FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
August 25-26, 2010
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, August 25, 2010

Administrative Matters

- ### Attendance

The following members were present throughout the meeting: Chairman Allen, Messrs. Dacey, Granof, Jackson, Reger, Showalter, and Steinberg. Mr. Schumacher was present the first day of the meeting. Ms. Regina Kearney represented Ms. Bond both days. The executive director, Ms. Payne, and general counsel, Mr. Dymond, were also present throughout the meeting.

- ### Approval of Minutes

The minutes of the June meeting were approved.

- **Rules of Procedure**

Ms. Payne thanked members for providing comments on the August 3rd draft rules of procedure. She provided a new draft to each member with changes based on the comments received from members as well as input from the AICPA. The most significant change was to include in the annual report whether the policies and procedures of the appointments panel were reviewed and any changes were made during the year.

Ms. Kearney inquired about the addition as a reportable event of the exercise of the option for an additional 90-day review period. Her view was that the option was intended to provide for unusual circumstances such as a newly appointed OMB Director not having time to complete the review. Ms. Payne indicated that she had explained that to the AICPA but they still wished to be notified.

Mr. Dacey suggested that another means of notification might be acceptable to the AICPA. It was agreed that the question would be posed to the AICPA representative, Greg Anton, during the upcoming Appointments Panel meeting.

Mr. Allen inquired about the survey. He was concerned that some items surveyed may not rise to the level of a reportable event. For example, number six talks about funding. Do we have all the funding we want? No. Is it adequate? I would say marginally adequate. Is that a reportable event? I probably would say no. However, on the survey scale it gets closer to that end than it is the other end. He wonders at what point on these scales there is a reportable event?

Mr. Showalter indicated that this is more of an annual confirmation that we complied with our rules procedure. He believes it ought to incorporate a reference to the rules of procedures so there is a context to answer the questions. But, he agreed there was a question about when you would have a reportable event – he would think it was any time you felt uncomfortable rather than being restricted to an annual survey. He viewed it as the AICPA asking “is there anything else you want to tell us about these areas that we need to know about and considering the continued compliance of the board with the principles?”

Mr. Dacey said he viewed the survey as having two components – the first was binary and that is independence. The rest is not the only mechanism for airing views or concerns. He believes the survey is just the check off at the end to confirm that there were not concerns people ought to be aware of or that a member feels strongly about.

Members expressed concern that a less than absolutely positive answer on the scale would be viewed as non-conformance to the AICPA’s criteria. In addition, members indicated that issues should be raised and dealt with during the year.

Ms. Payne indicated that she agreed that aspects such as independence and ethics are binary. However, to monitor performance and consider improvements as the AICPA desired, she believes the scale is necessary.

Members indicated that people outside the Board ought to assess against a scale but that the Board as a whole ought to be comfortable that due process was always followed. Ms. Payne pointed out that individual members may not agree with the majority and this provides a venue for them to anonymously report their views.

Several members expressed concerns regarding the public nature of the survey and its significance relative to meeting the criteria. Several believed the performance on a scale ought to be assessed by others and that a self-assessment ought to focus on a yes or no outcome.

With respect to anonymity, some members believed that the input would be more valuable if members were identified so that the Chairman and/or the AICPA could follow up with the member holding those views. In addition, members believed they should surface performance issues for discussion during the year. Other members believed anonymity was important since we find out things that help us improve. Responses may be more candid if they are anonymous. Mr. Allen also indicated that he prefers not to know who said what so that matters do not become personal.

Some members viewed the survey as a way to surface problems and, for that reason, thought identifying who surfaced the problem was important. Others viewed the survey as a means to both monitor and improve performance over time and, for that reason, supported anonymity.

Members suggested two separate vehicles – one that is binary to indicate continued conformance to the criteria and one that is designed to support improvement efforts. Some members indicated that a scale would not be appropriate if conformance to the criteria was an issue because they would be inclined only check the strongest answers while others said the strongest answer is rarely checked because “never” or “always” is rarely the right answer. Ms. Payne indicated that she would revise the document and continue to solicit comments.

Ms. Kearney asked to return to the rules of procedure – she asked if the Media Policy was directed to staff, or staff and members. Ms. Payne indicated that it was both and that she would review the document and clarify the references.

Ms. Kearney also asked about the appropriateness of the tone since this is a public document. Ms. Payne agreed and suggested that much of the advisory text could be moved to a “help aid” to be provided to new members.

Agenda Topics

- **Measurement Attributes**

The Board discussed a proposed exposure draft in two sessions. At the first session the Board approved changes made since the June draft and requested additional changes. At the second session, the Board discussed a preballot draft and requested some changes. Members received an updated preballot draft by email the following day, with a request for additional comments by September 3, 2010. The changes made by the Board as a result of the August meeting are as follows.

1. August 13th draft

   Title page: Change the title to clarify that the exposure draft addresses the measurement of elements in periods after initial recording.

   Page 12: Clarify that an adjustment to an allowance for uncollectible accounts because of a change in the risk of noncollection would mean that the net amount of accounts receivable would be a remeasured amount, but the gross amount would continue to be reported at the initial amount.

   Page 16, line 11: Insert "or settlement" after "the realization" and strike "such as federal debt."

   Page 17, lines 11–17: Place this paragraph after line 11 on page 16.

   Page 19, in par. beginning on line 18: Include an acknowledgement that some individuals espouse a mixed measurement approach, rather than measuring and reporting all assets and/or liabilities at either the initial amount or a remeasured amount.

   Page 26, line 12: Strike "all." Line 13: Change "incorporated" to "considered."

   Page 30: Add the word "net" after "Taxes receivable" in the illustration in Appendix A.

2. Preballot draft

   Change comment period deadline to November 30, 2010.

   Pages 4–5: Update the discussion of Federal Financial Accounting Concepts for changes in the GAAP hierarchy pursuant to SFFAS 34.

   Pages 8–10 (Questions for Respondents): Add to questions 1a, 2, and 4a a request that the respondent suggest improvements. Insert a reference to federal government entity financial statements in question 4c. Change the two references to "assessments" in question 4d to "discussion" and "aspects," respectively.

Paragraph 2: Add a reference to the usefulness of initial amounts vs. remeasured amounts for establishing accountability.

CONCLUSIONS: After incorporation of any additional comments from members on the preballot draft, staff will distribute a ballot draft and a ballot to members. Assuming majority approval, the exposure draft will be issued in September for public comment, with a request to respond by November 30, 2010.

- **Earmarked Funds**

Ms. Parlow opened the discussion by noting that she researched the source of funds for the earmarked funds with very large negative net position – primarily the civil service retirement funds. Preliminary results of the research indicated that the majority of funding for those funds comes from general fund appropriations, and not from dedicated collections. She said that it might be possible to exclude those funds from the category of earmarked funds by explicitly requiring that the majority of funding needs to be from dedicated collections and not from general fund appropriations. She said that the Board may wish to defer discussion of various potential “filters” until this possibility has been further explored.

Mr. Steinberg and Mr. Jackson said that they would very much prefer that the distinction be based upon the source of funding.

Mr. Dacey said that although one purpose of SFFAS 27 was focused on the balance sheet, another purpose was to show via the flow statements that there is money going in and out that is not part of general revenues. Ms. Parlow said that for the funds with large negative net positions, the amount of dedicated earmarked-type revenue is pretty small.

Mr. Dacey said that any solution should consider both the balance sheet and the operating statement, because any fund that has significant earmarked-type revenue should not be excluded.

Mr. Steinberg asked if SFFAS 27 requirements addressed this issue in the definition of an earmarked fund.

Ms. Parlow said that SFFAS 27 only implicitly addressed “predominant use” of a fund (for example, in excluding intragovernmental funds because they were “primarily” used for transactions within the federal government). SFFAS 27 also defines a “fund” as a stand-alone self-balancing set of accounts. She said that in 2006, David Mosso (then chairman of FASAB) wrote a letter that permitted agencies to classify funds as earmarked or not in accordance with the primary source of funding.

Mr. Steinberg said that paragraph 11 of SFFAS 27 did not explicitly address the source of funding.

Ms. Payne noted that staff had drafted guidance to clarify the guidance in paragraph 11, in particular to clarify that a fund must have at least one source of specifically identified revenue that is external to the federal government in order to meet the definition of an earmarked fund. [This draft guidance was included in the August 2010 briefing paper on pages 8-9.] The guidance would further indicate that this funding needs to be the primary source of funding.

Mr. Steinberg said that this guidance could potentially solve the whole problem. Mr. Dacey said that there might be unintended consequences regarding Medicare Parts B and D, which are funded by 25% premiums and 75% general fund.

Mr. Jackson asked what would be wrong with excluding funds that are primarily funded by the general fund. Mr. Dacey said that Medicare Parts B and D are combined in a single fund that currently has a positive net position of about $44 billion. Mr. Dacey said that he believes that Medicare Parts B and D should be included in earmarked funds. Mr. Allen said that Medicare Parts B and D are a relatively insignificant part of the multi-trillion dollar positive fund balance that the intent of SFFAS 27 was to focus on.

Mr. Dacey said that the operating statement is material. Mr. Allen said that although the operating statement might be material, the net position is dwarfed by Social Security. Ms. Parlow said that if the primary source of funds was part of the required definition, all but one of OPM's earmarked funds would be excluded. That fund, the Life Insurance Program, is relatively immaterial – out of the nearly $1 trillion in negative net position for the OPM earmarked funds, that Life Insurance fund has a net position of only about $2 billion.

Mr. Jackson said that he doesn't understand why we would account for Medicare Parts B and D any differently than we would any other long-standing program funded by appropriations. Mr. Dacey said that it is funded by a permanent appropriation rather than an annual appropriation.

Mr. Jackson said that he doesn't see how you can justify taking appropriated funds that are part of the general tax revenue stream and classify the appropriated funds as earmarked funds.

Mr. Allen said that years ago the Board made a tentative decision to treat Medicare Part A very differently from Medicare Parts B and D, because of the unique differences that are being discussed, although subsequently they were merged.

Mr. Allen asked Ms. Parlow if this issue should be examined in terms of the core definition of earmarked funds.

Ms. Parlow said that more than one issue is being raised. First: SFFAS 27 does not require a breakout of the statement of net cost. SFFAS 27 requires breakout of net position on the face of the balance sheet.[1] . SFFAS 27 does require breakout of the statement of changes in net position because one of the members wanted to show the changes from the previous year and provide articulation. She said that she could develop this issue for the next Board meeting, but that she currently cannot see a rationale for designating a fund as earmarked if the predominant source of funding is general fund appropriations. She said that it is her belief that this was not the intent of SFFAS 27, and perhaps the reason why the Board did not anticipate the inclusion of deferred compensation funds (with their large negative net position). She said she believes that such a clarification (predominant source of funds) would support the original intent of SFFAS 27.

Mr. Dacey said that Medicare Parts B and D have $40 billion in amounts that are held exclusively for Part B and D benefits. He said that he believes that the intent of SFFAS 27 was to segregate those amounts from net position that's available for general purposes.

Mr. Reger said that Treasury has been having discussions with the Department of Defense (DoD) regarding whether or not the military retirement fund should be classified as an earmarked fund. He said that Treasury asked the DoD not to take any action until the Board takes an action, to make sure that the interpretation of SFFAS 27 is consistent throughout the government. He said that he is bringing it up to illustrate the kind of confusion that there is and that the intent of SFFAS 27 is not clear.

Mr. Allen asked Ms. Parlow how she wanted to develop this issue. Ms. Parlow said that she is thinking about how to accommodate Mr. Dacey's concern regarding Medicare Parts B and D. She said that she would have to research issues such as whether the Medicare program is predominately funded by taxes and premiums, or whether the appropriations for Parts B and D were so large that perhaps the entire program is not

---

[1] Paragraph 63 in the Basis for Conclusions of SFFAS 27 explains that "Under this standard the financial statements would thus present- in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits."

primarily funded by earmarked revenues. She said that she does not think that allocating a fund proportionately would be feasible or desirable.

Ms. Kearney said that OMB Circular A-136 addresses mixed funding with permissive language that says that agencies may report a fund as earmarked based upon the predominant source of funding, so there is a precedent for doing what Ms. Parlow is proposing.

Mr. Allen said that most of the members appear to be amenable to this approach, and asked if there was anything more that the Board could do at this Board meeting.
Mr. Dacey said that he was concerned about the focus on source of funding because of the possible exclusions of Medicare Parts B and D. Mr. Jackson said that funds primarily funded by appropriations could not be distinguished in principle from any other fund primarily funded by appropriations.
Mr. Steinberg said that perhaps the source of funding could be the first criteria but then if there were a substantial amount of dedicated collections, perhaps that part could be separated out.

Ms. Parlow said that generally in funds with mixed funding obligations are not necessarily allocated according to the source of funds. Mr. Steinberg said that if there were a statutory 75/25 relationship, that can be assumed about the balance sheet assets and liabilities. Mr. Reger said that this is not always the case. Mr. Jackson said that because Medicare is so different from other programs, that perhaps it can get special treatment in this standard, by being explicitly excluded from the predominant source of funds rule. Mr. Allen indicated that staff should come back with more information about the predominant source of funding option as well as the existing options because it is premature to rule any out.

Eliminations
Ms. Parlow noted that SFFAS 27 was somewhat confusing on the topic of eliminations. For agency-level reporting, it only addressed eliminations in a footnote, which said that for the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations similar to the note disclosure provided by the U.S. Government-wide financial statements, as required by paragraph 30. She said that this is a strange requirement, because the earmarked funds disclosure, which provides summary information on assets, liabilities, and flows for earmarked funds should not display elimination entries between earmarked and non-earmarked funds (such as for earmarked fund investments) because the elimination column would not net to zero.

Due to confusion, there is inconsistent reporting: some agencies perform eliminations within earmarked funds and post adjusted amounts without an eliminations column;

other agencies show an eliminations column for within-earmarked funds; other agencies show eliminations between earmarked and non-earmarked funds.

Ms. Parlow said that one recommendation to avoid the confusion would be to require eliminations only when necessary to eliminate material overstatement of assets and liabilities within an agency's earmarked funds. She said that basically agencies have been showing good judgment but that the requirement is very confusing.

Mr. Dacey asked if this would present a problem for Treasury in preparing the government-wide statements. Ms. Parlow said that she checked with Treasury staff and was told that they get what they need by the way that the agencies transmit data rather than agency footnotes. Mr. Reger confirmed that Treasury gets the information from the "closing package." Ms. Parlow said that she is currently not recommending changes to reporting eliminations on the government-wide financial statements. Mr. Dacey asked why there is a problem for agencies reporting eliminations. Ms. Parlow said that numerous agencies do not have systems that can automate eliminations within earmarked funds, which is a greater level of complexity than agency-wide eliminations. She said that trying to do that by manual analysis is not feasible. As a result, there is a confusing footnote with an eliminations column that does not foot to zero.
Mr. Allen asked what staff would recommend. Ms. Parlow said that staff is recommending that eliminations only be required when necessary to eliminate material receivables and payables within earmarked funds. She said that those instances appear to be rare.

Mr. Steinberg said that he agrees that the guidance is confusing, but that he believes that the solution is to clarify the guidance. He said that regarding the lack of system capability, he does not recall any exceptions taken by auditors or material weaknesses due to the lack of ability to do eliminations for earmarked funds. Ms. Parlow said agencies are currently getting by with eliminations columns that do not foot to zero because the requirement appears to require eliminations between earmarked and non-earmarked, and not within earmarked funds. In other words, SFFAS 27 does not require eliminations within earmarked funds. She said that she would really hesitate to add a new requirement, knowing that most agencies do not have the system capability to comply. She said that clarifying the guidance would mean stating that, when there are transactions between earmarked and non-earmarked funds, agencies are required to perform eliminations between earmarked and non-earmarked funds. However, since the earmarked funds note only displays earmarked funds, it would be inappropriate and confusing to display those eliminations in the earmarked funds note. Mr. Steinberg agreed that the guidance should make it clear that there should not be an elimination column that does not foot to zero. He also said that if eliminations are within earmarked funds, those eliminations should be done before the amounts get onto the financial statements.

Mr. Dacey said that he wants to see consistency across the government. Ms. Parlow said that SFFAS 27 only requires agency-level eliminations in cases where earmarked fund investments are eliminated within the component entity, and that she does not believe that there are many, if any, other agencies besides Treasury where this occurs. However, the eliminations would eliminate the investments – which you don't what to do.

Ms. Payne indicated that staff would further develop the distinction between presentation of combined and consolidated information at the agency level. She asked if there is anything that the Board would like to see at the next meeting. Mr. Reger said that he would like to see a draft of what staff believes the change to the standards should be as well as illustrations of the disclosures and statements.

Ms. Payne projected the FY 2009 Earmarked Funds Note for the CFR, which displays eliminations within earmarked funds but not between earmarked and non-earmarked funds. The earmarked and non-earmarked eliminations appear on the face of the CFR statements. Mr. Jackson said that this is the way that the earmarked funds note should be.

<u>Placement of Basic Information at Agency Level</u>

Ms. Parlow said that nearly all of the task force members strongly believe that disaggregating net position on the face of the agency-level balance sheet in terms of earmarked and non-earmarked funds, in addition to unexpended appropriations and results of operations, resulted in a presentation that is confusing to the general reader. Neither of these distinctions is familiar to the general public. She said that this is not an issue for the CFR, because (a) the CFR does not disaggregate unexpended appropriations and results of operations, and (b) the government-wide split in net position is a basic objective of SFFAS 27. In addition, the breakout on the Statement of Changes in Net Position results in too many columns to be able to fit comparative fiscal years on the same page, which makes it more difficult to evaluate comparative information. Virtually all of the task force members believe that agency-level reporting should be in a note rather than on the face of the financial statements. Ms. Parlow said that staff is recommending that agencies have the discretion to report either on the face of the financial statements or in a note.

Mr. Dacey said that he agrees that the Statement of Changes in Net Position is too cumbersome, not so much the balance sheet. Mr. Reger said that, while he has a preference for not asking the CFR to do something agencies do not do, he wanted to make it clear that requiring the CFR to do something that the agencies do not do is not a problem. Treasury obtains the necessary earmarked funds data for the CFR from agencies' reporting, called "closing packages."

Ms. Kearney said that since Treasury is able to get the information it needs for the CFR, does it make sense to do all this reporting at the agency level? She said that there is a certain amount of tension between wanting to have clear and concise financial statements and asking are these disclosures adding value.

Mr. Jackson said that if this is important enough for the CFR, somebody needs to validate this information so that it can be rolled up, regardless of how it is submitted. It still needs to be part of the audited database. He said that if we didn't have any kind of distinct reporting and audit of the information, that it would be more difficult for Treasury to ensure the accuracy of that information going forward. For example, a potential government-wide clean opinion that would be partly based on the opinion of other auditors, you would want to make certain that this information had been subject to an appropriate level of audit.

Mr. Dacey said that his understanding is that the issue is not preparation or audit but rather presentation – is it overly cumbersome to the reader of the statements. Mr. Jackson asked if it would be acceptable for the agency to have discretion, since either way it would be basic information. Ms. Parlow asked Ms. Payne to project [on the screen] the SEC's FY 2009 Statement of Changes in Net Position as a good example of where the information would be better presented as a note only, because such a small proportion of the SEC's funds are non-earmarked and the statement looks very strange.

Mr. Allen said that this appears to stem from the misapplication of accounting standards – for example, the SEC should not have a separate column for earmarked and non-earmarked because the non-earmarked funds are immaterial. Ms. Parlow said that GAO is the SEC's auditor and wondered if GAO would have allowed the SEC to omit earmarked funds reporting on the face of its financial statements. Ms. Parlow said that this is an example of where she would like the standard to be a little clearer and say that if one or the other – earmarked or non-earmarked- is immaterial, that you don't have to split them out.

Ms. Payne said that the standard materiality box should take care of this, but that the community tends to do what the standard tells them to do [regardless of materiality], so perhaps a communications vehicle such as OMB's Form and Content could address this.

Mr. Jackson said that sometimes it's easier to just do it [apply a standard to immaterial items] than argue about it.

Mr. Allen said that perhaps it couldn't hurt to have a reminder in addition to the materiality box.

Mr. Steinberg suggested that we give agencies the option of a note-only reporting for the statement of changes in net position. Mr. Jackson said that you could achieve the same objective by using the notes in lieu of the face of the statements for the breakouts for both the balance sheet and the statement of changes in net position.

Mr. Showalter said that the preparer should make the choice. Mr. Schumacher said that would make more sense than to say that the balance sheet needs to be broken out of the face of the statement but that the statement of changes could be broken out in a note. He said that he would give the preparer a choice. Mr. Dacey said that he would think about it a little more but as long as it's somewhere in basic information he would consider it.

Ms. Kearney said that she is indifferent, because we would either be cluttering the statements or cluttering the notes. Mr. Allen said that he would favor preparer discretion.

Mr. Reger said that since the balance sheet is only four lines he would prefer to leave the reporting on the face of the balance sheet, but move it to the notes for the statement of changes. Mr. Granof said that he favors reporting on the face of the balance sheet so that there is uniform reporting throughout the government and because he favors simplicity.

Ms. Payne said that there was a slight majority in favor of staff recommendations 3a and 3b, to allow disaggregation to be presented either on the face of the financial statements or in a note.

Ms. Parlow said that it would be possible for staff to pursue two issues on a fast track as potential staff implementation guidance: (1) clarification that the source of earmarked inflows needs to be from a non-federal source, and (2) the classification of funds with mixed sources of funding. The members indicated that staff should not split off any issues but rather should address all issues as a single project, which would likely be an amendment to SFFAS 27.

Conclusions:

1) Staff will develop draft language to address the predominant source of funds in the format of a draft amendment to SFFAS 27 requirements (rather than staff implementation guidance). This option will be considered along with the original options at the next meeting.
2) Staff will develop illustrations and draft language regarding eliminations at the component level.
3) Staff will draft language allowing preparer discretion regarding placement of basic information for agency level reporting on the face of the financial statements or in a note.

4) Staff will develop draft language in the format of a draft amendment to SFFAS 27 requirements (rather than staff implementation guidance) regarding non-federal source of inflows required.

- **Federal Reporting Model**

The objectives of the federal reporting model session were to discuss the reporting model task force efforts, next steps, and deliverables and a project plan for evaluating disclosures. Mr. Simms began the discussion by providing a status of the reporting model task force efforts. He noted that the task force discussions have focused on how to better communicate financial information to users and a broader, more enhanced model for reporting the financial information. Mr. Simms noted that the task force is working on a report that will have recommendations for the board and its sponsors and its focus initially is on the government wide level of the reporting. The task force is considering a reporting model that involves layers of information that could meet the needs of different users.

Regarding whether the task force interfaces with the Chief Financial Officer's (CFO) Council, Ms. Kearney explained that she observes the task force and works closely with Mr. Simms. Also, Mr. Simms observes the CFO Council's subgroups. Mr. Allen requested that some preliminary feedback from the CFO council, as well as the task force, be provided to see whether there is some agreement on at least parts of a reporting model.

Mr. Granof noted that he is strongly in favor of a general approach of layers of information or drilling down. However, he expressed that he would be skeptical of the top layer being graphs or charts. Graphs and charts are very, very easy to manipulate and to mislead because one could change the scale. Changing the size of the scale or other variables could present a misleading picture.

Mr. Reger suggested that the task force should start to narrow things down to something that the Department of the Treasury could actually implement. The Treasury is looking to improve the consolidated financial statements and it is difficult to make progress when waiting for long periods of time for recommendations. Mr. Reger was concerned whether the reporting model project is focusing on form and content or display and presentation.

Ms. Payne noted that the task force was primarily concerned about awareness and delivery. At the last meeting the task force looked at a few items concerning the financial statements themselves, and some items concerning the MD&A. Some issues may be addressed by standards, while others are form and content. However, the bulk concerns how to communicate with the public – make them aware and provide them with a package they find useful.

Plan for Reconsidering Disclosures

Mr. Allen noted that while the Board is awaiting recommendations on the reporting model phase of the project, the staff would like to conduct a review of disclosures. He noted that one of the things that the project should ask is what information do users need that they are not getting currently. Obtaining this information might be beneficial to a comprehensive project on disclosures. However, the reporting model phase would take priority.

Mr. Granof noted that although surveys are a common research tool, they do not always provide the The information that the surveys were intended to produce. The questions that researchers should ask prior to conducting the survey are "what are we going to do with the results?" "What might you conclude when you get the results?" In other words, before you send out a survey you have to have a complete research design and know exactly what you are going to do with the results. That is where I have some question about the current questions being asked.

Mr. Showalter believed that the research should be structured in some way where the participants have a defined set of dollars they can spend on a set of disclosures and the project could actually get to the most important disclosures. It is not what you want to know. It is what you have to know. Also, the project needs to break the disclosures down into the detailed level to figure out; for example, what in the credit reform footnote is not necessary.

Mr. Steinberg noted that if the survey is going to the preparers and the auditors they will probably come back and want less and less and less because it is less work. Mr. Steinberg suggested interviewing individuals who write articles about topics such as the financial position of the federal government and its sustainability. The survey could ask where did the participant get their information; did they find it complete; and what more is needed.

Ms. Payne clarified that the initial stages of the project is a narrowing effort prior to trying to talk with users, rather than instead of talking to users. She noted that the project involves starting with preparers and auditors because the primary driver of a lot of evaluations is cost. Ms. Payne also noted that potential users are not yet familiar with disclosures and they may not schedule a meeting to discuss them if they are tasked with reviewing volumes of material.

Mr. Showalter suggested asking the preparers what questions they are getting from users. If they are getting questions, that should tell them one of two things - what is confusing or what users care about. This approach may be an indirect way to get to what users care about by seeing the questions they are asking the agencies.

Mr. Allen noted that one of the challenges that the Board has is that it has received enough feedback to know that preparers are overwhelmed. The Association of Government Accountant's survey discusses cost versus benefit.

Mr. Reger suggested talking to the public or other users of the statements and ask what are the five items that are useless to you. Then the question then is well what does it cost to do these things so I know what my trade off is.

Mr. Showalter noted that if you really challenged yourself about who are the real users of the financial statements, you will find there is a lot of information in there that is information that they already know. Users are flipping through pages trying to get to the good information that they are looking for to answer their questions.

Mr. Allen explained that the Governmental Accounting Standards Board (GASB) prepared an example footnote disclosure for all their footnotes, and GASB got the comment that the example footnotes were only about a third the size of the disclosures users commonly see. One thing GASB quickly learned from their disclosure review was that nobody takes anything out. Everything from the past is left and everything new keeps getting added. In a third of the pages you could fully meet the standard. The general footnote disclosures became far more verbose than the standard actually required them to be.

Mr. Reger noted that college and university professors are starting to teach their accounting staffs about governmental accounting and looking at the Citizens Guide. Members noted that although financial reports may be distributed, they may not be read.

Regarding the issue of if say the Citizens Guide is something users can put their hands around, why not make financial statements look like something they can put their hands around, Mr. Reger expressed that you do not need the discipline of generating statements to get to the Citizen's Guide.

Mr. Allen noted that the Financial Accounting Standards Board (FASB) identified items that are key decision useful items in a not-for-profit community. The FASAB could consider building an architecture around the items of federal financial information that would be beneficial to users and allow preparers flexibility in presentation .

Mr. Reger noted that presently we are on the path of getting a website up that starts with the consolidated statements, provides you access to all the agency statements and allows you to drill down in the consolidated statements to a level of activity. He was not envisioning going to individual payments at individual entities.

Mr. Steinberg noted that if we acknowledge the fact that financial statements are not designed for the public, the Citizens Guide may be, but the Consolidated Financial Report (CFR) is not designed for the public then why include the items that the people who are using it already know, like the significant accounting policy. Mr. Showalter's earlier point is a good thought to build on.

Also, consider what are the six things that citizens and managers do want to know? We have already placed into the Citizens Guide one of them which is the sustainability information. Maybe it is just identifying the four or five additional things like maybe the cost of the Iraq War or what have you and that is the top of the pyramid, the four or five things that people need to know.

Mr. Allen noted that it would be nice to have some kind of report that had a reliable number that citizens can look at and know what the real costs were. Mr. Showalter added that if you actually got more of a generally accepted place that provides information, over time, you can start to challenge some of the bad information.

Ms. Payne noted that starting with a granular approach to the project (a list of individual disclosures) could result in a list of individual items scattered here and there. Then, when we go to the focus group or structured interview phase where we are sitting down with users, we might be jumping all over the place. It may be more beneficial to focus on the higher level where we probably know direct loans, loan guarantees, could be a really expensive one. Also, environmental liabilities, and property, plant, and equipment could jump to the top. Next, we would be able to test the ones where we would get a bit of payback for what was there.

Mr. Steinberg noted we have to be granular, but we have to do it in such a way that it is not a checklist or we need to design points to how important the item is. A lot of the items that are being considered for listing in the current checklist may not be important to certain agencies; therefore, when those agencies answer the questionnaire, they are going to say the item is not important. Also, there may be items not included in the checklist that are very unique to some agencies, for example, the Department of Interior's water agreements with the western states and the nuclear waste disposal fund.

Mr. Dacey noted the concern of finding enough individuals who are knowledgeable enough to read disclosures and understand what they can or do present and whether or not it is useful. He suggested identifying a reasonable base of individuals that are reasonably informed and ask them to go through each disclosure and determine what type of information seems useful. Illustrative notes from various statements could be used. Also, they could be asked whether there is anything in the disclosures that is not worthwhile. Mr. Granof added that the project would be better off taking the approach of talking to a few knowledgeable people in depth, rather than talking to many people who are not going to give very much thought to the issue.

Mr. Steinberg noted that going to the preparers and/or auditors for an agency and asking them to identify which ones do you think are your five most important footnotes and which are your five least important and then tell us why it is so important and why they are not important.

Mr. Dacey noted that he would just ask the informed group of people to go down the list of disclosures and say there are things in each of these notes you think are either critical or unnecessary based on those criteria. However, members expressed concern about having participants review all the disclosures.

Ms Kearney noted that there will be disclosures that are very important to one agency but less important to another agency. Perhaps, some sort of guidance could be developed that would permit an agency to focus on only the core disclosures. Notwithstanding materiality the agencies are reporting all the disclosures. In some cases if they don't have that line item, they are not reporting the disclosure. But as long as they have that line item in the statements, they are reporting all the disclosures that go with that line item whether it is important to them or not. It could be a small line item for them.

Mr. Allen confirmed what Ms. Kearney had noted by giving an example of the GASB having reviewed a cross section of governments and determined what they were reporting for capital leases and, in almost every case, the item was immaterial. However, because the checklist the governments used says to disclose capital leases, they were disclosing it. Mr. Allen noted that this issue involves education.

Mr. Reger suggested having a discussion with deputy chief financial officers. He believed that a few agencies are issuing notes that they do not think are either required by us or by their auditors.

Mr. Allen noted that the Board wants to know the importance versus the cost of preparing disclosures and potentially identifying some candidates that need to be reexamined, i.e. Are we driving them to incur cost for something that they do not view as important? We need to test the approach on some users and make sure that they assess the same level of low utility to those as the individuals who are preparing them.

Mr. Simms noted that the project was planned to start in December 2010. Accordingly, staff could develop an approach involving structured interviews and provide it to the Board at the October 2010 meeting.

Conclusions:

The reporting model task force will continue developing a report for the FASAB's consideration and, for the October 2010 meeting, staff will develop a structured interview approach for reconsidering disclosures.

- **Steering Committee Meeting**

The Appointments Panel met in closed session.

Adjournment

The Board meeting adjourned for the day at 3:30 PM.

Thursday, August 26, 2010

Agenda Topics

- **Deferred Maintenance**

Mr. Savini began the presentation with an overview of TAB G wherein staff asked the Board to address whether a public hearing should be held and if not, if the Board wished to seek clarification from any of the respondents. Staff noted that although the majority of respondents were in favor of the proposed changes, some concurrences came with recommendations. In particular, there were two respondent comments (General Services Administration and Veterans Administration) that warranted consideration. Staff then invited the Board to proceed with any questions or observations that it might have.

Mr. Steinberg noted that although the ED received a good response, non-federal responses (i.e. CPA firms) seemed low. Mr. Steinberg suggested that this could be due to RSI not being subject to audit. Mr. Allen noted that although there were no (direct) CPA firm responses, the Greater Washington Society of CPA's (GWSCPA) did respond and their firm membership could constitute an indirect response.

Staff concurred with Mr. Steinberg and noted that the auditors who did respond were Inspectors General presumably because they deal with program and compliance matters. Mr. Savini then referred to the General Services Administration (GSA: Respondents #33 and #34) and Veterans Administration (VA Respondent #19) responses. Both of these responses are illustrative of two ends of a spectrum wherein on one end GSA does not believe that maintenance and repair (M&R) is deferred and on the other end, the VA opines that deferred capital improvements should be presented. The GSA position is based on the following assumptions: (1) M&R is not deferred but extended reflecting the life-cycle nature of long-term assets, (2) repairs are capital in nature and thus excluded from the definition and (3) SFFAS 6 only requires reporting deferred maintenance and repairs (DM&R) when it is expended or incurred in order to bring an asset back into acceptable condition. The VA position is based on the following assumptions: (1) VA is under-reporting its fiscal exposure by excluding capital improvements, (2) deferred capital improvement information is needed to place DM&R in proper context and (3) internal processes to separate the M&R from the capital effort is not only highly subjective, but time consuming and costly. Noting the GSA interpretation, the task force is advising the Board to either (1) delete references to acceptable condition or (2) clearly specify the spirit and intent of SFFAS 6 in this regard; specifically, that DM&R should be reported regardless of asset condition.

Staff then noted another important matter that came up surrounding the issue of expected/useful life. The GWSCPA (Respondent #16) has asked the Board to reconsider eliminating references to asset life. Lastly, staff advised that the remaining suggestions be addressed by (1) clarifying our document such as in the Basis for Conclusions and (2) issuing interpretation guidance or technical bulletin.

Mr. Steinberg noted that merely clarifying the definitions will not eliminate the variations which we are now seeing in practice. He asked staff what could be done to help achieve greater consistency among the agencies and if staff thought the original standard was (too) permissive?

Staff replied that the initial standard was in fact permissive to encourage experimentation. However, going forward the spirit and intent of reporting DM&R information needs to be stated clearly in our guidance. Furthermore, the Board should note that an interdisciplinary and holistic approach to DM&R be adopted by each agency.

Although generally agreeing with the staff comment, Mr. Jackson noted the need for an interdisciplinary approach is not unique to deferred maintenance reporting. The problem resides with disparate management information systems which are not always interfaced and linked to the overall financial system. In essence, both the CFO and Logistics communities need to come together to help ensure that their common needs are met. Bringing these parties together is beyond this Board's capabilities and resides squarely with the CFO who in many cases is a presidential appointee confirmed by the U.S. Senate. The standard might have to take an evolutionary process where we gradually eliminate inconsistencies. Although the Board does not have the authority to necessarily require agencies to adopt what staff is recommending, it can compose language that asks the agencies to consider the consequences of not adequately reporting DM&R information.

Mr. Dacey noted that the standard is in fact extremely flexible. The Board should continue to identify what it believes to be the best information that should be reported and used with an eye towards consistency.

Staff then noted the importance of reminding agencies that DM&R reporting needs to be looked at in connection to the consequences which could include health and safety concerns.

Mr. Allen noted that the discussion (establishing fairly uniform definitions) has a significant impact on the allocation of financial resources and in bringing about fairly comparable financial statement information among the agencies. The Chairman noted that if we were unable to at least achieve this initial step, there would be no need for the project to continue.

Staff replied that the General Services Administration (GSA - Mr. Dennis Goldstein; Director, Asset Management Division) has noted that from his point of view as a federal real property council (FRPC) representative, the proposed definition would be suitable for Federal wide application.

Mr. Steinberg then asked if the adoption of the definition would bring about a change in the way GSA currently measures deferred maintenance.

Ms. Kearney explained that Mr. Goldstein does not directly manage the technical division that executes maintenance and repair work at GSA. Other individuals at GSA would be responsible for measurement and reporting.

Ms. Payne stated that concerning what GSA would ultimately report as DM&R would depend upon the measurement guidance and indicators that we would promulgate. She further noted that it is premature to make any decisions regarding measurement and reporting since the task force's worked is not yet completed.

Agreeing with Ms. Payne, Mr. Steinberg added that it is in fact within the power of the Board to address this issue of inconsistent reporting regardless of whether it arises from a definitional interpretation or measurement and reporting problem. It is true that CFO's and organizations like OMB all have a stake in helping to solve this problem however, the Board should look to clarify and close any loopholes that might be bringing about this inconsistency and lack of comparability.

Mr. Jackson noted that what's missing and what needs to be addressed is "the how" in how we measure. This (first) phase of the project has dealt with the "what" by dealing with the definition and the next phase will be to look at the "how."

Accordingly, both Ms. Payne and the Chairman reminded the Board that the issue in Question 4 dealing with whether DM&R should apply to PP&E or fixed assets needs to be addressed before considering measurement and reporting.

Concerning Question 4, Ms. Kearney asked if there was any split along functional or professional lines to the respondent comments concerning whether or not they favored DM&R on PP&E or fixed assets. Mr. Savini noted that there was no real split along professional or organizational lines.

Ms. Kearney then raised a question concerning fiscal exposure. Specifically, she noted that if DM&R reporting is limited to PP&E and not all fixed assets, would financial reporting in essence understate the fiscal exposure that an agency has. Ms. Payne believed it would and provided historical context. She noted that since the original intent of SFFAS 6 was to identify unfunded costs (M&R), the requirement had more to do with cost than it did with PP&E. She further noted that since the standard applied to heritage asset (which are not on the balance sheet), the intent was not to necessarily create a link to the balance sheet.

Mr. Showalter noted that this issue deals more with the liability side of the balance sheet than it did the asset side.

Mr. Jackson suggested that in addition to imposing an administrative burden on the agencies, the capitalization requirement would be adversely impacted if the Board ever required DM&R reporting on all fixed assets. If agencies want greater accountability they are free to lower the capitalization threshold. Mr. Jackson cautioned the Board concerning the immense burden of asking agencies to track deferred maintenance on all assets; i.e. under $25,000.00.

In taking a slightly different view, Mr. Steinberg provided additional comments. First, he noted that assets needed to be identified by category such as real property, equipment, and personal property. Second, we have fully depreciated capital assets on the books and last, there are those items that fall under the threshold and were never capitalized but yet are being maintained. Whether we are using fully depreciated assets, classifying some assets as personal property or using expensed assets, DM&R applies.

Mr. Showalter noted that it seemed premature to discuss the implementation of the "how" until we've ascertained the "what" and that the first phase of this project deals with the "what". He went on to state that at least conceptually it is difficult to argue that deferred maintenance does not apply to all assets. In his opinion, the respondents in favor of tracking DM&R to PP&E did so primarily because of their current practice and not necessarily reflective of what they would prefer.

Mr. Dacey stated that he too would prefer tracking deferred maintenance on all fixed assets and wondered if there were similar type thresholds in real property management that would limit the effort expended in this regard. The Board should align itself and seek synergies with the practices of real property management.

Staff replied that there were no such capitalization-like thresholds and pointed to a Forest Service request that FASAB coordinate with the FRPC to establish capitalization thresholds for FRPP reporting purposes.

Ms. Kearney inquired as to (1) whether staff would look into whether individual agencies have their own thresholds that they might be now using for FRPP reporting purposes, (2) what agencies were doing relative to personal property, and (3) if there are categories of equipment where deferred maintenance is not currently being tracked.

Staff noted that agencies appeared to have different definitions and interpretations of personal property and equipment and that the personal property representatives on the task force have noted that in cases of material deferred maintenance on such things as furniture and fixtures, DM&R is not accounted for per se noting that the furniture is simply replaced. Regarding deferred maintenance on equipment using DOD as an example, the only deferred maintenance which is tracked is at the depot level and not the unit level. Therefore, as long as we do not require that agencies track incidental maintenance and repair effort, we would not be imposing any additional burden.

Mr. Jackson noted that concerning the DOD depot system, several years ago circa 2000, DOD brought information to the Board, although arguing against it, concerning the critical importance of asset condition reporting at the depots. Asset condition information is a byproduct of deferred maintenance. DOD reported to this Board the extraordinary importance of reporting asset condition information concerning weapons systems. Mr. Jackson noted that this is probably more important than any capitalization and depreciation issues we may wish to discuss.

Mr. Reger then offered some observations. First, he advised and cautioned the Board concerning perceived inconsistencies that might exist between what is reported in the media concerning deferred maintenance at some agencies versus what is reported in the financial statements. He noted that much of this is budgetary posturing and something that the Board should stay away from as it focuses on the accounting. Second, the Board should first finish discussions relative to (1) use versus non-use, (2) real versus personal property and (3) capitalization versus non-capitalization. These are key elements that need to be decided before we can determine what we want to measure. Third, accounting is historical and in the context of this discussion if a national park has not been adequately maintained it becomes more of a prospective budget matter than an accounting matter.

Mr. Allen noted that during his tenure as Chairman he has reviewed various annual surveys and heard repeated testimony that the federal financial statements are not used, not beneficial to management, not cost effective, etc. The number one issue that is high-lighted in the Association of Government Accountants (AGA) surveys is the relevance of capital asset reporting. The question then becomes how we can get some utility from capital asset reporting without imposing unnecessary burdens on the agencies. There are many things that are important with capital assets: custodianship, insurance coverage, and the effectiveness of service delivery. If we can add credibility to capital asset reporting we should do so. The Board should not go counter to what it's been advised to do which is to render information that is useful to a decision maker as it acknowledges that financial reporting is not the sole repository where such things as meeting stewardship objectives is documented. However, there seems to be a link between deferred maintenance and our capital asset reporting as contained in the financial statements. This is an area where we could increase financial statement credibility.

Mr. Steinberg noted that we were not specifically addressing capital assets but rather the costs associated with maintaining those assets. In his opinion, this project gives the Board a fantastic opportunity to make financial statement information useful for decision-making and managers. Here we have a project that has the facilities managers at the table and we should use this as a great opportunity to help meet their needs. In essence, this project gives the Board an opportunity to directly serve user needs.

Ms. Kearney agreed with Mr. Steinberg's comments. However, she viewed this a little differently since her focus was not so much on the discrete costs but rather fiscal exposure which is not being accurately captured. Ms. Kearney made two points. First, materiality needs to be considered and second, DM&R costs do not meet the definition of a liability since the government cannot owe itself. With that being said, she noted that this is important information which should be included within the statements.

Mr. Showalter stated that underreporting could be just as damaging as over reporting. Also, if this is not a true liability it is at least a contingent liability. Under reporting would give people a false sense of comfort. This is an extremely important project from a decision usefulness point of view not only for budgeting reasons but for departmental management purposes.

Mr. Jackson agreed with the others that this is a very important project and this is why he raised the condition issue that DOD brought to the Board's attention years ago. By improving the M&R definition we hope to improve the quality of the information flow. We need some consistency throughout government and further discussion on whether or not to extend requirements of the standard to the cohort of assets that fall under the capitalization threshold for each agency.

Mr. Showalter raised the concern that the definition should not be amended at this time until we understand the "how" component of what is to be reported.

Ms. Kearney and Ms. Payne noted that the issue raised in Question 4 was meant only for informational gathering purposes and is not in any way meant to be a basis for judgment or conclusion. Ms. Payne further noted that based upon the respondents, it seems that the changes are significant and would lead to appropriate revisions at this time.

Mr. Dacey noted that the Board is only trying to fix the definition in this phase and not address the measurement or what it gets applied to.

Mr. Jackson stated that as long as the disclosure requirements as currently written in SFFAS 6 (which limit reporting to PP&E), the definition can remain with references to fixed assets.

Mr. Steinberg stated before it is decided whether or not to have a public hearing, we should address Mr. Showalter's concern; that is, would the Board be causing problems by issuing a definition now and then later changes to the measurement and reporting aspect of the standard?

Ms. Payne stated that one of the reasons why we accelerated the definition was to honor the agreement we had with the FRPC that we would develop the definition for their agency data call for reporting into the FRPP database. At the next meeting staff will provide the pros and cons to deferring this definition until we have the measurement portion completed. Secondly, if we did go forward with the definition portion now, we would clarify and make clear that we do not intend making any changes to practice regarding "fixed assets" versus "capitalized PP&E" at this time.

Mr. Dacey concurred.

Mr. Allen stated that he did not believe that this definitions portion of the project would require the public hearing however, the next phase of the project will probably require a public hearing. Mr. Allen then concluded this portion of the meeting.

> **CONCLUSIONS:** Staff will provide an analysis of the effects of deferring the definitional changes at the next meeting as well as a draft SFFAS for consideration.

- **Federal Entity**

Staff member Ms. Loughan explained the primary objective for the August Board meeting was to discuss issue areas related to the federal entity project and staff recommendations that will enable staff to continue finalizing a Draft ED.

Staff directed the Board to the first issue --*Wrap up of Conclusive Principle Open Items.* Staff explained at the last meeting, members had expressed various concerns about the text of the conclusive principle and staff was not certain the concerns were resolved. As a reminder, staff noted the purpose of the conclusive principle was to capture entities that are 'clearly' federal. Staff noted inclusion in the "President's Budget" is the clearest evidence that an entity is "federal." Staff explained the two open issues are (a) whether the standards ought to clarify that financing accounts are included in the entity even though they are not listed in the President's Budget and (b) how to address the cases in which the President's Budget specifically mentions an entity that is not a federal entity but does receive a federal subsidy.

Chairman Allen opened the floor for discussion of issue 1(a) whether the standards ought to clarify that financing accounts are included in the entity even though they are not listed in the President's Budget. Mr. Showalter expressed concern with footnote 7 and whether users would understand what is meant. Ms. Payne explained she had drafted that particular footnote and she had a difficult time writing it because the President's budget included organizations and accounts. The question of whether an account can be an entity is often debatable.

Staff explained another option as detailed in the memo would be to remain silent on the issue, very similar to how the Board agreed it would address the issue of entities partially in the budget. The OMB Representative stated they would be agreeable to being silent if we can put something in the basis for conclusions for even more clarity that isn't confusing.

Mr. Steinberg asked how the proposed changes affect the District of Columbia and the D.C. courts, and the public defender. Staff explained those types of entities relate to the issue in par.18 in that the budget sometimes sweeps in things that everybody agrees are non-federal because they receive a subsidy of some sort. Mr. Steinberg commented the conclusive criterion is really no longer conclusive and questioned if the Board should consider a change in the wording.

Mr. Granof agreed and suggested that nothing is really conclusive about the conclusive principle any longer and that the indicative principle is just as conclusive. Mr. Granof suggested it could be worded in a way such as [suggestion per an email provided prior to the meeting]

An entity should be included in the government-wide reporting entity if:

a. it is listed in the *Budget……..* and is not merely a recipient of federal assistance [a footnote or later paragraph would incorporate most of what is now in para. 18 and footnote #8]
b. the federal government:
    1. established it and it and carries out federal missions and objectives

2. has a majority ownership interest in it.
3. has the ability to exercise control over it with expected benefits or risk of loss.

The OMB Representative noted concern and didn't want to have unintended consequences of excluding some entities that should be included. Mr. Granof explained he is just proposing to eliminate the words 'conclusive' and 'indicative' because simply stated it meets either A or B. Mr. Steinberg agreed that maybe the words conclusive and indicative are not appropriate anymore.

Chairmen Allen stated he preferred keeping it the way it was because if you're in the budget, you've got a pretty high hurdle for proving why it shouldn't be included. Mr. Granof explained B is just as conclusive as A the way we have it written. The only difference is that B requires a lot more judgment, but once you exercise the judgment and determine that it meets the criteria, and then it's included.

Chairman Allen explained staff had language from members and if we drop footnote 7 staff can work from there. Chairman Allen noted that the first sentence of par. 19 states "If the entity meets a conclusive principle, no further assessment against the indicative principle is required." While that's a true statement, it's only true for one part of it. It's true for part A, which is it in or out, but it doesn't answer the part B as far as what type of presentation. Mr. Jackson noted paragraph 19 isn't necessary because paragraph 17 says, "if an entity is in the budget…it's within the boundaries of the government-wide reporting." The Board agreed par. 19 could be dropped from the proposed ED.

Mr. Dacey explained he didn't have a strong preference if the conclusive or indicative wording titles are maintained, but would be happy with keeping it the way it was, because indicative implies judgment, and conclusive says it is and it isn't with some exceptions. He added that he believes the Board was not trying to create any new exceptions; we're just trying to better write what we had before. However, he explained he does favor a cascading approach, only because if you decide it's in the budget, you don't have to go to that judgment. He added he would prefer to stop people from looking at both and prefers the cascade because one should go to the budget first and if it's in the budget, it's in the entity. Mr. Dacey explained the standard should be clear on this fact.

Mr. Granof suggested use of the word "or" would still allow that effect. Mr. Dacey explained he understood the point. Mr. Steinberg agreed and suggested there should be wording in there that says it's persuasive when in the budget.

Mr. Jackson suggested it could be viewed as the first thing in paragraph 20 should be A) are you included in the budget? If yes, then you don't have to go to B. But if you're not in the budget, but yet you could have been established by the federal government then you go to B) determine if you meet that criteria, then that would bring you in, too.

Chairman Allen explained the Board appears to be in agreement that the words need to be worked on and they will leave it to staff to for the next meeting. He then suggested the Board move on to the next issue.

Staff directed the Board to the second issue *Approach for Considering the Indicative Principles for INCLUSION.* Staff explained the Board had discussed the Introduction to the Indicative Principles at the previous meeting and whether meeting one indicative principle was sufficient for inclusion in the boundary of the government-wide reporting entity or alternatively if an entity must meet all indicative principles for inclusion within the boundary of the government-wide reporting entity. During the June discussion, the Board deliberated how this should be addressed within the Statement. Staff noted the Board did not reach a decision, but instead requested staff to develop alternatives for further consideration. Staff developed the following four options for the Board's consideration:

OPTION 1--Consider in the Aggregate or Collectively
OPTION 2—Meeting ALL Indicative Principles
OPTION 3—Established by federal government combined with other principles
OPTION 4—Meeting ANY Indicative Principle (with Revised Indicative Principle 1)

Staff recommended Option 4 as staff believes this provides the most clarity for determining if an entity is within the boundary of the government wide entity by providing principles that lead to either yes an entity is within the boundary of the government-wide or no it is not, while still offering flexibility in determining the presentation and disclosure requirements. Staff also proposed to include exceptions/exclusion language to ensure the District of Columbia and territories are adequately addressed, along with other exclusions. Staff believes it is important that this be included as an indicative principle to ensure all relevant types of entities, such as GSEs, FFRDCs, and others that may be part of the government-wide reporting entity are considered. Staff explained the final assessment of the appropriate financial presentation and display would be made after considering the entity against all three indicative principles collectively in the aggregate, along with other criteria. For example, entities that meet only the "established by" principle may be the subject of disclosures rather than display on a statement.

Chairman Allen suggested it would be helpful to go around the table and have the members discuss their preference and reasons why or ask questions.

Mr. Granof explained he was in favor of option 4, until he read the GAO report on what federal entities consist of and realized we have a category of other federal established organizations, such as the American Red Cross. Therefore he explained he doesn't believe "established by the government" should be in there and carrying out federal missions and objectives is too vague. Therefore Mr. Granof stated he would opt for something that includes established by the federal government and meets B and C, or B or C. Staff noted this was similar to Option 3.

The OMB Representative explained she was going through, and in particular looking at the material where staff compared what is in the concept versus what's in the standard and questions do we even need the established by the federal government principle. The OMB Representative stated if we establish an entity but we don't control it, and then we have no risk, we have no benefits, or anything with that entity. Why would we want to report on it?

Ms. Payne explained as staff looked at it without this principle, for example, GSEs would drop out of the boundary. Now, you could treat GSEs through some other mechanism than the entity boundaries. But since the inception of this project, when we did the first project plan, one of the first things that came up was are we going to clarify that GSEs need to be considered in the scope of the federal government because we bear substantial risk.

The OMB Representative suggested that would fall under benefits and risks. Ms. Payne explained benefits and risk is coupled with control. Ms. Payne noted some may agree the federal government had some regulatory control over the GSEs before they went into conservatorship, but wouldn't say that we had absolute control, because it's structured more like a private sector corporation and had the traditional mechanisms of a board of directors.

Chairman Allen suggested maybe there's not a lot of examples of established by the federal government where there is no carrying out the mission, or where there is no expected risk or loss.

Mr. Dymond, FASAB Counsel explained that if an entity is established by the federal government, as a matter of Constitutional law, it has to be carrying out a federal mission--so, you could almost delete that as redundant. So, in effect Fannie Mae and Freddie Mac are carrying out a federal mission, even though the legal, the statutory framework that set them up structured them as private, publicly traded companies. Just as the American Red Cross and Federal Reserve were established and carry out a federal mission. Mr. Dymond stated anything that Congress established by law, Congress is invoking its Constitutional authority to exercise some federal prerogative to establish it so it is carrying out a federal mission.

Ms. Payne explained that as noted, staff had envisioned including exceptions or exclusions (just as GASB uses fiscally independent) for things that are federally created, but subsequently break all ties with the federal government and go on about their operating life. For example, the American Red Cross-- maybe it's fiscally independent, maybe there's no implied, implicit guarantee from the federal government, and we can conclude that meets some conditions for exclusion.

The OMB Representative expressed concern there would be a huge group of disclosures going down a path such as this as the federal government establishes a lot of organizations. Chairman Allen agreed that he began to question if the "established by" was as important as the other indicative principles.

Ms. Payne explained that some of the entities established would clearly be immaterial and she did want to re-emphasize the plan to create buckets of exclusions. For example, no one intends the American Red Cross to be disclosed. The concern is the federal government can create an incredible array of things, and they can cede some level of control, and risk and on paper (just like the GSEs) it looks like they're gone without that third criterion, it appears you're completely excluding them from the boundaries. Ms. Payne explained the Board can address in a separate project, or as a component of this project, as disclosures where there is some kind of risk. Some consider these like special purpose entities and if there is still risk, create disclosures for this category of things.

Mr. Dacey asked how the outer boundaries of the entity compare to related parties. He explained GASB and FASB have the same related party standard, which have disclosure requirements. He added at the outer fringe of this gets into maybe some of the boundary line we may decide to draw for related parties. He added part of his concern in making a decision here is there's another continuum to the next step--these are related parties; they're not part of the entity but the related party is sufficient that we need to disclose them. Mr. Dacey explained in reading some of the language of FASB, and subsequently GASB--if one party controls or could significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing it's own interest. Mr. Dacey explained there is a threshold there and if it doesn't meet that, you're not going to disclose it even under the FASB or GASB standards. He explained it's hard to draw this boundary unless there is some clarity about where the board thinks the related party boundary is, because it's getting confusing about whether it's an entity, but it's disclosed or if it's a related party, but it's disclosed. Mr. Dacey explained that he is not certain there is a need for that middle category. He added in his view he would probably prefer it's in the entity, or it's not, it's a related party, and we disclose it.

Chairman Allen explained he had a similar concern in understanding what do we mean by included in the reporting entity, because when both GASB and FASB went down this path, included meant displayed somehow, whether it was consolidated or a separate column. He explained 'not included, but having relationships' resulted in disclosure, depending upon the nature of the relationship. If there was the element of control and risk, then it was disclosure. If there was a relationship that didn't have those, maybe like the creation of the Red Cross, then there wasn't even a disclosure requirement for those.

Mr. Dacey explained it's hard to make a definitive decision on this without figuring out where that next phase is and I don't know where the Board is going on the related parties—will the Board have something consistent with FASB, GASB or not.

Mr. Steinberg explained he had a problem with this notion of meeting any single one of the criteria. He believes it brings in items that, by a smell test, should be out, and it leaves out items which, he thinks, should be in. In his opinion, he explained, in applying the criteria, it would bring in CitiCorp, GM, AIG, because right now we have majority interest in all of them. He added that Amtrak, in which we have 100 percent ownership plus exercise control to some degree as Congress legislated an inspector general, is not reported right now . Mr. Steinberg also explained he has a problem with the notion of saying something is in, but we don't have to consolidate it. For example if one concludes GM is in, but we don't consolidate, then it's not only an accounting problem, it would be a huge political problem to say that General Motors is part of the federal government. Mr. Steinberg suggested that we develop the right criteria and consider them in the aggregate. He added the Board should also come up with criteria for relationships, i.e., things that are not in, but with which we have a relationship, like GM, AIG, and possibly the Federal Reserve.

Mr. Jackson explained in looking at these various options, it seems that what we're trying to do is make the conclusion as to whether an entity is in or out in the standard absolute and you're doing away with judgment. However, he noted, if you look at option 1, it seems like you have to use your judgment. It doesn't say if you meet them you're absolutely in, it says an additional assessment against the following is required to ascertain if you're within the reporting entity and it appears softer because there's some judgment. He added whereas, option 4 for example, it says the government-wide entity includes entities meeting any of the following indicative principles, putting aside what A said a while ago, because A really wouldn't apply in a way because one you're established by the federal government, it by definition is carrying out a mission of the federal government.

Staff explained this is the first test as far as the boundaries, and the goal would be for a clear answer of yes or no. However, when you got to the presentation, that's where it was going to be much softer, judgment, and flexibility as far as where they fall out. Mr. Jackson explained he understood and wasn't certain that's the wrong thing, he was struggling with it.

Mr. Dacey explained ignoring the specific criteria he believes option 1 is better because you're going to have to have judgment. He added he didn't think you can set too many rules, because there are so many different things out there, but you've got to look at all of the facts and circumstances and not over-rely on any one to make your decision. Mr.

Dacey added that there needs to be a lot more language built around it to make it clear what the intent is, so at least it's clear what the judgment to be made is.

Mr. Granof stated that he agreed with Mr. Dacey with respect to certain organizations, like the Red Cross. However he explained that he believed the Board should be clear as to whether certain major organizations are going to be in. In other words, leave no doubt as to whether and how let's say Fannie Mae and Freddie Mac are in.

Chairman Allen explained he supported Mr. Granof's points. He added the reason you have this project, there is professional judgment right now that can be exercised to be what's in and what's not in. There is incentive, whether it's financial, or political, or whatever it is, to create things and keep it out and what we really need to do is to be aware that if you just say exercise your judgment, anything anybody wants is out. Chairman Allen explained that's why he agrees the Board needs to be clear. He added that maybe all it is, if any one of those three indicative principles are there, you've now got the burden of proof to prove why you're not in, as opposed to -- because if it's just exercise judgment, some might say yes to two out of three criteria then conclude the entity is out because all three weren't met.

Mr. Showalter suggested that what Mr. Dacey may have been saying he wanted more of a principles versus a rules- based approach. He added the Draft is written is a rules-based perspective. Mr. Showalter agreed with Mr. Granof and the standard has to be really clear here and the judgment is applied when you get to the edges. The judgment is how you go between the bright line, where there should   be 90-95 percent range that's pretty clear, and then the judgment is on that other part that determines which side of the line they fall.

Mr. Dacey asked if there was a sense that folks would like to see a related party drawn out a little bit more at this point going forward. He added that his concern in pursuing at this point is if we draw those two lines too close together. Mr. Steinberg explained he liked the idea and maybe as we're writing this we should be talking about both the entity and the related parties, which will help us when we get to the presentation.

Mr. Jackson asked if the Federal Reserve were not included here, would it be a related party. Mr. Dacey explained that's how it's treated today and there are extensive disclosures. He added one could argue that it isn't enough.   Mr. Steinberg explained it's treated that way today because SFFAC 2 provides that it's not part of the federal government.

Mr. Showalter asked if the Board was also revisiting the conclusion made earlier, which is what does "include" mean. Chairman Allen said let's kind of look at the back end, too, while we're doing the front end (i.e., how might meeting various criteria for inclusion be reflected in display or disclosure).

Staff asked if the Board planned to drop the principle "established by?" but the Board agreed that decision had not been made in its entirety. However, Chairman Allen noted that was the weakest of the three principles standing on its own.

Ms. Payne explained staff would come back with approximately three total packages at the December Board meeting. Ms. Payne explained one version would be similar to the Draft presented with refinements, and clarifications about the exclusions, developed presentations and disclosures and maybe some related party options. Another version would be as Mr. Dacey described where there's judgment up front in determining the boundary of what's in the reporting entity. The last package would rely heavily on Related Parties to be drawn out more fully developed and perhaps less emphasis (or without) the "established by" principle.

Mr. Jackson explained he thought the "established by" was not the problem. Instead he thought counsel brought out was it carries out federal mission and objectives were not necessary because constitutionally that's what -- if you created it, it was for that purpose. Ms. Payne explained it was added in hopes it might narrow the established by down a little bit, but it hasn't really. Ms. Payne explained that what staff would do instead is put the exclusion proposals back in with all of the exclusions that really continue to be a subject of conversation every time we come (despite the decision to group exclusions in a single section later in the document). So what we think we'd have to do is pull the exclusions into the body of what you're considering so you can see them.

Mr. Showalter explained if you bring back the issue of what is included, when I'm looking at these criteria , I've got to think about what does it mean to be included. Ms. Payne explained that's why she is suggesting staff bring back a total package the different kinds of presentations and where some of these might map to in terms of presentation.

Mr. Steinberg suggested if the standard addresses both what's in the entity for reporting and/or disclosure, and the criteria for relationship requiring disclosure, that would be a way to approach it. He also suggested giving thought to those questionable entities that have come up over the last few years.

Chairman Allen explained the third issue-*Indicative Principles Comparison to SFFAC 2 Criteria* was presented but probably would not result in much discussion. Staff explained it might be useful to consider the chart showing where the SFFAC 2 criteria fall within the three indicative principles. Staff believes the crosswalk shows the criteria is consistent with the indicative principles. If the Board believes the chart is helpful, it could be included as a reference in the Basis for Conclusions.

Mr. Dacey explained that it wasn't necessary to discuss, but just to clarify maybe for the next meeting--the current indicative criteria about exercising sovereign power and that he wasn't sure if it was exactly aligned with control. Mr. Showalter explained he agrees the first criterion is control, but perhaps a combination of control and establish is more appropriate.

Chairman Allen explained issue 4 could probably be dealt with independent of the rest of the project. Staff explained Issue 4: Indicative Principle—Majority Ownership (Board decided at the June Board meeting to address Minority Interest in the Proposed Statement) includes two sub issues. Staff explained at the June Board meeting, the Board discussed the indicative principle—Majority Ownership. Staff requested feedback on whether the issue of minority ownership interests (less than 50%) should be addressed within the Statement or if simply saying such interests should be accounted for in accordance with GAAP would be sufficient. Staff believed this was a relevant question because it was uncertain how broad the scope of the "entity" standard should be. The Board agreed at the June 2010 Board meeting that minority interests should be in the Statement under the majority ownership principle to address instances of less than 50% ownership.

Staff noted other accounting literature and other standards-setters typically require investments that are not majority (and not consolidated) to be accounted for by one of two methods—the cost method or the equity method. Staff researched other standards-setters and notes that many have separate standards on Investments, as this is a broad topic. For example, the International Public Sector Accounting Standards Board (IPSASB) covers the topic in IPSAS 7, *Investments in Associates*, and IPSAS 8, *Investment in Joint Ventures*, and briefly mentions it in IPSAS 6, *Consolidated and Separate Financial Statements*. This demonstrates staff's first concern. That is, how much detail would the Board want to provide on such a topic in the "Entity" standard considering this topic could get complex if one chooses to get into the complexities of Investments. Staff also explained while practice may vary, the equity method is generally followed for investments in unconsolidated entities, joint ventures and other non-controlled entities.

Mr. Granof asked if additional guidance is needed? In other words, has staff found that the guidance that's in the documents is inadequate? Staff didn't believe so and explained there are entities that use the equity method and there haven't been any voids brought to our attention.

Mr. Showalter explained he has a different concern. He explained when most people think about minority interest it's in an investment perspective. He doesn't believe the federal government has minority interests in organizations for investment purposes; instead it's to carry out part of the mission. And in most cases those minority positions actually represent liabilities to the government or, at a minimum, a risk. Do we need to include them at all in the financial statements or perhaps this is really a disclosure issue?

Chairman Allen noted that one would still be reviewing these entities through the other indicative criteria, because there we consider control and risk. Chairman Allen asked if the Board believes there is a need for additional guidance, or just tell them to follow FASB. He added that he believes it is fine for them to follow FASB. Mr. Showalter agreed.

Ms. Payne asked if that represents a consensus to be silent, or to simply say apply the GAAP hierarchy. Staff noted in the previous draft there was simply a footnote saying: for interest less than 50 apply the GAAP hierarchy. Chairman Allen explained that he believed that was the best approach.

Mr. Jackson explained that sometimes people are sort of at a loss unless the Board is somewhat prescriptive. For example, if the Board were prescriptive and refer them to the FASB standard for explicit guidance with regard to how to handle it, you wouldn't force them to try to think through the hierarchy to get there. Ms. Payne explained there are a number of standard-setting bodies out there now--FASB, GASB, IPSASB, and IASB. As a preparer that should be viewed as a benefit because one may want to look at GASB and IPSASB – which focus on governments - before FASB. Also, IPSASB may have dealt with the fact that sometimes these investments aren't investments, they're programs. Mr. Jackson noted that was a good point and if there was a preference for people to look at other government bodies, or government standard-setting bodies, then we should allude to that, because I think there's a natural reaction in the federal community to revert to FASB. Ms. Payne acknowledged that but noted the GAAP hierarchy is clear that one should look for analogous situations and standards.

> **CONCLUSION:** The Board made progress and decided the following on issues 1, 2, and 4 presented at the August Board meeting . The Board agreed to be silent regarding financing accounts not listed in the budget which is similar to how the Board agreed it would address the issue of entities partially in the budget. Instead, staff may include additional explanation in the basis for conclusions. The Board appeared in agreement that the indicative principles are consistent with the criteria presented in SFFAC 2. There is some question regarding how the current indicative criteria 'exercising sovereign power aligned with control. The Board agreed minority interests would not be addressed in the entity standard, instead there would be a footnote simply stating for interest less than 50 apply the GAAP hierarchy.
>
> The Board did not resolve the issue *Approach for Considering the Indicative Principles for INCLUSION* and requested staff to work on the following for the December Board meeting: Staff will reconsider if the Statement should have a distinction between conclusive and indicative principles. Staff will develop approximately three total packages or versions for the Board's consideration 1.)

One version would be similar to the Draft presented with refinements, and clarifications about the exclusions, developed presentations and disclosures and maybe some related party options. 2.) One version where there's more judgment up front in determining the boundary of what's in the reporting entity, more considering in the aggregate and 3.) One version Related Parties would be drawn out and more fully developed and perhaps either less emphasis or the established by principle would be dropped.

Adjournment

The meeting adjourned at 3:30 PM.