FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
April 29-30, 2015
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, April 29, 2015

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Mr. Allen, Messrs. Dacey, Granof, McCall, Showalter, Smith, and Steinberg. Ms. Ho was present with Ms. Davis representing her during brief absences. Mr. Reger was present with Ms. Kearney representing him during brief absences. The executive director, Ms. Payne, and general counsel, Mr. Marchand, were present throughout the meeting.

- **Approval of Minutes**

The minutes of the February meeting were approved in advance of the meeting.

- **Discussion of 2014 Consolidated Financial Report and Clippings**

Scott Bell, Senior Staff Accountant, U. S. Department of the Treasury, briefed the Board regarding the Fiscal Year 2014 Financial Report of the U. S. Government (FR) issued on February 26th. He acknowledged the hard work and enthusiasm of everyone involved including the Fiscal Service.

Messrs. Granof, McCall, and Scott also noted their use of the Citizens Guide in the classroom. They indicated that federal accounting is far more progressive in the area of sustainability than other sectors. Most students are not aware of the report and note how relevant it is. Mr. Reger also noted that Mr. Bell provides many presentations on the Citizens Guide and all are well received because of his creative approaches.

Mr. Bell noted the following regarding the 2014 report:

1. There is an HTML version of the full report available on the web at http://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/fr_index.htm

2. The Citizens Guide is also available as an ePublication for Kindle or tablets.

3. Key metrics include:

    a. The deficit fell to 2.8% of GDP; the lowest since 2007.

    b. Revenues exceeded $3 trillion due to a stronger economy and growth of wages and salaries, the expiration of certain tax cuts, and an increase in the tax rates.

    c. In terms of net cost, the largest three agencies remain Health and Human Services, Defense, and Social Security.

    d. Loans receivable now exceed property, plant, and equipment and account for most of the growth in assets.

    e. The emergency measures taken during the financial crisis – GSEs and TARP - are no longer a significant topic in the MD&A.

    f. Debt securities held by the public are $13 trillion and intragovernmental debt is between $5 and 6 trillion.

    g. Another major liability is for federal employee and veterans benefits. The Treasury implemented a more stable approach to providing interest rate information used to discount the actuarial estimates. The hope is that these estimates will become more robust and stable.

h. For social insurance, the estimates are $42 trillion in net expenditures for all programs. A notable change is that the Medicare estimates now include the annual physician payment updates that occurred as annual amendments to current law. That is, the Medicare projections show larger physicians payments based on the assumptions that the annual cuts will be overridden (note that a permanent end to the cuts has now been adopted in law). Mr. Dacey explained that the change did not result in an unmodified opinion on the statement of social insurance. The primary reason for the continued uncertainty is about whether productivity improvements under current law will be realized.

i. Regarding fiscal projections, the report indicates that we are on an unsustainable fiscal path and the sooner changes are put in place the less dramatic those changes would have to be.

Members briefly discussed the sustainability challenge and the status of agency audits. They thanked Mr. Bell for the excellent presentation.

Messrs. Dacey and Granof provided updates regarding the International Public Sector Accounting Standards Board and the Governmental Accounting Standards Board. Ms. Ho noted that several countries reported at the recent OECD forum that they are working to simplify their reporting models.

Agenda Topics

- **Reporting Model**

The Board discussed the main aspects of an ideal reporting model concepts statement and will discuss a staff proposal for detailed concepts in June 2015. During the meeting, Board members reviewed an outline of the concepts based on outline developed during the previous February 2015 meeting. The outline presented several topics, including: the two levels of the federal government's stewardship; intergovernmental financial dependency; financial statements and the interrelationships among them; budgetary reporting; performance reporting; and cost accounting. Although the current conceptual framework discusses some features of these topics, the Board believes the topics are important for developing an ideal reporting model. While the outline proposed a discussion on national indicators, members were generally not supportive of discussing this topic given that government policies do not always directly influence the indicators. Members believed that discussing the different topics could help clarify the role of the Board and how financial reports presented in conformity with generally accepted accounting principles (GAAP) relate to budgetary and other non-GAAP financial reporting by federal departments and agencies.

The Two Levels of Stewardship and National Indicators

The Board generally agreed that the federal government is responsible for: (1) its own assets and liabilities and its ongoing operations; and (2) the nation's wealth and well-being. Members noted that a discussion of the federal government's role would provide context for the government-wide financial statements. However, members were not supportive of discussing national indicators to assess the government's responsibility for the nation's welfare. They noted that indicators are not always directly influenced by government policies.

Intergovernmental Financial Dependency

The Board generally supported a relatively high-level discussion on intergovernmental financial dependency. Members indicated that the topic provides context. Users need to understand the relationship between the federal government and state and local governments and that the federal government uses state and local governments to provide services. However, members were concerned that the topic could divert the Board's attention from priority issues such as integrating budget, cost, and performance information. Also, non-GAAP financial information sources are enabling users to obtain financial data by location such as state and zip code.

Interrelationships among Financial Statements

The Board supported a hierarchy and management's discussion and analysis (MD&A) for discussing the interrelationships among financial statements. The ideal reporting model outline proposed two options for discussing the interrelationships among financial statements: (1) presenting a hierarchy that lists the priority sequence of methods for helping users understand the interrelationships among financial statements; and (2) requiring a narrative discussion of the interrelationships in the MD&A. Achieving the reporting objectives requires financial statements that apply different measurement bases and that present long-term projections. Members noted that the relationships among them should be clear so that the preparers can explain the relationships in the MD&A. Also, members discussed how: financial statements at the component level may relate to the government-wide statements; financial statements may relate to non-GAAP financial information sources; and the MD&A discussion could consider referencing non-GAAP financial information sources.

Budgetary Reporting

The Board generally agreed that the ideal model concepts statement should address budgetary reporting. Some members expressed concerns with the budgetary reporting topic. They noted that the current budgetary statement is difficult for users to understand and two-thirds of federal spending is mandatory, not subject to annual appropriations. A supplementary narrative description of the budget process might be the best alternative. However, other members noted that the budgetary reporting topic is important to the concepts statement. While existing concepts discuss the relationship between budgetary reporting and financial reporting, it is important to clarify FASAB's role with respect to budgetary reporting and consider how the budgetary integrity objective of financial reporting could best be achieved.

Other Topics

The Board generally agreed that the concepts statement should include a discussion on performance and cost. Some members noted that existing concepts could be refreshed or enhanced and that qualitative characteristics of performance information could be included in the concepts. Also, the concepts should encourage alternative ways of reporting, such as electronic reporting, and citizens' guides or popular reports should be discussed in the concepts statement.

> **Conclusion:** Staff will begin drafting sections of the concepts statement for discussion at the June 2015 meeting.

- **Public-Private Partnership**

Mr. Savini began the session by asking members to turn to TAB B and provided a brief overview of the February meeting wherein (1) the task force review of respondent comments was discussed and (2) members asked staff to conduct additional outreach and revise the ED as appropriate.

The Chairman then stated that it appeared to him that most members would agree with the working group's (WG) position to exempt P3s whose lives are less than 5 years in duration as discussed in Question 2 on page 9 of the staff memo. Members in fact agreed, noting that because this criterion is included in both the definition and as a conclusive risk-based characteristic, staff should consider realigning or better linking the definition to the risk-based characteristics.

The discussion then proceeded as follows:

Definition – Apart from the linkage issue discussed above, members did not note any additional changes. Staff explained the difficulty the WG encountered in attempting to refine the task force's definition. There was no clear consensus among the WG. However, although preliminary WG results are to not change the definition, they seem to advise that we should explain what is meant by risk sharing (refer to page 6 and to Question 3 on page 9 where 3 new paragraphs (Paragraphs 16 thru 18) are being proposed that would immediately follow the definition).

Regarding paragraph 16, Mr. McCall noted what appeared to be an inconsistency in the language. Specifically, in Question 3 on page 9, item B states that either the public sector or private sector entity can be at risk of material loss however, the definition says that each party shares in the risks and rewards. Members asked staff to address Mr. McCall's concern in the re-write.

Regarding paragraph 18, Mr. Showalter noted that introducing the concept of materiality creates an exit ramp per se prior to the application of the risk-based characteristics which could lead to under reporting. However, Mr. Dacey replied that even if materiality is discussed later, it is still going to be an effective operational filter that can be applied early-on. As a result, he questioned from an operational perspective if it is going to matter where in the document we first discuss materiality.

Although Mr. Smith agreed that this standard will require professional judgement especially in the area of materiality, he asked staff to better align the definition with the description in the 3 new proposed paragraphs.

Regarding paragraph 18, members also noted that relationships cannot be “immaterial” and that auditors would find that difficult to evaluate. Accordingly, staff was asked to adopt alternate language.

Exclusions – Members generally agreed with each of the proposed WG exclusions. Mr. Steinberg inquired about material risk contained in P3s with other governments, domestic or foreign. Staff explained that (1) in the case of state/local governments that would be an inter-dependency issue best handled as a Reporting Model questions, (2) at the project’s on-set, the State Department clearly noted concerns with foreign P3s and potential diplomatic/national security concerns and (3) simply put, the projects’ scope was never intended to cover public-public partnerships; only those with private entities.

Mr. Steinberg agreed with staff’s explanation, noting that it seems that we are setting a principle for these kinds of arrangements that they do not possess risk and we know that not to be true. Mr. Allen asked staff to develop some wording that would express those concerns.

Some then questioned a grant’s risk profile where OMB requirements are waived and more fundamentally, if a grant would ever even be part of a P3 arrangement or transaction. First, staff explained that two members of the task force were not respondents, but were invited by staff to serve as objective expert advisors – an agency director for grants management and a trial attorney specializing in construction and government contracts law. The agency director for grants management advised that all grants can be defined as public-private partnerships. The trial attorney stated that our current language could in fact sweep-in grants made to states that ultimately award to a private entity. Staff has anecdotal knowledge of P3 arrangements that although they may not meet our five-year criterion, do in fact involve grants and some form of risk-sharing.

Concerning a grant’s risk profile, in consultation with OMB, waiving OMB administrative and reporting requirements increases a grant’s risk profile – similar to a FAR-exempt contract. Staff pointed to OMB Circular A-133 and the various cost circulars as examples.

Some asked about the "nominal or incidental resources" exclusion and sought clarification.

Mr. Dacey asked for a brief review of the WG analysis of exclusions pertaining to legislative or mandated exclusions. Staff explained that the WG seemed to understand that because agency appropriations must be in accord with legislative requirements, having such a broad exclusion could lead to significant under-reporting.

In applying the exclusions, Mr. Granof proposed that staff update the graphic illustration (bubble-chart) shown to the Board previously that demonstrates how each part of the standard acts as a filter but now beginning with the five-year requirement. Members agreed that including this illustration would be helpful to practitioners.

Risk-based Characteristics – Members did not support the elimination of the two-tier conclusive and suggestive labeling. Some believed that the increased flexibility that this might cause would give rise to problems when assessing materiality.

The Board generally agreed with adding an additional risk-based characteristic intended to reflect a higher profile for those (i.e., non-governmental) grants or other arrangement not excluded by the ED exempt from OMB requirements.

Pending further review, the Board did not take exception to the staff recommendation.

The following summarizes Board discussions concerning each of the questions as summarized on page 12 of the staff memo.

1. Does the Board agree with the working group's position that the definition should not (1) be restricted to the four cited conditions and (2) presume mandatory disclosure should any of the cited conditions be present? If not, what changes would the Board advise be made?

   The Board generally agreed and recommended better linkage between the definition, risk-based characteristics, and the proposed new paragraphs.

2. Does the Board agree with the working group's position to exempt P3s whose lives are less than five years in duration? If not, what changes would the Board advise be made?

   The Board generally agreed.

3. Does the Board agree with each (a-d) of the preliminary working group positions as stated above? If not, what changes would the Board advise be made?

   There were concerns over two items in particular; Par. 16 and Par. 18. Staff was asked to revisit the language in the proposed new paragraphs.

4. Does the Board agree with each specific exclusion suggested by the working group? If not, what changes would the Board advise be made?

The Board generally agreed.

5. Does the Board agree with the creation of an additional risk based characteristic specific to grants/other arrangements? If not, what changes would the Board advise be made?

   The Board generally agreed.

6. What does the Board think about the option of eliminating the distinction between Conclusive and Suggestive characteristics in an attempt to simplify the ED and provide management with greater discretion and flexibility? How does the Board believe this would impact preparers and auditors when determining materiality?

   The Board did not agree, noting that eliminating the current distinctions would be problematic for preparers and auditors when ascertaining materiality.

Conclusion:

- Revise the ED to further include edits as a result of this meeting's re-deliberations.
- Update the graphic illustration emphasizing the different filters contained in the standard.

- **Leases**

Ms. Valentine opened the lease discussion by stating that the objective for the current session is to review an initial draft exposure draft (ED) for the lease standard. She noted that the lease standard will include guidance for all federal leases, including intragovernmental leases. The Board has tentatively agreed that intragovernmental leases should be accounted for similar to current operating leases guidance. Ms. Valentine also noted that the Board materials included a staff summary of possible FASAB-relevant comments from the Governmental Accounting Standards Board's (GASB) Preliminary Views (PV) on Leases – the GASB PV was released for comment in November 2014. The Board had previously directed staff to use the GASB Lease PV as a platform for developing the FASAB standards on non-intragovernmental leases. Ms. Valentine mentioned that she received comments on the Board materials from Chairman Allen, Mr. Steinberg, Mr. Showalter, and Mr. McCall.

INTRAGOVERNMENTAL LEASES

The draft ED includes definitions of relevant terms, as well as specific provisions that address the recognition and measurement of intragovernmental leases for both the lessee and the lessor. Staff asked the Board if they agreed with the proposed language.

Ms. Valentine presented eight lease-related definitions to the Board for discussion. All of the definitions were discussed by the Board at previous meetings, although some had been revised. Mr. Granof stated that the GASB had a long debate over the use of “contract” versus “agreement” as it relates to the definition of a lease. GASB agreed that “contract” was a stronger term as it relates to legal enforceability. Mr. McCall pointed out that the Board had previously agreed to insert “nonfinancial” into the lease definition – the revised definition will read “a lease is a contract or agreement that conveys the right to use a *nonfinancial* asset (the underlying asset) for a period of time in exchange for consideration.” Mr. Granof asked staff if “nonfinancial” would be defined in the standard. Staff noted that we will define it in the standard and we will review how GASB defines “nonfinancial.” Mr. Steinberg suggested minor revisions to the definition of “intragovernmental.” Mr. Dacey suggested deleting the “intragovernmental” definition and leave the “intragovernmental lease” definition because it was more relevant to the proposal. The Board agreed with Mr. Dacey’s suggestion. Mr. Showalter suggested minor revisions to the “lease term” definition to denote that the lease term would include multiple option periods if applicable and not just one option.

Ms. Valentine asked the Board if there were any comments on the intragovernmental lessee recognition and measurement or disclosure proposal. Mr. Steinberg stated that since it was very likely that most of the leasing activities in the federal government were intragovernmental leases as opposed to non-intragovernmental leases, the intragovernmental lease section should precede the proposal on non-intragovernmental leases. Chairman Allen noted that the Board agreed to closely follow the GASB lease standard, so structure should be similar where ever possible. Staff explained to the Board that the approach taken in the proposal was to have an overall lease standard that closely parallels the GASB lease proposal, but includes an exception for intragovernmental leases. The Board agreed with the staff approach.

Ms. Valentine stated that Mr. Steinberg asked staff if the standard was going to address leases with contingent rentals, since it was mentioned in the “scheduled rent increases” section of the draft. Chairman Allen pointed out that the accounting would be the same as the fixed rent increases. Staff noted that all increases would be reflected in the guidance. Mr. Showalter suggested explanatory language as well as edits to the “rent increase” section. There were no Board objections to the suggestions.

Ms. Valentine noted that both Mr. Showalter and Mr. Steinberg commented on the proposed language for the accounting of leasehold improvements. Mr. Showalter suggested changing the leasehold improvement amortization language to “amortized over the useful life of the leasehold improvement *but no longer than the lease term*.” Mr. Steinberg asked about a situation where the leasehold improvement could be removed by the lessee at the end of the lease term, therefore extending its useful life beyond the lease term. Mr. Smith stated that leasehold improvements are not removable items from the leased property and if an item is removable it should be classified as PP&E and not a leasehold improvement. Therefore a clear definition of leasehold improvement will need to be included. Ms. Payne added that staff had a good discussion with the task force on the accounting for leasehold improvements. One of the issues with intragovernmental leases is that the agreement may not spell out additional option periods; however the lessee has every intention of staying in the space beyond the stated lease term. She noted that the *FASAB Handbook* consolidated glossary defines useful life as “the normal operating life in terms of utility to the owner.”

Ms. Payne also stated that “useful life” is a more flexible term and is from the perspective of the lessee. Mr. Smith suggested adding the notion of the lessee’s expectations of the improvements.

Mr. Granof asked staff if the intragovernmental lease standard will include any exclusions to nontraditional assets, like timber or software. Ms. Valentine noted that the overall standard will exclude natural resources. Ms. Payne noted that the AAPC has a working group discussing internal use software (IUS), including shared services. The current IUS guidance subjects software licenses to the lease standards.

Mr. Dacey asked staff if the language for the accounting for lease concessions could be clarified. He also suggested the possibility of sample journal entries or an explanation of the journal entries being provided in the guidance. Chairman Allen added that he would suggest the same for the lease incentive guidance. Staff agreed to add the suggestions.

Ms. Valentine mentioned that Board members asked staff if the lessee disclosure guidance was going to be expanded beyond, “a broad summary of significant clauses of the lessee’s intragovernmental leasing arrangements.” Ms. Valentine stated that the task force suggested the broader language to allow more flexibility to the preparer. Ms. Valentine noted that example disclosures could be added. Mr. Smith noted that examples would become nothing more than required disclosures. Mr. Showalter stated that he had issue with “significant clauses” because of the subjective nature of that phrase. Mr. Steinberg noted that he believes the lessee should disclose what they are leasing, the future lease expense, and any significant leases. Mr. Dacey suggested that the lessee should be disclosing the information in aggregate and more detailed information for those significant leases. Mr. McCall noted that the lessor disclosures were different. Staff reminded the Board that the decision was previously made to not require the 5-year minimum payments disclosure for the lessee. Chairman Allen asked staff to develop the language based on the discussion and bring it back to the Board.

Ms. Valentine noted a few edits to the lessor draft guidance suggested by the Board. Chairman Allen noted that he would like to see more information disclosed by the lessor than the lessee. Mr. Smith agreed with Chairman Allen’s suggestion and added that segregating leases between federally-owned buildings and privately-owned buildings would be important. Ms. Payne reminded the Board that GSA is not the only significant federal lessor.

GASB LEASE PV DISCUSSION

Ms. Valentine noted that GASB received 37 comment letters on their lease PV and held three public hearings. Staff provided the Board with staff's summary of possible FASAB-relevant comments from the GASB PV on leases for discussion. She also mentioned that GASB expects to issue its exposure draft in February 2016 and a final standard in early 2017. Since the Board previously agreed to use the GASB lease accounting proposal as the foundation for the FASAB lease account proposal, staff recommended that the FASAB ED also be released close to that same timeframe as the GASB ED. Ms. Payne noted that since the Board has agreed to align the non-intragovernmental lease accounting with the GASB, any wording differences could denote a difference in meaning. The Board agreed to stay in sync with the GASB timeline for the release of the lease ED and final standard.

Conclusion: Staff will make the revisions noted above, continue to monitor the GASB's works, and provide a revised draft for consideration at a future meeting.

- **Risk Assumed**

During the April 2015 meeting, staff presented the proposed standards for review. The following items were discussed:

How to Clarify Claims Incurred but not Reported (IBNR)

Staff presented to the Board Crop's challenges with how to account for IBNR which are due to the nature and timing of their adverse events, most of which are not single events, but a series of events that typically conclude months after the reporting year end. Staff determined that the adverse event and IBNR definitions, along with the recognition and measurement of the liability for unpaid losses, should provide clarity to address this challenge.

Mr. Dacey asked if Crop would then recognize these liabilities in the losses for remaining coverage (previously premium deficiency) instead of in the liability for unpaid claims and does moving it from one liability to another address this challenge. Staff responded yes and explained that Crop spends a significant amount of time estimating future claims on current policies and then divides the total estimate between contingencies and the liability for unpaid claims (IBNR). Staff believes that the proposed updates will clarify what IBNR claims are, when they should be recognized, and should address the additional workload challenge.

In relation to the IBNR definition, Mr. Dacey recommended that we clarify the timing of when the series of events has concluded and said that the adverse event and IBNR definitions alone might not provide enough clarity.

Ms. Payne noted that staff can update the liability for unpaid losses to provide more clarity about the timing of a series of events. Mr. Allen suggested we include that in a footnote rather than in the standard. Ms. Payne noted that staff will reword it in a positive way to say what is in IBNR and include a footnote that if the adverse event is a series of events that spans the end of the reporting period, that it is not IBNR.

Conclusion: The Board directed staff to provide more clarity about the timing of a series of events within the liability for unpaid losses to address the recognition and measurement of IBNR.

Recognition/Measurement and Disclosure Standards for the Liability for Losses on Remaining Coverage

The following was discussed in relation to paragraph 23:

> *Estimates should be based on expected cash flows using all available information that existed at the balance sheet date, experience with previous transactions and historical trends, and, as appropriate, the views of independent experts. Therefore, expected cash flows should not be adjusted based on actual events that occur subsequent to the balance sheet date that were not estimable using information that existed at the balance sheet date.*
>
> Subsequent Events:

Mr. Showalter said that only using information that existed up to the balance sheet date is inconsistent with current standards that recognize information available up to the issuance of the report.

Mr. Gray asked that, if additional information becomes available after the balance sheet date, does this standard say that we cannot go back and reestimate. Mr. Granof said that, for example, if there was a hurricane on the last day of the reporting period and the estimate is based on past experience, what would it cost? Two weeks later you find that the estimate was totally off. Do you base the liability on the information that was available on the last day of the year or with the best information available at the time you prepared the financial statements? Mr. Dacey said that this is for losses that happened after the balance sheet date. For example, if a loss occurred on October 1st, then you base your projection on what was known on September 30th.

Ms. Payne said that this addresses challenges that Flood and Crop have experienced with trying to estimate these projections that are still inaccurate as compared to the actual settlement amounts. True amounts are not known until full settlement has occurred. She referred members to the October 2104 briefing material—Appendix D, pages 15-16, information from the Accounting and Auditing Guide on Property and Life Insurance about premium deficiency calculations and how it provides two options, one to base estimates on information up through the reporting date and the other to estimate based on information that conceivably could be known up to the balance sheet date.

Mr. Allen asked if the standard could let them choose between the two methods. Ms. Payne noted that staff chose the balance sheet cut off to provide consistency and remove as much uncertainty as possible in order to provide auditors with a clear cut off point to avoid the burden of continuing to reestimate until the issuance of the statements.

Mr. Gray noted that we would be considering these losses for the liability on remaining coverage (premium deficiency) against the unearned premiums which will give us better information.

Ms. Gilliam confirmed that because this relates to the liability for losses on remaining coverage, staff focused on adverse events that might occur during the remaining coverage period. Therefore, only information that existed at the balance sheet date would be included in the projected estimated losses. For example, you might know that a storm is brewing as of the balance sheet date and will hit in October, but you do not know that an oil spill is going to happen on October 15th. In relation to the storm, the standards would guide programs to use all information as of the balance sheet date, which might include historical and trend data, to estimate losses. If no information was available, then it would not be included in the projected losses.

Mr. Smith asked if this then becomes a subsequent event disclosure. Mr. Steinberg wanted to ensure that reporters disclose what subsequent events were not recognized and why. While staff did include a disclosure in 29.e.II with a reference to SFFAS 39 as guidance, Mr. Steinberg requested that this be included closer to the actual recognition standard in par. 23.

Conclusion: The Board directed staff to include a disclosure reference to SFFAS 39 for subsequent events closer to the actual recognition standard, in addition to the disclosure standard.

Expected Cash Flows (ECF)—Par. 23

Estimates should be based on expected cash flows…

Mr. Dacey is concerned about using expected cash flows because:1) it is the only place FASAB would be using it, and 2) FASB uses it sparingly and only as an option. He questions whether FASAB should have a single option. He noted that FASB treats it in two ways, (1) if you cannot come up with a most likely amount within the range then default to expected value, or (2) select the option that provides the better predictive estimate. He asked that if we only go with expected value, is this a precedence to change all of our standards.

Mr. Allen noted that expected cash flow is superior according to FASB concept 5 and avoids a liability of zero. Mr. Dacey disagreed noting that you could come up with a most likely amount using historical data and trends without using probability weighting. He also said that the weighting of probabilities can be extremely subjective and manipulated, and therefore may not be supportable versus using historical data to determine patterns for a most likely number.

Members agreed that they do not want a zero amount or the lowest amount in the range, but the best estimate.

Ms. Payne referred members to page 8 of the memo and Crop's use of regression modeling, and asked Mr. Dacey if he would tell Crop they cannot use that model under the proposed standards. Mr. Dacey said he believed that model would be acceptable now, but not under the proposed standards. He preferred the standard to provide for best estimates and allow use of either Crop's current approach or expected cash flow.

Mr. Allen noted then that the standard might read—probability assessments affected by trends to determine the most likely estimate, or, if that does not work, then use the expected cash flow method. Mr. Showalter asked that staff be careful in rewording this as to not contradict SFFAS 5.

Conclusion: The Board directed staff to avoid the use of the word "contingency," which will remain in SFFAS 5. They noted that this insurance standard is conceptually different in that the insurance liability is comparing the estimated losses to unearned premiums, whereas SFFAS 5 speaks only to liabilities. The Board also directed staff to remove expected cash flows as a single measurement model and replace it with wording such as…*probability assessments affected by trends to determine the most likely estimate, or, if that does not work, then use the expected cash flow method*.

Premium pricing policy and subsidy rate—par. 29.d.ii:

The next question addresses disclosure of requirements to set premium prices that are not based on full cost or on market price and, as a result, the premiums that do not cover the full cost, if available; an estimate of the subsidy rate provided; how the subsidy rate is determined; and changes in the subsidy rate over time.

Mr. Steinberg noted his concern about the language referencing full cost or market price. Ms. Payne discussed that our standards do not specifically define subsidy and its relation to market cost and that staff captured current SFFAS 7 wording to allow agencies to continue using existing methodologies for calculating their subsidy, if they have one.

Mr. Smith recommended that there be a disclosure about how subsidies were calculated to support comparability.

Mr. Dacey asked if we are talking about one subsidy rate for one insurance program. Staff said not necessarily, noting that the use of insurance portfolios will allow a better break out of this information. Programs should take subsidy rate into consideration when grouping contracts into portfolios.

Ms. Gilliam explained that insurance programs do not pay a subsidy toward a premium; the subsidy is used to directly pay losses that are not covered by the premiums collected. Ms. Payne further explained that in some subsidies it is really the time value of money because the program borrows money from Treasury to cover the shortfall only until premiums make up for past losses.

A number of members were concerned with the use of the term “rate,” in that it is a number and might be hard for the reader to understand. Ms. Payne asked if they would rather focus on a discussion of how premiums are set (pricing policies) and related legal restrictions. Members agreed and asked that the word “rate” be removed.

Ms. Payne asked if the Board wanted to include the word subsidy, in that it is a very difficult word to define; did the Board want staff to spend time defining it or speak to whether premiums cover the full cost to settle, and, if not, what is the cost to the government in relation to other financing sources, such as appropriations/borrowings.

Conclusion: The Board directed staff to remove the word subsidy, reword the disclosure, and provide an illustration.

<u>“Condensed” Disclosure for Insurance Programs par. 30:</u>

Mr. Dacey noted his concern with why we are proposing to require this type of information for only insurance programs. He asked if the intent is to show the self-funding of ta program and whether it would also be proposed for other programs that are also self-funding.

Ms. Gilliam explained to the Board that this disclosure will help with understanding the subsidy costs of these programs. That by combining the statement of net cost and changes in net position, the reader can see the whole story about how much loss the premiums did cover and what additional financing sources were needed. She referred them to the illustration that is currently only in the memo and noted that this disclosure will begin to address some of the concepts from the reporting model into the standards.

Ms. Payne also noted that during staff’s extensive research it was very difficult to piece together this information.

Mr. Allen noted that much of the information is reported in the component level financial statements. Other members said that this works for programs with their own financial statements—like Crop in RMA, but noted that it would not work for programs that are rolled into department financial statements like Flood (FEMA) into DHS.

Mr. Showalter said he did not want to ask for a note that is otherwise available. Mr. Steinberg is concerned about what “available” means in relation to where the information is and whether it has been audited and not just from any report. Ms. Kearney said that there are stand-alone audited reports for some insurance programs that can be referenced.

The Board agreed that programs should provide a reference if the information is presented in audited financial statements, however, if not specifically presented, then programs would be required to comply with this disclosure.

Conclusion: The Board directed staff to rework this requirement to exclude disclosures that are already available in audited financial statements.

<u>Disclosures for the Consolidated Financial Report (CFR)—par. 34:</u>

c. Balances for each of the following, including a break out for insurance programs that are material:
  - i. unearned premiums,
  - ii. liability for unpaid claims,
  - iii. liability for losses on remaining coverage,
  - iv. gross claims expense and related earned revenue,
  - v. borrowing by programs and a narrative discussion of repayment requirements including the ability to repay the borrowing, and
  - vi. the amount of coverage provided through insurance in force at the end of the reporting period, including:
    - a) a narrative discussion that this amount represents the maximum risk exposure during the remaining contract period, and
    - b) appropriate information to aid in avoiding the misleading inference that there is a more than remote likelihood of a loss of that amount.

Ms. Davis noted that the current disclosures are confusing and difficult to put together.

A number of members did not want to include unearned premiums and gross claims. Mr. Allen did think that annual information would help to provide the magnitude for the liability for paid claims. Mr. Dacey was concerned about what information would really be broken out due to materiality and noted that including gross claims is not consistent with the treatment of other programs. A number of members were concerned about how to disclose insurance in force while avoiding misleading.

Conclusion: The Board directed staff to remove unearned premiums and gross claims and related earned revenue, and to reword information about insurance in force.

Mr. Allen closed this session, requested that members provide Ms. Gilliam with any additional comments as to how to shorten the CFR disclosures.

Conclusion: Staff will revise the proposed standards consistent with the decisions documented above.

- **Steering Committee Meeting**

The Steering Committee discussed the status of appointment recommendations and agreed to provide an update at the next meeting. Ms. Payne indicated that the FY 2017 budget would be provided as soon as salary data for 2015 is finalized.

Adjournment

The Board meeting adjourned for the day at 5 PM.

Thursday, April 30, 2015

Agenda Topics

- **Department of Defense Request for Guidance – SFFAS 3**

Ms. Loughan explained the objective of this session (Tab F) is to review a exposure draft regarding use of alternative methods in establishing opening balances for inventory, operating materials and supplies, and stockpile materials under SFFAS 3. [Ms. Loughan provided a marked version of the document with member comments the previous day and asked members to speak from that version.] She welcomed Mr. Norwood Jackson, FASAB contractor, who was at the table. Ms. Loughan explained that the draft was shared with DoD and they seemed receptive to it, feeling it will address their concerns.

Mr. Allen asked for member comments.

Mr. Dacey explained paragraph 10 says deemed cost may be based upon one or a combination of five methods, he asked if there is an expectation that DoD would provide support for the selected method. He explained he was not sure if there is an expectation that documentation in support of the basis of accounting at transition was required.

Mr. Jackson explained DoD has asked if they have to document the basis of accounting at the time of transition. If they made the argument that they were using the latest acquisition cost, then they must provide evidence in support of that basis at transition.

Mr. Jackson explained that the transition value forms in whole or in part the opening balance for the year that DoD gives the unqualified assertion. The auditors have to validate the opening balance. The only question then becomes how will the auditors do that? While the method will be an auditor decision, surely it will involve a sampling regime.

Mr. Jackson explained that he believes this is an area where the GAO working with the OMB could provide guidance to make certain there is some sanity in that process because you carry such great weight being the government's auditor for the financial statements and so forth, and OMB's responsibility for providing form and content and the audit requirements for federal agency financial statements. He explained that there is an opportunity to come together and provide some real meaningful guidance to ensure that whatever the auditors do meets their requirements but does not become excessive. Mr. Jackson explained that he does not have any initial thoughts on what kind of guidance could be provided. He was more inclined to think that the GAO can provide guidance in the context of stratifying the population of inventory or selecting an efficient sampling technique.

Mr. Allen suggested that Mr. Dacey (or GAO, as the audit organization) will assume responsibility for the work of the other auditors. What Mr. Jackson is saying does not sound like an option, it sounds like a requirement that GAO would pass on to the auditors.

Mr. Dacey explained that the DoD IG is responsible for the audit of DoD. Under the current structure, independent public accountants perform the audits of the components. Mr. Dacey explained that, under the current structure, there are likely to be three sets of auditors (a combination of GAO for the consolidated financial statements of the U.S. Government, DOD IG for the consolidated financial statements of DOD, and the auditors of the components that are doing the audit directly that would need to generally agree on the same answer. Part of it drives off the expectation from the GAAP standpoint as to what the level of evidence is required to support these amounts where you do not have historical cost.

Mr. Dacey explained he had some concerns if a specific method cannot be audited. Is it acceptable to default to another method?

Mr. Jackson explained he understood his concerns but believes that the valuation method that presents the greatest documentation hurdle is latest acquisition cost. Selling price is straight forward, because that is in a catalogue. The Army uses selling price. The Navy has used latest acquisition cost, and so they are confronted with a documentation issue. Mr. Jackson explained he did not know of components using replacement cost, estimated historical cost or actual historical cost right now.

Mr. Dacey explained that his question is if there is a problem found, can they change approaches and have different items on different bases. Mr. Jackson explained that there may not be a replacement cost if a component is using latest acquisition cost for an asset that is no longer even manufactured.

Mr. Dacey asked if all else fails, is there some kind of reasonableness test to apply to determine whether the cost in the system is within a reasonable range of what it is expected to cost? Mr. Jackson stated that having worked through some very difficult situations at individual federal agencies, he has never seen a situation where all else failed and there was not a way to work through. It becomes incumbent upon you to find a creative solution that will make the auditors comfortable that the result is consistent with the standards.

Mr. Dacey asked if Mr. Jackson believed it provides sufficient flexibility given the fact you have got five choices and the fact that you could maybe change your basis if you could not find one adequately supported.

Mr. Jackson agreed that it does. For example, if the Navy cannot provide documentation in support of the items valued at latest acquisition cost, it would be acceptable under the proposed standard, to go to the Army's catalogue price for that same item and value that item at that catalogue price.

Mr. Jackson explained DoD should consider different scenarios for addressing situations in which it does not have documentation in support of transition values. For example, using the Army Selling Price or replacement cost for items still being manufactured.

Mr. Reger suggested that to the degree that we get something with a basis that is at least reasonably defendable; it will work itself out over a period of time. If it has a basis, this is going to self-correct over a period of time. Mr. Jackson agreed and explained the standard provides a basis for the voice of reason. Any valuation method that you have used in the past will work; you just have to adopt a historical cost model moving forward. The imperfections in the opening balance are recognized and now referred to as deemed cost.

Mr. Smith asked what were DoD's concerns about supporting documentation. Ms. Loughan explained DoD's concern was similar to what the Board had discussed. They questioned what supporting documentation would be required for the opening balance. The proposed standard cannot address supporting documentation.

Mr. Showalter explained that while the standard allows them flexibility in certain areas; it does not allow flexibility on the type of documentation because that is a standard which we do not set. He explained that we need to make sure we are clear on the flexibility we intend. However, the audit firm will be held to auditing standards pertaining to sufficient and appropriate audit evidence.

Mr. Allen suggested that in GASB Statement 34 basis of conclusion there is some discussion that if you have the cost of your infrastructure, that is what you should use but if you do not, then estimate and document your method of estimation. He explained that we do not tell them that you have to go back to do anything, it just says use an estimation and document that estimation, because the number will become more accurate over time. Mr. Allen suggested adding a discussion in the basis for conclusions with regard to inventory is being recognized at whatever level of precision but it will take care of itself in probably fairly short period of time and it will become more accurate.

Mr. Granof explained that he feels a little uncomfortable using a standard to give what some might consider dispensation for them to violate our standards. He also has concern with using a standard for something that is temporary. He asked if there is any other mechanism that we can use to solve this problem.

Mr. Dacey explained that he believed one could argue an interpretation, but he believed it would be a stretch.

Mr. Steinberg explained that the role of our Board is to establish generally accepted accounting principles for the federal government, which is unique. One of the unique aspects is the Department of Defense, whose role has been to defend the country. In order to get them to the point where they provide meaningful financial statements, we are establishing a generally accepting accounting principle that says at the very beginning they can use quantity times a deemed cost.

Mr. Allen explained that no one gave them dispensation not to keep the books. The individual Air Force officers who are out there do an incredible job of keeping track of things; it is the accumulation process that does not work.

Mr. Showalter added that we are not the first accounting standard setting body to do this. Our actions are not inconsistent with the other standards setters who have given guidance for initial adoption of standards.

Ms. Payne explained that being the staff person that worked on SFFAS 3, she wished that the Board had done this when SFFAS 3 was issued. Reading SFFAS 3 now, it appears that as a matter of public policy we told DoD to go out and figure out historical cost for hundreds of thousands of line items, and we would not have asked them to spend that much money. Mr. Jackson, who served at OMB during the development of SFFAS 3, added that the DoD Board member, asserted that they could meet the SFFAS 3 requirements at that time.

Mr. Granof clarified that he is not objecting to doing this. He wanted to know if there was some other way to accomplish this goal short of the standard.

Mr. Reger explained he understood as we are making a standard for what is a onetime unique situation, and that may not seem like standard setting. On the other hand, DoD is 60 percent of our assets and 40 percent of our income. He explained that he is open to another alternative, but that just seems like a lot longer process.

Mr. Jackson explained that for DoD to be able to get through the process, they have to have a proposal such as this. It will be much faster to do this through a standard.

Mr. Dacey asked about DoD's reaction to the document as well as some of the concepts the Board has discussed today? Mr. Jackson explained DoD's main concern is the documentation issue. As discussed earlier, he explained to them that with billions of dollars in the opening balance, there is no way that the auditor can ignore it.

The Board acknowledged Ms. Jenkins, Director of the Financial Improvement and Audit Readiness from DoD's Office of the Under Secretary of Defense (Comptroller). Ms. Jenkins shared that DoD is concerned about supporting the opening balance. She explained that they need to look at each DoD component to identify exactly their status and which technologies they can support. The discussion made it clear that you cannot just take whatever you have in your system and say that is my opening balance; you have to have support behind it.

Mr. Jackson also pointed out that he believed a very important aspect of the proposal is that it also allows DoD to give an unreserved assertion on a particular line item (such as inventory) without having to give an unreserved assertion on the financial statements taken as a whole.

Mr. Dacey asked if in paragraph 12 when we state "the first period in which the reporting entity makes an unreserved assertion that its financial statements" is that different from the FIAR plan assertion that they are audit ready. He explained that he assumed they are not the same.

Mr. Jackson explained that it seems the statements would be congruous, if one makes an unreserved statement about the auditability of financial statements, he cannot help but to believe that is a statement that they are audit ready.

Mr. Dacey explained he was asking that question because he can see a situation where you were not audit ready, then you do not want to make that unreserved statement. Mr. Jackson explained that you would hope that DoD goes through a process of determining they are audit ready prior to making an unreserved assertion.

Mr. Dacey explained that he believed the unreserved assertion would not be made until later, after the audit readiness assertion. He believed it is conceivable that the unreserved assertion could be made after some of this audit effort would take place. Because once you make that assertion, then it seems like you are now tied to that opening balance and having to come up with the support for that opening balance. Mr. Jackson agreed and stated you should have done some audit work to give you comfort with the evidence prior to making the assertion.

Mr. Dacey explained that he understood that the financial statement footnote disclosures would explain that it is based on deemed cost and that at some point it would go away. He asked if the DoD's new systems have information on turnover rates and if judgments can be made about that. Would the footnotes state the deemed cost and at some point in time that would roll to historical cost?

Mr. Jackson explained that DoD is given the opportunity not to have to say that it is at deemed cost, but if DoD chooses to make a statement that inventory, OM&S, and stockpile materials are valued as historical cost (moving average cost), then DoD must be able to support that disclosure and the auditors will want to validate that disclosure. Mr. Showalter suggested that something be added to the basis for conclusions that they should reassess disclosures at a later date.

The Board again discussed the importance of ensuring supporting documentation issues are addressed and documentation is validated through sampling or other means prior to the assertion. If not, it will be a problem for a number of years. DoD should actually be doing the test work to verify the transition values now.

Mr. Dacey asked if there are changes to SFFAS 3. Ms. Payne explained that there was no transition guidance when it was issued, so there is nothing to amend. She explained if we were to try to do this as an amendment to SFFAS 3, it would have to be an addition rather than a change. She had envisioned the chance for this to be an opening balances type guidance similar to IPSASB first time adopter, but it does only cover one standard at the moment. After discussing ways to address Mr. Dacey's concern, staff suggested that a paragraph would be inserted in SFFAS 3 that refers readers to the implementation guidance because the SFFAS 3 is broken up by chapters and the guidance would be for three chapters.

The Board agreed to add a section to the proposed standard for an amendment to SFFAS 3 for implementation guidance.

Ms. Loughan clarified that the Board requested additional language to the basis for conclusion regarding assessing disclosures and the transition from deemed cost and that more accuracy will be gained over time with turnover rates.

The Board discussed certain small wording and editorial suggestions. It was agreed that:

- "the quantity of" would be added after increase in paragraph 5
- "stockpile materials" would be added to paragraph A2
- "Military Departments" would be changed to "DoD components" throughout the document
- Paragraph 2, first sentence will be clarified to state we are referring to what the current standard provides
- Paragraph A15, second sentence will be changed to "DoD would make a DoD-wide assertion when ~~all~~ <u>a sufficient number of</u> DoD components are compliant"
- "As used in this Statement, "deemed cost" is" would be added to the beginning of the definition of deemed cost in paragraph 7

Mr. Allen suggested if there were no other comments, the Board discuss due process and the document move as quickly as possible with a short exposure period. He did not believe it was necessary to not come back to a Board meeting, but instead the drafts could be shared electronically after the meeting.

Staff discussed that much of the additional text is boilerplate with the exception of questions for respondents. The Board agreed to one general question regarding do you agree or disagree with the proposal and please provide your rationale. After discussing this, the Board agreed to go straight to a ballot draft and staff would accept grammar corrections and minor corrections that do not change the meaning but make it clearer. The Board requested staff to provide a ballot draft and agreed to expose the document for 45 days.

Conclusion: After reviewing and discussing the staff draft of a proposed standard, the Board agreed staff should move to a ballot draft as soon as possible. The Board agreed staff should incorporate the changes discussed at the meeting including adding a section to the proposed standard for an amendment to SFFAS 3 for implementation guidance, adding additional language to the basis for conclusion for topics discussed and other small editorial suggestions. The Board agreed the exposure draft would be exposed for 45 days.

- **Draft Interpretation on PP&E Estimates**

Ms. Loughan explained that this session (Tab G) relates to the DoD Implementation Guidance Request project. The objective is to clarify whether capital improvements are included when estimating the historical cost of general property plant and equipment (G-PP&E) and whether estimates are permitted to capture the historical cost of construction in progress. She explained that staff presented a draft interpretation for the Board's consideration. [Ms. Loughan provided a marked version of the document with member comments the previous day and asked members to speak from that version.] The Board has not discussed this area in prior meetings. Staff explained at the February 2015 meeting that they would be participating as a liaison with the DoD Financial Improvement and Audit Readiness (FIAR) working groups to assist on discrete issues. Staff responded to an issue by developing this draft interpretation.

Ms. Loughan explained that DoD Inventory and Related Property workgroups requested clarification regarding capital improvements and whether estimates could be grouped with their real property capital improvements. She explained that DoD submitted draft scenarios developed to address their baseline real property issues (see Tab G, Appendix A- Draft RP Baseline Business Case, prepared by DoD FIAR). After considering the information and discussions with DoD, staff believed an interpretation could clarify the issue. They also had another issue regarding construction work in progress and whether estimations could be applied to that.

She explained the draft interpretation is intended to clarify implementation of standards for capital improvements and construction in progress after considering the principles within SFFAS 6 and 23. Ms. Loughan explained that the draft interpretation clarifies that:

- current cost would include all capital improvements
- this approach may be applied to all classes of G-PP&E
- estimates may be applied to construction work in process in accordance with SFFAS 35

Mr. Allen confirmed that the interpretation does not change anything because most of us who read the draft believe this is what should be done or what would be done.

Ms. Loughan agreed and noted that is why staff selected an interpretation, not a standard. It is not changing anything; it is just hopefully clarifying existing standards. She explained that most likely, some agencies are already doing this or have done this. Ms. Loughan explained the interpretation provides clarity around an already existing standard. Ms. Loughan also explained that the draft was shared with DoD.

Ms. Loughan explained the heart of the interpretation is paragraph six and she did make some changes to it in response to member input. She asked members if they had any questions or comments on the marked draft.

Mr. Allen noted that he appreciated the few wording changes recommended by members and it appeared to be an easier read with those changes.

Mr. Dacey asked if we bought a building in 1970 and had capital improvements in 1990, then we would basically take the current replacement cost including the capital improvements, and deflate that all back to 1970, the date when the building was originally acquired, pre-addition? He explained that essentially it would decrease the net value further than it would have had you had historical cost. So you are not overstating the assets, you may be understating it based upon a technical application of historical cost.

Mr. Allen explained that he did not read that you had to do that, it is optional. If the improvement was really quite recent, several times more than the building itself cost years ago, there may be a desire to separate that.

Mr. Dacey explained it was not clear. He also did not believe it was clear whether it is original service year of the property itself or the addition. After discussion, it was agreed to clarify those and change paragraph 6 by adding “permitted but” and “of the G-PP&E item itself” for so the sentences read:

Separately estimating the cost of capital improvements is permitted but not necessary and such costs may be included in a single estimate.

For example, in the case of a real property asset, Plant Replacement Value which includes all capital improvements should be deflated to the estimated original in-service year or actual original year of acquisition of the G-PP&E item itself.

Mr. Dacey explained that in paragraph six, it refers to one of the methods in paragraph five, the current cost of similar assets. He explained with respect to the other two it becomes difficult to figure out how you would apply that in an aggregate basis, because in those methods it would seem that you have to go back and figure out the cost of the addition separately, for methods A and C.

Mr. Allen explained that the proposal does not require that it has to be included all at the same time. It is permissive language, so it is not necessary that such costs be included as a single estimate. He wanted to ensure it is clear that it is permissive to combine them, but you could still break them out separately.

Ms. Loughan explained that with the addition of permitted and it states separately estimating the cost are not necessary, it appears to be clear.

Mr. Dacey presented a question along those lines, if you knew the date of the addition and the estimate of the cost and it was recent can you choose to take it back to the original in service data, the asset, and essentially more fully depreciate it rather than use the better estimate?

The Board acknowledged Ms. Jenkins, Director of the Financial Improvement and Audit Readiness from DoD's Office of the Under Secretary of Defense (Comptroller), who offered to share information regarding plant replacement value and capital improvements at DoD. Ms. Jenkins explained when DoD calculates a plant replacement value (PRV) for a facility, several factors go into that calculation. It takes all capital improvements in that calculation. The issue has been DoD might not have all the documentation to know when the capital improvements have been made over the life of the asset. She explained that DoD can estimate the in-service date for the original asset. However, the challenge is can we separate it and calculate the improvement separately, because my PRV as a whole for the building is based on the total cost including the capital improvement. DoD cannot separate the capital improvement cost out of it because there would be a need for supporting documentation.

Mr. Allen explained the proposed interpretation addresses her challenges, but to address Mr. Dacey's concern—would DoD use that in all cases or believe that you must use this approach? For example a building was built 60 years ago, and within recent years you have a major addition that enlarges the building by three times what it was, and you have all of that documentation, would you feel that you need to lump those together and go back to that 60 year period of time, or would you as a reasonable approach take the information that you now have that is more current and break that out separately?

Ms. Jenkins explained that DoD is asking the board for a cost effective approach to do a onetime deflated PRV to establish our baseline so they do not try to chase or look for the documentation. This is for an initial baseline for the real property, because there are so many improvements that have been made over the years that they do not have the documentation for.

Mr. Dacey explained that some of the wording changes and the discussion help, but he may have some other suggestions. He is thinking that if you had a major capital improvement last year effectively you might fully depreciate it immediately.

Mr. Allen explained he thinks of the high school in his town that has some little original 100 year old part to it with these major new additions. If he took that whole thing and depreciated it back 100 years, the value is $0, even though within recent years they have spent millions and millions of dollars on it. .

Mr. Allen explained that from a reasonable approach, if that were the case you may say the building's original date is the date of the major addition and start from there. He explained there is a lot of judgment and none of these are hard and fast considering materially and reasonable approaches.

Mr. Dacey explained he is not disputing the current estimate; it is just how far back you take that if there is a major improvement. Sometimes a recent improvement might have extended the life of a fully depreciated building, yet you may basically fully depreciate the addition immediately under the proposal. Mr. Dacey explained that he did not know if there is an easy answer to this; we know this is going to understate property at the point in time if they select this way. Whether or not there is any more guidance or maybe you do not take it back to the original service date if you have a major change and you know when that happened, or only take it so many years. He explained those were just brainstorming ideas.

Mr. Allen explained that there is no GAAP over depreciation lives or methods. It is just a reasonableness that you have to apply.

Ms. Payne explained that we are talking about this in terms of real property because that is how DoD raised the issue, but as staff we did not think we could carve out real property and say this is acceptable for real property but not other property. So this would apply to everything; aircraft carriers, airplanes, etc. She explained that Mr. Dacey is correct in pointing out that on average, it is going to understate the original cost, and the tradeoff is the cost of getting the baseline.

Mr. McCall explained that this is similar to inventory discussed earlier. He explained they had a similar situation 30 years ago with state institutions in Florida where they did not have a value on them and they had to start somewhere. They considered many factors including construction, the number of floors, square feet and all those things and came up with a current cost, and then discounted it back to cost.

Mr. Dacey explained that he would like to see more in the basis for conclusions about the fact that it could result in understating pure historical costs, and the Board considered this was still an appropriate cost effective measure.

Mr. Smith asked why the interpretation would not be effective once issued. Staff agreed and would make the change to be effective upon issuance.

Mr. Allen explained if there no other comments then he would like to discuss the due process for the interpretation. If possible, he would like to shorten it.

Ms. Payne explained that interpretations do not have as long of an exposure period, so she suggested keeping the timeline in sync with the ED for the Opening Balances.

The Board agreed to a 45 day exposure period exposure period for the Interpretation and this would keep both documents on the same timeline. The only difference will be after final, the interpretation does not go for 90 day review with the sponsors, and it goes for a 45 day review with the federal board members.

Conclusion: After reviewing and discussing the staff draft of a proposed interpretation, the Board agreed staff should move to a ballot draft as soon as possible. The Board agreed staff should incorporate the changes discussed at the meeting including "permissive" language, the interpretation is effective upon issuance, and add additional language in the basis for conclusions that it could result in understating costs

- **Updated Project Plans and Priorities**

Ms. Payne noted that the briefing materials provide an update on the current projects and a plan for the new tax expenditures project. She indicated that the tax expenditures task force members have been identified and a few invitations were outstanding. Members thought it would be beneficial to add a member from a citizen outreach group, such as the Concord Coalition and an additional experienced academic.

Members responded to the questions in the briefing memo as follows:

1. Do members support the project milestones for FY2015 and the accompanying timelines (Table 1)?

   Members agreed with the milestones.

2. Are there any changes to the priority projects?

   None were identified.

3. Are there any suggestions regarding the tax expenditure project plan?

   No changes other than the earlier noted suggestions for the task force membership.

   Conclusion: The tax expenditure project will proceed and updates will be provided at future meetings. The revised three-year plan will be provided for discussion at a future meeting.

Adjournment

The meeting adjourned at 11:30 AM.