FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
October 20 - 21, 2004
Rooms 7C13 & 6N30
441 G Street NW
Washington, DC 20548

Wednesday, October 20, 2004

Administrative Matters

- **Attendance**

The following members were present: Chairman Mosso, Messrs, Anania, Dacey, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen and Ms. Robinson.

The general counsel, Jeff Jacobson, and the executive director, Wendy Comes, were present.

- **Approval of Minutes**

The minutes were approved electronically prior to the meeting.

- **Current Events**

The Board discussed briefly some of the articles included in the clippings.

Agenda Topics

- **Concepts – Objectives**

Mr. Bramlett said that his October 6th memo for this discussion included an outline of a working paper based on the Board's discussion in August. He directed the Board's attention to questions listed on page four of that memo:

1. Whether the headings in the outline on pages 1-2 of this memo describe topics they would like to see discussed in a working paper?

2. If not, which of the headings would they delete?

3. What other topics would they add?

4. What ideas about the listed and new topics would members want to see conveyed in the discussion?

5. Are the "implications for FASAB" discussed starting on page 9 (including the bracketed staff addition to the minutes) ones that the members support?[1] Is there an alternative, e.g., to develop a "new product line" other than standards for agency-level financial statements? What other implications should be listed?

Before opening the discussion on those questions, however, he noted that Mr. Patton had written an article titled "Accountability and Governmental Financial Reporting," which has potential relevance to the discussion of objectives.[2] He asked Mr. Patton to summarize its implications.

Mr. Patton explained that the article was written in the institutional context of GASB, which also emphasizes "accountability" in its objectives. He noted that the staff paper

[1] Mr. Bramlett summarized those implications by saying that FASAB might first seek accountability, then try to address users' information needs to the extent that doing so seems cost/beneficial.
[2] "Accountability and Governmental Financial Reporting," *Financial Accountability and Management* 8(3), Autumn 1992.

raises the possibility of focusing on accountability as the primary or fundamental objective for FASAB. He discussed three major points:

1. **What does 'accountability' mean?** "Accountability" is a term that has been used in many different ways over time. Among the issues are: (a) Does it imply a need for explanation/justification beyond pure reporting? (b) Does it imply that there will be sanctions/rewards based on the accountability report? (c) Who will be accountable to whom, and for what?

   Each of these elements has implications for the nature of the accountability and the likely effects of reporting. For example: (a) there are systematic effects on the behavior of reporters that occur when they know they will be expected to explain/justify actions. Research shows that if the reporter knows they will be expected to explain or justify choices to someone with a known position, there is tendency to migrate toward that position. If they must explain or justify actions to an unknown accountee, or someone with an unknown position, then they are more likely to engage in systematic, broad analysis rather than bias it. (b) If reporters are subject to sanctions/rewards based on reports, there is a need, theoretically and empirically, for 'harder' (objective) data in the reports; and (c) The accountability could focus on inputs, process, output, and outcomes; and the accountor/accountee relationship could vary in its directness. These issues must be kept in mind as accountability reporting principles are considered.

2. **How is 'accountability' different from 'decision usefulness'?** Usually accountability focuses on *ex post* 'control', while decision usefulness focuses on *ex ante* decision-making. This has implications for when the information is needed, the possibility/ tolerance of subjectivity in the information, and both the aggregation and the structure of the information, which need to fit the task at hand.

3. **Accountability can be achieved by a number of means** other than financial reporting. FASAB's role as a source of principles for accountability information may be limited if these alternative methods of establishing accountability are more efficient/effective.

Mr. Patton concluded that focusing on "accountability," instead of "accountability <u>and</u> decision-making," <u>may narrow</u> the range of impacts and alternatives to consider, <u>but it does not</u> provide a simple structure for establishing financial reporting principles.

Mr. Mosso said he does not agree with the notion that accountability is preeminent, as opposed to decision-making: he finds the notion totally unacceptable. For one thing, the President's Management Agenda is stressing decision-making and the use of accounting, and is increasing the timeliness of these reports. This is not being done for accountability; it is being done for decision-making. Accountability is important, it is useful to retain it as one of the two main objectives, but it also leads to decisions, such as whether to fire or promote the manager.

Ms. Robinson said that she appreciated the focus on accountability, but she understands what Mr. Mosso said: some kinds of decision-making relate to this kind of financial reporting. She complimented Mr. Patton's analysis of accountability; decision-making should be similarly analyzed. In the federal environment there are a number of other reports, the budget being the largest one, which are explicitly for decision-making. So the balance sheet and other financial statements exist in an environment where there is a lot of other information. If we are going to talk about decision-making, we need to talk about what type of decision-making. Some decisions may be made based on financial statements, but the federal government does not make programmatic decisions based solely on the financial statements.

Mr. Mosso noted that we always say that financial statements are just one source of information; they are another tool.

Mr. Anania asked how the notion of accountability fits into our notion of stewardship. Is it a subset of stewardship? Is there more to stewardship than accountability? Can we reconcile the two? Mr. Mosso said the working paper would attempt to sort that out.

Ms. Robinson said that she thinks accountability is part of stewardship, and one where the Government needs a lot of work. The role of the financial statements in accountability, and in that part of stewardship, is essential: the agency reports on the universe of assets it had and what it did with them. The budget includes some information about existing assets, but focuses on what you plan to do with them or to improve them.

Mr. Anania said he also thinks of accountability as a subset of stewardship. There are aspects of stewardship, such as actions taken and plans made, which you can't find directly by looking at the financial statements or even from some internal reporting.

Mr. Mosso agreed that accountability is important, but decision-usefulness is equally important.

Mr. Zavada said the notion underlying some of the things being done with the President's Management Agenda, such as accelerated reporting, was that there would be an underlying improvement in terms of discipline and control. This would lead to improvements in other reports, which are probably more directly decision-useful.

Ms. Robinson said another reason to accelerate was to improve the Budget. Until now, the prior year data in the Budget have been based on unreconciled Treasury data; the reconciliation took place months later, and never got into the Budget itself. Thus the data in the Budget on transactions of the prior year were always suspect.

Mr. Zavada agreed. Accelerated financial reporting has brought the budget and accounting worlds much closer together, they are working closely to assure that the data are consistent. We have seen more discipline and control developing in that area.

Mr. Mosso noted the list of indirect benefits of financial reporting on page 2 of the staff memo. The Board had identified them at its August meeting. These, and perhaps other things, could be discussed more fully in the forthcoming paper on objectives. In addition to the indirect benefits, he thinks the financial statements *per se* are decision-useful. For example, as he said previously, they can focus attention on assets that need to be managed and have done so. The financial statements can be the beginning of the decision process in many cases.

Mr. Patton noted that some managerial accounting texts describe that as "attention directing."

Ms. Robinson asked whether it is useful to think more about whether there are different roles for agency financial statements versus the Government's consolidated financial statement. This could be explored in the paper.

Mr. Mosso agreed. The paper should address at least three inter-related topics:

1. FASAB's mission, including its role with managerial cost accounting

2. the objectives of federal financial reporting

3. a strategic plan.

In conjunction with developing the working paper, therefore, he would like to start thinking about a strategic plan.

Mr. Anania said he sees the paper as first describing the total range of federal reporting, with references to the various statutes and reporting requirements, and then trying to scope it down to our role. What we have in SFFAC 1 now is mostly about the broad topic of federal reporting; it is not as specific as it should be with regard to our mission. He has catalogued about ten or twelve laws and half-a-dozen Executive Directives that relate to federal reporting; he does not know whether they have been gathered up in one place. That would be a proper part of the paper, perhaps as an appendix.

Mr. Mosso noted that Ms. Comes provided briefing materials when new members joined the Board. Mr. Anania said that perhaps other laws have been passed and directives issued since that material was developed. If we set up the overall model for federal reporting it will be easier for us to focus on what our mission should be.

Mr. Reid said the financial reports do two things that the Budget does not accomplish. First, the financial statements report on assets acquired in previous periods. Second, they include cost that is not cash-based; the accrual statements are not disbursement-based. This is part of the value added and comparative advantage of the financial statements. Whether one describes the accrual statements as "attention directing" or "decision-enabling," they add this value.

Mr. Mosso agreed that benefit comes from the accrual-basis reporting of costs and revenues.

Ms. Robinson noted that the Budget does not ignore accrual information; in some of the places where we typically talk about accrual information being useful for programmatic decisionmaking (e.g., loans and loan guarantees), the Budget presents it. The Budget also includes long-term projections as well.

Mr. Reid acknowledged that the Budget takes a first step; he has some concerns about whether the sustainability computations really are something he would consider an accrual costing concept. They are valuable for what they do in supporting decisions on whether we can continue the program as it is today. He does not know whether the sustainability computations provide a snapshot of where we are today.

Ms. Robinson noted that for loans and some other programs there is explicit accrual information in the Budget. The Budget does not only deal with cash. Mr. Mosso agreed that there is a lot of accrual in the Budget; interest and the loan and guarantee information are on an accrual basis. He noted the reconciliation statement reports these. Mr. Reid said that for him, it was one of the more interesting schedules in the report. It ties the two worlds together.

Mr. Patton said that, if we are going to retain both accountability and decision usefulness as parallel objectives, we should explain exactly what we mean by them, how they differ, and how they overlap. He thinks there are different implications for what we would do, if we were aiming for accountability versus decision-usefulness.

Mr. Mosso agreed. He noted that accountability and stewardship have many meanings. Some of the ideas in Mr. Patton's paper would be helpful, he thought. Both accountability and stewardship have been used in the past to justify not doing anything beyond reporting on what was done with the money provided. We need to move beyond that notion.

Mr. Reid noted that compliance with statutory requirements about what is done with the money is appropriately a primary focus. Many accounting systems are pointed at providing information about that. Ms. Robinson said "that is a good thing; we don't want that to change." Mr. Reid agreed, "we have been doing that for two hundred years; we would like to think that we have it figured out." Ms. Robinson suggested that the number of Antideficiency violations observed by OMB might lead one to think differently. "At least from an accountability standpoint," Mr. Reid said, "we do report them." "Preventing them is the problem," Mr. Mosso observed. Ms. Robinson noted that the financial systems at some agencies do not help managers avoid the violations.

In response to a question, Mr. Bramlett said he would need to reassess how to present the Board's position, how to describe what we are about, given our desire to retain a dual focus on accountability and decision-usefulness. After the August meeting, he had thought there was agreement to step back from attempts to tie financial statements *per se* directly to specific decision makers' decision models; i.e., agreement to rely more on accountability and "second order" effects, such as indirect benefits of discipline, control, and increased assurance regarding detailed data used by internal managers. He suggested that the Board's final conclusion regarding accounting for weapon systems was based more on such considerations than on specific decision-usefulness.

Mr. Reid observed that an important objective for the Board in that case was for the Department of Defense to agree on an official, reported cost number for a given weapon system. The Department agreed that it needed to get, in one place, accessible information on what it had spent for a particular purpose rather than simply have various units try to start from ground zero to try to recreate that cost information in various ways.

Mr. Mosso noted that previously the cost reported for a weapon system might vary, e.g., in reports to one Congressional committee and another. One might properly use full cost for some decisions and incremental cost for others, but having a common framework, with all cost information coming from one system, provides discipline and control.

Mr. Farrell said that sounds like accountability. That sounds like how we have traditionally operated.

Ms. Robinson noted that "decision making" is a very broad term. Information reported for accountability can be useful for decision-making. The Budget tries to gather a wide range of information that is relevant to the budgetary decisions; the financial statements don't need to duplicate that—or to support all types of decision-making. One system should feed into the other. There may be a class of decision making that the financial statements should directly support, but not the entire suite of decisions. If so, we need to decide that class.

Mr. Mosso observed that SFFAS 4, FASAB's managerial cost accounting standard, stresses operational management, with the intention of facilitating management at the program level. He does not see accountability and decision-usefulness as separable; they are interactive and both are useful.

Mr. Patton asked about the relevance of the cost of the old plane, for example, to make the new plane. The actual cost of the old plane could be compared with the benefits expected from it. Regarding a decision to make a new plane, however, the actual cost of the old plane could be compared with its predicted cost. This might influence one's assessment of management's ability to estimate the cost of a new plane.

Mr. Reid recalled that the Board had heard evidence that, even within one branch of the military, different amounts were reported as the historical cost of an existing weapons system. Thus there was not a common, accepted baseline from which people could make that kind of assessment.

"Also, people were comparing apples with oranges," Ms. Robinson said. There was no agreed standard within the Department for what to include in the full cost of the plane. Some would include the cost of a modification, others would not, for example.

Mr. Anania asked, “isn’t it true that for some management decisions, there is a need to obtain information beyond that a routine reporting system would provide?” No external financial statements come close to doing that. Mr. Schumacher said management should have a variety of interim and internal reports.

“At least you need to understand what the numbers are,” Ms. Robinson said. She noted that one needs a whole supporting infrastructure to operate a particular system, such as a helicopter fleet. There are many things that need to be considered for a given management decision. Accounting helps by eliminating confusion about what is in a given number. Then at least analysis can start from the same place. That was the breakthrough DoD made in order to facilitate analysis.

Mr. Anania said that, for him, the concept of decision-usefulness in the federal government model is quite different from the private sector model. FASB’s model mainly deals with decision-making from an external point of view, for people making decisions about allocation of capital in investment decisions. Here, we are probably talking about it more from an internal standpoint.

Ms. Robinson suggested that the investor model is not totally irrelevant for the federal government. While we may have seemingly involuntary “investment,” we do have people making decisions about taxes and other things that might change the level of investment. There is a widespread perception that the Government is riddled with waste, fraud and abuse; the public is wary of this. The perception may influence willingness to invest in Government. So it seems there is a connection with public confidence that its “investment” is being used wisely. A model that says the public is a user is not off base.

Ms. Cohen did not disagree that the public certainly has an interest in the federal government and is a user, but she thinks there is a difference between an investor’s interest in—and assessment of—a private entity, and the public’s interest in—and assessment of—Governmental entities. In the “FASB world” the focus is on the investor who purchases financial instruments of the reporting entity; the situation is somewhat different for the U.S. Government.

Mr. Mosso noted that when it comes to not-for-profit organizations, FASB uses the term “resource provider,” which is a general term that includes investors for profit-seeking entities. The basic point is that any resource provider is looking for a return on investment, whether it is mandated as a tax or given voluntarily as a contribution. There is an expectation that there will be a benefit greater than the cost. So it is the same objective in that sense: it is reporting to the people who have put up the money. It is partly for accountability and partly for their decision-making.

Mr. Farrell said it seems that, inherent in our definition of accountability is the concept of decision-usefulness for internal users. Also, inherent in our discussion of decision usefulness is the concept that we have to be accountable, and have accountability for those people who make those decisions. Neither has primacy over the other in our environment.

Ms. Cohen observed that in a democracy the same is true vis-à-vis the public. There is a need for accountability to the public and a need for decision-making as the public makes judgments about what is appropriate in policy decisions of the Government. This is true for GASB too, to some extent. It is her impression that investors have not been the primary users of GASB's material. Despite the fact that GASB is concerned to address the needs of investors, they are not necessarily GASB's most important constituency.

Mr. Mosso said that, even for profit-seeking firms, the financial statements provide a framework for analysts who produce other reports that are useful for investors. There is a parallel with Government there. Also, it is often the case in the federal government that one level of government may in some ways be regarded as an external user of reports from another level. He agreed with Mr. Farrell and Ms. Cohen, that accountability and decision usefulness are interrelated.

Mr. Reid said Mr. Mosso's comment raises the issue of whether comparability is important. For comparability, one needs a sense that the underlying information is prepared in the same way. Mr. Anania said that he didn't see anything in the staff paper about comparability or transparency. Maybe those are embedded in accountability. We need a reference to the big picture, the fact that agency reports are now prepared in the same way, in the same format, with some common elements.

Mr. Bramlett suggested that the Performance and Accountability Reports now go a long way toward giving the resource provider the kind of assurance that Ms. Robinson had discussed earlier. In practice some information-intermediary would more likely be looking at it on behalf of the citizen. There is some level of assurance about fraud waste and abuse in the internal control assertions, there is information in the financial statements about what resources were available to the entity and how the resources were used, and some information about the "return" on resources, mainly in the performance report section.

Ms. Robinson asked whether it was still OMB's intent to include the annual and strategic plans with the Budget, in the same way as it has agencies combine their GPRA performance report with their financial statements in the Performance and Accountability Report. Mr. Zavada said yes, so there would be a comprehensive planning document and a comprehensive accountability document.

Mr. Bramlett asked whether, in the process of "narrowing down" as previously discussed, the Board wanted some mechanism to define what portions of the Performance and Accountability Report it would address. For example, do we want to narrow down by carving out some subset of the Performance and Accountability Report, e.g., by excluding the performance reporting section?

Ms. Robinson asked Mr. Anania if he envisioned describing the entire range of federal reporting, including the Budget and GPRA, and then narrowing down to FASAB's role. He said, "yes," he was thinking that broadly.

Mr. Zavada said that almost all agencies have consolidated their Performance Reports with their Accountability Reports, pursuant to GMRA and the Reports Consolidation Act. OMB has tried to bring together its guidance on the different laws regarding controls (e.g., FMFIA, FFMIA, Improper Payments) in its recent draft guidance regarding internal controls. Ms. Robinson noted that OMB maintains a long list of the statutory requirements related to the Budget.

Mr. Schumacher asked Mr. Anania if he envisioned including program effectiveness. Mr. Anania said no. Ms. Robinson said the question was whether the document should say explicitly that we stay away from that. Mr. Zavada said that he views FASAB as dealing with financial statements: providing a GAAP foundation for the financial statements and footnotes, without going further into internal control and performance measurement.

"That is part of what the paper needs to deal with," Mr. Mosso said. He noted that we already have a performance report among our statements, and an objective that deals with systems and control: that is part of the reason for stepping back to look at our mission. These are things we can look at in developing the paper. Mr. Anania asked if staff could provide a rough draft outline of a paper.

Mr. Bramlett handed out a brief memo that included information on "logic models" and the Board's Mission Statement as attachments for the Board to consider in the future. He said it might offer a tool for thinking about the issues just discussed in advance of the next meeting.

> CONCLUSION: staff will draft a preliminary outline of a working paper that will address FASAB's mission and strategic plan as well as the objectives of federal financial reporting. Members are encouraged to offer their input prior to the next meeting.

- **Concepts – Elements**

Ms. Wardlow opened the discussion by reviewing the Board's prior discussion on the essential characteristics of a liability. Her paper addressed three main issues. The first issue dealt with whether and, if so, when the federal government might incur a liability to provide goods and services. The UK Accounting Standards Board has proposed that general political commitments to provide goods and services would not result in liabilities, whereas more specific commitments would be identified based on certain obligating events and, possibly, the identification of specific recipients and would result in liabilities. On page five of her paper she had listed for discussion potential obligating events that would convert a general political commitment to a specific obligation.

Her paper also discussed the distinction between exchange and nonexchange transactions, and whether classification as a nonexchange transaction automatically means that there is not a liability until the settlement is due and payable. SFFAS 5 does not allow for the possibility that, in a nonexchange transaction, a liability may be incurred before the amount becomes due and payable. .

Thirdly, she said, there is the question whether a legal obligation or legal enforceability is critical to the definition of a federal liability. Part of that decision is to narrow down what we mean by legal obligation and legal enforceability.

Mr. Schumacher asked whether the UK has accrued the cost of its medical programs. Ms. Wardlow said she was not certain, but thought any accrual would be limited to the due and payable. That seems to be common, based on what she infers from the IFAC PSC's *Invitation to Comment.*

Ms. Robinson complimented the staff on the paper. She indicated that she had a hard time reading it because of the link, whether intentional or not, between the concepts of exchange versus nonexchange and legal versus constructive liabilities. In the federal context, she said, when the government acts like a business and has an exchange transaction with employees or others, you bring societal norms to those kinds of transactions that are potentially recognizable in a legal environment. The staff paper's discussion of "promissory estoppel" is relevant to that. But the fundamental foundation for nonexchange transactions is legal. The government defines and communicates what it is doing in the nonexchange program in the law. There, the liability must be legally based. Thus the difference between exchange and nonexchange is important in determining whether one believes a constructive obligation can arise. In her view, it can only arise in an exchange transaction.

Mr. Anania asked Ms. Robinson whether her view allows for the possibility of an "exchange-like" transaction? She indicated that for her, the distinction was fairly clear cut.

Mr. Reid suggested that the U.S. might have an essential difference from other countries in having dedicated revenue sources for social insurance. That gives us a different perspective than if we had only a general income tax to finance Social Security and Medicare. He also noted that he thinks the idea of "exchange-like" transactions needs to be developed.

Mr. Zavada said that, to him, the distinction has been between exchange and nonexchange; he would need some examples or further discussion to get at the concept of exchange-like transactions.

Ms. Wardlow explained that GASB developed the concept in its standard on accounting for revenues.[3] There was concern that labeling a revenue as "nonexchange" would imply that only cash-basis recognition would be possible. The Board identified four types of nonexchange transactions in which state and local governments participate. In looking at transactions, they found a spectrum or range. Some transactions are clearly exchange, some are clearly nonexchange, and then there are some in between that are difficult to classify. With some licenses and permits, for example, you can associate what you are getting with what you are paying for the license, but with others there is no relationship. The GASB didn't want a third category, but "exchange-like" was a way of getting around being too arbitrary about whether there was an exchange or not. A lot of the exchange-like transactions have enough characteristics of exchanges that they can be treated like exchanges for accrual accounting purposes.

Then GASB looked at different points at which a liability might be recognized for different kinds of nonexchange transactions. SFFAS 5's approach, where there can be no liability for future nonexchange transfers beyond the amount currently due and payable, is quite foreign to her. Therefore, she wanted to look at whether conceptually there are different kinds of nonexchange transactions and whether some kinds might result in a liability before the amount became due and payable.

Mr. Schumacher asked whether GASB made a distinction between a program such as Food Stamps, where the individual receives a service without paying anything, and a program like Social Security where the individual has paid something in? Ms. Wardlow said the distinction would depend on how the program operated. In the case of sales taxes, the tax is imposed on an exchange, but the exchange is not between the government and the citizen.

Mr. Mosso said he is not sure it is useful to make such a distinction. In looking for criteria to recognize a liability, we are looking for the obligating event. Even in exchange transactions that is not always clear.

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[3] See Statement No. 33 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Nonexchange Transactions*. Issued December 1998; effective for periods beginning after June 15, 2000. This Statement identifies four classes of nonexchange transactions based on shared characteristics that affect the timing of recognition:

1. Derived tax revenues, which result from assessments imposed on exchange transactions (for example, income taxes, sales taxes, and other assessments on earnings or consumption)
2. Imposed nonexchange revenues, which result from assessments imposed on nongovernmental entities, including individuals, other than assessments on exchange transactions (for example, property taxes and fines)
3. Government-mandated nonexchange transactions, which occur when a government at one level provides resources to a government at another level and requires the recipient to use the resources for a specific purpose (for example, federal programs that state or local governments are mandated to perform)
4. Voluntary nonexchange transactions, which result from legislative or contractual agreements, other than exchanges, entered into willingly by the parties to the agreement (for example, certain grants and private donations).

Ms. Wardlow said in accounting we are trying to report the situation right now, and we are trying to couple that with the obligation because it is telling us something about future outlays, and that is what we are trying to focus on. She has difficulty seeing why, just because something is nonexchange, we are not going to do that. There should be something more than the due and payable amount.

Mr. Mosso asked whether it is true that under SFFAS 5 there are different categories of transactions, and for some of them recognition is not deferred until an obligation becomes due and payable.

Mr. Anania noted that the glossary definition of a liability does not distinguish between exchange and nonexchange transactions.

Ms. Comes said that it was difficult in SFFAS 5 to distinguish between the definition and the recognition criteria because they are in the same paragraph:

> 19 A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize* probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) nonexchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date. *[A footnote in SFFAS 5 explains "Recognition means reporting a dollar amount on the face of the basic financial statements."][4]

Ms. Comes said she looks at the second sentence as recognition guidance; others say it is part of the definition. So, Statement 5 is not structured in the same way as the structure we are using in the Elements project, where we are distinguishing whether an item is or is not a liability (definition) from whether it should be recognized. It is feasible to say that for nonexchange revenues the Board set recognition disjointedly from definition because they did not find it relevant to apply a full-accrual concept to nonexchange. It is something of a rules-based approach absent a broader expression of a principle. They did not explain why the recognition is split out the way it is. At Ms. Robinson's request, Ms. Comes explained "government-related" and "government-acknowledged" events.

Ms. Robinson asked about the potential for being sued as a criterion. She mentioned that this is sometimes discussed in the context of budgetary accounting for leases. Ms. Wardlow said that is why she wanted to introduce the concept of promissory estoppel, which FASB is discussing now. It narrows the scope of what might be called a constructive liability under FASB's prior concepts. At some point even for nonexchange transactions the government might have a commitment strong enough to be recognized.

[4] Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government.* Issued December 1995, effective for fiscal years beginning after September 30, 1996.

Mr. Jacobson said he liked the phrase “legally based.” A focus on legal enforceability strictly defined could be limiting, because the federal government can be sued only when it has waived its sovereign immunity. Congress could pass a law that is a firm commitment without giving any private party the right to sue to enforce it. So, the notion that you are not going to recognize a liability, no matter how strong the legislative base is for the government’s action, because it is not legally enforceable would not work well.

Mr. Mosso agreed and said that, although he did not know where the FASB was going with promissory estoppel, he did not expect them to rely on legal enforceability. The criteria for promissory estoppel happen to coincide with a lot of accounting standards already in existence. So it is a way to reinforce the notion of constructive liability but also to set limits.

Mr. Zavada noted that promissory estoppel is a legal concept that would be applied by a court and would result in a legally enforceable decision. If you just look at the criteria without considering legal enforceability, he thinks you are left with the same difficulties in applying it as you have with the notion of constructive liability.

Ms. Wardlow said you do not really know a legal conclusion unless you go to court, and different courts can differ. Neither GASB nor FASB has accepted the idea that some kind of legally sanctioned foundation is an essential characteristic of a liability. In state and local government accounting, for example, there is a long tradition of periodic conflict between those in government, who would base liabilities only on legal requirements, and standard setters, who believe other criteria can indicate that a liability has been incurred.

Ms. Robinson noted that government agencies have general legal authority to enter into exchange transactions, which are further defined by contracts; they are legally based in that sense, although not specifically defined in the law. She sees this as different from nonexchange transactions with the citizenry, where the law defines the entire transaction. She questioned whether we should recognize these further instruments, and all the complexity that comes with that, whether that would be material. Is it material how the public perceives things in law, as being a liability or not?

Mr. Reid said he thinks it depends on whether they are acting in a way that indicates they believe it will happen. Ms. Comes said it goes further than that. When people move to Florida, they have a general expectation that FEMA will help after a hurricane. That is different from cases where the law provides a specific structure for citizens to act and to perform under the law almost as if they partially performed under a contract. An example is working in covered employment, because the law provides that if people work in covered employment there is a specific flow of benefits that they can expect. So, the law influences the citizens to do different things. Some things are very specific and could be considered performance.

Ms. Robinson noted that FEMA operates under mandatory authority that does not expire. It can incur expenses up to a certain amount under the Stafford Act. We usually give Florida more than that amount. Legally, the people of Florida should only expect the Stafford Act amount. If we want to go by past practice, however, they may expect more, usually about twice that much. To which perception do you lend credence? If you don't live in Florida, you tend usually to get only the Stafford Act amount.

Mr. Mosso noted that under FASB's standards, a pledge, which is purely nonreciprocal, must be recognized by the corporate giver if it is unconditional. This is based not on promissory estoppel, but on other factors, such as reliance and communication. It is not just any pledge that must be recognized as a liability, but those that meet certain criteria. So, that is a purely nonexchange transaction that is recognized before it is due and payable. Ms. Wardlow said GASB's standard is similar, but worded differently.

Mr. Patton said it would be hard to operationalize a standard based on others' reliance. He thinks about whether we, as the government, have little or no discretion in avoiding the obligation. If others have relied on a perceived commitment, that may create adverse consequences from a failure to pay, which in turn may imply little or no discretion to avoid doing so. But thinking about others' reliance on our commitments is not the best way to frame the question.

Mr. Mosso said the notion is more whether one has acted in a way that would reasonably create such an expectation, not testing whether there has been actual reliance. Mr. Patton asked whether it would be parallel for assets and liabilities. Messrs. Mosso and Anania said yes.

Mr. Anania referred to Ms. Robinson's view that a liability must be legally based. He listed several different legal factors that the Board has been discussing: Is it in the law? Can you be sued for it? Are people expecting more than the law provides, and then can you be sued for it? He is not clear what the model would be if you took a pure legal approach to it.

Ms. Robinson said that it also includes the recognition point because in the case of a nonexchange transaction, when can you be sued? You cannot sue now for something the government may do in two years.

Mr. Jacobson asked: what if you can never be sued? For example, would you want the result where Congress passes a law directing an agency to clean up some environmental problem and appropriates the funds, but the agency does not record a liability because Congress does not grant any nonfederal entity the right to go to court to sue for performance. If all you are looking at in a nonexchange transaction is whether Congress granted some nonfederal entity the power to go to court to compel performance, you would exclude many liabilities now on the books that no one would otherwise debate.

Ms. Robinson agreed that judgment is needed about the point when something is legally required.

Mr. Anania asked whether that judgment was not tied to obligating events? In his view, if we are going to make a judgment call, we need some way to flesh out the things that will inform us on how to make that judgment.

Mr. Reid agreed and noted that the question of a liability for FEMA does not arise until the hurricane hits. Before then, you do not have a trigger point to record a liability. So, whether it is legally enforceable or not is not the issue. He agrees with the GASB's idea that there is a spectrum of transactions; a simple on/off [exchange/nonexchange] is not good enough. Ms. Cohen and Mr. Anania agreed.

Ms. Robinson said it is important to keep point (c) [the event has occurred] in the definition because it keeps the focus on what "present" in "present obligation" really means. Mr. Mosso said that (c) is in the FASB's definition for emphasis because at the time the FASB was trying to prevent hidden reserves,—people putting money in the liability pot just for rainy days—such as for self-insurance, which was a big one at that time. So, (c) is redundant in a sense, but sometimes we may want to be redundant.

Mr. Dacey said he would agree with Mr. Patton on promissory estoppel; it is not very workable to measure the reliance of someone outside the government. He asked whether there is a class of information that is not a liability about what potentially may happen in the future? The SEC requires disclosure of many things that are not liabilities but that may use resources in the future. How does the concept of liability fit into the broader objective of reporting potential future claims on resources? Many of the programs we are discussing will, if they continue as they currently operate, require future use of resources for things that—depending on how we define liability—may not fit the definition.

Mr. Anania said this gets to sustainability. There is a broad range of things you might be interested in, ranging from purchase commitments to intergenerational transfers, that are not liabilities. We have a project, originally called commitments, that might explore information that goes beyond information that fits the definition of liability.

Mr. Dacey indicated that the way one approaches the question focuses attention differently: "What is a liability?" or "What is the best way to present the information?" or "What is the purpose of a balance sheet?"

Mr. Patton said one strategy would be to have a narrow definition of liability for unambiguous items that everyone would agree on, but to have another category of important commitments and make them visible by putting them on the balance sheet. He noted that the paper on social insurance did not address that approach.

Ms. Comes asked Mr. Patton if he contemplated a point-in-time notion as of the balance sheet date for this other element? She would argue that the SOSI is a vehicle to supplement the balance sheet with that more forward-looking approach to commitments. She would view the balance sheet as a snapshot as of a certain date, versus the more long-term perspective of the SOSI. She thinks that is an inherent limitation when talking about a new element.

Mr. Patton responded that he did have in mind a point in time, but he would also be willing to consider some sort of narrow definition of liability for the balance sheet supplemented by some sort of tabular disclosure such as is now in the CFR on other kinds of responsibilities. This would make them visible, with less ambiguity about what a liability really is.

Mr. Anania suggested a second way to do that would be to have a new classification, with numbers, in the balance sheet, but with the clear understanding that those numbers are not as firm or exact as the “exchange” or “due and payable” liabilities

Mr. Zavada said it makes sense to pursue this reporting alternative. We have been struggling with the nonexchange issue and, to him, some kind of off-balance-sheet presentation of commitments as of a point in time makes sense. He thinks it would be better to direct our efforts there, rather than to the exchange-like and nonexchange criteria.

Ms. Robinson would prefer not having it on the balance sheet. Now we have the SOSI, but under the same philosophy, we should have more. There are other programs that look like social insurance, in that Congress need not take action for them to continue: student loans, food stamps, et al. We should look at the criteria that would more comprehensively define what should be reported.

Mr. Mosso said that is the subject of the project currently called “application of the liability definition.” He is not sure that title conveys the scope of the project.

Ms. Comes said there is a critical difference between the two approaches. One approach is acceptance that the balance sheet is a statement of financial position and that we should complete our work on getting a robust statement of financial position that people would agree is complete. In that view, you would also consider things like the SOSI or reports on commitments—something with a longer horizon that you might consider as, perhaps, going toward a statement of financial condition of the federal government, keeping that distinction about the future focus crisp. In that view of our efforts, which we are addressing in multiple projects, finishing the statement of financial position is the primary goal.

Alternatively, she would characterize Mr. Dacey’s and Mr. Zavada’s suggestions as approaching the issues more holistically and setting aside the notion that we know what a statement of financial position could be or that completing the statement of financial positon is a key goal that should be addressed first. Rather, one could make the primary objective addressing sustainability and financial condition-type work earlier.

Ms. Comes added that, because of the issues concerning the credibility and completeness of the balance sheet, we currently have three projects running parallel. Their descriptions are written so that we first complete a statement of financial position. The notion is that liabilities include a whole spectrum of things, but they are grounded in the idea that liabilities are present obligations for future outflows. If the Board does not agree with that order of priority, we should look at the three different pieces (projects) and maybe talk first about what should be the purpose of the different statements.

Mr. Reid said he wants to avoid locking up the definitions so much that we cannot do what we regard as the appropriate accrual accounting on the flow side. For example, legal enforceability of a liability might not be the most important reason why you want a credit to be recognized. Maybe you want the credit because you believe you have a cost, but have not paid it yet. You want to match the cost with revenues, but you are not sure about the credit part. Maybe classification in the balance sheet would be appropriate for those kinds of situations. Mr. Reid repeated that the statement of net cost is very important and he would not want decisions about the credit to affect the ability to account for costs on the accrual basis. He favors some sort of gradation of transactions [between exchange and nonexchange] because it may help the cost accounting side.

Mr. Mosso agreed; we need to stress more the flow side of what we are doing. Mr. Reid said that if we get that right, it can help answer other questions, such as what is the appropriate size of intergenerational transfers. Mr. Mosso did not see the asset and liability definitions as being in conflict with that. Mr. Reid agreed but repeated his concern that the definitions not be too tight.

Ms. Wardlow said it is helpful to remember the cost side, and the notion that we are focusing on particular periods. That is one reason she has difficulty with saying that for nonexchange transactions there is no cost until one makes the payment. Whether it is exchange or nonexchange should not drive a conclusion about when a cost has been incurred. She directed attention to the list of potential obligating events in her paper.

Ms. Robinson suggested the Board go through all the questions in the paper.

Mr. Patton requested first a clarification about whether question 7 refers to the provision of goods and services as well as cash payments. Ms. Wardlow said that the question refers to all three kinds of provisions. Mr. Patton observed that the IFAC came to different conclusions about when liabilities should be recorded for the provision of cash versus goods and services. He quoted from the IFAC Invitation to Comment: "When a government meets its social policy budget by providing goods and services to individuals, there is no present obligation prior to the provision of the good or service." By contrast, for cash payments, a liability is recognized when an individual has satisfied all eligibility criteria. Ms. Wardlow noted that the IFAC ITC includes a different minority proposal regarding cash payments.

Ms. Robinson noted that many other countries have a different mindset, because most of their social programs involve the provision of goods and services, whereas that is not the case in the U.S. For example, other countries' public health services are for everybody. So, she believes they are trying to distinguish between setting up a government clinic to serve a particular population versus providing cash. She is not sure why IFAC makes that distinction in its proposal; she would not.

Mr. Anania asked Mr. Patton whether he was referring to a way to look at different circumstances and go beyond a narrow definition of a liability? Does he see this as a way to look at some classes of nonexchange transactions? Mr. Patton agreed that the IFAC is referring to social policies of governments that we would classify as nonexchange, and we are looking for different obligating events—that is, when does a commitment become an obligating event? The IFAC's structure distinguishes between goods and services and cash payments, and between individuals or identified groups and the citizenry. Their answer to what is an obligating event depends on which cell you are in. Mr. Anania responded that he was trying to fit this in with Mr. Patton's earlier comments concerning possibly leaning toward a narrower concept of a liability. Mr. Patton said that earlier, he was not necessarily proposing that solution; rather, he was commenting on a potential implication of Mr. Dacey's comments about commitments that might not meet a definition of liability.

Mr. Mosso asked whether you would get different answers as to when a liability is incurred for Medicare, which is goods and services, versus social security, which is cash? Mr. Patton said you would, under the IFAC proposal. Ms. Robinson said that Medicare is actually cash. IFAC is talking about whether setting up a clinic—i.e., just the act of setting one up—is an obligating event.

Mr. Jacobson likened Ms. Robinson's example of a clinic to a VA hospital. Would you record a liability for all the probable care the VA hospital will provide to veterans over the next twenty-five years? Mr. Bramlett noted that in the foreign context, the clinic would be for the general population. Mr. Jacobson acknowledged that and Ms. Robinson agreed with Mr. Jacobson's framing of her question. Mr. Reid noted that was why Ms. Robinson was referring to the provision of goods and services in other countries, because here we basically pay cash to the doctors when they send in a bill.

Mr. Zavada said the VA-health care analogy is a good one, because there you set up a clinic and the care is limited by access. Whoever presents himself for care and meets the criteria is treated. Ms. Robinson said she thought the IFAC was saying that building a VA hospital means that you can identify an earlier obligating event and capture more, because setting up the hospital creates an expectation of care. In contrast, with Medicare the government can and does change from month to month what you pay the doctors. Ms. Cohen countered that the government can close a VA facility. Ms. Robinson agreed, and said again that she did not agree with the IFAC's distinction between cash and goods and services; but she thought she had described why they were making that distinction.

Ms. Cohen said the example would apply to the citizenry, whereas she thought that Mr. Patton was referring to a distinction in the IFAC proposal between the citizenry—or general public—and specific groups or individuals. She asked for clarification. Mr.

Patton referred to the summary in the IFAC's ITC and noted that they had been talking about the majority view. Mr. Reid said he thought there was a substantial minority view. Mr. Patton indicated that the minority view occurred only with respect to cash transfers.

Mr. Anania agreed with Ms. Robinson that we should consider the mindset and circumstances of other countries that may have influenced the IFAC proposal. He noted in particular a factor cited by Mr. Reid, that for our (U.S.) social programs there are dedicated revenue streams, such as the payroll tax and premiums, that are providing inflows to the government for general use, and they are being used currently. He thinks that is an important difference from some other countries.

Mr. Reid noted as well that the IFAC document is an exposure draft and the majority view was a narrow majority, so the final document could be different. Mr. Patton said he was not suggesting we should necessarily adopt a similar standard; he was simply saying the structure of collective versus individual and of cash versus goods and services would be a useful way of thinking about the nature of the commitments and to examine possible obligating events.

Ms. Comes noted that the IFAC document deals with broad social policies where service is collective. In contrast, VA hospitals provide services to a group that has provided direct services to the government, through military service. Mr. Patton said that is consistent with the distinction between collective goods and individual goods.

Ms. Robinson asked for clarification regarding question 1[5] in the staff paper. Ms. Wardlow said it should read "liabilities to purchasers" rather than "suppliers." She said she had included the question to distinguish obligations to purchasers from general political commitments to the citizenry and specific obligations to specified groups and individuals. She assumed the Board's answer to question 1 would be yes. Mr. Anania agreed and others agreed. Ms. Wardlow continued that the only example she had found of a standard that does not recognize a liability for the provision of goods and services to purchasers is the Canadian standard, which limits its liability definition to financial obligations.

Mr. Mosso said he would say yes to question 1 but thought Mr. Patton would say no. Mr. Patton said he would say yes, because he understands the question to deal with ordinary exchange transactions where, if someone pays us for services, we have an obligation either to provide the services or give the money back.

Regarding question 2[6], Mr. Patton asked whether the question referred to all the possibilities he had referred to earlier: collective versus individual provision, cash

[5] "1. Does the Board agree that a federal entity can incur liabilities to suppliers for goods and services, rather than cash?"
[6] 2. Does the Board regard any of the following points as, generally, better candidates for obligating events than the other points? Can any of these points be ruled out?

versus goods and services? Ms. Wardlow said all were included, but the question could be divided along those lines, if that would be helpful. She did not intend to be quite so specific in this paper, but rather to see whether certain possibilities were candidates for further analysis and others could be eliminated. Mr. Patton said that, for example, eligibility may be useful for events involving individuals and groups, but not for goods collectively provided to the citizenry, such as national defense.

Ms. Wardlow said the list at the end of the paper is reproduced from an earlier section of the paper. There, she indicates that the UK Board did not give examples of how one would get from a general political commitment, which they say does not give rise to a liability, to a specific obligation, which they say could be a liability. There would have to be an obligating event and her list provided several possible obligating events for discussion.

Ms. Robinson said she liked going through the list of seven events. For example, she quoted from number four, "performance by entities or individuals making them eligible to apply," and noted that this question frequently arises in estimating the outflows from federal programs because "take-up rates" vary. The take-up rate is generally 60% or less, especially if the government is not actively trying to find eligible recipients. So, she found it interesting, as she went through the seven events in the list, to think about the different issues and whether it is a true liability if we know that only one-half of the eligible people will take food stamps; are we liable for one hundred percent?

Ms. Comes said one could consider that a measurement issue. Mr. Anania said one would measure it at the take-up rates.

Mr. Reid said he would rule out most of the obligating events listed. He would say yes to number five, but change it to read "satisfaction of eligibility requirements," or add that as an eighth possibility. Ms. Comes and Ms. Wardlow asked whether that possibility was not covered under, respectively, item 4 or items 5 and 6? Mr. Reid said we were talking about eligibility to apply for benefits. Ms. Cohen agreed with "satisfaction of eligibility," which Mr. Reid said removed the issue of applications generating liabilities, which concerned him. He acknowledged, however, that it might be viewed as a measurement issue.

Ms. Robinson asked about cases where the government has only a limited amount of money to grant—for example, scientific research grants. Hundreds of people may qualify, but the government can only give out a certain amount. Mr. Reid said that,

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1. Effective date of legislation to establish the program.
2. Appropriation of the necessary funds.
3. Specific identification of the classes or groups of individuals or entities who are eligible to receive the assets or services.
4. Performance by individuals or entities making them eligible to apply.
5. Receipt of applications that meet eligibility requirements.
6. Approval of applications.
7. Approval of the transfer of assets (e.g., cash payment) or provision of services to recipients.

there also, the approval of an application does not necessarily create a liability. He is not sure there is a liability until you agree to write the checks.

Ms. Wardlow asked whether notifying the applicant that his application has been approved would create a liability? Mr. Reid thought it might. But then, he said, there are measurement concerns. For example, let us assume that is the case and I have approved a grant that runs for four years. Should I book a liability for the whole four years? Or do I recognize the cost as I get ready to make each disbursement? He added that, as he read the list, he kept coming up with reasons why each of them would not work in a lot of cases.

Ms. Cohen said that the underlying thought in the paper, that eligibility implies that the recipient will receive the payment [as an entitlement], is different from the kinds of grants Ms. Robinson and Mr. Reid were discussing, where not everyone who is eligible will receive the grant. Mr. Reid agreed. Ms. Comes said she would almost classify the grant recipients in those cases as suppliers, because they have to perform in order to keep the grant money. Mr. Reid said they would have to submit some justification that they had spent the money

Mr. Zavada said the criteria listed did not help him distinguish commitments.

Mr. Dacey said his concern was that there are so many different kinds of grants that they would not all fit the alternatives. Some might be liabilities earlier, some might not be liabilities until later.

Ms. Wardlow said that the discussion was very helpful. She thought that we need to be able to group transactions and the list is not specific enough to deal with the kinds of specific questions the Board has been discussing. Based on the examples members have given, some programs may be more in the nature of exchanges, and others more like nonexchange transactions. She then referred to the second part of question 1 and asked whether the Board could rule out any of the possibilities as events that they generally would not consider to be points at which liabilities are incurred.

Mr. Reid said he would rule out numbers 1, 2, and 3. Mr. Anania said 1 and 5. Ms. Robinson said 1, 2, 3, and 5. Ms. Cohen said she was not sure about number 4. Ms. Robinson asked Ms. Cohen whether that was not the point she had referred to earlier as an obligating event for certain programs? Ms. Cohen said no; what she was referring to earlier was certain programs, such as Medicaid, where, if you qualify, it is an entitlement. If you meet the eligibility requirements, you have a right to receive the benefit. You do not have a right on a continuing basis because eligibility can change and you may become ineligible, but at the point that you are eligible you get it. This is in contrast to a grant where you compete and even if you meet all eligibility requirements, it does not mean that everybody gets the grant.

Mr. Mosso noted that there would not be time to go through all the questions. He asked Ms. Wardlow to select the questions where she might need some guidance or the most guidance. She said that exchange versus nonexchange is very important and asked whether the Board wished to pursue that issue and, if so, was there a particular direction to explore?

Mr. Reid said he would like to see an expansion of question 4 in the exchange versus nonexchange section of the paper. [“4. Does the Board believe that, in a *nonexchange* transaction, a liability is incurred when the settlement amount becomes due and payable (and not earlier)?”] He would answer “no” to that question because he thinks that focusing only on the fact that a transaction is nonexchange is too limiting. He thinks a “no” to question 4 may mean that the answer to question 5 is “yes.” [“5. Does the Board wish to explore further the concept of *exchange-like* transactions.”] He would like some discussion of what GASB has done and how they have made those distinctions.

Like Mr. Reid, Mr. Schumacher would like to see an expansion of question 5, concerning exchange-like transactions, because he does not see the distinction between exchange and nonexchange as black and white. Mr. Patton agreed, saying he would like to see something other than “I know it when I see it.” It needs to be more operational.

Ms. Robinson asked whether the FASB has concepts relating to the not-for-profit sector that could be useful? Ms. Wardlow responded that the information was very limited. Mr. Anania agreed and said that one has to look at the not-for-profit standards to see what the FASB was thinking.

Ms. Wardlow asked Mr. Patton to clarify his earlier comment about exchange versus nonexchange. Mr. Patton said he thought that, based on what the GASB wrote, “exchange-like” is very ambiguous and appears to be something that would have to be decided on a case-by-case basis. Ms. Wardlow briefly explained the background to the GASB’s adoption of the concept, which was due to the board’s reluctance to arbitrarily group all transactions into exchange or nonexchange when some have features of each. Moreover, GASB Statement 33 is not a rules-based standard but, rather, provides guidance and encourages examination of the characteristics of individual transactions in order to classify them.

Mr. Anania asked if it would be possible in the federal environment to develop some factors that one would look at to classify a transaction as exchange or nonexchange? For example, he believes that if there are revenue flows coming in that are being used in a general way, that makes it different from a nonexchange transaction where those revenue flows do not exist. Ms. Cohen agreed. Ms. Robinson said it is useful to think about the two cases of Social Security versus Medicare. Currently, the inflow of dedicated taxes for Medicare pays for almost nothing under Medicare. Most of Medicare comes from general fund transfers. So, does the fact that a part of Medicare is paid for by a dedicated flow make a difference? It may be clearer for Social Security, where we have more than enough money from dedicated taxes; in fact those taxes are used for other things.

Mr. Anania said he might come to a different conclusion for each of these programs, but his point is that he does not want to rule them both out and say they are nonexchange. That is the first step. The next step is more detail and more information and more discussion.

Mr. Jacobson asked whether that was another way of saying that there are some transactions that are nonexchange as classically defined, but that are nevertheless constructive obligations because of other factors? The factors could include payments going to the government , but there are other factors as well and you have to look at all the factors. Mr. Anania agreed and added the question, “Are there benefits deriving to the recipients of those programs that you would ignore if you based your decision only on whether the transaction is exchange or nonexchange?”

Referring to questions 6 through 8[7] in her paper, Ms. Wardlow asked what she could give the Board to help resolve the issue of legal versus constructive liabilities? She said the members have different views and it is a fundamental issue to resolve.

Mr. Anania said he finds it difficult to take a legal versus nonlegal approach to defining a liability. Ms. Cohen agreed with question 8, that the definition should not be based on notions of equity or custom. Mr. Anania agreed with Ms. Cohen. Ms. Wardlow pointed out that the notions of equity or custom are subsumed to some extent in the general concept of constructive obligations (question 7).

Mr. Reid mentioned the concern he had expressed earlier about not making the definitions of assets and liabilities so restrictive that our ability to do accrual accounting is hindered. However, he did not think that ruling out notions of equity, custom, and moral sanctions would make the liability definition too restrictive. Mr. Mosso is not ready to rule them out entirely, because they might fit into some criteria, such as promissory estoppel. He did not think that, as a general proposition, we would want to base a liability just on one of those notions. But they might contribute in the totality of circumstances.

Mr. Dacey thought this related to Ms. Robinson’s earlier comments that employee pensions are not legally enforceable in some sense but that there can be liabilities for them. Ms. Robinson said that is because employee pensions are based on an exchange transaction. That is an important consideration for her. In her view, there are a host of obligations that arise in an exchange that do not arise when there is no exchange. Mr. Reid said Congress is the ultimate authority; when they say “yes,” it’s

[7] 6. Does the Board agree that liabilities do NOT have to be legally enforceable, in the sense of being based on contracts and legislation?
7. Does the Board agree that liabilities should include certain kinds of constructive obligations, particularly those contemplated in the doctrine of promissory estoppel?
8. Does the Board agree that liabilities should NOT be based on notions of equity (fairness), custom, moral sanction, etc., except to the extent that those notions are subsumed in the notion of constructive obligation underlying question 7?

yes, when they say “no,” it’s no. While that is true, we need to look at what they have done so far.

Mr. Mosso summarized that there does not appear to be complete agreement on the issue of legal versus constructive obligations. Some further analysis and the development of some criteria that the Board might use would be helpful. The criteria could be related to the notion of constructive obligations in some way but would limit it. There appears to be consensus that it should not be open ended.

Mr. Patton asked for clarification of what the Board concluded could be ruled out from the list of potential obligating events discussed earlier. There were several nominees for exclusion, but he was not sure there was a consensus. He thought that the list was structured for the provision of goods and services to individuals, and that is why members were talking about eligibility. So, he would like to see the issue separated into individual versus collective goods, and it may be that nobody believes that there is any obligating event for collective goods, such as national defense. If staff presents a new list of potential obligating events, he would like to see it separated between individual and collective goods. Also, separate discussion of cash versus goods and services would be useful.

Ms. Wardlow said that in her paper she had assumed that the Board agreed with the conclusion of the UK Board that general political promises do not result in liabilities, so that the list of obligating events in her paper referred only to specific obligations to specific individuals or groups. She asked whether that assumption was incorrect? Ms. Robinson noted that, in her view, defense is not a “general political promise” because it is written in law that the government shall provide national defense. Mr. Reid said the government would provide it through 2004. Ms. Robinson disagreed, saying that it is in the Constitution that the government will always provide national defense.

Mr. Patton said that he did not recall that the Board had excluded general political promises from consideration as liabilities. However, if the Board does exclude them, it should be for reasons consistent with those applied to potential liabilities for specific obligations.

> **Conclusion**: Mr. Mosso asked for further analysis of the concepts of exchange, nonexchange, and exchange-like transactions, including the reasons for the GASB’s distinctions. Also, the Board would like to consider some criteria that it might use to incorporate a notion of constructive obligations into the essential characteristics of liabilities, but that also would limit the scope of that notion.

The Board adjourned for lunch at 12:30 PM.

- **Social Insurance**

For the October meeting staff proposed three alternative [Alternatives A, B, and C] obligating events for Social Security that would result in liability recognition earlier than the current “due and payable” recognition point. The Board had voted in August to consider alternatives to the “due and payable” liability for the Social Security program.

Alternatives “A” and “B” proposed the same obligating event: “work in covered employment;” but with different rationales. Alternative “A” argued that the characteristics of Social Security together with the work in covered employment constituted a “present obligation” for which the Government has little or no discretion to avoid settlement. Alternative A presented this as a “non-exchange transaction” obligating event.

For alternative “B,” it was argued that Social Security contains sufficient exchange elements between the participant and the Government and therefore the obligating event – work in covered employment – constituted an exchange transaction and recognition was justified.

The staff explained that a “work in covered employment” obligating event would result in benefits accumulating or accruing with work performed in covered employment. Staff considered 40 quarters in covered employment (QC) a variation of the “work in covered employment” approach because, after 40 QCs, benefits presumably would accumulate; staff did not offer a separate alternative featuring the 40 QC point.

Staff also presented a “full eligibility” obligating event for discussion as “Alternative C.” Staff explained that benefits would not accumulate under Alternative C but rather would be recognized in total at the date of full eligibility. For Social Security, full eligibility occurs at 62 years of age, the initial eligibility age.

Staff noted that the Elements Project will be addressing concepts that affect the Social Insurance Liability Project (SILP), and that the two Projects are complementary.

Staff also noted that in August the Board had asked for display alternatives for discussion, and several preliminary options were provided in appendices to the staff paper as a start for that discussion.

The staff provided a list of issues for each alternative. The first issue under alternative “A” was whether the Board considered the Social Security characteristics, individually or collectively, sufficient to create a present obligation.

Ms. Robinson said that she wanted to take issue with a number of assertions in the staff paper. She cited a statement that Social Security has permanent and indefinite budget authority in connection with the assertion that Social Security is on autopilot and other programs are not. [Ms. Robinson said she thought the staff paper referred to both Medicare and Social Security, but the staff paper did not mention Medicare, except in Appendix Q, the table that compares characteristics among selected programs; and Appendix S, the table that summarizes pros and cons for liability recognition from SFFAS 17, where Medicare is contra-distinguished from Social Security with respect to the characteristic of individual equity in the benefit formulas because, in the latter program, unlike Medicare, greater levels of taxes result in greater levels of benefits.] Ms. Robinson said staff might want to really look at that because direct student loans and SSI do not require re-authorization. Also, she said that the annual appropriation for food stamps is really a fiction; food stamps is in a class of programs called "appropriated entitlements," which means that the appropriators want to put their stamp on the program even though the amount actually appropriated is set to conform to the mandatory level. She said that having the annual amount appropriated is actually a political choice. The program is actually an entitlement.

The staff mentioned that Congress would have to act with respect to food stamps. Ms. Robinson disagreed. She said if food stamps beneficiaries were to sue for their benefits, the Administration has taken the position that it does not matter whether Congress had appropriated the money; but she said she did not think there was ever a case where Congress had not actually appropriated the money. She said that Congress, when it went on Continuing Resolutions (CR), always used to put in a provision for food stamps; and now, because CRs have become routine, Congress is considering putting in a forward-looking first quarter for all the appropriated entitlements programs automatically.

Mr. Jacobson said he thought the issue on the CRs was the calculation of the amount available, not whether Congress had appropriated funds permanently in another law. . Ms. Robinson said, with respect to the amount available, that she thought the courts have said that that limit is not actual and real: if more people show up, they get paid. The food stamps program got around this by having a trigger: if more people show up, more money is available, up to a certain amount. In essence, if they miscalculate on the appropriation, they get more money. Mr. Kilpatrick said the appropriation language was "such sums as may be necessary," rather than a dollar amount. Ms. Robinson agreed. Mr. Kilpatrick added that this approach was used for other such programs, e.g., SSI. Ms. Cohen said that that is what an entitlement is. Ms. Robinson said that food stamps actually show up on annual appropriation bills because Congress wants to say they appropriated money for food stamps every year, but it does not mean anything.

Mr. Farrell asked whether they stop paying food stamps when the Government is shutdown. He said they keep paying Social Security. Ms. Robinson said they have kept paying food stamps when the Government is shutdown.

Mr. Zavada said they are all entitlements and that it is not possible to distinguish between them as the staff paper attempts to do. They are all entitlements.

Ms. Robinson said Social Security is not alone even when you look at permanent and indefinite budget authority and the lack of a requirement for reauthorization.

Ms. Cohen said there was a difference between a need for an appropriation and having a continuing appropriation. Ms. Cohen said Social Security has a continuing appropriation and although Ms. Robinson may consider it a legal fiction, she believes that these programs had to be appropriated each year, even though it is an entitlement. Ms. Robinson disagreed. Ms. Cohen said no money could be expended without an appropriation. Mr. Reid said there are continuing and indefinite appropriations. Ms. Robinson agreed and said they go with almost all of the appropriated entitlements, and particularly with food stamps, because we know that there is a backstop of "such sums as may be necessary." Mr. Jacobson said that language appropriating such sums as may be necessary is an appropriation whether located in an appropriation act or program legislation. . Ms. Robinson said everything is an appropriation, that Social Security gets an appropriation it just does not get it in what we call an "appropriations bill."

Staff said that the issue being addressed asked whether distinctions could be drawn between federal programs based on the program's characteristics, and one characteristic is whether Congress has provided permanent and indefinite budget authority. Staff said that the annual appropriation by Congress for food stamps is more than a mere formality.

Mr. Anania asked why a vote would be a mere formality. He said he did not understand a formality from a non-formality. Ms. Robinson said it goes back to the fact that we decided to classify things into mandatory entitlement versus yearly appropriations in the budget legislation of the 1980s. She said they had to deal with these things that were neither fish nor fowl, and they created a concept of appropriated entitlements, which is a contradiction in terms, a non sequitur, in the context of putting an entitlement on an appropriation bill every year. But she said they wanted to do it because the appropriators still wanted to have control over these programs; so, theoretically, Congress has to deal with it every year and give them the money; but Congress has not yet passed a law that says that that's binding. Mr. Kilpatrick added that the amount Congress appropriates is determined by the program, not the other way around; and thus the appropriation does not control the spending. Ms. Robinson agreed. She said that the point is that we cannot think we are only dealing with Social Security and Medicare if we are going to narrow this class; she believes that the class is much larger.

Ms. Robinson also said that the staff paper asserts that Social Security is not means tested and she said she did not really understand that. She said that in her view Social Security is explicitly means tested; it is regressively means tested. Staff asked if by "means tested" Ms. Robinson meant that some Social Security benefits were subject to income taxation at higher levels of income. Ms. Robinson said yes. Staff said that one's income is not a criterion for getting the benefit. Mr. Farrell said that that is not means-testing but rather an income tax formula. Ms. Cohen said the benefit is based on one's earnings not on one's means. Mr. Zavada mentioned that the program weights the benefits toward the lower wage earner in terms of income replacement percentage. Ms. Robinson said it depended on whether one thought there was a correlation between what one earns over 35 years and what one's means currently are. She said it was true that Social Security does not assess one's current assets in order to decide whether or the amount of one's benefit; it is calculated based on a formula that probably relates to one's assets. But she said the income tax test is a concurrent means testing. Ms. Cohen disagreed. She said that was not means testing any more than any other provision of the tax code; the tax code is progressive.

The Board discussed the 40 QC option under Alternative A whereby benefits would start accumulating at 40 QC rather than before that point. Mr. Patton said that the 40 QC option, which he labeled “Alternative A.1,” is conceptually very similar to Alternative C, the “full eligibility” alternative, rather than Alternative A, the “accumulate when works begins in covered employment” alternative. He said in alternatives A.1 and C seemed to be conceptually similar because in both cases there was a long period of not accumulating and then a trigger where we accumulate a lot and then as time goes by after that some would be accumulated.

Staff explained that the 40 QC option was presented as equivalent to Alternative A (i.e., accumulate when work begins in covered employment) because it occurs early in a participant’s career, after which benefits would accumulate over a long period before the participant reached the age of retirement. On the other hand, Alternative C (full eligibility) occurred at the end of the participant’s working life and presumably each year the present value obligation would be calculated for that population. Staff said that its goal was to present opposites, i.e., (1) accumulate benefits as one works in covered employment or (2) recognize the present value of the amount to be paid to those eligible to retire. Mr. Patton said he had not focused on the measurement issues but was still trying to decide whether there was a present obligation and what was the obliging event.

The Board discussed whether the measurement of the benefit obligation would be similar regardless of whether one included (1) the entire population of current workers and those eligible to retire or (2) just the latter. Mr. Reid said that the measurement of the amount you expected to pay the retirement-eligible population might be different than for the entire population of participants. He said the former might be a value for liquidating the obligation today versus a projection of the ultimate obligation over a period of time for the ongoing program, including all current participants.

Staff suggested focusing on the two alternative obligating events: at the beginning of the participant’s career as work in covered employment takes place [Alternative A (and B)], or at the end of the participant’s career when s/he his fully eligible [Alternative C]. Mr. Patton said that both Alternatives A.1 and C struck him as conceptually similar: both require the participant to reach some level of eligibility.

Mr. Anania said that this is not a big group and it seemed to him there was another possible event that would be obligating for a certain group. He asked whether the death of the threshold-eligible participant with dependents was an obligating event. The staff responded that that event would have to be included in the measurement of the obligation. Mr. Schumacher noted that under the full eligibility alternative [Alternative C], if someone died before reaching 62 the dependent and survivor obligation would never be accrued; or it would have to be otherwise picked up. Mr. Reid noted that a spouse would be eligible for a benefit as a result of a participant working 40 QCs, but not right away. The spouse would be eligible in the future when reaching 62 years of age. He said that under the full eligibility alternative, the benefit obligation to the spouse would be measured when she reached 62. Ms. Robinson also noted that a spouse has to be married to the participant for 10 years to be eligible, even if the participant has 40 QCs.

Mr. Mosso noted that all three alternatives focused on the first time you would report something, either the first pay period a participant works or the pay period they hit 40 QCs or the pay period they hit 62. Mr. Reid said that, assuming that the Board can come together around one of those three alternatives, the decision is somewhat different than the decision that would say is this exchange-like versus something else. He said the justification for Alternative A versus the justification for Alternative B is a separate issue from the three recognition points. Mr. Zavada said the Board was simultaneously searching for a conceptual basis. Mr. Reid said the Board could decide the two issues separately and then marry-up the winners.

Ms. Robinson said she wanted to focus on issue #1 and whether the characteristics listed there "work." Starting from the bottom of the list, she said she did not understand why it mattered if a program was means-tested, why it would make a material difference. Mr. Reid responded that it would make a material difference because means testing means that one could become ineligible whereas in Social Security you never become ineligible. Ms. Robinson asked why that would matter in regard to whether the government had an obligation or not. She could understand that that would matter to the individual with respect to whether or not they had an asset. Mr. Schumacher said that for him it means that the obligating event does not go away. He agreed with Mr. Reid's example: if it is means tested one year you may be eligible but that eligibility may go away the next year.

Ms. Robinson said that the individual's asset can go away but the liability for the government to make payments to a class of beneficiaries does not go away. She asked whether the Board was saying now that the government has to know what individuals it is going to pay. Mr. Schumacher said the government would have to know enough to measure the liability. Ms. Robinson said the government knows who is going to get food stamps, as much as we know who is going to get Social Security.

Mr. Anania asked Ms. Robinson whether, if the means test characteristic were struck, would there be enough left in the other four [characteristics listed under Issue #1, page 15, to create a present obligation]. Ms. Robinson said she would strike more of them. She said she also did not see why it mattered that dedicated taxes are paid.

Ms. Cohen responded that she thought many people feel that, if you get a paycheck and it says on it that money is withheld for Social Security and Medicare and you are working your quarters to be a part of that system, there is a connection between the payment and the benefit.

Ms. Robinson said that, with respect to whether or not the government has an obligation, it does not matter whether the government labels these taxes for a specific program or not.

Ms. Cohen said that some feel that, since we get a sheet every year that tells us what we can expect to receive from the government and what our earnings have been and what we have paid, there is a connection.

Ms. Robinson asked whether the Board agreed with that. Ms. Cohen said some people she knows and most people outside Washington would agree with it. Mr. Zavada said past earnings and other factors are included in the formula for benefits. Mr. Patton said it increases the probability that the government cannot realistically avoid the payment. Ms. Robinson agreed but she said there were other examples where the government sends things out. She said the government sends out a lot of program information. The Board discussed this statement. Several members said they do not receive any communications from the government similar to the ones they receive from Social Security. Ms. Robinson noted that parents with college age students would get information about student loans, and veterans would receive communications about benefits. She said the Board members might be a special group who would not receive many communications. Ms. Cohen disagreed.

Ms. Robinson said the question was whether it mattered to the government that you pay specific taxes. Ms. Cohen said it did. Mr. Anania said there was a question of benefit here, and even though the government does replace the funds it uses with Treasury securities and pays interest on them, the question is whether there is a benefit to the government from the Social Security taxes collected above and beyond what they pay into the "fund" for the money that is utilized. If there is a benefit associated it, Mr. Anania said it seems to him that it was getting closer to an exchange transaction. Mr. Anania said he believed that the specific taxes benefited the government above and beyond the interest paid to the fund. Mr. Reid said that that was a reason why he liked the concept of "exchange-like," because it limits the consideration to those programs where some of those things are present. He said that is why he thought the work on the liability definition needed to pursue that line of reasoning. He also noted the difficulty of pursuing both projects simultaneously. He said he liked the exchange notion more than Alternative A and that is why earlier in the Board's discussion he was trying to separate the trigger from the rationale. Mr. Reid said he agreed with the notion that expectations are created with the payment of dedicated taxes. Mr. Mosso said the collection of taxes is irrelevant for liability recognition.

The Board discussed whether any of the characteristics should be eliminated. Mr. Patton said that he would drop some characteristics and perhaps add others, but that whatever list is presented, all of the characteristics should be necessary to create a present obligation.

Mr. Anania said he would eliminate the means test characteristic. He did not think it was important.

Mr. Reid said if you think of these characteristics as requirements, the third characteristic – specific, dedicated taxes – would result in a short list of liabilities, perhaps only the ones current classified as social insurance. Ms. Comes mentioned that there were many programs with dedicated taxes. The highway fund was mentioned.

Mr. Mosso asked the members about Issue #1 – whether the program's characteristics would be sufficient to create a present obligation.

Mr. Patton said he did not like Alternative A. He said he did not think the characteristics were sufficient to create a present obligation in part because they do not mention reaching some eligibility formula. And he said that because Alternative A did not focus on eligibility, he was having a problem responding. Mr. Anania agreed and asked if the characteristics helped Mr. Patton think about Alternative B, the exchange transaction rationale for accumulating benefits. And Staff suggested that the characteristics also could be thought of in relation to Alternative C [full eligibility]. Mr. Anania agreed but said he did not favor Alternative C.

Mr. Patton said he did not like the idea of a present obligation existing before some notion of eligibility has been established. He said he would oppose accumulating benefits before eligibility is established.

Mr. Schumacher agreed with Mr. Patton. He said he did not like Alternative A. He said he does like the idea of meeting eligibility requirements. He said he would like to see some eligibility threshold reached before accumulation begins. He would include eligibility as a necessary characteristic.

Mr. Dacey referred to comments he made in the previous session [in Elements]. He said he found it a bit confusing to try to figure out what the liability is at this point. Although the Board talked last time about there being something beyond due and payable, he was not sure the Board had explored the possibility of what this other thing is. He mentioned disclosure of long-term commitments. He said he was not sure how Social Security would fit in the overall picture of liabilities versus these other commitments. He said the approach was causing him some consternation. We have a statement of social insurance and perhaps are going to pull parts of that out and call them liabilities. He wondered how other programs that are like Social Security and Medicare would be disclosed. He said he thought it was important to show people the information about the total projections in the statement of social insurance. The question is: what is the value of pulling out pieces of that, what are we trying to show? Is it a balance sheet or is it a statement of financial condition we are driving toward? He said he was trying to get himself out of a rigid model of liability and financial statements. He said he was not sure it quite fits.

Mr. Zavada said he agreed with Mr. Dacey. He said this might be a case of trying to fit a square peg in a round hole. The conceptual framework does not quite fit. He said other viewpoints or alternative presentations are worth exploring. He added that none of the specific characteristics listed lead him to conclude that there is a present obligation. He said he did not think the benefits accumulate.

Mr. Reid said he agreed with Mr. Patton.

Ms. Robinson said she did not think the characteristics were sufficient to create a present obligation.

Ms. Cohen said she did think the characteristics were sufficient to create a present obligation. She said she would prefer if the specific, dedicated taxes were better tied to the fact that they are assessed on covered employment. Make it clear that this is not a tax like the gasoline tax. It is based on earnings.

Mr. Farrell said he was leaning toward Messrs. Patton's and Reid's and Ms. Cohen's view. He said it was likely there is more than a due and payable liability. He said he did not have a concern about pulling a piece out of the SOSI. He said he found the characteristics helpful and that they should be developed further.

Mr. Anania said he was close to where Ms. Cohen is. He said he would like to see the obligating event broadened a bit. He would strike the means test characteristic. He said he probably would prefer Alternative A.1. He said he took to heart Ms. Robinson's comments about singling out Social Security for autopilot, and that more work needed to be done so that the decisions during Social Security do not entrap the Board in regard to other programs. He said in his view there are exchanges or exchange-like activities taking place. This leads him to thinking there is a liability beyond due and payable.

Mr. Mosso said he would be close to Ms. Cohen, although there is a lot more work to do. He said Ms. Wardlow would develop the liability concept further and hopefully prevent the Board from creating any traps.

The Board did not conclude that the list of characteristics under issues #1 would be sufficient to create a present obligation.

<u>Staff Summary</u>

Regarding Social Security characteristics that may lead to the conclusion that "a present obligation exists that the government has little or no discretion to avoid" prior to the point when benefit payments are due and payable,

- ✓ Several members said that the establishment of permanent eligibility is a critical characteristic.
- ✓ Several members stated that participants' paying into the systems is important for establishing that the government has "little or no discretion to avoid settling the obligation."
- ✓ Several members said that the exchange or exchange-like elements of the Social Security program help create a present obligation.
- ✓ Several members noted that specificity is an important characteristic. The benefit obligation would have to be specific enough to measure its present value. Staff note: The identity of the specific individuals in the population of potential beneficiaries might be important in this regard.
- ✓ Several members said that the government's communication with the participant about his or her accruing benefits is very important for a present obligation.

Regarding the reporting model, several members asked for more financial reporting context for the decision about a Social Security liability. They asked for options beyond the confines of the balance sheet.

CONCLUSION

For the next meeting, staff will sharpen the distinction between Social Security characteristics and other programs' characteristics. Staff will compare and contrast Social Security characteristics with other programs that the Board has discussed in this and the related "application of the liability definition" project.

The staff will focus on the obligating event alternatives discussed in August: (1) "full eligibility," e.g., 62; (2) "threshold eligibility" at 40 quarters of work in covered employment; and (3) beginning of work in covered employment. The staff will cite exchange and/or exchange-like concepts as an important characteristic.

- **Research into the Application of the Liability Definition**

Ms. Ranagan presented a preliminary plan for the proposed project on research into the application of the liability definition. Ms. Ranagan indicated that this project was previously introduced in April under the title of Long-Term Commitments but, at the urging of several board members, had been renamed to more broadly address the objectives of the project, which is to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for commitments of the federal government that could potentially result in a net outflow of resources. Ms. Ranagan further explained that this project is a companion project to the liability elements and social insurance projects.

Ms. Ranagan summarized the various sections of the project plan: primary objective, background, scope, and approach. She specifically referred to the footnote disclosure for Veteran's Disability Pension Benefits in the 2003 Performance and Accountability Report as an example of the type of disclosure the Board may want to consider addressing as they review the usefulness of financial statement reports. In addition, Ms. Ranagan reviewed the chart on page 4 of the project plan, stating that the terms "implicit" and "explicit" will be dropped from the chart, absent any objection from the Board since the terms have been deemed confusing by several members of the Board and staff. Shading will be used instead of the terms "implicit" and "explicit" to denote which programs need additional consideration. There were no objections. Ms. Ranagan also noted that the chart on page 4 does not apply to the due and payable portion of the liability for each program, which is already being recognized under SFFAS 5.

Ms. Ranagan directed the Board's attention to the three phases proposed for the project (summarized here due to numerous references to the phases during the Board's discussion):

<u>Phase One – Benefits Provided to Individuals</u>

This phase would address entitlement programs other than SI. Programs to be considered include veterans' benefits, Medicaid, Food Stamps, Temporary Assistance to Needy Families, and Supplemental Security Income.

Phase Two – Government Sponsored Enterprises

> This phase would explore the implied assumption of risk associated with Government Sponsored Enterprises, e.g. Fannie Mae and Freddie Mac, and any recognition or disclosure warranted for these activities.

Phase Three – Agreements that include broad assumption of risk

> This phase would address treaties, contracts, and grants that often include broad assumption of risk by the federal government.

Ms. Ranagan then stated that the specific staff objective for the October meeting is to obtain agreement from the Board to continue research on other obligations of the federal government beyond social insurance, beginning with Phase One – benefits provided to individuals, specifically veterans' benefits. Ms. Ranagan then responded to questions and comments from the Board members.

Ms. Robinson said that the definitions of accumulate versus non-accumulate are difficult ones. She provided the specific example of Medicare where she felt the distinction between accumulate and non-accumulate is difficult to make because the eligibility is based on 40 quarters in covered employment but the benefits are based only on how sick the individual is at the time they seek treatment. She said it is important to look at whether the notion of accumulate versus non-accumulate is relevant to the various programs staff is reviewing.

Ms. Robinson also said she believed that for completeness purposes, there are a number of other programs that could be looked at for Phase One – unemployment insurance, child nutrition, direct student loans, PBGC. Ms. Ranagan responded that unemployment insurance is one of the five programs being looked at by staff on the social insurance project. She also noted that on page 2 of the plan under project scope, the programs addressed by SFFAS 5, i.e., insurance, were specifically excluded for this project. However, she noted that Mr. Patton had provided comments prior to the meeting that he thought maybe the SFFAS 5 programs should not be excluded from the scope since we are revisiting the liability definition itself.

Mr. Mosso asked what staff saw as the eventual long-term outcome of the project. Ms. Ranagan responded that the result would depend on the direction of the Board but could be any of a number of options: a new element on the balance sheet, a chart of commitments and contingencies, additional disclosures. Ms. Ranagan said she felt that the project would provide research and other relevant information to the Board concurrently with the social insurance project to enable the Board to develop a principle-based standard with enough comfort that the Board has covered the wide variety of federal programs.

Ms. Ranagan also provided two examples of government obligations – food stamps and post-traumatic stress disorder resulting from military deployment – that might not be a liability but may be very useful information for accountability and decision-making that the Board might want to consider in their broad review of the overall financial reporting package for the federal government. She said she sees this project as the vehicle for providing the Board that type of information to enable them to make informed decisions.

Mr. Anania said there are three projects with a nexus (connection/link)– the project on social insurance, the project on elements definition, and this project. He asked if the Board's priority should be (1) looking at areas of government activity that may encompass a liability where a liability has not been recognized before or (2) exploratory to determine whether the Board has all the data the Board needs to determine what to look at next.

Ms. Robinson said that there might be some activities we can include in Phase Three – multi-lateral financial institutions and "callable capital" for World Bank and IMF, for example – that the Board may find easier to agree is a liability than some of the other programs. She said at least there is a Statement of Social Insurance for social insurance but there is nothing reported on some of the other programs.

Mr. Anania said he questioned whether the Board needs to decide that the research is helpful and then pick one of the programs on page 4 of the plan, convert the project from a research project into an outright review of the selected program, and then decide whether an additional liability is required.

Ms. Ranagan passed out a handout of alternative obligating events for four programs – Social Security Old Age and Survivors, Social Security Disability, Food Stamps, and Veterans' Disability Pension Benefits – to demonstrate the linkage between obligating events and accumulation and to show the type of information that would be provided through this project, similar to what staff has presented for the social insurance project.

Mr. Anania asked what importance would be placed on the differentiation between explicit and implicit denoted in the chart on page 4 of the project plan. Ms. Ranagan responded that the terminology was originally discussed at the April Board meeting and was adopted from a GAO report on fiscal exposures. She said she has received several comments from staff and members since the plan was drafted that would lead her to believe that the differentiation is confusing and adds little value to the structure of the project. Explicit merely means the item is already recognized as a liability while implicit means the item is not already recognized as a liability. She again proposed removing the differentiation between explicit and implicit. There were no objections.

Mr. Zavada stated that, for the record, he does not think that the veterans' health benefits and veterans' disability pension benefits are properly classified as explicit. He said the veterans' health benefits are limited by access; it is not a voucher-type program where everyone receives the same benefits. He said the veterans' disability pension benefits program is an income maintenance program. He said he does not see a link between these programs and the accumulation of benefits.

Staff presented the notion of accumulation as a potential distinguishing characteristic between programs such as social insurance and other programs such as food stamps. In his review of the staff handout of alternative obligating events discussed above, Mr.

Mosso said the concept of accumulation might not be a helpful criterion because it depends on which obligating event is selected. He provided Veterans' disability pension benefits as an example. He said that at the point at which you determine you have a long-term liability (the obligating event), accumulation becomes a function of measurement. Ms. Ranagan offered that the criterion of individual (attributable) versus collective (non-attributable) might be a more helpful distinction. She provided the examples of social security, national defense, and food stamps. The individual participants in the social security program can be determined at any given time through the use of social security numbers, work in covered employment, and the payment of the social security tax. While the liability number would not be 100 percent of the total participating population, at least the pool of individual participants is known. In contrast, amounts appropriated for national defense five years from now will benefit individuals not yet born, and thus are unknown at the present time. Furthermore, the individual participants are not identified at the time the food stamp appropriation is passed but they are known once the individuals have applied for benefits and met the eligibility criteria. Ms. Ranagan referenced the IFAC PSC discussion of collective versus individual.

Mr. Anania said he feels the research is helpful but he believes that it may be useful for staff to fully research an additional project that is closely related to the social insurance project in order to flesh out any problems that may arise from the development of additional criteria for liability recognition instead of continuing to gather information on a wide variety of programs.

Ms. Comes referred to item 5 on page 5, "alternative displays for the balance sheet, statement of net cost, and/or other statements" as being a potential outcome of the project that we may want to elevate and focus on sooner rather than later so the Board has a frame of reference for another outcome beyond just additional liability recognition.

Ms. Robinson said she feels looking at programs from Phase Two and Phase Three at this time could also yield a lot of benefit to the project. She specifically referenced the potential for bailout of Fannie Mae and Freddie Mac;; multi-lateral financial institutions and "callable capital"; savings and loans; Federal Deposit Insurance Corporation; and other programs that could snatch resources away from the federal government.

Ms. Cohen said she felt the fact sheets provided on Medicaid, Food Stamps, TANF, and SSI at the August meeting were excellent and could facilitate decision-making without the need for additional information. Mr. Mosso said they could make a tentative decision with input and feedback from interested parties. He said staff could pick a representative program or two from each of the three phases to develop further.

Ms. Comes said staff would come back in March with enough information, including alternative displays, for the Board to make a strawman decision about when the obligating event occurs for each of the programs selected.

Mr. Patton asked about what new elements might be developed beyond liabilities. Ms. Comes responded that any new elements presented would first be developed and coordinated in the staff project on element definition.

Mr. Anania described a liability presentation that was based on how difficult it is to estimate (i.e., Type A – easy to determine, Type B – harder to determine, Type C – very hard, very complex, subject to substantial adjustments, like Social Security and pensions). He said such a presentation would be a more creative way to call attention to the reader that there are different qualities that make the liabilities either more or less difficult to estimate. Mr. Reid referred to such a presentation as classified liabilities based on computational risk. Mr. Schumacher questioned how one would get a clean audit opinion on such a presentation.

> CONCLUSION: Staff will select one or two representative programs from phases one, two, and three and come back at the March meeting with relevant alternative obligating events and displays for the selected programs.

Steering Committee Meeting

The Steering Committee discussed the budget presented for FY2005 and the need to address the staff vacancy created by the resignation of Sebastian Rodriguez. Mr. Zavada and Ms. Robinson emphasized the uncertainty of FY 2005 appropriations and that the uncertainty may not be resolved until February 2005. They also indicated that budget pressures would continue in future years. Of the alternative approaches to filling the vacancy, hiring a full-time permanent staff member was preferred. In light of the budget uncertainty, the committee agreed that the recruitment effort should begin but final approval to hire would be deferred until appropriations are finalized.

Ms. Comes alerted the committee that an annual report would be provided for review at the December meeting and the Appointments Panel would be reconvened in early 2005. The Panel will begin efforts to recruit a chairperson to succeed Mr. Mosso, whose term ends in December 2006.

Adjournment

The meeting adjourned at 4:30 PM

Thursday, October 21, 2004

Agenda Topics

- **Inter-entity Cost**

Staff member Ms. Loughan began the discussion on Inter-Entity Cost by explaining to the Board that the comment letters to the exposure draft (ED) entitled *Inter-Entity Cost*

Implementation: Amending SFFAS 4 Managerial Cost Accounting Standards and Concepts had been presented at the August Board meeting. Ms. Loughan explained that staff had also presented an analysis of those comments along with recommendations at the August meeting.

Staff reminded the Board that the ED had definitely sparked quite a bit of interest as there were a 21 comment letters received. Ms. Loughan then recapped a high level summary of responses to the questions included in the ED:

> 12 of 21 agree with the Board's proposal that the inter-entity cost provisions of SFFAS 4 be fully implemented for reporting periods beginning after September 30, 2007.
>
> 13 of 21 agree with the alternative view proposal to implement the inter-entity cost provisions by identifying specific costs to be recognized on a step-by-step basis. Staff explained that there was an overlap of 4 respondents agreeing with both the ED proposal and the alternative view.
>
> 11 of 21 believe that there are now non-reimbursed or under-reimbursed inter-entity costs meeting the recognition criteria in SFFAS4.
>
> 14 of 21 believe that federal entities will seek additional reimbursable agreements or modify existing agreements (e.g., by increasing fees) because non-reimbursed or under-reimbursed inter-entity costs may be recognized.
>
> 10 of 21 believe that additional guidance is needed to apply the factors in determining whether an inter-entity cost is material to the receiving entity.
>
> 9 of 21 believe that additional guidance is needed to apply the broad and general support exception.

Ms. Loughan explained that at the August meeting, the Board agreed that a public hearing would be held on the ED and related comments on December 16, 2004. In addition, the Board did request that staff prepare a draft plan of guidance that would be forthcoming. The Board had requested that the draft guidance include the partnerships, timelines, and types of guidance that would be envisioned from the different sources—AAPC, staff, etc.

Staff explained that the goal for the October meeting would be to review the draft guidance and discuss any comments that the Board may have. Staff also explained that the goal would also be to make the draft document available as an attachment to the press release for the public hearing so participants would be aware of the forthcoming guidance and be able to speak to specifics.

Staff explained that the Draft Guidance, which was included in the Board Binder materials Tab F, is broken up into three sections-- specific areas to be addressed by Staff, AAPC and OMB:

· Areas that needed to be elaborated upon or clarified as to the intent of the Board in SFFAS 4-such as materiality, would be accomplished best by FASAB staff and based upon the project/history files.

· Areas that involved more application of the standard-such as applying the factors detailed in SFFAS 4 and resolving individual case examples, would be accomplished best by the Task Force that includes representatives from the community with practical experience. In addition, developing the list of costs that should be considered "Broad and General" would be accomplished best by the Task Force with their government-wide representation.

· Areas that related to the operational aspects of implementing the standard-such as time lines for agencies and supporting documentation, would be accomplished best by OMB in a manner similar to other directives issued by OMB.

Staff also explained that if the Board believes it to be more appropriate, the Materiality or Staff Guidance described in the Draft Plan could be combined with the Technical Release to be developed by the AAPC and include all of the topic areas in one Technical Release issuance, as all of those topics could be considered guidance related to an existing accounting standard.

Staff then asked for the Board's comments or specific questions on the Draft Guidance Plan. The Board offered the following:

Mr. Anania asked if OMB and the AAPC had agreed with the Draft Guidance Plan and proposed dates. Staff explained that OMB had not commented on the draft. Staff also explained that they do not foresee any problems with agreement from the AAPC. Mr. Zavada explained that it was his understanding that OMB would be providing operational type guidance. Staff explained that was correct and that the Draft Guidance Plan actually had a target milestone completion date of 9/30/05 for guidance detailing the responsibilities and deliverables of both the providing and receiving entity, establishing timelines for carrying out those responsibilities; and establishing a communication process between providing and receiving entities; and a target date of 9/30/07 for all remaining items. Ms. Comes explained that the earlier timeframes for establishing the communication process is necessary to ensure that parties are communicating so other issues can be resolved. Ms. Comes explained that OMB would then have an additional two years (9/30/07) to develop guidance related to eliminations and supporting documentation.

Mr. Zavada explained that he did not foresee a problem and that most likely OMB would facilitate that process through the CFO Council and the Department of the Treasury. Mr. Anania asked if section C of the Draft Guidance Plan should be modified to incorporate the CFO Council and Treasury. Mr. Zavada suggested that wording could be added to state that OMB would work through the CFO Council and in conjunction with Treasury on developing the guidance.

Mr. Patton expressed concern with the Draft Guidance Plan section A, Guidance to be Developed by FASAB Staff Relating to Paragraph 112, that addressed materiality. Mr. Patton explained that the Board has been reluctant to address materiality in the past, so it would be a change in policy to take on the concept of materiality. Ms. Comes explained that actually the change in policy occurred in SFFAS 4 when the Board chose to address materiality differently in inter-entity costs by stating that it "is directed to the individual inter-entity transaction rather than to all inter-entity transactions as a whole". Staff further explained that under that concept, the Board envisioned a much more limited recognition when compared to the general materiality concept. In addition, SFFAS 4 provided that materiality should be considered in terms of the importance of the inter-entity transaction to the receiving entity and that it should be judged in light of the three factors (significance to the entity, directness of the relationship to the entity's operations, and identifiability.) Ms. Comes explained that short of amending SFFAS 4, FASAB can only provide additional guidance on how to apply the language set forth in SFFAS 4.

Mr. Patton explained that he believes the risks of exacerbating the problems created in SFFAS 4 are significant. He added that if amending SFFAS 4 was not an option, then he would prefer to not address the issue at all as it would be unfair to address such a large topic (materiality) in staff guidance. Ms. Comes explained that there is additional information and language in the SFFAS 4 project files that did not make its way into the final standard that would assist staff in providing additional language or guidance in the area. Mr. Patton reiterated that he believed that materiality is a huge concept that should not be left to staff for guidance. Ms. Comes explained that the Board always has an opportunity to review Staff Implementation Guidance as well as Technical Releases. Ms. Comes added that there are a number of issues, based on past experience, that do not rise to level A-type GAAP guidance that must be addressed by staff or preparers would be at a loss as to proper guidance.

Mr. Mosso clarified that the guidance suggested in the Draft Guidance Plan was not on the concept of or meaning of materiality but more on how to apply it as envisioned in SFFAS 4 par. 112. For example, the guidance may expand on how it is applied at the transaction level. Mr. Patton suggested that it would more of operational type guidance and preparers may try to rely on it in applying materiality in other situations. Staff explained that the guidance would be explicit in the fact that it would be specific to par. 112 of SFFAS 4. Mr. Patton explained that he understood that but it would not prevent users from making inferences.

Staff explained that the Board had previously addressed materiality in detail by discussing the yellow book definition, FASB's Concept No. 2 on qualitative characteristics, and its applications in SFFAS 3. Staff provided the Board with a copy of SFFAS 3 par. 7-15. Staff explained that the paragraphs explain the Board's position on materiality and also what lead to the box with the standard language ("The provisions of this statement need not be applied to immaterial items.") that is included in all of the standards.

Mr. Anania explained that he was sympathetic with Mr. Patton's concerns and that he was unclear as to what staff may provide in the additional guidance. Staff explained that the guidance would elaborate upon the language in SFFAS 4 and perhaps be drawn upon some of the information contained in the project files. Staff explained that the guidance would most likely be presented in a Question and Answer format, similar to what was done in the Technical Release for SFFAS 10. Staff referred to the questions listed in the Draft Guidance Plan. Staff explained that anything that would relate to specific case studies or application would be addressed by the AAPC.

Mr. Patton reiterated his concern about addressing materiality as he explained that it would not make sense to address materiality in such a small area when the Board has not done so in other areas. He explained that if the Board plans to say something about materiality, he would rather do so in a broader sense versus just carving out one small piece. Mr. Farrell supported Mr. Patton and explained that the Board (or staff) should not be making decisions that relate to the application of materiality and determining if it should apply at the entity or program level.

Chairman Mosso asked what would be the alternative. Staff explained that the alternative would be not to address materiality or to be silent on it in any additional guidance. Staff also stated that there were certain Board members at the August Board meeting that suggested the Board should not issue any additional guidance. Mr. Patton suggested that one alternative would be to amend SFFAS 4 and change the term from materiality then it might be appropriate to provide additional guidance in the area. Ms. Comes explained that when this project was initiated, it was with the understanding that it would not delay other projects and it could be accomplished without diverting too much staff time. She explained that a project to amend SFFAS 4 would be a huge undertaking and absent a fatal flaw, she would be reluctant to do so at this point.

Mr. Zavada asked staff to summarize what the AAPC had concluded in its Task Force work. Staff explained that the AAPC had concluded that there were no material un-reimbursed or under-reimbursed inter-entity costs with government-wide implications, meaning affecting all agencies that would warrant government-wide guidance. However, the AAPC did believe that there were material un-reimbursed or under-reimbursed inter-entity costs that exist that may affect certain agencies and that may need further evaluation, such as the DOJ legal costs and certain facilities costs. Staff also explained that in the responses to the ED, over half of the respondents stated that they believed material un-reimbursed or under-reimbursed inter-entity costs did exist.

Ms. Comes explained that the ultimate purpose of the ED was to establish a date certain and that once a date was established, one would expect cases and issues to come forward. Staff explained that with the target dates in the Draft Guidance Plan, OMB would provide guidance that would require the studies and evaluation of costs early in the process so issues can be identified and resolved.

Chairman Mosso explained that the Board needed to determine if additional guidance should be provided. He also suggested that the Board could wait until after the public hearing to decide on what, if any, additional guidance will be provided. Staff stated that was an option, but the Board would have to decide if they want potential participants to be aware of the forthcoming guidance so testimony could be targeted to specific areas. Staff suggested that the Draft Guidance Plan could be revised to move the staff guidance area to the AAPC or it could be eliminated.

Ms. Comes directed the Board to section B, Guidance to be Developed by the AAPC Task Force and Issued as a Technical Release. She explained that this may be considered one of the most important areas as it does clarify that there is a place for agencies to come with questions or problems. Ms. Comes suggested that the Board could wait and determine if additional guidance on materiality is warranted after reviewing the specific questions and cases that are brought to the AAPC.

Mr. Mosso asked the Board if there were any objections to sections B and C of the Draft Guidance Plan. Staff suggested that the scope of section A could be narrowed and grouped with section B to be developed by the AAPC and issued in the Technical Release. Mr. Anania suggested that he liked that idea, as long as there was active staff participation on the AAPC Task Force. Mr. Patton suggested that he would prefer that the AAPC be charged with addressing the issues without addressing the materiality issue as materiality is a matter of professional judgment. Mr. Patton then asked would the specific cases addressed by the AAPC come to the Board for approval. Ms. Comes explained that they would.

Mr. Farrell explained that he believes the Board and the AAPC should steer away from addressing materiality. Instead, the AAPC could suggest which entity (larger, receiving, etc.) would be the one driving the decision in situations where disagreements occur. Ms. Robinson asked Mr. Zavada if there were any OMB directives that would assist in this matter or in addressing materiality. Mr. Zavada explained that there was not any specific guidance. He did explain that OMB does often play a role in matters where agencies disagree on issues.

Mr. Zavada suggested that if the AAPC did not identify any material un-reimbursed or under-reimbursed inter-entity costs with government-wide implications, perhaps the Board should not be taking on this project. Ms. Comes explained that the project began because OMB was tasked in SFFAS 4 to provide additional implementation guidance in this area, and OMB in turn delegated that to the AAPC. Ms. Comes reminded the Board that it has been 10 years since SFFAS 4 was implemented and there have not been any additional costs identified. Ms. Comes explained that if the Board is comfortable with the status quo, then the Board can stop work on this. Otherwise, Ms. Comes explained that setting a date certain as proposed in the ED, is the best way to ensure implementation of the inter-entity standard and full costing as envisioned by SFFAS 4. Ms. Comes explained that the guidance would provide for assistance when the need arises.

Mr. Reid explained that the AAPC did not identify any costs that would have global impact. He explained that his position on this project is known and detailed in his alternative views, but he wanted to reiterate his position that he does not believe this is an area that the Board should be working on and he would really be concerned if the Board becomes an arbitrator of materiality issues.

Ms. Cohen suggested that the standard has been in effect over 10 years and this remains an open item for implementation and she wonders if perhaps the comments are more to ensure that it goes on for another 10 years. Mr. Reid explained that he genuinely believed an honest evaluation was performed to identify global costs and it was determined that they do not exist. He added that now it is a question of how far down in the weeds do you want to go and this will lead to disagreements between preparer and auditor. Mr. Mosso suggested that the preparer and auditor would work it out just as they do in other situations.

Staff explained that there are certain agencies that have identified material un-reimbursed or under-reimbursed inter-entity costs but are not recognizing them because they believe they are not allowed to do so because it is not one of the four costs identified by OMB. Staff explained that one of the prime tenants of SFFAS 4 is full cost recognition and SFFAS 4 recognized that there are material costs between agencies. Staff explained that perhaps time and utilizing reimburseable agreements have addressed many of the situations, but not all of them.

Chairman Mosso explained that the ED is out there so the Board needs to decide how to dispose of it and he would recommend that the Board move forward with the public hearing in December. He suggested that staff make the Draft Guidance Plan available to participants after removing the section on materiality. Mr. Mosso explained that he would prefer that the Draft Guidance Plan be silent on materiality and the Board could reconsider that after the public hearing. He asked if there was any objection to that approach.

Mr. Patton asked if (based on the wording in section B) individuals would be able to bring questions about whether something was material in certain situations to the AAPC. Ms. Comes explained that question 4 in section B would allow that and that would fall under the specific cases that would come forward. Mr. Farrell suggested that perhaps the sub-bullets included in section A at the top of page 2 of the Draft Guidance Plan could be incorporated into question 4 of section B. Mr. Patton explained that would lead us back to the problems previously discussed in addressing materiality. Ms. Comes explained that we would be moving away from an explicit or broad discussion of materiality and just be addressing specific cases or questions brought forward. In addition, she explained that if the language is carefully crafted for each specific case, it could be worded in a way to prevent application in other situations.

Mr. Mosso asked Ms. Comes if she supported Mr. Farrell's suggestion that some of the questions from section A be moved to section B. Ms. Comes explained that she supported that idea. Mr. Patton expressed concern and did not support that idea, especially considering the Board has to review and vote on the Technical Release. Mr.

Anania explained that he never interpreted that staff would make decisions on materiality in individual cases. Instead, he thought there would be general guidance provided, but decisions would be left up to the agencies. Ms. Comes explained that the guidance would provide a vehicle for resolution and it would be consistent with SFFAS 4, which originally planned for OMB to provide implementation guidance.

Mr. Anania explained that other standard setters try to stay out of this area. He explained that he does not believe the Board should create a new mechanism for issues of materiality to be addressed. Mr. Farrell asked if the AAPC releases could instead go through the OMB for the individual cases. Ms. Comes explained that if the releases go through the OMB, it would break it out of the GAAP hierarchy.

Mr. Dacey suggested that perhaps AAPC could provide clarifying guidance through a Technical Release, but forward any specific cases to OMB with their recommendation or advise OMB on disposition. Mr. Mosso explained that the AAPC could at least collect the cases and review them and assess the different types of examples. Mr. Mosso asked if the guidance could be revised to reflect this as part of the AAPC's initial role and if it would still be advantageous to make the Draft Guidance Plan available before the public hearing. Ms. Comes explained that it would be possible and the Board should still make the Draft Guidance Plan available, as the major concern of respondents was whether there would be a vehicle in place to address issues.

Mr. Zavada asked if the Board still believed a public hearing was necessary. Staff explained that the main reason the Board decided to have a public hearing was due to the fact that there was an overwhelming response to the ED (21 letters) and the fact that it was split down the middle with half supporting the proposal and half supporting the alternative views. Mr. Anania suggested the public hearing could focus in on specific issues by having the Draft Guidance Plan available.

Mr. Anania asked if the AAPC will be in existence for a long time. Mr. Mosso explained that it is a permanent body and does not have a limited life.

Mr. Patton asked if the changes were significant enough to warrant a re-exposure. Staff explained that the ED was specific to remove the barrier and that has not changed. Ms. Comes explained that the changes discussed would not warrant re-exposure.

Mr. Farrell suggested that the press release for the public hearing should state the Board is interested in hearing specific examples of potential costs and related implementation problems.

All Board members except for Mr. Reid agreed with moving forward with the public hearing.

> CONCLUSION: Staff will revise the Draft Guidance Plan to incorporate changes agreed to by the Board—specifically, portions of section A will be moved to section B and the guidance will be silent on materiality. Staff will also move forward on announcing the public hearing for December 16, 2004 and request participants provide specific examples in their testimonies.

- **Fiduciary Activities**

Staff opened the discussion by noting that the Board's intention to provide clear accounting standards for the category called "dedicated collections" in SFFAS 7, pars. 83-87, was divided into two separate projects:

- dedicated collections designated as earmarked funds, for which the reporting standards were approved by the Board in September and sent to the FASAB principals for the 90-day review period ending December 28, 2004, and

- dedicated collections designated as fiduciary activities, which are the focus of the current discussion.[8]

Staff introduced the first question: Should non-Federal nonentity assets be taken off the balance sheet and be reported in a proposed new principal financial statement, the Statement of Fiduciary Accountability? The proposed new statement would also report the flows. Staff noted that the pros and cons for that question appeared on page 3 of the briefing memorandum.

Mr. Schumacher said that he liked the idea of providing a separate principal statement, but asked if that were not similar to putting fiduciary activities on the balance sheet? Staff replied that some fiduciary assets were currently reported on the balance sheet,

[8] Reference materials for the discussion on fiduciary activities included the following:
- List of Federal "deposit funds" and balances from the U.S. Treasury's FY 2003 Annual Report
- Audit requirements for Federal agency financial statements from OMB Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, Transmittal Letter and Sections 1-7
- Definition of "entity versus nonentity assets" from FASAB SFFAS 1, pars. 25-26
- State and local government reporting requirements for fiduciary activities, from Government Accounting Standards Board Statement 34, pars. 106-111 and Appendix C, illustrations E-1 and E-2
- Article, "Changes in the Budget Classification of the Indian Tribal Funds," from pp. 347-351, Analytical Perspectives, FY 2001 Budget of the U.S. Government

but some were not. For example, at the public hearing in March 2004, the Department of the Interior (DOI) explained why they objected to reporting the Indian trust funds on the agency's balance sheet. Mr. Schumacher said that he thought that Interior did not want to show the Indian trust funds on any financial statement at all.

Mr. Reid said that Interior did not wish to show the assets commingled on the agency's balance sheet. He said that Treasury would support removing fiduciary assets from the agency's balance sheet, and would also support a separate stand-alone statement, or a stand-alone set of audited statements. He said that he was unsure of whether the Board had the scope of authority to assure that those statements were issued. Mr. Reid said that there were actually two questions here: (1) should the fiduciary assets be removed from the balance sheets, and (2) should they be included in a new principal statement. He said that he would support the former, but not the latter. He said that getting all the fiduciary reporting together in one place would be a good idea, but "commingling" the fiduciary statements with the agency's statements would not be a good idea. He said that if there were some way that the Board could require separate audited statements to be issued, he would support that.

Mr. Schumacher asked why Mr. Reid objected to adding a proposed new principal statement to the agency's required financial statements. Mr. Reid said that the proposed new statement might be confusing, in that it might not make it clear that fiduciary assets were not owned by the Federal government. Mr. Schumacher asked if he was concerned about audit issues. Mr. Reid said that perhaps Mr. Dacey could opine on whether an audit opinion could apply to both sets of financial statements. Mr. Reid said that Treasury was concerned that the reporting standards for fiduciary activities were higher than the standard for reporting non-fiduciary activities and whether that might affect the audit opinion. Mr. Mosso asked if Mr. Reid wished to see separate stand-alone audited financial statements for fiduciary activities. Mr. Reid replied that this is what currently occurs with two of the major fiduciary activities- Indian trust funds and the Thrift Savings Fund. Mr. Reid said that agencies would need to do something similar for other fiduciary activities: perhaps combine them into a separate set of financial statements.

Mr. Mosso said that he thought that Mr. Schumacher was raising a different question. Mr. Schumacher said that he did not object to a new principal statement, but that he was concerned about whether it addressed the concerns that the DOI raised at the public hearing. Mr. Schumacher asked whether the DOI objected to reporting Indian trust funds in any of its financial statements.

Mr. Anania asked how we could deal with the requirement for accountability and stewardship if we simply said, "create a separate set of statements, do with it what you will, and have it audited if you want to." Mr. Schumacher said that this was not what he was proposing. Mr. Anania said that unless we include it as either a principal statement or a required supplementary statement, the Board was mitigating its responsibility of carrying out some of the basic concepts [of accountability and stewardship] that it has.

Mr. Zavada said that there is accountability, because they are separately audited. Dr. Robinson clarified that the two fiduciary activities being discussed are audited. Mr. Reid said that the Indian trust funds are, in effect, audited twice: once when the trust fund stand-alone financial statements are audited, and again when they are reported in the footnotes of the DOI audited financial statements. Mr. Reid suggested that perhaps the information in the proposed new statement could be required in an expanded footnote. Dr. Robinson asked whether the confusion was whether the government owned these assets, and if there were a way that a fiduciary statement could be presented and labeled in such as way as to make that clear. Mr. Reid said that the one of the concerns in the controversy about the Indian trust funds was that the information was commingled.

Mr. Patton said that, to pick up on Mr. Anania's point, there is a different accountability going on, for fiduciary items versus program items. To mix them together on one statement seems like a mistake. For the program activities, the focus is on the central mission of the agency. He said that he would support Mr. Reid's idea of having a separate footnote disclosure. That would remove fiduciary items off the balance sheet, but still maintain accountability.

Dr. Robinson asked Mr. Patton a question to clarify. She asked if the footnote he described would be associated with a separate statement to show the flows. Mr. Patton said that the flows could be in the footnote also. Dr. Robinson said that she didn't understand how this addressed the concern about publishing fiduciary information in the same document as the agency's financial statements. Mr. Reid said that the footnote would be to the principal financial statements, which it is now. Staff noted that OMB's audit guidance indicates that the footnotes are a part of the principal financial statements. Staff mentioned that a representative of the DOI Office of the Special Trustee for American Indians had called to informally comment on the staff proposal. He said that he agreed with the proposal to exclude fiduciary assets from the balance sheet, but was concerned about the proposed new statement. He was not concerned that the proposed statement would be one of the DOI's financial statements, but that the accounting for Indian trust funds is currently on a cash basis, and not on the accrual basis required for the other principal statements.

Mr. Dacey asked if most of the fiduciary inflows were in the form of cash that are then converted into Treasury securities- so that they would be currently reported as Debt Held by the Public. Staff replied that there were a variety of inflows, and they are not always invested in Treasury securities. For example, the Department of Defense (DoD) collects money from foreign governments- about $10 billion at the end of FY 2003- that represents deposits on sales of military equipment to the foreign governments from commercial vendors, and seized Iraqi cash, about $1 billion last year. Staff noted that both of these items were reported on the DoD's balance sheet as nonentity cash, and the flows for both were reported in the custodial statement. If a new FASAB standard requires reporting in the footnotes alone, that would result in the DoD's removing its reporting on fiduciary activity from the face of the principal statements and putting it into a footnote.

Mr. Dacey asked if the DoD kept separate cash accounts for this money. Staff replied that DoD maintained separate Treasury account symbols for this activity. Mr. Dacey asked if the cash was kept in Treasury and turned into Treasury securities, or whether it was kept in banks. Mr. Reid said that it was a mixture. For example, a substantial amount of the individual Indian monies are kept in a variety of securities outside of the U.S. Treasury. However, some cash- in excess of $2 billion- is kept in Treasury because it is in the process of being allocated or invested on behalf of the Indians. Staff introduced a representative from the DoD, who replied that there were three different locations where foreign government monies were kept: Fund Balance with Treasury, Federal Reserve Bank accounts, and commercial bank accounts. Mr. Dacey asked if fiduciary cash held outside of the Treasury would also be reported in the footnote or in the separate statement. He noted that the government was accountable for some significant amounts of fiduciary money. Mr. Reid said that that there only a few of the deposit funds listed in the U.S. Treasury's Annual Report were over a billion dollars- the largest was theThrift Savings Fund's G Fund; there were also two at DoD and one at Customs.

Mr. Mosso said that he didn't understand Mr. Reid's point about footnote disclosure. Mr. Mosso said that a financial statement would be more prominent, get more attention and more audit scrutiny, than a footnote.

Mr. Schumacher asked staff if Interior had provided any feedback on a separate statement. Staff replied that it had, and acknowledged a representative from Interior, Ms. Deb Carey. Ms. Carey said that Interior's concern was primarily the commingling on the balance sheet, and that Interior would support either a separate fiduciary statement or a footnote disclosure. Interior does not support reporting fiduciary assets on Interior's balance sheet. On the issue of basis of accounting, she said that investments were normally reported on a modified cash basis, because revenue received cannot be allocated to account holders until it is received.

Mr. Anania noted that Interior's reporting of Indian trust funds going forward would still be an "other basis" of reporting, as opposed to full accrual. Mr. Anania said that lack of accrual accounting would seem to preclude including it either as a footnote or a separate principal statement, which are on the accrual basis. He does not want the FASAB model to incorporate any other basis of accounting. Ms. Comes noted that neither the Fiduciary ED nor the current proposal advocate any other basis of accounting other than full accrual accounting.

Ms. Comes said that she was pleased to hear that Interior would support the idea of a separate fiduciary statement. Ms. Comes said that footnote disclosure had been causing some confusion about the level of audit coverage. Specifically, some auditors had even concluded that because some fiduciary information did not relate to a principal financial statement, that auditors did not consider it in expressing the audit opinion on the financial statements. Ms. Comes said that a separate principal statement would be consistent with the level of accountability that is appropriate for fiduciary activities.

Mr. Reid asked if Interior would have to convert its statements to a full accrual basis. Ms. Comes said that although the issue could be revisited, the proposal calls for full accrual accounting.

Mr. Patton said that he opposes a separate principal statement, because there is a “different level of accountability” for fiduciary versus program activities. He said that fiduciary reported on a narrower interest, and that there already were numerous principal financial statements. He said that it would lead to “information overload” for the general reader, and that the interested reader could read the footnotes.

Mr. Anania asked if Mr. Patton would support a modified accrual basis. Mr. Patton said that he was not addressing that issue. Mr. Reid noted that the Government-wide Financial Report footnote on the Indian Trust Funds currently states that the information reported was prepared using a cash basis of accounting, which is a comprehensive basis of accounting other than GAAP, and that if explained exactly what was included and what was not for the two types of Indian funds (tribal and individual).

Mr. Farrell asked whether the Indian Trust Funds are in the same fiduciary category as the Thrift Savings Plan (TSP). Mr. Farrell asked why the Indian Trust Funds are not reported in the same way as the TSP. Mr. Reid replied that the TSP is currently not reported at all. Mr. Dacey said that it was an outside party, and the Treasury securities issued to the TSP are reported as Debt Held by the Public. Mr. Anania noted that the TSP has its own set of financial statements. Mr. Farrell said that he just wanted to confirm that whatever applied to the Indian Trust Funds would apply to the TSP.

Dr. Robinson asked if the Thrift Savings Board was a government entity. Mr. Kilpatrick, staff advisor from OMB, said that the Thrift Savings Board is in the budget and it is a government entity. Mr. Farrell asked about the involvement of the TSP in the debt limit issue that had recently been in the news. Mr. Kilpatrick explained that under certain circumstances, the Secretary of the Treasury could refrain from keeping the TSP fully invested. After Congress increases the debt limit, the Secretary is required to fully invest the TSP and to compensate it for interest forgone.

Deposit Funds

Mr. Anania noted that the list of deposit funds for FY 2003 contained $68 billion. He asked if some part of those funds was currently being included in the financial statements under current requirements – for example, the activity statements. Mr. Reid said that he does not believe that those amounts are currently being run through the activity statements. Staff noted that SFFAS 7 does not require deposit funds to be included in the agency’s financial statements except insofar as an agency might decide that an individual deposit fund may be classified as being a part of the reporting entity, or if the agency provides a disclosure regarding a fiduciary relationship on the part of the entity toward a particular deposit fund.[9] Staff said that many of the deposit funds listed are used as clearing accounts, and may or may not be included by the agency in

[9] SFFAS 7, par. 370

its financial statements. Staff said that one advantage to sweeping deposit funds into the agency's financial statement reporting requirements is that it would discourage the use of deposit funds as suspense accounts for unidentified and unreconciled balances.

Mr. Anania and Mr. Zavada were interested in finding out whether the modified cash basis used for the Indian Trust Funds was a standard practice or not. Staff said that the audit report for the Indian Trust Funds did not provide any citations to support the use of modified cash basis accounting.

Staff asked if there was general approval for removing fiduciary assets from the balance sheet. Mr. Anania said that he wanted be sure that there is no benefit that accrues to the Federal government as a result of the fiduciary activities- that the benefit all goes to the recipients. FASAB legal counsel Jeff Jacobson clarified that Mr. Anania meant financial benefits, and Mr. Anania agreed. Staff agreed that any net benefit, or net cost, to the agency as a result of fiduciary activity would be accounted for on the Statement of Net Cost. A representative from DoD, Ms. Allen, who was present at the meeting, confirmed this.

Mr. Dacey asked Ms. Allen if the amounts of non-entity cash represented advances from foreign governments for something that the foreign governments were purchasing. Upon her affirmation, Mr. Dacey said that this sounded more commercial than fiduciary.

Ms. Mosso said that, with the understanding that there would be no net residual effect of taking them off the balance sheet, if the Board supported removing fiduciary assets from the balance sheet and putting them somewhere else- either in a separate principal statement or in a footnote. Mr. Dacey said that some items, such as the DoD Foreign Military Sales amounts, appeared to be ordinary advances to him, and so he would question removing them from the balance sheet. Mr. Mosso agreed. Dr. Robinson disagreed. Staff explained that the DoD was acting in the capacity of holding money in escrow, as the foreign governments were purchasing military equipment from commercial vendors. The DoD was not either a buyer or a seller involved in the transaction, but only as a trustee holding of a bailment, and transferred the funds to the seller at the appropriate time. Mr. Reid said that it would depend upon how each individual agreement was written, but that this example was clearly fiduciary in nature.

CONCLUSION: Mr. Mosso directed staff to bring back some further analysis of the three alternatives:

1) fiduciary assets reported on the balance sheet,

2) in a new principal statements, or

3) in the notes.

Mr. Mosso also directed staff to look at the issue of modified cash accounting, and to look at the larger amounts in the list of deposit funds, and provide some more information on those.

Dr. Robinson said that Treasury and OMB don't allow deposit funds unless certain criteria are met, and that perhaps the Treasury and OMB's criteria for deposit funds could be provided instead of researching all those individual funds.

Mr. Mosso said that it would be a good idea to research the criteria of assigning deposit funds, and noted that he wondered why some deposit funds appeared to have negative balances. Dr. Robinson said that this is one reason why she would like to see them audited.

Mr. Patton recommended that the analysis include a reference to the current project on asset definition, especially the issue of "control," to see whether the conceptual framework might support removing fiduciary assets from the balance sheet.

- **Heritage Assets and Stewardship Land**

Staff member Ms. Loughan began the discussion on Heritage Assets and Stewardship Land by directing the Board to the materials at Tab H. Ms. Loughan explained that the Heritage Assets and Stewardship Land project was last on the agenda in March 2004, when the public hearing was held on the Exposure Draft *Heritage Assets and Stewardship Land: Reclassification from Required Supplementary Stewardship Information*. Ms. Loughan explained that the participants at the public hearing did not support the Board's proposal. She added that the testimonies reiterated many of the issues conveyed in the comment letters, which included the following:

Need for more specific guidance, especially as it relates to reporting unit information.

Cost-benefit considerations as the cost to implement and audit the proposed standard would be significant.

Agencies would most likely present less information and/or the information would be disjointed when presented in different sections of the report.

Ms. Loughan explained that the project has not been on the agenda since March to allow time for staff to research issues further, review alternatives for an incremental or staggered transition toward implementation of the proposed standard and develop options for consideration by the Board. She explained that a staff issues paper is included in the binder materials Tab H that details key areas for discussion, such as Accountability and Stewardship Considerations, Categorization and Unitization, Materiality, Audit Costs, and Possible Phased Implementation Methods. She added that each topic area includes a Staff Analysis/Comments Section and Questions for the Board, which will hopefully guide the discussion. Ms. Loughan explained that the main objective for the Board meeting is to discuss the above areas and related questions for the Board, so staff will learn the Board's direction and determine next actions on the project.

Mr. Mosso reminded the Board that the ED was issued in keeping with the Board's plan to eliminate RSSI. He explained that the ED proposes that heritage assets and stewardship land information be classified as basic information, except for condition information which will be classified as required supplementary information. Mr. Mosso added that there were no major changes to the required disclosures. Mr. Mosso suggested that the Board should focus on moving the proposal forward as a final standard.

Staff added that the ED provides for a line item to be shown on the balance sheet for significant heritage assets and stewardship land, but no financial amount should be shown. Instead, the line item would reference a note disclosure that would provide minimum reporting requirements. Staff explained that the ED introduces minor changes to the current disclosure requirements for heritage assets and stewardship land by requiring additional reporting disclosures about entity stewardship policies and an explanation of how heritage assets and stewardship land are pertinent to the entity's mission. Staff also pointed out that none of the respondents to the ED had a problem with the new disclosures. Staff explained that the respondents that noted a need for additional guidance, identified areas specific to unitization.

Staff directed the Board to page 5 of the issues paper, which discussed the differences between the FASAB proposal and the current FASB and GASB standards. Staff explained that there are two major differences between the Board's current proposal and other standard setters. First, GASB and FASB encourage capitalization of collections and the FASAB proposal does not. Staff also explained that in their review of museum reporting practices, there were very few museums that actually elected to capitalize their collections. Staff explained that the other difference relates to the required disclosures. Specifically, the Board's current proposal requires a description of each major category of heritage assets and specific unit information for those categories. However, the other standard setters simply require a description of the collection. Staff also explained that in their review of museum reports that several museums actually listed specific individual acquisitions in their annual reports, although this was not required.

Staff explained that as noted in the comparison of the FASAB proposed standard with other current standards, one main difference is FASAB's reporting requirement of unit information and that it may be logical for the Board to consider further whether this is an appropriate requirement. However, staff explained that as the Board deliberates this issue further, staff believed the Board would be interested to learn about some recent initiatives that promote accountability and stewardship over real property assets and heritage assets. A brief summary of each was included in the briefing materials as well as more detailed information on each was attached as an exhibit.

Ms. Robinson asked staff if it was fair to say that the main issue discussed by respondents was what the proper level of aggregation was for reporting and whether the Board was allowing the preparer the flexibility in determining the proper level of aggregation based on materiality. Staff agreed with Ms. Robinson's statement. Staff explained that the proposed standard does not specify the level of aggregation nor define the physical units. Staff added that part of the staff recommendations is to include additional language to clarify that fact.

Mr. Mosso suggested that the recent initiatives included in the staff issue paper reinforce the Board's proposal and in fact, there was one particular study that specifically referenced FASAB in the recommendations. Staff concurred with Mr. Mosso's assessment and directed the Board to page 8 of the staff paper which discussed the report *Becoming Better Stewards of Our Past*, Recommendations for Enhancing Federal Management of Historic Properties issued in March 2004. Staff explained that the report included several recommendations, but one of particular interest was "The Federal Government should create or enhance accountability systems to measure success in the stewardship of federally owned historic properties." The recommendation included a discussion of FASAB and suggested "The Board should review and, if appropriate, revise or clarify its guidance on heritage asset reporting to improve consistent and comparable data collection and reporting." The report also suggested that OMB should consider making specific recommendations to agencies on improving their management of historic properties.

Staff then directed the Board to page 9 of the staff issue paper that discussed the categorization and unitization issues. Staff explained that the comment letter respondents and public hearing participants noted unitization as a major implementation issue and the Board had directed to staff to research the unitization issue further. Staff explained that in looking at the issue of units, it is appropriate to look at categorization first, as staff believes this is the emphasis of the proposed standard. Staff further explained that the issue may better be described as what is the proper aggregation or categorization of assets for presentation and what is the proper unit of reporting within those categories.

Staff explained that considering the ED is reclassifying the information previously reported as RSSI for HA and SL, staff thought it would be appropriate to look at SFFAS 8 for a better understanding of the Board's original intent with categorization and unitization. Staff noted that SFFAS 8 provides considerable latitude on how to present information on HA and SL. Because of the unique character of this information, agencies are encouraged to experiment with various narratives, tables and schedules. Staff explained that the lack of specific requirements for heritage asset information was intended to encourage creativity in reporting the variety of heritage assets held by federal entities. Staff also explained that Appendix B of SFFAS 8 illustrates sample report formats that entities might refer to when reporting on SL and HA. Staff explained that Appendix B was only intended as a guideline, since the Board provided entities with "maximum flexibility" when applying the stewardship standards, according to the Basis for Conclusions to SFFAS 8, paragraph 124.

Staff explained that the proposed standard (as well as SFFAS 8) emphasizes reporting on asset categories, rather than individual assets. Staff explained that entities should designate asset reporting categories that allow inclusion and aggregation of their SL and HA. Staff noted that entities should determine the appropriate level of detail for their categorization and it is helpful if entities designate asset categories that are meaningful and reflect how the entity views the assets for management purposes.

Staff also explained that the proposed standard does not define the term "physical units" or specify which physical units should be used to quantify the variety of SL and HA categories held by federal entities. The selection of the physical unit for quantifying a category is left up to entities. Staff noted that the proposed standard is consistent with the language and Board's intent in SFFAS 8.

Staff explained that although the standard does not specify it, it is logical that entities should select physical units that are meaningful and based on how they actually manage the assets. Staff added that defining physical units as individual items to be counted is not necessary. Particularly for collection-type heritage assets, it may be appropriate to define the physical unit as a collection, or a group of assets located at one facility, and then count the number of collections or facilities. Meaning, the level of detail may differ by entity, however; each entity should measure their asset quantities in a manner consistent with how they manage.

Staff also explained that the Board also requested staff to determine if there was a way to provide additional guidance on the categorization and unitization issue. Staff explained that in 1998-1999 there was a multi-agency team engaged in a project to identify and define standard categories and subcategories for heritage assets that would facilitate reporting of complete, consistent, and comparable heritage asset information by Federal agencies, consolidating departments, and the U. S. Government. These standard categories and subcategories were intended to provide an overarching, high-level framework for aggregating the various heritage asset categories that are reported by agencies throughout the government.

Staff explained that the team developed proposed standard categories, subcategories, and physical units of measurement for heritage assets based on an analysis of the government's heritage assets, and consultation with experts in the field of federal museum management and historic preservation, representatives from the Departments of Defense and Interior, the Smithsonian Institution, the GAO, and other entities. The team also developed definitions for the proposed categories and developed crosswalk to entities' reports to show how the various categories reported by Federal agencies fit within the proposed standard categories. Staff explained that the team's work and categories would be a good starting point, but certain areas, such as physical units could be expanded upon to show further levels of aggregation and units at sub-category levels—meaning that item counts could be things such as the number of museums in that category, number of collections in that category, or individual items in that category.

Mr. Patton commented that having management choose to report the categories in line with how they manage would be similar with FASB's treatment of segment disclosures and it would make the MD&A consistent with this area. Mr. Patton suggested that the consistency with how they manage point should be emphasized as it is a positive point.

Mr. Mosso suggested that the Board look at the staff analysis and recommendations on pages 12-13 of the staff issues paper so the Board' could vote on its position on the categorization and unitization area. Staff explained the analysis a bit further by discussing that there may be difficulties for agencies in determining the appropriate level of aggregation for reporting categories of heritage assets. However, staff believes that the agencies are in the best position to determine the most meaningful level of presentation. Staff explained that ultimately the presentation would depend upon the specifics of the entity—its mission, the types of heritage assets, how it manages, and materiality considerations. Staff added that it would be difficult for the proposed standard to define such specific reporting requirements, as they may be unique to each entity. Staff explained that additional language could be added to the proposed standard to reiterate that categorization and unitization is determined by the preparer, and the preparer should document the reasoning for major class determinations. Staff further noted that additional language could be added to the proposed standard to clarify that reporting is at the major category level, to ensure that readers do not interpret this to mean an item-by-item count. In addition, additional explanatory language could be added to the Basis for Conclusion that conveys the information included in the Categorization and Unitization section above.

Mr. Mosso asked the Board if they still feel comfortable with the reporting requirements in the proposed standard—specifically, does the Board still wish to include reporting unit information by major category and if the Board wants to provide any additional prescriptive requirements regarding the level of aggregation or specific units for reporting. The Board agreed to still require reporting unit information by major category and did not wish to prescribe specific formats for categorization. Instead, the Board agreed that it was best to provide flexibility and allow the preparer to decide.

Mr. Anania asked if there was any difference in the proposed language and the language in SFFAS 8 that would lead to individuals interpreting the proposal to believe there is a unit versus a categorization level requirement. Staff explained that the main difference was that SFFAS 8 contained the sample reports, which assisted users with the understanding of category reporting levels. Staff explained that the Board opted not to include sample reports, but staff did include a recommendation that clarifying language be added to ensure that the reporting is at the category level. Mr. Anania suggested that examples of categories be included in the narrative.

Chairman Mosso directed the Board to the next discussion area, Materiality, on page 13 of the staff issues paper. Staff explained that the concept of materiality and how it would apply in the reporting of this type of non-financial information has come up during several Board discussions of the HA & SL project and staff wanted to find out if this is an area that the Board would like to address further in the HA & SL project.

Staff explained that the language in the current proposal has the standard "The provisions of this Statement need not be applied to immaterial items" included. In addition, par. 28 and 44 of the proposed standard requires disclosures for "Entities with significant heritage assets/ stewardship land…" (Note: The ED shows "Entities with significant <u>amounts of</u> heritage assets/ stewardship land…" but the Board decided to remove the “amounts of” at a previous Board meeting. In earlier drafts of the ED, the language read “Entities with material heritage assets/ stewardship land…” but the Board decided to replace material with significant.

Staff also explained that the AAPC Stewardship Guidance Workgroup included a detailed discussion on the application of materiality in HA and SL in their draft guide that the Board may find helpful and it was included in the Board materials. Staff explained that the AAPC Stewardship Guidance Workgroup has done extensive research and collaboration on how to report and audit stewardship land and heritage assets, drawing upon early implementation experience of the Departments of Interior, Defense, Agriculture, and other agencies. Staff added that the group developed a Draft guide-- *Reporting and Assurances Guide for Stewardship Land and Heritage Assets*—that was exposed for comments. However, in 2002 the AAPC decided not to finalize the guide based on FASAB’s decision to reclassify RSSI. Staff explained that the AAPC plans to re-evaluate the guide and make necessary revisions after FASAB finalizes this project.

Ms. Robinson asked for staff to clarify the status of the AAPC Draft. Staff explained that the AAPC put the product on hold when the Board decided to reclassify RSSI. Ms. Robinson then confirmed that it would be the AAPC’s intention to revisit the Draft and update it accordingly, once the Board finalizes its proposal. Staff confirmed that understanding. Staff explained that certain areas in the guide, such as unitization, could be expanded upon. Staff explained that once the AAPC finalized the guide, it would come through the Board for its approval as a Technical Release. Ms. Comes stated that she did want to qualify that the audit portion of the draft would be removed from the guide, as the Board does not approve that. Ms. Comes explained that the AAPC/FASAB has moved to a model where any audit related guidance is issued through the PCIE or GAO FAM. She reiterated that any AAPC guidance would exclude audit related guidance.

Mr. Farrell suggested that the Board should encourage some of the participants from the public hearing to serve on the AAPC Task Force. Staff explained that the Task Force would welcome the participation. Mr. Dacey commented that the Task Force has had a good working group in the past and hopefully that would continue.

Staff also distributed an excerpt from SFFAS 3, *Accounting for Inventory and Related Property*, that discussed materiality in detail by referencing the yellow book definition, FASB’s Concept No. 2 on qualitative characteristics, and applications in SFFAS 3. Staff provided the Board with a copy of SFFAS 3 par. 7-15. Staff explained that the paragraphs detail the Board’s position on materiality and also what lead to the box with the standard language (“The provisions of this statement need not be applied to immaterial items.”) that is included in all of the standards.

The Chairman suggested that the language from SFFAS 3 regarding materiality be footnoted, included in the standard, or at a minimum, included in the Basis for Conclusions of the Proposed Standard. Mr. Anania suggested that it be included in the standard so it is easily referenced. Ms. Comes asked if the Board believed it should be placed in all standards or just included when the situation warrants. The Board agreed that it should just be included as situations warrant or when it is an issue. The Board agreed that the language from SFFAS 3 regarding materiality be added to the revised proposed standard.

Staff directed the Board to page 24 of the staff issues paper that discussed audit cost. Staff explained that another issue brought up by respondents to the ED as well as conveyed by participants at the public hearing, was the additional audit costs that will be incurred implementing the proposed standard. Accordingly, the Board had expressed an interest in learning more about potential audit costs of implementing the proposed standard from the audit community. Staff explained that staff had queried Offices of Inspector General and CPA firms responsible for financial statement audits to solicit their views on the cost issue and staff held a Roundtable meeting in February 2004. Staff explained that they had planned to present this at the March Board Meeting. However, due to the length of discussions at the public hearing, staff was not able to present the results and summary of the round table at the March Meeting.

Staff explained some of the results of the meeting, which included:

The DOI OIG representative and the representative from the CPA firm (KPMG) currently auditing DOI both conveyed that there would be a significant increase in audit costs. Although considered a “swag” DOI OIG suggested that the accounting and program offices potentially could spend $2 ½ to $3 million in the initial year to implement the standard. KPMG suggested that audit fees for the initial year could be approximately $5 million, with subsequent years approximately $2 million.

Participants who did not support the proposal discussed the following:

Difficulties with accelerated reporting dates

Agencies will reduce the information being reported

Only unit information being reported

No baseline inventories

Count information is not as important as other factors, such as the preservation of the information

Materiality issues are complex with this type of information

There are internal control weaknesses in this area which would naturally lead to more substantive type testing and result in more audit costs

Participants discussed the following in support of the proposal:

For accountability and control, it is very important to know what heritage assets an agency has and where they are located

The public is concerned about these types of assets and how they are being safeguarded

This information is essential for prudent management of assets

Value added may not necessarily be in the number themselves, but actually results from reporting the information and having it subject to audit implies sound management

Providing the information and the audit may be difficult, but it is important

Discussion resembles the same type of arguments against implementing the CFO Act over 10 years ago, but we now know how it has led to better financial management and accountability

Several participants suggested that if the Board moves forward with the proposed standard, certain actions could be taken by the Board to reduce costs, such as:

Develop an incremental approach for implementation of the standard

Provide language in the standard that would provide some flexibility or relief as to what would be sufficient documentation for support. One participant noted the Board provided relief in SFFAS 23 as it recognized that some historical records may not have been maintained.

Mr. Anania suggested that it would be appropriate for the Board to provide some sort of flexibility when it comes to the historical documents that support ownership. Mr. Zavada questioned if it was appropriate to do, as it appears to be more of an audit substantiation issue. Mr. Reid suggested that there are ways to accomplish this and referenced GASB's work in the infrastructure area.

Mr. Anania explained that it was because of issues such as this—ownership and supporting records—FASB moved away from reporting unit information. He added that since FASAB is not moving away from reporting unit information, there has to be at least some flexibility in this area of historical origin.

Mr. Dacey stated there are a couple of issues in the area of completeness and whether the agency has identified all assets with due diligence and whether there is a reasonable process for identifying such assets. Mr. Zavada explained that there is a lot of room for differing interpretations that could result in a lot of additional audit costs and that concerns him.

Mr. Anania asked that if the notion that the Federal Government is maintaining it and that there are no claims registered against it, wouldn't that be sufficient to document ownership. Mr. Patton asked if 'ownership' was some sort of key test. Staff explained that ownership—or more appropriately "rights and obligations" is one of the audit assertions that the auditors would test.

Ms. Robinson commented that the Library of Congress (LOC) had pointed out that the safeguarding and control of the assets is often more important than the actual number of items. She explained that their mission is to protect and preserve, not to count the items. Staff explained that they believe it is important to know what you have in order to manage and protect it. Ms. Robinson suggested that it may be more important to audit their methods or controls versus their numbers. Mr. Zavada explained that he did believe that the controls are more important than the numbers. Ms. Robinson asked if it was important for the LOC to know how many boxes of papers and Mr. Farrell suggested it was considering they are preserving them.

Mr. Zavada asked if the Board agreed that there is enough flexibility in the standard that the audit cost issue could be addressed by presenting information at a higher level of aggregation. The Board agreed. Mr. Reid explained that agencies, in an effort to meet the standards requirements and balance audit costs, will provide less detailed information than they might otherwise. However, agencies have the option of still providing additional information outside of the footnote, such as in other accompanying information. Mr. Mosso explained that is why the Board is providing flexibility so agencies can still tell their story and provide additional information in other areas of the report, but it would not be subject to the audit.

Mr. Dacey asked if there are certain management assertions regarding controls that should be considered for disclosure. Mr. Mosso asked if he meant the assertion should replace the unit information disclosure or accompany it. Mr. Dacey suggested that some type of statement along with the high-level unit information would be powerful and more informative.

Mr. Mosso asked if there was any type of language in the proposal regarding controls over the heritage assets. Staff explained that there is no requirement for a management assertion, but the proposal did contain the new requirement in par. 28 regarding stewardship policy. Specifically, it requires “A brief description of the entity’s stewardship policies for heritage assets. Stewardship policies for heritage assets are the goals and principles the entity established to guide its acquisition, maintenance, use, and disposal of heritage assets consistent with statutory requirements, prohibitions, and limitations governing the entity and the heritage assets. While not all encompassing, the policies may address preserving and maintaining condition, providing public use or access, and enhancing the heritage assets’ value over time.”

Mr. Zavada explained that there are a number of mechanisms in place to get at the controls, such as FMFIA. Mr. Farrell also suggested that some of the recent initiatives also support this area. Ms. Comes explained that it would be difficult for FASAB to walk away from the unit information considering some of the recent initiatives.

LUNCH BREAK

Ms. Robinson suggested that the proposal would be much stronger if there was some sort of language regarding a management assertion about the controls. Mr. Zavada explained that it is more or less required through other requirements such as FMFIA.

Staff added that with the Reports Consolidation Act, the FMFIA reporting is included in the Performance and Accountability Reports.

Mr. Mosso explained that there is the issue of the internal control objective and he is not sure if it should be addressed in this limited area. Mr. Mosso explained that it might be possible to expand on the policy disclosure to require a description of the controls instead of an assertion on the controls. Mr. Anania supported Mr. Mosso's point in that it might not be appropriate to address controls in this limited context.

Ms. Robinson suggested that the last sentence in par 28 could be revised to replace "may" with "should" so it would read "While not all encompassing, the policies should address preserving and maintaining condition, providing public use or access, and enhancing the heritage assets' value over time." Mr. Mosso stated that he would support that change. The Board agreed with the wording change.

Mr. Mosso again polled the Board to ensure the Board is comfortable maintaining the unit information requirement. The Board agreed.

Staff directed the Board to the phased implementation methods discussed on page 28 of the staff issues paper. Staff explained their recommendation was to phase the implementation based on reporting requirements. Staff explained that based on the Public Hearing presentations, it appears that most entities concerns are with the reporting requirements (that would be subject to audit) that relate to the unitization and substantiation of reported unit amounts.

Therefore staff determined the most appropriate phased approach would be based on required disclosures. Staff explained that the phased approach could be as follows:

For periods beginning after September 30, 2005—disclosure requirements in a, b, d, and e above are required.

For periods beginning after September 30, 2007—disclosure requirements for those required in previous year and disclosure requirement c1 for ending balances is required. NOTE: *Once the ending balances were substantiated in this year, those balances would then become the beginning balances the following year. For years thereafter, all required information, including additions and withdrawals, would be basic information and subject to audit.*

For periods beginning after September 30, 2008—disclosure requirements for all of the above are required.

Staff explained that the above phased-in implementation offers additional time for agencies to address determining the proper level of aggregation for major categories, as well as determining the appropriate physical unit of measure and documenting their reasoning for such. This additional time will also allow for the AAPC to update and issue their Guide in ample time for consideration before implementation. FASAB could request that AAPC finalize the guide by January 2006 or perhaps within one year of the issuance of the proposed standard, which would be over a year and a half prior to the implementation of the required reporting by major categories.

Mr. Patton suggested that four years appeared to be a long time for implementation. Mr. Anania agreed that it did appear to be a long time. Mr. Zavada explained that the financial management community is still addressing many issues with the accelerated time frames. Staff also explained that the additional time for the unit and category information was to allow the AAPC time to finalize and issue their guide as a Technical Release, which must be reviewed by the Board. Mr. Schumacher also commented that there may also need to be additional audit guidelines developed so the additional time would allow for that.

Mr. Mosso asked the Board for their concurrence with the staff recommendation for the phased implementation. The Board agreed with the staff recommendation.

Chairman Mosso then asked the Board to vote on moving forward to finalize the proposed standard for issuance based on the changes discussed at the meeting. The Board agreed and directed staff to work on incorporating the discussed changes for a pre-ballot version for the December Board meeting.

> CONCLUSION: Staff will move forward with finalizing the proposed standard for issuance. Staff will revise the proposed standard based on the recommendations approved by the Board and for other changes discussed at the meeting and detailed in the above minutes. Staff will provide the Board with a pre-ballot Draft for the December meeting Board.

- **Agenda Setting**

Ms. Comes introduced the topic. She indicated that the proposed criteria for ranking projects was initially developed for the Board's previous agenda setting discussions. It was revised based on comments at that time.

Ms. Comes recommends that the criteria be finalized and made available to potential participants in an agenda hearing. Members agreed that the criteria are useful but subjective. No changes to the criteria were recommended.

The Board discussed the possibility of holding an agenda hearing to solicit input. While an agenda hearing may be helpful, the resources to hold a hearing would be diverted from other projects. Therefore, the Board agreed to solicit written comments and defer the decision on holding a hearing. Members suggested and the Board agreed to limit the number of potential projects included in the solicitation.

Members indicated an interest in addressing leases, (Federally Funded Research and Development Centers (FFRDC) and related party transactions. Members noted that a number of the projects included issues that could be addressed through guidance on consolidation. For example, FFRDCs might be consolidated and, if consolidated, many of the issues on accounting for individual elements would be resolved under existing standards. With respect to the issue of some federal entities preparing audited financial statements under Financial Accounting Standards Board (FASB) standards and receiving opinions that refer to this basis as “generally accepted accounting principles” (GAAP), Mr. Jacobson asserted that the Board lacked authority to compel government corporations to convert to its standards.

Members and staff explained that the Board was the designated GAAP standard setter for federal government reporting entities. In 1999 the Board acted to permit federal government reporting entities using FASB prior to FASAB’s designation to continue to do so. This guidance was included in a newsletter article and could be withdrawn with limited due process. If this happened, entities electing to continue complying with FASB standards would receive audit opinions referencing an Other Comprehensive Basis of Accounting.

Mr. Reid noted that a consolidated financial report (CFR) relief project proposal was included in the materials. He indicated that items proposed for relief include disclosures that don’t add up well and disclosures that could require pages of descriptive language. The proposed project is in the nature of a technical corrections effort.

Mr. Mosso noted Treasury’s offer to staff the project. Members noted that Board time would be needed to review and approve the document but that Treasury appeared ready to provide most of the staff resources.

Ms. Robinson indicated that item 1 in the table is of concern and she was not prepared to act on every item without further discussion. Mr. Reid responded that the requirement would not go away for component level reporting; the change would simply be for the CFR. He observed that all of the disclosures could be accomplished but the weight of information and the preparation effort would be reasons for relief.

Mr. Farrell observed that the Board had encouraged Treasury to come up with this proposal and he would support the proposal if it would not require a lot of effort. Mr. Dacey indicated that there should be a regular process in place to look at these disclosure items each year for material numbers. If the requirements were eliminated through amendments to existing standards, material disclosures would not be reported for these relief items.

Mr. Anania noted this was a narrow and manageable project. The drafters will not have a totally free hand. The project can be done in a reasonable time – essentially this project involves back filling for standards that did not consider the CFR.

Mr. Patton opined that opportunity costs could be high if this involves much FASAB staff time. If it can be done without taking up a lot of FASAB staff time it would be OK.

In response to Mr. Dacey’s concern, Mr. Reid noted that there are other ways material impacts get disclosed – if there is a material change to a number it will be discussed in the footnotes. A list of specific disclosures is not needed to ensure fair presentation. FMS will come up with language and FASAB staff will tell the Board what the impacts of specific relief provisions would be. It might be a simple matter of having an up or down vote on each item. Mr. Reid indicated that FMS would have something for the Board in the spring. Mr. Farrell suggested having the Board address 4 items at each of its meetings. Mr. Reid responded that the Board will be given all the items and it can address the items as it determines.

Ms. Comes indicated that Treasury will staff the project and FASAB staff will ensure that the Board understands the original intent of the requirements under review.

> CONCLUSION: The criteria for ranking projects are considered final. Staff will revise the individual projects based on members' input. A project covering consolidation issues will be developed. Staff will work with Treasury FMS staff regarding the proposed "relief" project and establish a project timeline.

- **Educational Session – JFMIP Update**

Ms. Karen Cleary Alderman, Executive Director of the Joint Financial Management Improvement Program, briefed the Board. She provided an overview of JFMIP's mission, operations, current projects, and systems certification.

Adjournment

The meeting adjourned at 2:45 PM