of the measurement focus used, although the measurement focus affects the scope of the resources reported in the financial statements. In a sense, the GASB’s term “indirect services” substitutes for “economic benefits.” The GASB indicates (par. 6) that direct services refer to those that provide a non-monetary benefit and do not generate resources, such as providing a park, road, or historical building to the citizenry. Indirect benefits result from items that generate additional resources, are exchanged for other assets that can be used to provide services, or are used to settle liabilities.

The FASAB’s proposal indicates (par. 20) that governments need many kinds of resources and that an asset is a particular kind of resource, as indicated by the definition (par. 17):

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<sup>2</sup> Measurement focus refers to what types of resources are being reported (economic resources, current financial resources, or cash). Basis of accounting refers to when a transaction is reported (accrual basis, modified accrual basis, or cash basis).

An asset is a resource that embodies economic benefits or services that the federal government can control.

Thus, a government may have resources that are not assets. FASAB staff believes the GASB holds the same view, based on the GASB's definition of an asset and comments by GASB staff.

The GASB's definition of "asset" is (par. 9):

*Assets* are present resources that are controlled by the entity.

- A resource, as described in paragraphs 5 through 7, is an item with a present capacity to provide service.
- Control provides an entity access to that capacity to provide service.

Except for wording and format, the two Boards' definitions of assets are quite similar. Both refer to two essential characteristics: the embodiment or capacity to provide economic benefits or services and control by the government entity. However, the FASAB definition indicates that control refers to the ability to control access to the benefits or services and deny or regulate the access or others; it does not refer to control of the resource itself. The FASAB's definition allows for a determination as to which entity (or entities) has an asset in situations such as certain leases and principal-agent arrangements where control of the resource through possession or ownership rests with one entity and access and use of the benefits rests with another entity.

The GASB definition indicates that it is the resource that is controlled by the entity and it is control of the resource that provides the entity access to the service capacity. Subsequent discussion in the GASB draft refers in some places to control of the resource and in others to control of access to the service potential. A similar variation in identification of the subject of control occurs in the "first principles" summary of the draft that GASB staff has provided. However, GASB staff believes the subject of control is conceptually the same as in the FASAB draft and attributes any apparent variation to wording differences.

## **LIABILITIES**

The GASB's definition of liabilities is as follows (par. 16):<sup>3</sup>

*Liabilities* are present obligations of an entity.

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<sup>3</sup> Similar to the FASAB draft, the GASB indicates in a footnote that the term "obligation" is not used in the budgetary sense, but rather with the meaning explained in the discussion following the liabilities definition.

- An obligation provides an entity little or no discretion to avoid a future sacrifice of resources.
- The future sacrifice of resources is a present responsibility of the entity.

The FASAB's definition (par. 38) is:

A liability is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

Both Boards base their definitions on two inherent or essential characteristics. One of these, a present obligation to provide assets or services (FASAB) or to make a future sacrifice of resources (GASB), is essentially the same in both definitions. Unlike the FASAB, the GASB does not state in the definition that the sacrifice must be to another entity. However, the notion is implicit and is mentioned in the subsequent discussion: "the other party or parties [to whom the obligation is owed] should be external to the government" (par. 20).

The other essential characteristic of a liability may at first appear to differ between the two Boards. GASB states that the entity has little or no discretion to avoid the future sacrifice of resources and FASAB states that the provision of assets or services to another entity is at a determinable date, when a specified event occurs, or on demand. However, FASAB staff believes that the essence of the two definitions is the same. The FASAB at one time considered using the "little or no discretion" language, which originates in FASB Concepts Statement No. 6, *Elements of Financial Statements*, but then decided on the reference to when the provision of assets or services to another entity would occur. The FASAB draft includes a discussion of the need for the government and the other entity to have an agreement or understanding concerning settlement in order for the government to have a liability.

One difference between the sections on liabilities in each draft is that the GASB draft refers to a difference in when an obligation is created,

depending on whether the transaction is an exchange or nonexchange transaction. The GASB indicates (par. 17) that the reason that many obligations cannot be avoided is that they are legally enforceable, so that an obligation is created when it becomes legally enforceable. However, similar to the FASAB, the GASB acknowledges that legal enforceability is not always present. The GASB indicates (par. 17):

For exchange transactions, the obligation becomes legally enforceable when the underlying exchange takes place. For some types of nonexchange transactions, mechanisms for legal enforcement may not be available or practical. In these cases, an obligation is considered to be created when eligibility requirements have been met by the recipient.

The GASB also refers to constructive obligations, which may not be legally enforceable but can be inferred from the facts and circumstances. This is similar to the FASAB draft, although FASAB does not use the term “constructive obligation.” GASB takes the position that constructive obligations arise only from exchange transactions. This issue is not discussed in the FASAB draft. The FASAB concluded that in defining a liability, it was unnecessary to distinguish between exchange and nonexchange transactions.

## **REVENUES AND EXPENSES**

GASB does not use the terms “revenues,” “expenses,” or “expenditures.” Instead, the term “inflows of resources” is used and includes revenues, gains, and other financing sources. The term “outflows of resources” includes expenses, expenditures, losses, and other financing uses. The GASB and FASAB definitions of these elements are:

### **GASB**

*An outflow of resources* is a consumption of net resources of or by the entity that is applicable to the reporting period.



An *inflow of resources* is an acquisition of net resources by an entity that is applicable to the reporting period.

## FASAB

An expense is a decrease in assets, an increase in liabilities, or a combination of both from providing cash or cash equivalents, goods or services, or any other activity (excluding repayments of borrowing) performed during the reporting period.

A revenue is an increase in assets, a decrease in liabilities, or a combination of both from providing goods or services, levying taxes or other impositions, receiving donations, or any other activity (excluding borrowing) performed during the reporting period.

The two sets of definitions are equivalent in concept. The different wording is due in part to the GASB's decisions not to use the terms "revenue," "expense," or "expenditure" and to use the term "resource" in the definitions of almost all elements, rather than referring to "assets," once assets have been defined in terms of resources. The phrase "applicable to the reporting period" in the GASB definitions refers to the period in which the taxpayers are charged (consumption of net resources) or receive the benefit (acquisition of net resources). That period may vary according to the measurement focus used. GASB staff indicated that the Board continues to discuss whether the word "net" in each definition should modify "outflow" and "inflow" of resources rather than "resources" in the phrases "consumption" and "acquisition" of "net resources."

## **DEFERRED OUTFLOWS AND INFLOWS OF RESOURCES**

The GASB's discussions of outflows and inflows of resources also explain the relationship to (adjustment of) two additional balance sheet elements: "deferred outflows of resources" and "deferred inflows of resources." These two proposed elements are defined as follows:

*A deferred outflow of resources* is a consumption of net resources of or by the entity that is applicable to a future reporting period.

*A deferred inflow of resources* is an acquisition of net resources by the entity that is applicable to a future reporting period.

The terms "consumption of net resources," "acquisition of net resources," and "applicable to a future reporting period" are referred to as "inherent characteristics" of these two proposed elements. The first two phrases have the same meaning as when they are used in the definitions of outflows of resources and inflows of resources. Thus the only differences are the use of the word "deferred" in each definition and the

corresponding change of applicable period from “the reporting period” to “a future reporting period.”

The GASB draft does not discuss the need for these two elements and there are no examples of the kinds of transactions that would give rise to them. GASB staff indicated that the need for and scope of these two elements are still under discussion. The intent is to allow for items that are flows of resources that are not applicable to the reporting period and thus (1) should not affect the activities statement in the current period but (2) affect the government’s net assets even though they do not meet the definition of an asset or liability. Thus, these elements would not cover items such as prepaid expenses and deferred revenues that meet, respectively, the definition of an asset or a liability. GASB staff indicated that the types of items for which these elements are being considered include certain valuation or holding accounts related to, for example, reporting derivatives at fair value and other items that currently are not covered by GAAP.

## **NET ASSETS**

The GASB defines net assets (par. 32) as “the residual of all other elements presented in a statement of financial position.” If the new elements are adopted, the accounting equation would be expanded to: assets + deferred outflows of resources – liabilities – deferred inflows of resources = net assets.

## **APPLICATION OF DEFINITIONS OF ELEMENTS TO DIFFERENT MEASUREMENT FOCUSES**

This section of the GASB draft explains (par. 34) that “[t]he term “resource” has the same meaning in all of the definitions of elements; however, the scope of the resources measured in a particular financial statement may be different depending upon the measurement focus of the financial statement.” The discussion explains the differences in reporting scope among the economic resources, current financial resources, and cash measurement focuses.

## **UNCERTAINTY**

Uncertainty is discussed in one paragraph at the end of the draft and addresses only existence uncertainty. (The draft does not propose recognition or measurement criteria.) The paragraph provides examples of unforeseen circumstances that might occur in the future and prevent the realization of benefits from assets or might reduce or extinguish obligations. Similar to the FASAB draft, the GASB states (par. 36):

The definitions in this Concepts Statement do not require certainty regarding such future events because that would be impractical. Neither does this Concepts Statement specify a level of probability of an event occurring for an item to meet the definition of an element.

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## **STAFF SUMMARY**

### **Similarities**

Except for wording, style, and some of the terminology, and allowing for consideration given by the GASB to differences in state and local government financial reporting, the GASB and FASAB draft proposed Concepts Statements on Elements are very similar. For example, the approach taken by both Boards is to base the definitions of elements on their “inherent” or “essential” characteristics and to distinguish between definition and recognition, indicating that meeting the definition of an element is only one criterion for recognition. Both Boards have identified essentially the same two inherent characteristics for assets and liabilities, and both Boards define net position or net assets as residual amounts. The documents both provide a discussion of the essential characteristics of each element, and both reflect the Boards’ intent to avoid restricting the concepts to a particular financial reporting model or, in the GASB’s case, to a particular measurement focus or basis of accounting. Both documents explain why the power to tax does not meet the definition of an asset. Both indicate that legal enforceability is a common characteristic of liabilities but not an essential one, and both cover constructive as well as legal liabilities. Each document provides a discussion of uncertainty about whether an item meets a definition (existence uncertainty) and indicates that certainty is not required and a probability level or threshold for meeting a definition is not specified.

### **Differences**

FASAB staff has identified these principal differences in the GASB draft compared with the FASAB draft. They are listed in the order they appear in the GASB draft. These and other, more minor differences are discussed earlier in this memorandum.

The GASB draft:

1. Does not include recognition criteria.
2. Uses the term “resources” as the central feature of each definition, whereas the FASAB draft uses “assets” in the other definitions, once assets have been defined.
3. Identifies inherent characteristics for all elements (except net assets), including activity or change statement elements. In contrast, the FASAB identifies the essential characteristics of assets and liabilities and derives the definitions of other elements from the definitions of assets and liabilities.
4. Does not refer to “economic benefits.” The term is included within the terms “services” or “service potential” and the draft distinguishes between indirect services, which include economic benefits, and direct services, which do not.
5. Distinguishes between when a present obligation is incurred, depending on whether the transaction is an exchange or non-exchange transaction. FASAB does not indicate a different conclusion but does not use the terms exchange or non-exchange.
6. Indicates that constructive obligations arise only from exchange transactions. FASAB discusses constructive obligations but does not use that term or relate them to non-exchange transactions.
7. Does not use the terms “revenue,” “expense,” or “expenditure.” Instead, defines “inflows of resources,” which include revenues, gains, and other financing sources, and “outflows of resources,” which include expenses or expenditures, losses, and other financing uses.
8. Proposes two balance-sheet elements in addition to assets and liabilities: “deferred outflows of resources” and “deferred inflows of resources.” The draft does not provide examples of items that

would be included in these elements. However, GASB staff indicates that they are intended to be used for items that affect net assets but do not apply to the current-period activity or change statements, and which, unlike prepaid assets and deferred revenues, do not meet the definitions of assets or liabilities.

9. Would expand the accounting equation and, therefore, the definition of net assets, if the proposed new balance-sheet elements are adopted, to:  $\text{assets} + \text{deferred outflows of resources} - \text{liabilities} - \text{deferred inflows of resources} = \text{net assets}$ .
10. Includes an explanation of the application of the definitions of elements to different measurement focuses (economic resources, current financial resources, and cash).