Federal Accounting Standards Advisory Board

July 12, 2007

TO: Members of FASAB

FROM: Penny Wardlow, Consultant

THROUGH: Wendy Comes, Executive Director

SUBJECT: **Conceptual Framework: Elements—Draft Final Statement—TAB B**

This memo summarizes proposed revisions to the May 2007 draft of a final Statement on Elements. The goal of the meeting is to reach agreement on the draft and proceed to a preballot draft.

Staff is preparing a second memo on whether Congress's ability to change the law affects the existence of a liability (par. 44 of the ED). At the May meeting, Mr. Werfel asked for further discussion of the issue at the July meeting. This second memo will be distributed next week.

Proposed Revisions to May Draft

Tab B-1 has a marked-up draft on Elements that shows proposed revisions made since the May meeting based on the Board's comments at that meeting and subsequent suggestions. The principal proposed revisions are as follows.

1. The material included in the preamble and basis for conclusions (BFC) in the May draft to clarify the role of concepts vs. standards has been reduced following a request from Mr. Dacey and staff discussions with him. The material was included to respond to some concerns of Mr. Werfel. Appendix C (excerpt from the AICPA's AU Section 411 on the GAAP hierarchy) has been shortened by deleting pars. 10 through 13. These paragraphs refer specifically to the application of Section 411 to nongovernmental entities and state and local governmental entities.

2. At the May meeting, Mr. Reid expressed his concern that the discussion of "Settlement of the Obligation" (an essential characteristic of a liability) did not address situations when the

government and the other entity are in litigation. Staff has added language suggested by Mr. Jacobson to par. 46 to address that issue.

3. After the May meeting, Mr. Jacobson expressed concerns with wording staff had included in the May draft to address a concern of Mr. Jackson—namely that the document should mention that terms of settlement might be established by statute, not just in agreements or understandings between the government and another party. Mr. Jacobson is concerned that the phrase "established by statute" overstates what one might actually find in statutes that one would consult in situations where the government does not have an identifiable partner to whom it is liable—as with environmental liabilities, for example. To address this concern, staff has reworded the second essential characteristic of a liability at the end of par. 40 to read as follows: "Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled." A conforming change has been made in par. 45.

4. Mr. Jacobson also recommended that the references to additional *components* of recognition decisions in the section on "Recognition" and elsewhere in the draft should be changed to additional *considerations* for recognition decisions. Staff has made that change in the subheading of par. 7 and in par. 8 and has made conforming changes throughout the document.

5. At the May meeting, Mr. Dacey disagreed with the term *reversals* of transactions in par. 54. Staff has reworded the second sentence of par. 54 as follows: "Transactions that are in substance adjustments or completions of previous transactions rather than new transactions involve the same elements as the original transaction." The paragraph provides as examples the treatment of (a) a tax refund as a revenue reduction and (b) a reimbursement of an expense received by one agency from another as an expense reduction by the recipient agency and an expense by the reimbursing agency. If the Board agrees with the new language, staff will make a conforming change in BFC par. A32.

6. In response to a request from Mr. Dacey, staff has included a reference to uncertainty in the last sentence of par. 57, which now reads: "Items that, because of uncertainty, do not meet the basic recognition criteria may be candidates for disclosure."

7. Mr. Dacey also requested clarification of the reference in par. 59 to the possibility of reassessments and restatements. Staff has added the following to par. 59 as footnote 11: "This Statement does not change existing standards concerning whether new information should result in restatement of previously reported information or should be treated prospectively as a change in estimate."

Does the Board agree with these revisions?

TAB B-1

Federal Accounting Standards Advisory Board

Elements of Accrual-Basis Financial Statements and Basic Recognition Criteria

Statement of Federal Financial Accounting Concepts 5

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TAB B-1

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General established the Federal Accounting Standards Advisory Board (FASAB or "the Board") in October 1990. FASAB 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 standards are 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 or its website:

- "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"

Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING CONCEPTS

This Statement of Federal Financial Accounting Concepts (SFFAC) is the fifth in a series of concepts statements intended to set forth objectives and fundamentals on which financial accounting and reporting standards will be based. The objectives identify the goals and purposes of financial reporting. The fundamentals are the underlying concepts of financial accounting—concepts that guide the selection of transactions, events, and circumstances to be accounted for; their recognition and measurement; and the means of summarizing and communicating them to interested parties.

The Federal Accounting Standards Advisory Board's (FASAB or "the Board") conceptual framework enhances the consistency of standards and serves the public interest by providing structure and direction to federal financial accounting and reporting. The most direct beneficiaries of the FASAB's concepts statements are the Board itself and preparers and auditors of federal financial reports. The statements guide the Board's development of accounting and reporting standards by providing the Board with a common foundation and basic reasoning on which to consider the merits of alternatives.

Knowledge of the objectives and concepts the Board considers should help users and others who are affected by or interested in federal financial accounting and reporting standards to understand better the purposes, content, and qualitative characteristics of information provided by federal financial accounting and reporting. That knowledge should enhance the usefulness of, and confidence in, federal financial accounting and reporting.

Concepts statements enhance preparers' and auditors' understanding of the common foundation and reasoning employed in considering alternatives. The GAAP hierarchy provides that statements of federal financial accounting standards constitute level A (the highest level) guidance. Statements of federal financial accounting concepts are not GAAP. Instead, concepts statements constitute "other literature" and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature. In developing and amending accounting standards, the Board looks to concepts statements for guiding principles and also considers relevant existing standards and guidance issued by the Board and other standard setting bodies. Until the Board amends existing standards, the Board expects practice to be governed by the accounting principles embodied in the four levels of the GAAP hierarchy. Thus, the Board distinguishes between material presented in concepts which are used to guide Board deliberations on future GAAP and accounting principles presented in standards which constitute current GAAP. (Appendix C presents the sources of generally accepted accounting principles.)

For federal entities, in the absence of specific authoritative literature applicable to a transaction or event, it should be possible to report the event or transaction by selecting an established accounting principle for an analogous transaction or event that appears appropriate when applied in a similar manner. In the unusual case where an analogy cannot be drawn to established authoritative literature, the American Institute of CPAs permits consideration of other literature including concepts statements. Consideration of individual concepts statements

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Current generally accepted accounting principles may be inconsistent with the concepts statements. However, concepts statements do not (a) require changes in existing generally accepted accounting principles, (b) amend, modify or interpret existing pronouncements in effect, or (c) justify either changing existing generally accepted accounting and reporting practices or interpreting the pronouncements of the Board based on individual interpretations of the concepts. The professional standards of the American Institute of CPAs identify the sources of generally accepted accounting principles for three types of entities—nongovernmental entities, state and local governments, and the federal government—and indicate that there are four levels of authoritative literature applicable to each type of entity.

will be helpful but often may not provide sufficient guidance in resolving emerging issues. Therefore, the Board encourages careful study of the conceptual framework and established practice in resolving such issues.

Statements in this series describe concepts and relations that will underlie future federal financial accounting standards and practices and in due course will serve as a basis for evaluating existing standards and practices. With issuance of this statement, the series of concepts statements comprises:

- SFFAC 1, *Objectives of Federal Financial Reporting* (includes the qualitative characteristics of information in financial reports)
- SFFAC 2, *Entity and Display*
- SFFAC 3, *Management's Discussion and Analysis*
- SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*
- SFFAC 5, *Elements of Accrual-Basis Financial Statements and Basic Recognition Criteria*.

Like other pronouncements of the FASAB, Statements of Federal Financial Accounting Concepts remain in effect until amended, superseded, or withdrawn by appropriate action under the Board's Rules of Procedure.

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Executive Summary

Objective of This Statement

Elements of financial statements result from an entity's transactions or other events that affect the entity. Elements are the "building blocks" of financial statements—the broad classes of items from which the statements are constructed. This Statement defines five elements of accrual-basis financial statements of the federal government. Items that meet the definitions also are elements of accrual-basis financial statements of the relevant component entity. The elements are defined as follows:

An ***asset*** is a resource that embodies economic benefits or services that the federal government controls.

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.

Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

A ***revenue*** is an increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

An ***expense*** is a decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

This Statement establishes two basic recognition criteria that an item must meet to be a candidate for recognition in the body of a financial statement: (1) The item must meet the definition of an element and (2) The item must be measurable, meaning a monetary amount can be determined with reasonable certainty or is reasonably estimable. An item that meets the definition of an element but is not measurable is a candidate for disclosure in the notes to financial statements or as supplementary information.

Meeting the basic recognition criteria is a necessary but not a sufficient condition for recognition. Additional considerations for a recognition decision are measurement of the candidate for recognition and assessments of the materiality and benefit versus cost of the amount measured. Measurement entails selection of an appropriate attribute, such as historical cost, fair value, or expected value, and application of a measurement method. Measurement may require the use of estimates or approximations and an assessment of the probability that future inflows or outflows of economic benefits or services will result from the item.

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This Statement includes a discussion of the effects of uncertainty on financial reporting but does not otherwise address the assessment of probabilities or other measurement issues. The Board intends to address those considerations for recognition decisions in future pronouncements. In

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the meantime, this Statement does not change existing standards for assessing probabilities or for selecting the appropriate measurement attribute, which the Board expects will continue to be based on the reporting objectives, qualitative characteristics, and cost-benefit constraints applicable to financial information.

Reasons for This Statement

Questions have arisen about the usefulness of certain definitions of elements in current standards and their applicability to transactions outside the scope of the defining standard, as well as about the absence of definitions of other important elements, such as assets. The Board believes that a concepts statement that defines the elements of federal accrual-basis financial statements and establishes basic criteria for selecting candidates for recognition will be an important part of its conceptual framework. The Board believes that this Statement will provide more consistent, useful, and enduring guidance to the Board and its constituents than establishing definitions and recognition requirements standard by standard.

The concepts, definitions, and basic recognition criteria in this Statement will provide a common foundation for distinguishing between items that meet the definitions of elements of accrual-basis financial statements and those that do not, and between items that are candidates for recognition in the body of financial statements and those that qualify only for disclosure in the notes or as supplementary information. The Board therefore believes that the guidance in this Statement will enhance the understandability, consistency, and comparability of financial reporting for the benefit of users, preparers, and auditors of the financial statements as well as the Board itself. As a result, the Board believes that this Statement will contribute to meeting the government's overall financial reporting objectives of demonstrating accountability and providing useful information, as well as the more specific objectives of assisting users in evaluating a reporting entity's operating performance and stewardship.

Effect on Practice

The concepts in this Statement are consistent with those established in earlier SFFACs,[1] which are not superseded or modified by this Statement. The definitions of elements and basic recognition criteria in this Statement also are generally consistent with current practice and do not imply radical change. However, they are expected to guide the Board's future deliberations, which may lead to future changes in practice through new or amended standards of federal accounting and financial reporting. The Board intends future change to occur in the gradual and evolutionary way that has characterized past change.

[1] SFFAC 1, *Objectives of Federal Financial Reporting*; SFFAC 2, *Entity and Display*; SFFAC 3, *Management's Discussion and Analysis*; and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*

Acronyms

AcSEC	Accounting Standards Executive Committee of the AICPA
AICPA	American Institute of Certified Public Accountants
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GASB	Governmental Accounting Standards Board
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards

Introduction

PURPOSE OF THIS STATEMENT

1. This Statement of Federal Financial Accounting Concepts (SFFAC) establishes definitions and **basic recognition criteria**[2] for **elements** of accrual-basis financial statements of the federal government and its component entities. The concepts it contains are consistent with the concepts established in earlier SFFACs,[3] which are not superseded or modified by this Statement. The definitions of elements and basic recognition criteria in this Statement also are generally consistent with current practice and therefore do not imply a fundamental change. However, they are expected to guide the Board's future deliberations, which may lead to future changes in practice through new or amended standards of federal accounting and financial reporting.

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ELEMENTS AND RECOGNITION

2. The term *elements* refers to broad classes of items, such as **assets** and **liabilities**, that comprise the building blocks of financial statements. Components of those broad classes, such as cash, investments, and debt instruments, may meet the definitions of elements but are not elements as the term is used in this Statement. Instead, they are called *items* or by descriptive names. This Statement focuses on the broad classes and their characteristics instead of defining particular assets, liabilities, or other items. Notes to financial statements generally are considered an integral part of financial statements, but they are not elements. They serve different functions, including amplifying or complementing information about items reported in the body of financial statements.

3. The elements of accrual-basis financial statements defined in this Statement (paragraphs 17 through 56) are assets, liabilities, **net position**, **revenues**, and **expenses**. The definitions of assets and liabilities derive from the essential characteristics of those elements. The definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities.

[2] Terms defined in the Glossary are printed in **bold-face** type the first time they appear in the text.
[3] SFFAC 1, *Objectives of Federal Financial Reporting*; SFFAC 2, *Entity and Display*; SFFAC 3, *Management's Discussion and Analysis*; and SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*

4. The terms ***recognition*** and *recognize* refer to the process of formally recording or incorporating an element into the financial statements of an entity. Recognition comprises depiction of an element in both words and numbers, with the amount included in the totals of the financial statements. For an asset or liability, recognition involves recording not only acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements.

Concepts

RECOGNITION

Basic Recognition Criteria

5. Basic recognition criteria are the conditions an item should meet in order to be a candidate for recognition in the financial statements. The basic recognition criteria established in this Statement are (a) The item meets the definition of an element of financial statements and (b) The item is **measurable**. As used in this Statement, the term *measurable* means a monetary amount can be determined with reasonable certainty or is reasonably estimable.

6. The existence or measurability (or both) of many assets, liabilities, and other elements may not be certain, but this Statement does not require certainty. Uncertainty and its effects on financial reporting are discussed further in paragraphs 57 through 59. Conclusions about whether an element exists and is measurable may require judgment based on the available evidence.

Additional Considerations for Recognition Decisions

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7. Meeting both of the basic recognition criteria established in paragraph 5 is a necessary but not a sufficient condition for recognition. Additional steps are necessary before a recognition decision can be made. For example, a candidate for recognition needs to be measured. **Measurement** of an item entails the selection of an appropriate attribute to be measured, such as historical cost, fair value, or expected value, and application of a measurement method. Measurement may require the use of estimates and approximations as well as an assessment, in a manner consistent with the attribute being measured, of the probability that future inflows or outflows of economic benefits or services will result from the item. Recognition decisions also incorporate the results of assessments of the materiality and benefit versus cost of recognizing the item measured. Thus, it is possible that an item that meets the basic recognition criteria would not be recognized due to measurement, materiality, or cost-benefit considerations.

8. This Statement establishes the basic recognition criteria for elements but does not address these additional considerations for recognition decisions. The Board intends to establish concepts and standards for these additional considerations in future pronouncements. In the meantime, this Statement does not change existing standards for measurement or for assessing probabilities. The Board expects that the selection of an appropriate

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measurement attribute in specific circumstances will continue to be based on the reporting objectives, **qualitative characteristics**, and cost–benefit constraints applicable to financial information.

9. An item that meets the appropriate definition of an element is an asset, liability, revenue, or expense, even if it is not recognized in the accrual-basis financial statements because, for example, it is not measurable or its amount is not material. Unrecognized elements are candidates for disclosure in the notes to financial statements or as supplementary information.

ENTITY CONCEPT

10. All elements defined in this Statement are defined in relation to the U.S. Government ("federal government" or "government"). That is, an item that meets the relevant definition is an asset, liability, net position, revenue, or expense of the federal government. An item that meets the basic recognition criteria established in paragraph 5 and the additional considerations for recognition decisions referred to in paragraph 7 is recognized in the consolidated financial statements of the federal government, except when it is eliminated in the consolidation process, as discussed in paragraphs 14 and 15.

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11. The federal government is composed of component entities that **control**, manage, or are otherwise accountable for the government's assets and may be authorized to incur liabilities. Component entities include departments, independent agencies, and government corporations, as well as their agencies, bureaus, offices, administrations, corporations, and other organizational units. An item that meets the definition of an element of the federal government is also an element of a component entity. It is recognized in the component entity's accrual-basis financial statements provided it meets the basic recognition criteria and the additional considerations for recognition decisions.

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12. Sometimes a question may arise as to which component entity should report a particular item. Typically, a review of the authorizing legislation establishing a government program or activity, the appropriations act funding it, and related federal laws, regulations or other executive issuances clearly identifies one component entity as having a comprehensive relationship to the program or activity. That is, the component entity is responsible and accountable for receiving, controlling, managing, and utilizing government assets or incurring liabilities on behalf of the government in performing operations related to the program or activity. When a component entity has such a comprehensive relationship, the assets and other elements involved should be reported by that component entity.

13. When no component entity has a comprehensive relationship to a government program or activity, the assets and other elements involved should be reported by the component entity most responsible for managing them. For example, if one component entity has acquired and has some control over a government asset but another component entity presently manages and utilizes the asset as part of its routine operations, the second component entity should report the asset. In other circumstances, a component entity's management responsibilities may be limited to, for example, collecting monies owed to the federal government and depositing them in the U.S. Treasury. Although the component entity has no authority or responsibility to retain or use the monies collected, it should report the assets and other elements involved in the collection activity.

14. While items that meet the definition of an element from the perspective of the federal government are assigned to component entities, some items recognized in the accrual-basis financial statements of component entities are not recognized in the consolidated financial statements of the federal government because they do not meet definitions of elements from the perspective of the federal government. Instead, they are items that would meet element definitions from the component entity perspective and are treated as such by the component entity. For example, component entities may exchange services for a fee and recognize the resulting intra-governmental assets, liabilities, and related elements in their financial statements. However, intra-governmental items offset each other when the government is viewed as a whole and are eliminated in preparing the government's consolidated financial statements.

15. Appropriations are another example of items reported in the accrual-basis financial statements of component entities but not in the consolidated financial statements of the federal government. For the component entities, appropriations are inflows of **resources** against which the component entity may incur obligations in support of authorized activities. Assuming an appropriation complies with the basic recognition criteria and additional considerations for recognition decisions,a component entity would recognize the appropriation as an increase in assets and revenues and would recognize the use of the appropriation as an increase in expenses and a decrease in fund balance with Treasury. However, from the perspective of the government as a whole, an appropriation is not a resource flow to the federal government or from the government to a component entity. Rather, it is a budgetary amount that constitutes legal authority for a component entity to incur obligations for specified purposes during specified time periods, and for the U.S. Treasury to liquidate the resulting obligations of the component entity. The actual liquidation will be from cash and other assets of the U.S. Treasury resulting from the inflow of resources from taxes and other financing sources. Therefore, appropriations recognized by component entities are eliminated in the

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process of consolidation and are not reported in the consolidated financial statements of the federal government.

16. The definitions of elements may refer to *another entity* or *other entities*. For the federal government, these terms describe entities external to the government, such as foreign, state, and local governments, business enterprises, not-for-profit organizations, and individuals. For a component entity, the terms *another entity* and *other entities* include other component entities of the government as well as entities external to the government.

DEFINITIONS OF ELEMENTS

Assets

Definition of an Asset

17. An asset is a resource that embodies economic benefits or services that the federal government controls.

18. The definition of an asset addresses only whether an asset exists. It does not address whether the asset is measurable and, if so, how it should be measured or whether or when it should be recognized in the federal government's or a component entity's balance sheet. Nor does the definition address whether or when the economic benefits or services embodied in an asset will be used. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other considerations for recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

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19. The definition of an asset derives from the nature of assets—that is, their **essential characteristics**. An essential characteristic of an asset is one that is inherent to all assets and, therefore, without it an asset would not exist. Paragraphs 20 through 34 highlight and discuss those characteristics. Also discussed are certain characteristics that are common to many assets but not to all assets. As such, those characteristics are not essential, but they may provide additional evidence that an asset exists.

Essential Characteristics of Assets

20. The federal government needs financial, economic, human, and other resources to help it achieve its mission. In this context, the term *resource*

means "a useful or valuable possession or quality of a country, organization or person"[4] or a "means of supplying a want."[5] The government has numerous resources. However, those resources are not assets unless they have the essential characteristics of assets and, therefore, meet the definition of assets in paragraph 17.

21. To be an asset of the federal government, a resource must possess two characteristics. First, it embodies economic benefits or services that can be used in the future. Second, the government controls access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.

22. To illustrate the distinction between a resource that is an asset and one that is not, the federal government may obtain economic benefits or services from a resource but be unable to deny or regulate the access of other entities to those benefits or services. If so, the resource is not an asset of the federal government. For example, outer space is a natural resource from which the federal government can obtain economic benefits. However, outer space is not an asset of the federal government because the government cannot deny or regulate the access of others. In contrast, natural resources under federal lands qualify as federal government assets because the government can obtain the economic benefits and regulate the access of other entities as provided under federal law. Such natural resources are assets of the federal government even if they are not measurable and therefore are not candidates for recognition in the financial statements.

23. In addition to the two essential characteristics identified in paragraph 21, many resources have other features that help identify them as assets. For example, they may be acquired at a cost and owned by the federal government. However, those features are not characteristics of all assets. Whereas access to economic benefits or services often is obtained through legal ownership of the underlying item of property, legal rights to economic benefits or services can be obtained without ownership of the property—for example, under certain lease arrangements.

24. The federal government's resources often are tangible and exchangeable, and the government often has legally enforceable rights of access to the resulting benefits. But the absence of those features is not sufficient to preclude an item from qualifying as an asset. For example, an intangible resource, such as an easement on property, is an asset if the federal government can benefit from it and regulate or deny the access of other

[4] *American Heritage Dictionary of the English Language*, Fourth Edition (Houghton Mifflin Company, 2000)
[5] *The Concise Oxford Dictionary* (Oxford, U.K.: (Oxford University Press, 1964)

entities. A resource may embody economic benefits even though the federal government cannot exchange it or sell it—for example a machine that continues to provide a needed service even though there is no market for the machine. Similarly, the fact that the government's ability to access or use a resource is not legally enforceable does not mean that the resource is not an asset, if the government nevertheless can obtain the economic benefits or services it embodies and deny or regulate other entities' access to or use of those economic benefits or services.

Economic Benefits or Services

25. A characteristic possessed by all assets is the ability to provide economic benefits or services. Some sources use the terms *economic benefits* and *services* (or *service potential*) interchangeably. However, as used in this Statement, economic benefits may result in inflows of cash, cash equivalents, goods, or services to the federal government, whereas the services embodied in an asset may benefit the government in other ways. For example, assets such as public parks, museums, and art galleries often provide recreational, educational, and research opportunities to the public at no charge or for a reduced fee or voluntary contribution, thereby assisting the federal government to achieve its objectives and meet its mission to provide public services.

26. The economic benefits or services that a property can provide can be distinguished from the property itself, whether it is tangible or intangible, such as a right. Not all properties embody economic benefits or services and the assumption that a particular type of property will always be an asset is not justified. For example, whereas equipment normally is expected to provide economic benefits or services, sometimes it has become unusable and has no scrap value. If so, it no longer embodies economic benefits or services and does not meet the definition of an asset.

27. The economic benefits or services embodied in resources may be shared by the government and another entity through specific arrangements. For example, the government and another entity may enter into a joint venture and share an interest in the resources committed to the joint venture. If so, each party may possess assets comprising its respective share of the benefits or services. Similarly, lease agreements unbundle the economic benefits or services embodied in leased property and may, for example, give the lessee the right to hold and use the property and the lessor the right to receive rentals and any residual value. Thus, both parties may have assets corresponding to their respective rights.

Control by the Federal Government

28. The second essential characteristic of an asset is control, which refers to the *ability* of the federal government to obtain the economic benefits or

services embodied in a resource and to deny or regulate the access of others. It is possible that the government does not actively *exercise* control. Nevertheless, as long as the government currently has the ability to exercise control, the item is an asset of the government. In exercising control of the economic benefits or services, the government may, depending on the nature of the resource, hold the resource; exchange it; use it to obtain cash, cash equivalents, goods, or services; exact a price for other entities' use of the economic benefits or services; or use it to settle liabilities. Many resources are subject to certain legal or other external constraints, such as public land subject to preservation requirements. Such restrictions on the use of a resource do not negate the government's control of the economic benefits or services embodied in the resource.

29. The ability of the federal government to control access to the economic benefits or services embodied in a resource normally stems from legal rights and may be evidenced by title deeds, contractual agreements, possession, or other devices that protect the government's interests. However, legal enforceability of a right is not a prerequisite to the establishment of control of access to economic benefits or services, because the government may be able to exercise control in some other way.

30. Possession or ownership of a resource normally entails control of access to the economic benefits or services embodied in it, but that is not always the case. Whereas control of access is an essential characteristic of an asset, possession or ownership is not. For example, the government may grant another entity, acting as an agent of the government, physical possession of goods for sale and retain the right to receive the proceeds of sale. The goods are assets of the government because it controls access to the economic benefits embodied in the goods. The agent has physical possession of the goods, but they are not the agent's assets because it does not control access to the economic benefits. Also, as discussed in paragraph 27, through a lease arrangement the government may control access to the economic benefits or services embodied in a resource that it does not own.

31. Sometimes the federal government cannot control the economic benefits or services that it obtains from a resource because it cannot deny or regulate the access of other entities. In those circumstances, the resource does not meet the definition of an asset of the federal government. Public goods are an example. Public highways provide economic benefits to the entities that use them. However, they are assets only of the entity that has the capacity to control their use or regulate other entities' access to them by, for example, the use of tolls or other restrictions. Similarly, natural resources, such as air and water do not qualify as assets of the federal government when it has only general access to them along with all other entities, even if the government has incurred costs to help clean the environment.

32. The federal government obtains most of its resources from cash or credit transactions. The government may acquire resources in exchange for other resources or for an obligation to transfer resources or provide services in the future, or resources may result from the exercise of the government's powers, such as, for example, the imposition of taxes, penalties, fines, and forfeitures. Government resources also may result from events such as accretion and discovery.

33. Implicit in the definition and essential characteristics of assets is that the event giving rise to the government's ability to control access to the economic benefits or services embodied in a resource must have occurred. The government's intent or ability to acquire a resource in the future does not create an asset. For the resource to qualify as an asset, the government already must have acquired the resource or otherwise obtained access to the economic benefits or services it embodies to the exclusion of other entities. For example, the mere existence of the government's power to tax is not an asset because, until the government has exercised that power by imposing a tax and has access to benefits by virtue of completion of a taxable event, no event has occurred to generate resources and there are no resulting economic benefits that the government can control and use in providing programs and services.

34. Once acquired, a resource that meets the definition of an asset continues to be an asset until the government transfers it to another entity or uses it up, or until some other event or circumstance destroys the economic benefits or services previously embodied in the resource or removes the government's ability to obtain them and deny or regulate the access of other entities.

Liabilities

Legal Framework

35. The federal government is governed by and operates within a framework of laws. Thus, a federal liability must have its foundation in law. Some federal liabilities result from discrete actions of the government that are authorized by law but are not explicitly required by law. Examples are liabilities that result from contractual arrangements, including amounts borrowed, amounts owed for purchased goods and services, and liabilities for providing goods or services to entities that have paid for them in advance. Other liabilities flow directly from a law and its implementing regulation that specifically require the federal government to provide assets to another entity. Examples include formula grants and subsidies, claims owed under workers' compensation, and amounts owed for environmental clean-up.

36. Although all federal liabilities have their foundation in law, some liabilities are construed from the totality of the conditions and facts of a particular

situation, rather than from specific legal or regulatory requirements. In those circumstances, the government should weigh the totality of the facts of the situation against the definition and essential characteristics of liabilities (discussed in paragraphs 40 through 48) and make an informed judgment as to whether or when a liability has been incurred. Factors that may affect that conclusion include relevant aspects of the legal framework within which the government is constituted, whether the government has an agreement or understanding with another entity concerning the nature and amount of the government's obligation and the timing of settlement, and decisions or actions in previous situations that are relevant precedents.

37. Settlement of a federal liability often is legally enforceable, as is the case, for example, with contracts. However, laws that create or support federal liabilities do not always confer legally enforceable rights on recipient entities. Legal enforceability may provide additional evidence that a liability exists, but it is not a prerequisite.

Definition of a Liability

38. A liability is a present obligation[6] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

39. The definition of a liability addresses only whether a liability exists and not how it should be measured or whether or when it should be recognized. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other components of recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

Essential Characteristics of Liabilities

40. Similar to the definition of an asset, the definition of a liability is derived from the nature of liabilities—that is, the essential characteristics without which a liability would not exist. A liability of the federal government has two essential characteristics, which are discussed in paragraphs 41 through 48. First, a liability constitutes a present obligation to provide assets or

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[6] The term *obligation* is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.

services to another entity. Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled.

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Present Obligation

41. As the term is used in this Statement, an obligation is a duty or responsibility to act in a certain way. To have a *present* obligation means that the obligation arose as a result of a past transaction or other event and has not yet been settled. Thus, a present obligation should be distinguished from a mere expression of future intent, such as the government's announcement that it intends to acquire equipment. A present obligation is incurred when the government takes a specific action that commits or binds the government and affects another entity.

42. To meet the first essential characteristic of a liability, a present obligation must entail the provision of assets (cash, cash equivalents, or goods) or services to another entity in the future. For example, the government may have received from another entity goods or services that it has agreed to purchase but has not yet paid for, or it may have agreed to provide assets or services to another entity under certain conditions and those conditions have been met. In these situations the government has a present obligation to fulfill its commitments, even if the actual provision of assets or services is not required until a later date.

43. As indicated in the previous paragraph, for a present obligation to qualify as a liability of the federal government, two separate entities must be involved.[7] Separate entities must be involved because the same entity cannot be both the recipient of settlement of a liability and the entity with the duty to settle. For example, when the government operates machinery, the government may have an obligation to maintain it. However, the obligation does not qualify as a liability for maintenance because the government cannot have a liability to itself. In contrast, if the government contracts for maintenance from another entity, it may have a liability to that other entity for the price of the maintenance services it has received.

44. To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on *existing* conditions, including current law, because an essential characteristic of a liability is that the government has a *present* obligation,

[7] As indicated in paragraph 16, for a component entity the other entity could be another component entity. When component entities transact with each other, they are external to each other. Paragraph 14 explains that some items meet the definitions of elements from a component entity's perspective but not from the federal government's perspective. Such items would be reported in the accrual-basis financial statements of the relevant component entities but would be eliminated in consolidation and therefore would not be reported in the consolidated financial statements of the federal government.

even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability.

Settlement of the Obligation

45. The second essential characteristic of a liability is that either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled. The timing of settlement often is expressed in contracts and other agreements as a specific or determinable date. However, in some cases the parties agree that settlement will be triggered by a specific event or by the demand of the recipient of the assets or services, the timing of which may be uncertain. If the government and the other entity do not have an agreement or understanding concerning settlement and the government is free to decide whether and when to settle the obligation, the government's obligation does not meet the definition of a liability.

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46. In addition to uncertainty as to the timing of settlement, many present obligations involve uncertainty regarding the amount of settlement. For example, the amount required to settle the obligation may be contingent on the occurrence or non-occurrence of a future event, such as a decline in market prices. The government nevertheless is obligated to fulfill its obligation upon resolution of any contingencies affecting the timing and amount of settlement. Uncertainty regarding the amount or timing of settlement is addressed through measurement of the liability. Assuming the government concludes that there is a present obligation to provide assets or services to another entity with which it is in litigation, the essential characteristic of settlement of the obligation must be satisfied in order for a liability to exist. When litigation is ongoing, the government and the other entity will not know when the obligation will be finally determined and settled, but both parties will have a common understanding of the chain of events that will trigger settlement, namely the resolution of the litigation either by the courts or by settlement.

47. Frequently, the federal government knows before settlement is due which specific entities or individuals will receive settlement. However, such advance identification of specific recipients is not an essential characteristic of a liability. For example, the government may have a long-term disability agreement with federal employees without knowing the identity of each of

the employees who ultimately will qualify for payment. The obligation qualifies as a liability if both of the essential characteristics of a liability are present.

48. Once incurred, a liability of the federal government continues as a liability until the government settles it or another event or circumstance discharges it or removes the government's responsibility to settle it.

Net Position, Revenues, and Expenses

49. Whereas the definitions of assets and liabilities derive from the essential characteristics of those items, the definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities. Thus, in assessing whether items meet the definitions of net position, revenues, and expenses, reference should be made to the definitions of their underlying assets or liabilities.

Definition of Net Position

50. Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

51. Entities often subdivide net position in financial reports to provide information about its composition. However, the reported composition and intended interpretation of net position depend on the particular financial reporting model applied and resulting display requirements. As such, a discussion of the meaning of the government's or a component entity's reported net position is beyond the scope of this Statement.

Definitions of Revenue and Expense

52. A revenue is an increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

53. An expense is a decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

54. Common sources of revenues are charges and fees to other entities for goods or services; tax levies and other impositions; and donations. Expenses generally result from the provision of cash, cash equivalents, goods, and services to other entities. Transactions that are in substance adjustments or completions of previous transactions rather than new

transactions involve the same elements as the original transaction. For example, a tax refund is considered a revenue reduction and not an expense, and reimbursement of one agency's expense by another agency is considered a reduction of an expense, not a revenue, to the recipient agency and an expense to the reimbursing agency. The definitions of revenue and expense address only whether those elements exist. The definitions do not address how a revenue or expense should be measured or whether or when it should be recognized in the federal government's or a component entity's financial statements. Basic recognition criteria for all elements of accrual-basis financial statements are set forth and discussed in paragraphs 5 through 9. Those paragraphs also indicate that measurement issues and other considerations for recognition decisions will be addressed in future pronouncements. In addition, paragraph 6 acknowledges the possibility of uncertainty about whether an item meets the definition of an element and the need for judgment based on the available evidence. However, this Statement does not establish a threshold to be assumed in applying judgment.

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55. Existing standards or established practice may indicate that certain increases and decreases in assets should be reported as gains and losses, rather than revenues and expenses. Use of the terms *gains* and *losses* generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature[8] or their having resulted from peripheral or incidental activities of an entity.[9]

56. The definitions of revenue and expense in this Statement include items that might be reported as gains and losses. Gains and losses are considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets. Whether certain kinds of revenues and expenses should be reported as gains and losses and, if so, under what circumstances, is beyond the scope of this Statement.

EFFECTS OF UNCERTAINTY

57. Uncertainty about economic activities and results is pervasive. Uncertainty about whether a transaction or other event gives rise to the existence of an element means that judgment often is required as to whether the item possesses the essential characteristics of an element and therefore meets the relevant definition. Items that are judged to meet the definition of an element are candidates for recognition provided they are measurable—that is a monetary amount can be determined with reasonable certainty or is

[8] See, for example, SFFAC 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, par. 35 (FASAB, 1996).
[9] The latter distinction is included in FASB Concepts Statement No. 6, *Elements of Financial Statements,* par. 87 (FASB, 1985).

reasonably estimable. Items that, because of uncertainty, do not meet the basic recognition criteria may be candidates for disclosure.

58. In addition to the basic recognition criteria, decisions whether to recognize or disclose an item take into account considerations that also include uncertainties. These considerations are measurement of an appropriate attribute, which may include an assessment of the probability of future flows of economic benefits or services, and assessments of the materiality of the item and the benefit versus the cost of recognizing it.[10]

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59. Uncertainty increases the costs of financial reporting, particularly the costs of recognition and measurement. Also, reassessments and restatements may be required if items previously reported as expenses or revenues, or not reported, are later found with benefit of hindsight to have the essential characteristics of assets or liabilities.[11] It may be possible to reduce uncertainty by exerting greater effort or spending more money, but it also may not be worth the added cost. As discussed in paragraph 6, the exercise of judgment may be necessary, but this Statement does not require certainty.

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[10] As discussed in paragraph 7, measurement issues, probability assessments, and other considerations for recognition decisions beyond the basic recognition criteria are not addressed in this Statement. The Board intends to address those issues in future pronouncements. In the meantime, existing standards for those issues continue to apply.

[11] This Statement does not change existing standards concerning whether new information should result in restatement of previously reported information or should be treated prospectively as a change in estimate.

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Appendix A: Basis for Conclusions

A1. This appendix summarizes important matters that FASAB considered in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others.

BACKGROUND

A2. The FASAB 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. In 2003, the Board decided that it should review and add to or modify its concepts statements as needed. The Board's desire to evaluate its concepts after more than twelve years of successful progress is stimulated by a realization that (a) some critical concepts that have been relied on are not yet included in a concepts statement, (b) certain aspects of the concepts are not widely understood or accepted, and (c) an expansion or modification of its concepts statements will help the Board communicate more effectively with the growing community of federal financial report users, preparers, and auditors.

A3. As part of its project to review and expand its conceptual framework, the FASAB began deliberations on this Statement of Federal Financial Accounting Concepts (SFFAC), *Definition and Recognition of Elements of Accrual-Basis Financial Statements*, in October 2003. This Statement defines the elements of federal accrual-basis financial statements and establishes basic criteria for selecting candidates for recognition in those statements. The Board believes that this Statement is an important part of its conceptual framework and will provide more consistent, useful, and enduring guidance to the Board and its constituents than establishing definitions and recognition requirements standard by standard.

A4. Part of the reason for this Statement is that, for several years, the Board has received questions about the usefulness of certain definitions of elements, such as liabilities, in current standards and their applicability to transactions outside the scope of the defining standard, as well as about the absence of definitions of other elements, such as assets. Moreover, in certain standards the Board requires disclosure or other required reporting of financial and non-financial information that does not meet the definition of an element and is not directly linked to an element—for example, social insurance cash flows, tax gap, acres of land, and current service assessments. In this Statement, the Board provides definitions of the elements of financial statements that will inform the Board's deliberations of future standards as well as providing guidance to preparers and auditors on issues that are not addressed in current standards. This Statement does not change existing standards. However, the Board intends to apply the definitions and basic recognition criteria in this Statement when it deliberates new standards and modifications of existing standards.

A5. The concepts, definitions, and basic recognition criteria in this Statement provide a common foundation for distinguishing between items that meet the definitions of elements of accrual-basis financial statements and those that do not, and between items that are candidates for recognition in the body of financial statements and those that qualify only for disclosure in the notes or as supplementary information. The Board therefore anticipates that the guidance in this Statement will enhance the understandability, consistency, and comparability of financial reporting for the benefit of users, preparers, and auditors of the financial statements as well as the Board itself. As a result, the Board expects this Statement to contribute to meeting the government's overall financial reporting objectives of demonstrating accountability and providing useful information, as well as the more specific objectives of assisting users in evaluating a reporting entity's operating performance and stewardship.

A6. The Board issued an Exposure Draft (ED) of this Statement in June 2006, with a majority vote in favor. The ED was circulated with a request for comments to more than 250 federal and nonfederal individuals and organizations, including financial statement preparers, auditors, and users; state-level taxpayer organizations; professional associations and journals; and U.S. and overseas standard-setting authorities. The Board received 40 comment letters and heard five presentations at a public hearing in September 2006. Respondents generally were supportive of the Board's proposals. This Appendix includes a discussion of the principal issues raised and the reasons for the Board's conclusions.

DEFINITIONS OF ELEMENTS IN EXISTING FASAB PRONOUNCEMENTS

How Does This Concepts Statement Affect Existing Definitions in Statements of Federal Financial Accounting Standards?

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A7. The following are definitions of liabilities, and revenues included in federal financial accounting standards and a definition of asset included in the explanatory text of a federal financial accounting standard. Also, the Consolidated Glossary includes a different definition of assets and a definition of expenses. However, those definitions are not included in any final Statement approved by the Board.

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> The term ***asset*** as used in this document means an item that embodies a probable future economic benefit that can be obtained or controlled by the federal government or a reporting entity as a result of past transactions or events. (The definition of assets will be considered by the Board in the future.)—SFFAS 1, Basis for Conclusions, par. 93

> ***Assets:*** Tangible or intangible items owned by the federal government which would have probable economic benefits that can be obtained or controlled by a federal government entity. (Adapted from Financial Accounting Standards Board, Concepts Statement No. 6, *Elements of Financial Statements* (FASB CON 6))—Consolidated Glossary

A ***liability*** for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.—SFFAS 5, par. 19

Revenue is an inflow of resources that the Government demands, earns, or receives by donation—SFFAS 7, par. 30

Expense—Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from providing goods, rendering services, or carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period. (Adapted from FASB CON 6))—**Consolidated Glossary**

A8. Concepts statements do not establish generally accepted accounting principles (GAAP) and cannot amend existing standards, interpretations, technical bulletins or releases, or staff implementation guidance. The GAAP hierarchy provides that statements of federal financial accounting standards constitute level A (the highest level) guidance. Statements of federal financial accounting concepts are not GAAP. Instead, concepts statements constitute "other literature" and may only be relied upon by financial statement preparers and auditors to resolve specific accounting issues in the absence of GAAP literature. In developing and amending accounting standards, the Board looks to concepts statements for guiding principles and also considers relevant existing standards and guidance issued by the Board and other standard setting bodies. Until the Board amends existing standards, the Board expects practice to be governed by the definitions embodied in the four levels of the GAAP hierarchy. Thus, the Board distinguishes between definitions presented in concepts which are used to guide Board deliberations on future GAAP and definitions presented in standards which constitute current GAAP.

For example, SFFAS 5, *Accounting for Liabilities of the Federal Government*, provides and will continue to provide authoritative general guidance on liability recognition and measurement in the absence of more specific liability standards. SFFAS 5 provides the general liability definition presented in par. A7 and general standards regarding recognition of liabilities in four classes—exchange transactions, nonexchange transactions, government-related events and government-acknowledged events. It also provides specific standards for contingencies, capital leases, federal debt and related interest, pensions, other retirement benefits, and other postemployment benefits, and insurance and guarantees (excluding loan guarantees). Specific standards regarding liabilities also exist in SFFAS 1, 2 (as amended by 18 and 19), 6, and 12.

A9. The Board's – and the profession's – expectation is that standards will continue to be applied until they are amended or rescinded. It is widely recognized that GAAP guidance at any point in time may contains provisions that are inconsistent with concepts. Because concepts are not GAAP and are to be considered only in the absence of GAAP, any inconsistency of definitions should not cause a different outcome as the

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GAAP definitions would be applied. ~~than other observed inconsistencies, such as inconsistent treatment resulting from general standards versus specific standards.~~

A10. The definitions of elements and basic recognition criteria in this Statement are generally consistent with current practice and therefore do not imply a fundamental change. However, they are expected to guide the Board's future deliberations, which may lead to future changes in practice through new or amended standards of federal accounting and financial reporting. The Board plans to consider how the element definitions should be applied in each standard-setting project undertaken. Projects may include both new specific standards and amendments to existing standards. The Board solicits input on its agenda prior to adding new projects. This Statement will help respondents contribute input by providing a framework for identifying any inconsistencies in current standards.

What General Improvements Are Gained by the Adoption of the New Concepts Statement?

A11. The Board believes that the definitions in this concepts statement will better support the Board's future deliberations by providing for the first time:

1. Internally consistent definitions for all of the elements of accrual-basis financial statements (some of which are not defined in current GAAP), all of which have been subject to due process; and
2. Explanatory text for each definition to assist the Board in application of the definitions (for example, the discussion of essential characteristics is intended to enhance the clarity of the definitions and the consistency of their interpretation and application by the Board).

A12. In addition, the concepts statement responds to the following general concerns that were raised regarding the prior asset and liability definitions:

a. *Potential confusion concerning the use of "probable" in both definitions.* For example, there are various thresholds applied in practice and there is difficulty in establishing at the financial reporting date what future flows will result.

b. *Potential redundancy and confusion about inclusion of the concept of past transactions or events that create assets and liabilities:* Some view this as redundant because the asset or liability exists and thus a past transaction or event must have occurred. Some believe this causes confusion about what assessment is being made; whether the characteristics of an asset or liability exist or whether there was a qualifying past event. The Board believes that the concepts of "resource" (assets) and "present obligation" (liabilities) better convey the intended meaning.

c. *Potential confusion concerning the use of the terms "future outflow" and "future economic benefit."* Some confusion may exist in the use of the word "future" when an asset is a resource that the government controls today and a liability is a present, not

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future, obligation. The Board believes that the definitions in this concepts statement convey a more clear understanding.

d. *Clarification concerning settlement*. The Board believes that it is important to clarify, as an essential element, that there must be statutory requirements or an agreement or understanding concerning settlement before there is a liability. If the government is free to decide whether and when to settle the obligation, the government does not have a liability.

APPROACH TO DEFINING ELEMENTS

Assets and Liabilities

A13. The Board's approach to defining assets and liabilities is to identify the essential characteristics of those elements—that is, the characteristics that *all* assets and *all* liabilities, respectively, possess and without which they would not exist. The definitions of assets and liabilities established in this Statement are designed to capture those essential characteristics succinctly. However, the definitions considered without further explanation could be interpreted differently. To enhance the clarity of the definitions and the consistency of their interpretation and application, the Board has included in the Statement a discussion of the essential characteristics underlying each definition. The Board encourages those who read and apply this Statement to consider the definitions and the subsequent discussions of essential characteristics as a "package," rather than considering the definitions in isolation of further explanation.

A14. The principal advantage of the Board's approach to defining assets and liabilities is that it enhances objectivity and consistency in establishing standards and in practice in the absence of guidance at a higher level within the hierarchy. Whether an asset or liability results from a particular transaction or other event can be determined objectively and consistently by the Board, preparers, and auditors by comparing the item to the definition of an asset or liability and considering whether the item has the essential characteristics of that element. The alternative approach where the Board decides standard by standard what activities result in assets or liabilities may result in a lack of objectivity and inconsistent treatment of similar transactions or other events. A large majority of the respondents to the ED agreed with the Board's approach to defining assets and liabilities.

Net Position, Revenues and Expenses

A15. The Board has concluded that the elements net position, revenues, and expenses are not independent of assets and liabilities and do not have their own essential characteristics. Net position is total assets less total liabilities. Revenues and expenses are changes in assets and/or liabilities during a reporting period that result in a change in

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net position. Thus, the definitions of all three elements are dependent on the definitions of assets and liabilities.

A16. Some believe that a conclusion that the definitions of revenues and expenses derive from the definitions of assets and liabilities indicates that assets and liabilities are more important than revenues and expenses. They believe that, by extension, a “stocks” statement, such as a statement of financial position or balance sheet, will be considered the principal statement in a financial report and a “flows” statement, such as an activities statement or statement of net cost, will be secondary in importance. Many of those with these views disagree with the perceived primacy of “stocks” statements and believe that “flows” statements are either equally important or more important in government financial reporting.

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A17. The Board disagrees that the derivation of the definitions of revenues and expenses from the definitions of assets and liabilities accords more importance to a statement of financial position or balance sheet than to an activities statement. Each type of statement has its own purposes. The relative importance of one type of statement over the other varies because it depends on the decisions that users wish to make in particular circumstances and, therefore, the information they are seeking. The two types of statements are related. They articulate, just as revenues and expenses articulate with assets and liabilities. Assets and liabilities represent real-world phenomena, such as cash, equipment, and debt, and can be defined by the characteristics that all assets and liabilities, respectively, share. In contrast, revenues and expenses do not represent real-world phenomena and do not have characteristics that are independent of assets and liabilities. They are accounting constructs that measure the effects of activities during a reporting period on the amounts of assets and liabilities at the beginning of the period. Without assets and liabilities, revenues and expenses do not exist. They cannot be defined without reference to assets and liabilities. A large majority of the respondents to the ED agreed with the Board’s approach to defining net position, revenues, and expenses. In addition, the Board notes that its view of the relationship between revenues and expenses and the definitions of assets and liabilities is shared by other standard setters, including the Financial Accounting Standards Board and the International Accounting Standards Board, as well as the Australian, Canadian, New Zealand, Swedish, and United Kingdom standard-setting authorities, which promulgate standards for the public sector as well as the business sector.

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DEFINITIONS, RECOGNITION, AND MEASUREMENT

A18. The Board’s approach in this Statement also separates the path to recognition on the face of financial statements into three components: meeting the definition of an element, meeting recognition criteria, and measurement of the item to be recognized. Although the components may be addressed simultaneously in practice, the Board believes that a conceptual distinction is useful. It clarifies that an item that meets the definition of, for example, an asset is an asset, even if it does not meet the criteria for recognition in the body of the financial statements, or it is not material, or it is not cost-beneficial to report the item in the financial statements or notes or as supplementary information. The item remains an asset until it is disposed of or no longer meets the definition of an asset.

A19. The recognition criteria established in this Statement ("basic recognition criteria," as discussed later) include a conclusion as to whether the asset is measurable, meaning that a monetary amount can be determined with reasonable certainty or is reasonably estimable. The basic recognition criteria do not include requirements for the actual measurement of an element. Measurement includes selecting an appropriate attribute (historical cost, fair value, expected value, or some other attribute) and quantifying it monetarily using an appropriate measurement method, which may include an assessment of the probability of future flows of economic benefits or services. Recognition decisions also include consideration of the materiality of the amount measured and the cost-benefit of reporting it. The scope of this Statement includes definitions of elements and the establishment of basic recognition criteria, but it does not include measurement requirements. The Board intends to address measurement issues in a separate pronouncement.

MODIFICATIONS TO THE EXPOSURE DRAFT

Probability Assessments and Thresholds

A20. The Board had numerous discussions about the role of probability assessments in determining whether an item meets the definition of an element and/or is measurable for financial reporting purposes. The Board's decision in the ED was that judgment might be required in determining whether an item meets the definition of an element and is recognizable in the body of financial statements. However, an assessment of probabilities was not included as a mandatory component of determining compliance with the definition of an element or basic recognition criteria, although such an assessment was not precluded. Rather, an assessment of probabilities should be made, if appropriate, when measuring the item to be recognized.

A21. Three Board members presented an alternative view. These members were concerned that, by not requiring probability assessments, the ED implied that items with a low probability of meeting the definition of an element or of meeting the recognition criteria could be recognized in the financial statements. In their view, the Board should specifically state that an assessment of probabilities should be made as part of determining whether an item meets the definition of an element. Similarly, the probability that an item is measurable should be assessed when considering whether a candidate for recognition is measurable. Also, the Board should acknowledge that there exists a threshold at both the definition and the recognition stages where the probability of meeting the definition and recognition criteria is so low that an item should be considered not to meet the definition of an element or the recognition criteria.

A22. Respondents to the ED were evenly divided in their support for the ED (majority) view or the alternative view concerning probability assessments and probability thresholds. The reasons given were similar to those expressed respectively in the ED and the alternative view. After further deliberation, the Board reaffirmed its decision that probability assessments should not be required when determining compliance with definitions or recognition criteria and the potential existence of probability thresholds should not be mentioned; the Board would address probability assessments and consider potential thresholds in a future project on measurement. However, the Board decided that references to recognition criteria in paragraph 5 and elsewhere should be modified to indicate more clearly that the Statement does not address all matters to be considered in recognition decisions. Also, the references to uncertainty about the existence of an element and whether it is measurable should be clarified.

A23. As a result, paragraph 5 and related discussions now refer to “basic recognition criteria” and identify additional considerations for recognition decisions to be addressed in one or more future pronouncements. “Basic recognition criteria” are defined in paragraph 5 as “the conditions an item should meet in order to be a candidate for recognition.” The Board also has expanded the definition of “measurable” in paragraph 5 to mean “a monetary amount can be determined with reasonable certainty or is reasonably estimable.” In the section on “Effects of Uncertainty” (paragraphs 57 through 60) the Board has clarified aspects of uncertainty in financial reporting and modified the discussion to achieve greater consistency with the revised paragraphs 5 through 8 under “Recognition.”

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Qualitative Characteristics

A24. The members with an alternative view on the location of probability assessments also presented an alternative view concerning the qualitative characteristics of information in financial reports. These members said that the ED should explicitly acknowledge that the qualitative characteristics—or at a minimum the characteristics of relevance and reliability—should be considered when determining whether an item meets the definition of an element and is measurable. The majority of the Board, however, indicated that the proposed concepts Statement on elements mentioned the qualitative characteristics in paragraph 1 and did not supersede or change the applicability of those characteristics in accordance with SFFAC 1.[12] Past practice of the FASAB has been not to repeat in new statements of concepts or standards the content or requirements of prior statements that the new statement does not supersede. Those requirements automatically continue until superseded by a new pronouncement. Therefore, to repeat the qualitative characteristics in the elements ED was unnecessary and might be confusing to readers of the ED accustomed to the FASAB’s past practice in this area by implying that the qualitative characteristics established in SFFAC 1 had been changed. Respondents to the ED were slightly more in favor of the alternative view than the ED (majority) position on this issue. However, the Board concluded that the alternative view might have unintentionally implied that the qualitative characteristics need not be considered unless they were specifically repeated in the elements statement.

A25. The Board reaffirmed its decision not to list the qualitative characteristics in the Statement or to refer specifically to their applicability to definition and recognition decisions. Nevertheless, the Board decided to clarify the issue in the elements Statement. As a result, the Board has (a) expanded the discussion of the role of this

[12] Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting,* 1993.

Statement in the Board's conceptual framework and the continuity of prior concepts statements (See the page on "Statements of Federal Financial Accounting Concepts" placed before the Table of Contents.), (b) highlighted the reference to qualitative characteristics in paragraph 8, and (c) added the definition of "Qualitative Characteristics" to the Glossary (Appendix A) with a cross-reference to the identification of them in paragraph 156 of SFFAC 1.

Applicability of Current Law

A26. Paragraph 44 of the ED states that

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> To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on *existing* conditions, including current law, because an essential characteristic of a liability is that the government has a *present* obligation, even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability.

A27. Three Board members presented an alternative view to the effect that "the government's power to modify the law to change or withdraw future benefits related to non-exchange transactions could affect the existence of a present obligation." In the view of these members, "the government's ability to change the law may provide additional evidence about whether a present obligation exists and, in some instances, may preclude recognition of a liability." Also, members with an alternative view stated that the position adopted in paragraph 44 of the ED might need to be revised when the Board's projects on social insurance and the application of the liability definition became final.

A28. A large majority of the respondents to the ED on this issue supported the position in paragraph 44 of the ED for reasons similar to those stated in that paragraph—primarily that "liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred." Respondents who supported the alternative view generally echoed its reference to changes in future benefits or emphasized their view that social insurance obligations are different in nature from other obligations. The Board redeliberated the issue and reaffirmed the position stated in paragraph 44 of the ED. The majority did not agree that Congress's ability to change a law should affect whether a liability does or does not exist at the reporting date. Given the broad powers of Congress, if such an effect were acknowledged, the government would recognize virtually no liabilities. Some Board members observed that the possibility or probability of a change in the law might be taken into account in measuring a liability and could be disclosed.

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Definition of Assets

A29. A large majority of the respondents to the ED agreed with the essential characteristics of assets identified by the Board and that the Board's definition of assets adequately conveys those characteristics. Further, they did not identify any additional characteristics that are essential to all assets. Two respondents, while agreeing with the definition of assets, questioned whether the requirement in the definition that the government "can control" the economic benefits or services embodied in an asset should be changed to "controls" the economic benefits or services. The respondents were concerned that "can control" might be construed as applying only to the future, whereas they believe the government should be controlling the economic benefits or services at the reporting date. The Board believes that "controls" implies that the government is actively controlling access to the economic benefits or services at the reporting date, which is not an essential characteristic of an asset. Rather, the essential characteristic is the government's *ability* to control access whether or not it is *actually controlling* access at the reporting date. For example, the government might be willing currently to allow other entities free access at will to the economic benefits or services embodied in its asset, without relinquishing its right to regulate or deny that access and obtain the benefits for itself at a future date. STAFF NOTE: This paragraph and the following one will be updated to conform to a final decision on the wording of the asset definition.

A30. The Board acknowledges the potential for ambiguity whether the definition says "can control" or "controls." Therefore, the Board has revised the definition to read "An asset is a resource that embodies economic benefits or services that the federal government i*s able to control*" (emphasis added). Conforming modifications have been made to the paragraphs describing the essential characteristics of assets.

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Definitions of Revenues and Expenses

A31. The following definitions of revenues and expenses were proposed in the ED:

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52. 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.

53. 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 large majority of respondents to the ED agreed that the definitions adequately convey the relationship of revenues and expenses to assets and liabilities. Respondents generally did not comment on the actual definitions. However, a few respondents suggested clarifications or simplifications, such as referring to changes in net position instead of to increases or decreases in assets and liabilities, clarifying or avoiding the reference to borrowings, and clarifying the phrase "any other activity."

A32. The Board agreed that referring to changes in net position would remove the need to refer to the exclusion of borrowings and repayments of borrowings. Also, the Board concluded that the reference to "any other activity" lacked clarity and effectively made the definitions all-encompassing. The Board decided to simplify the definitions and has included the following wording in this Statement:

> 52. A revenue is an increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.
>
> 53. An expense is a decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

The Board has included examples of revenues and expenses in the following paragraph instead of in the definitions. The Board also has confirmed that reversals of a transaction would use the same element as the original transaction. For example, tax levies would be reported as revenues and tax refunds would be reported as reductions of revenues, not expenses.

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OTHER ISSUES RAISED BY RESPONDENTS

Definition of Liabilities

A33. A large majority of the respondents to the ED agreed with the essential characteristics of liabilities identified by the Board and that the Board's definition of liabilities adequately conveys those characteristics. Further, they did not identify any additional characteristics that are essential to all liabilities. Nevertheless, a few respondents thought that an agreement or understanding between the parties concerning settlement of the obligation is not an essential characteristic of a liability, or is part of the "present obligation" characteristic.

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A34. The Board discussed the "settlement" characteristic before issuing the ED and concluded that if the government *alone* can determine whether and when to settle an obligation then it does not qualify as a liability. A liability always is between two separate entities. There must be either an obligation and a requirement for settlement with the other entity supported in law or some agreement or "meeting of the minds" between the government and the other entity as to whether an obligation exists and what circumstances would trigger settlement. The Board believes that the respondents who disagreed that the "settlement" characteristic is an essential characteristic of a liability may have inferred that the FASAB was saying that the *precise* timing of settlement must be specified and agreed between the two parties. However, that was not the Board's intent. As stated in paragraph 45:

> . . . The timing of settlement often is expressed in contracts and other agreements as a specific or determinable date. However, in some cases the parties agree that

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A35. Paragraph 46 indicates that both the timing and the amount of the settlement may be uncertain, but that "Uncertainty regarding the amount or timing of settlement is addressed through measurement of the liability." The Board does not believe that there is uncertainty about whether the government has a liability simply because the precise settlement date is unknown. Based on these considerations, the Board reaffirmed its conclusion that an essential characteristic of a liability is that the government be legally required to make settlement with the other entity or the government and the other entity have an agreement or understanding concerning settlement.

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Additional Elements

A36. A few respondents to the ED suggested that certain items that the Board had concluded meet the definitions of revenues or expenses should be defined as separate elements. Those items and the number of respondents who suggested them are gains and losses (4 respondents), appropriations (2 respondents), intra-governmental transfers (3 respondents), and imputed costs (1 respondent). Also, two respondents proposed that the currently reported components of net position, unexpended appropriations and cumulative results of operations, should be defined as separate elements. In its deliberations leading to the ED, the Board concluded that these items are subdivisions of net position according to a particular financial reporting model and should not be considered separate elements.

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A37. With respect to gains and losses, the Board reviewed the practice of other standard setters prior to issuing the ED and found that some define gains and losses as separate elements whereas others do not. Regardless of whether they are defined separately from revenues and expenses, the reporting of gains and losses generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature or their having resulted from an entity's peripheral or incidental activities. The Board has concluded that, conceptually, gains and losses are subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are subsets of assets. The Board believes that whether and under what circumstances certain items should be displayed in the financial statements as gains and losses rather than revenues and expenses is an issue for financial reporting standards.

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A38. SFFAS 7[13] defines appropriations and transfers as other financing sources, rather than revenues. However, the standard states that other financing sources are inflows of resources like revenues. Moreover, in practice, many component entities regard

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[13] Statement of Federal Financial Accounting Standards 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, 1996

appropriations as revenues, regardless of whether they are referred to as other financing sources in certain statements. The Board believes that, as with gains and losses, the distinction between other financing sources/uses and revenues/expenses is not a true conceptual distinction. Rather, it is attributable to display considerations under a particular financial reporting model. As such, the Board has concluded that other financing sources, such as appropriations and transfers, are not separate elements from revenues. Appropriations are not revenues of the government as a whole. However, they are like revenues for component entities because they provide the legal basis for the entities to incur expenses.

A39. FASAB Interpretation 6[14] states the following:

> 11. Imputed intra-departmental costs are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, components or responsibility segments within the department or larger reporting entity).

Consistent with this definition, the Board has concluded that imputed costs are not separate elements, but are included in the definition of expenses for component entities.

A40. The Board does not consider unexpended appropriations and cumulative results of operations to be separate elements. Rather, they are components of net position in the current federal financial reporting model. To define them as elements in this Statement would imply that the definitions in this Statement are designed to apply to the current reporting model and may not be applicable to other models. On the contrary, the Board concluded at the outset of the elements project that the definitions and related concepts in this Statement should not be geared or restricted to any particular financial reporting model because that would constrain the Board's ability to modify the model to meet the changing or emerging needs of decision makers. For these reasons, the Board has not included definitions of unexpended appropriations or cumulative results of operations in this Statement and has not discussed their role in financial reporting.

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[14] Interpretation 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4,* 2003

Appendix B: Glossary

Asset: A resource that embodies economic benefits or services that the federal government controls.

Basic recognition criteria: The conditions an item should meet in order to be a candidate for recognition in financial statements.

Control: The ability of the federal government or a component entity to obtain the economic benefits or services embodied in a resource and to deny or regulate the access of others.

Elements: The broad classes of items, such as assets, liabilities, revenues, and expenses, which comprise the building blocks of financial statements.

Essential characteristic of an asset (or a liability): A characteristic that is inherent to all assets (or liabilities) and, therefore, without it an asset (or liability) would not exist.

Expense: A decrease in assets, an increase in liabilities, or a combination of both that results in a decrease in the government's net position during the reporting period.

Liability: 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.

Net position: Net position or its equivalent, net assets, is the arithmetic difference between the total assets and total liabilities recognized in the federal government's or a component entity's balance sheet. Net position may be positive (assets greater than liabilities) or negative (assets less than liabilities).

Measurable: A monetary amount can be determined with reasonable certainty or is reasonably estimable.

Measurement: The act or process of measuring; a figure, extent, or amount obtained by measuring.

Qualitative characteristics: The basic characteristics that information in financial reports must have in order to communicate effectively with users. These characteristics are understandability, reliability, relevance, timeliness, consistency, and comparability.[15]

Recognition: The process of formally recording or incorporating an element into the financial statements of an entity. Recognition comprises depiction of an item in both words and numbers with the amount included in the totals of the financial statements.

Resource: A useful or valuable possession or quality of a country, organization or person; a means of supplying a want.

[15] SFFAC 1, par. 156.

Revenue: An increase in assets, a decrease in liabilities, or a combination of both that results in an increase in the government's net position during the reporting period.

Appendix C: Generally Accepted Accounting Principles

Excerpt from the AICPA's AU Section 411 - The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles

05 Independent auditors agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of established accounting principles that are generally accepted in the United States of America are—

a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 [ET section 203.01] of the AICPA Code of Professional Conduct. Rule 203 [ET section 203.01] provides that an auditor should not express an unqualified opinion if the financial statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 [ET section 203.01] implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 [ET section 203.01] provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements. (See section 508, Reports on Audited Financial Statements, paragraphs .14 and .15.)

b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a). fn 2

c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.

d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

[Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 93.]

.06 Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The auditor should consider whether the substance of transactions or events differs materially from their form.

.07 If the accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 [ET section 203.01], the auditor should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (b), (c), or (d) is relevant to the circumstances, the auditor should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (b), (c), or (d), the auditor should follow the treatment specified by the source in the higher category—for example, follow category (b) treatment over category (c)—or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

.08 The auditor should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects. Section 544, Lack of Conformity With Generally Accepted Accounting Principles, paragraph .04 and section 623, Special Reports provide guidance if the auditor is reporting on financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

.09 Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.

Paragraphs 10 through 13 omitted.

Application to Federal Governmental Entities

.14 For financial statements of federal governmental entities— fn 8

a. Category (a), officially established accounting principles, consists of Federal Accounting Standards Advisory Board (FASAB) Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to federal

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.10 . For financial statements of entities other than governmental entities— fn 3 ¶
a. . Category (a), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.¶
b. . Category (b) consists of FASB Technical Bulletins and, if cleared fn 4 by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.¶
c. . Category (c) consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared fn 4 by the FASB and consensus positions of the FASB Emerging Issues Task Force.¶
d. . Category (d) includes AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.¶
.11 . In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general rec ... [37]

governmental entities by FASAB Statements or Interpretations. FASAB Statements and Interpretations will be periodically incorporated in a publication by the FASAB.

b. Category (b) consists of FASAB Technical Bulletins and, if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position. fn 9

c. Category (c) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.

d. Category (d) includes implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

[Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

.15 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of a federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASAB Concepts Statements; the pronouncements referred to in categories (a) through (d) of paragraph .10 when not specifically made applicable to federal governmental entities by the FASAB; FASB Concepts Statements; GASB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB Concepts Statements would normally be more influential than other sources in this category. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

Effective Date

.16 This section is effective for audits of financial statements for periods ending after March 15, 1992. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

Transition

.17 Most of the pronouncements or practices in categories (b), (c), and (d) of paragraphs .10 and .12 had equal authoritative standing prior to the issuance of this section. An entity following an accounting treatment in category (c) or (d) as of March 15, 1992, need not change to an accounting treatment in a category (b) or category (c) pronouncement whose effective date is before March 15, 1992. For example, a nongovernmental entity that followed a prevalent industry practice (category (d)) as of March 15, 1992, need not change to an accounting treatment included in a pronouncement in category (b) or (c) (for example, an accounting principle in a cleared AICPA Statement of Position or AcSEC Practice Bulletin) whose effective date is before March 15, 1992. For pronouncements whose effective date is subsequent to March 15, 1992, and for entities initially applying an accounting principle after March 15, 1992 (except for FASB Emerging Issues Task Force consensus positions issued before March 16, 1992, which become effective in the hierarchy for initial application of an accounting principle after March 15, 1993), the auditor should follow the applicable hierarchy established by paragraphs .10 and .12 in determining whether an entity's financial statements are fairly presented in conformity with generally accepted accounting principles. [Paragraph added, effective April 2000, by Statement on Auditing Standards No. 91.]

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Concerns have been expressed about the impact on the community of two definitions for certain elements – one in concepts statements which are not GAAP and another in standards which are GAAP – and whether this will cause changes in practice to emerge. The principal objective of concepts statements is to provide a framework for the Board's standard-setting activities. Concepts statements do not lead to immediate amendments of standards nor are they an effective vehicle for causing immediate changes in practice

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Concerns have been expressed about the impact on the community of two definitions for certain elements – one in concepts statements which are not GAAP and another in standards which are GAAP – and whether this will cause changes in practice to emerge. The principal objective of concepts statements is to provide a framework for the Board's standard-setting activities. Concepts statements do not lead to immediate amendments of standards nor are they an effective vehicle for causing immediate changes in practice.

What General Improvements Are Gained by the Adoption of the New Concepts Statement?

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Several issues have been raised with these definitions.

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In this Statement the Board has developed an integrated set of definitions, has provided explanatory text for each definition, and has resolved or clarified the other issues that have been raised with respect to one or more of the definitions. The Statement is helpful because it (1) fills the void in current element definitions, (2) provides robust explanatory text to support each definition, and (3) ends the reliance on definitions of asset that have not been exposed to due process. As a result, the Board believes that the definitions in this Statement will better support the Board's future deliberations.

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In this Statement the Board has developed an integrated set of definitions, has provided explanatory text for each definition, and has resolved or clarified the other issues that have been raised with respect to one or more of the definitions. The Statement is helpful because it (1) fills the void in current element definitions, (2) provides robust explanatory text to support each definition, and (3) ends the reliance on definitions of asset that have not been exposed to due process. As a result, the Board believes that the definitions in this Statement will better support the Board's future deliberations.

In addition, the

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Does it have a meaning equivalent to SFFAS 5 – more likely than not – or does it simply mean that the likelihood is greater than zero? Is the word "probable" misplaced? If the benefit is a probable *future* one, does it have to exist now, at the reporting date? Does the resource have to "embody" it now? Either way, how can we know now (reporting date) that the government will be able to obtain or control a *future* benefit? Should the definition be that the item "*probably embodies* a benefit that the government can obtain or control (or *probably* can obtain and control) in the future"?

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All definitions: The definitions are not part of an integrated set of definitions. It is generally agreed that, because financial statements and their elements articulate, element definitions should be related and should be parallel where possible.

All definitions: Explanatory text is not provided. Generally, single sentence definitions are insufficient and subject to various interpretations. Standard setters generally provide explanatory text regarding each essential characteristic embodied in the definition.

Assets: Uncertain status. Each of these two definitions of assets appears in the original pronouncements. It is clear that the first was approved by the Board in the context of its basis for conclusions to SFFAS 1. The second was presented in an ED but omitted from the final statement. It is difficult to argue that either definition is significant.

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Assets: "Owned" by the government is not generally a requirement for an item to be a government asset and is redundant (or conflicts) with notions of obtaining or controlling benefits. Which is necessary – ownership or right to benefits?

Assets: "Embodies a probable future economic benefit that can be obtained or controlled by the federal government" When applied, does this mean that it has to be both (1) probable that there will be an economic benefit in the future and (2) that the federal government can obtain or control it? If there is little or no chance that future economic benefit will be derived – for example, oil and gas reserves that are not accessible without great harm to a pristine area – is it sufficient that the government is the only entity that can obtain any future benefits? Also, the potential for the government to exert control over others' assets in the future is not excluded from "asset." Is the right past event the power to exert the control or the actual exertion of control? No text explains this.

Assets and liabilities:

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Probable –

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There is confusion about application of the notion of

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Focusing on past transactions or events that create

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Past transactions or events –

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you are looking for

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. Are you looking

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for the asset-creating event?

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"". Some confusion may exist in the use of the word "future" when an asset is a resource that the government controls today and a liability is a present, not future, obligation. The Board believes that the definitions in this concepts statement convey a more clear understanding.

Clarification concerning settlement. The Board believes that it is important to clarify, as an essential element, that there must be statutory requirements or an agreement or understanding concerning settlement before there is a liability. If the government is free to decide whether and when to settle the obligation, the government does not have a liability.

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Revenues: Gains—listed as separate from revenue (Exchange revenue and gains are inflows of resources to a government entity that the entity has earned. (par. 33 of SFFAS 7), but are not defined.

Revenues: *What resources?* Inflows of any resources or only resources that are assets?

Revenues: *Sources of revenue*. Can revenue arise from (1) forgiveness of debt (decrease in a liability) and/or (2) an increase in an asset balance (revenue from market appreciation), and/or (3) an inflow of assets on behalf of another entity (offset by a liability to that entity)?

Expenses: Programs and missions. These references appear to be a substitute for the FASB's "ongoing and central operations." Requiring an item to be "related to an entity's programs and missions" in order to be an expense may mean that certain events are not recorded—for example, a loss from a natural disaster might be viewed as not related to an entity's programs or missions.

In this Statement the Board has developed an integrated set of definitions, has provided explanatory text for each definition, and has resolved or clarified the other issues that have been raised with respect to one or more of the definitions. As a result, the Board believes that the definitions in this Statement will be more useful to the Board's future deliberations and to preparers, auditors, and users than definitions provided in the past.

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How Does This Concepts Statement Affect Existing Definitions in Statements of Federal Financial Accounting Standards?

9. Concepts statements do not establish generally accepted accounting principles (GAAP) and cannot amend existing standards, interpretations, technical bulletins or releases, or staff implementation guidance. However, preparers and auditors may look to concepts statements

to provide a framework for assessing emerging issues that cannot be resolved by reference to literature in the hierarchy of GAAP..

10. Concerns have been expressed about the impact on the community of two definitions for certain elements – one in concepts statements which are not GAAP and another in standards which are GAAP – and whether this will cause changes in practice to emerge. The principal objective of concepts statements is to provide a framework for the Board's standard-setting activities. Concepts statements do not lead to immediate amendments of standards nor are they an effective vehicle for causing immediate changes in practice. In fact, concepts statements are generally not accompanied by immediate changes in standards; rather, changes to standards are carefully deliberated and practical applications that do not conform to well-established concepts may be adopted when they bring incremental improvement over current practice.

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What Impact Should This Concepts Statement Have on Practice Where Standards Require Application of a Different Definition?

Standards provide the highest level of authoritative principles and these principles cannot be overturned by a concepts statement. The Board's – and the profession's – expectation is that standards will continue to be applied until they are amended or rescinded. It is widely recognized that GAAP guidance at any point in time contains provisions that are inconsistent with concepts. Because concepts are not GAAP and are to be considered only in the absence of GAAP, this inconsistency of definitions should not cause a different outcome than other observed inconsistencies, such as inconsistent treatment resulting from general standards versus specific standards.

For example, SFFAS 5, *Accounting for Liabilities of the Federal Government*, provides and will continue to provide authoritative general guidance on liability recognition and measurement in the absence of more specific liability standards. SFFAS 5 provides the following liability definition:

> A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. (par. 19)

In addition, SFFAS 5 provides general liability standards regarding recognition of liabilities in four classes—exchange transactions, nonexchange transactions, government-related events and government-acknowledged events. Specific standards are provided in SFFAS 5 for contingencies, capital leases, federal debt and related interest, pensions, other retirement benefits, and other postemployment benefits, and insurance and guarantees (excluding loan guarantees). Specific standards also exist in SFFAS 1, 2 (as amended by 18 and 19), 6, and 12.

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13. In practice, the general liability standards establish level A GAAP for liabilities not covered by a specific liability standard. For example, grant obligations are not addressed in a specific standard but GAAP is provided by the SFFAS 5 provisions for nonexchange transactions. With respect to current practice, GAAP does not permit treatment of a liability that would be inconsistent with SFFAS 5's general standards in the absence of a specific standard applicable to that transaction or event. Issuance of a concepts statement does not alter existing GAAP for liabilities and the Board expects that the definition, recognition, and measurement standards in SFFAS 5 will continue to govern practice in the absence of a specific standard.

14. An additional concern is the potential confusion created by multiple definitions and variation in practice. While the Board recognizes the potential for confusion, it believes that far greater confusion can exist if (1) the void created by the current piecemeal approach to element definitions is not resolved, (2) robust explanatory text to support element definitions is not offered, and (3) the reliance on a working definition of an asset that has not been exposed to due process is perpetuated.

15. There also exists potential for confusion in future standard setting if comprehensive and interrelated element definitions for accrual-basis financial statements are not communicated. The Board seeks input from its constituents on individual standards. Absent a framework against which to assess proposed standards, respondents to requests for proposals may be uncertain of the Board's underlying rationale or be forced to study evolving concepts that are altered slightly with each new proposal.

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How Will the Board Reconcile

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Any Differences Between the Concepts Statement and Standards?

The Board plans to consider how the element definitions should be applied in each standard-setting project undertaken. Projects may include both new specific standards and amendments to existing standards. The Board solicits input on its agenda prior to adding new projects. This Statement will help respondents contribute input by providing a framework for identifying any inconsistencies in current standards.

The Board expects that elimination of inconsistencies between concepts and standards—and among specific standards—will require many years and will entail incremental improvements.

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Application to Nongovernmental Entities

.10 For financial statements of entities other than governmental entities— fn 3

a. Category (a), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.

b. Category (b) consists of FASB Technical Bulletins and, if cleared fn 4 by the FASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c. Category (c) consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared fn 4 by the FASB and consensus positions of the FASB Emerging Issues Task Force.

d. Category (d) includes AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

.11 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) Statements, Interpretations, and Technical Bulletins; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category. [Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3.]

Application to State and Local Governmental Entities

.12 For financial statements of state and local governmental entities— fn 5

a. Category (a), officially established accounting principles, consists of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are periodically incorporated in the Codification of Governmental Accounting and Financial Reporting Standards.

b. Category (b) consists of GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared fn 6 by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.

c. Category (c) consists of AICPA AcSEC Practice Bulletins if specifically made applicable to state and local governmental entities and cleared fn 6 by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities. fn 7

d. Category (d) includes implementation guides ("Qs and As") published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.

.13 In the absence of a pronouncement covered by rule 203 [ET section 203.01] or another source of established accounting principles, the auditor of financial statements of state and local governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, GASB Concepts Statements; the pronouncements referred to in categories (a) through (d) of paragraph .10 when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them; FASB Concepts Statements; FASAB Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements would normally be more influential than other sources in this category. [Revised, June 1993, to reflect conforming changes necessary due to the issuance of Statement of Position 93-3.]