FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD
January 11 - 12, 2006
Room 7C13
441 G Street NW
Washington, DC 20548

Wednesday, January 11, 2006

Administrative Matters

- **Attendance**

The following members were present throughout the meeting: Chairman Mosso, Messrs. Allen, Dacey, Farrell, Patton, Reid, Schumacher, Zavada, and Ms. Cohen. Mr. Marron, representing CBO, attended from mid-morning to mid-afternoon on January 11th. Mr. Torregrosa represented CBO for the remainder of the meeting.

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

- **Approval of Minutes**

Minutes of the prior meeting were approved electronically in advance of the meeting.

- **Other Administrative Matters**

New members, Tom Allen and Donald Marron, were introduced. Mr. Allen is designated to succeed Mr. Mosso as chairman in 2007.

Agenda Topics

- **Objectives**

Staff member Ross Simms presented the Objectives update to the Board. Mr. Simms explained that staff had completed summaries and analysis for the Budgetary Integrity and Operating Performance Roundtable meetings and those are included in the January binder materials. Staff plans to present the summaries and analysis for the Stewardship and Systems and Control Roundtable meetings at the March Board meeting.

Mr. Simms explained that the participants at the both roundtables discussed the importance of the objectives in federal financial reporting and they discussed issues and methods that could enhance achievement of the objectives and concerns with the financial statements used to achieve the objectives. Mr. Simms explained that most of the participants at both roundtables agreed that the objectives in SFFAC 1 were very broad, but believed that was the intent.

Mr. Simms explained that the participants did not expect FASAB or financial statement reporting to meet all the objectives alone. Mr. Simms explained that based on the discussions and the analysis of the first two roundtables, it appears that a feasible approach for the Board to consider (as it moves forward) is to develop a strategic plan or strategic objectives for FASAB (versus amending the objectives). Mr. Simms explained that the strategic plan would identify the objectives from SFFAC 1 that most influence FASAB's direction for the next 3-5 years.

Most of the Board members were pleased with the results of the roundtables and supported the focus on strategic planning efforts as a means to define FASAB's role and articulate FASAB's short term goals. The Board also noted that there are several issues related to changes in the environment and FASAB's comparative advantage in the Draft White Paper on Objectives. The Board requested that staff elaborate further on accrual accounting, internal versus external users, proper matching of expenses and revenues, and the advantages of GAAP in the white paper. The Board also discussed that many of the topics from the white paper will ultimately be brought into a new concepts statement or perhaps an amendment to Concepts 1.

The Board also discussed that many important points were identified during the roundtables that may not relate to a specific change in an objective, but are things that FASAB should keep on the radar. Specifically, given resource constraints, FASAB can't focus on all of the issues but should keep them in mind as the Board goes through strategic planning.

The Board discussed that prior to beginning its strategic planning efforts, they would request additional information or perhaps a briefing on the approach and kinds of things that should be done and considered to do effective strategic planning.

> **Conclusion:** Staff will present the summaries and analysis for the Stewardship and Systems and Control Roundtable meetings at the March Board meeting. Staff will also continue with and elaborate on certain topic areas in the Draft White Paper on Objectives.

- **Elements**

Ms. Wardlow provided a revised draft of a proposed concepts statement with a transmittal memo that referenced the changes made since the October 2005 draft. She also provided a memo in which she compared the definitions of revenues and expenses adopted by various standard-setting authorities and recommended definitions of federal government revenues and expenses. The proposed definitions are included in the revised draft concepts statement as follows:

> A revenue is an increase in the federal government’s assets, a decrease in its liabilities, or a combination of both from providing goods or services, levying taxes or other impositions, receiving appropriations or donations, or any other activity (excluding borrowing) performed during the reporting period.
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> An expense is a decrease in the federal government’s assets, an increase in its liabilities, or a combination of both from providing cash or cash equivalents, goods or services, or any other activity (excluding repayments of borrowing) performed during the reporting period.

The memo also recommended that gains and losses should not be treated as separate elements in the concepts statement but should be considered sub-elements or subsets of revenues and expenses. The Board agreed and concluded that whether and under what circumstances certain items should be reported as gains and losses instead of revenues and expenses is a display issue and should be addressed in financial reporting standards.

<u>Appropriations</u>

The Board discussed the nature and role of appropriations and generally agreed with Mr. Jacobson’s and Mr. Reid’s view that appropriations are like revenues for component entities because they provide the legal basis for the entities to incur expenses but do not reflect revenues of the government as a whole. Consequently, because the definitions of all elements in the proposed concepts statement apply to both agency financial statements and the consolidated financial report (CFR), the Board agreed that appropriations should not be included in the definition of revenues. In addition, the word “entity” should replace “federal government” in the definition of revenue to avoid potential misinterpretations that appropriations are revenue of the government as a whole. The Board decided to include a brief explanation of appropriations in paragraph 14, which covers elements that are recognized in agency financial statements but not in the CFR. Mr. Reid said that the explanation also should cover fund balance with treasury, because it includes primarily unspent appropriations. Mr. Jacobson agreed to assist Ms. Wardlow with appropriate wording for paragraph 14.

Materiality

Mr. Allen indicated that the references to materiality in paragraphs 10, 11, and 60 of the draft should be changed or deleted because they imply that materiality is required for recognition and that immaterial items should not be recognized. After some discussion, Mr. Allen and other members agreed that the references should be deleted from paragraphs 10 and 11, and the wording in paragraph 60 should be modified to clarify that materiality is not required for recognition.

Qualitative Characteristics

Following a suggestion by Mr. Patton, the Board discussed whether the reference to qualitative characteristics in paragraph 8 should be repeated in paragraph 10, which refers to measurability as a recognition criterion but does not refer to the qualitative characteristics. Mr. Allen, Mr. Schumacher and Mr. Mosso did not view meeting the qualitative characteristics as a recognition criterion. Ms. Wardlow added that they apply as much to disclosures in the notes or supplementary information as to recognized items. Mr. Mosso said that the recognition criterion of measurability encompasses probability and qualitative characteristics and he thought the reference to qualitative characteristics in paragraph 8 could be deleted. Mr. Dacey thought that deciding whether an item meets the qualitative characteristics is an issue for the Board, rather than for preparers, and therefore he questioned the appropriateness of the reference to qualitative characteristics in paragraph 8. Ms. Wardlow suggested retaining the reference to the pervasive constraints of materiality and cost/benefit in paragraph 8 and deleting the reference to the qualitative characteristics. Mr. Dacey tentatively supported that proposal.

Probability

Mr. Dacey questioned the Board's earlier decision not to include probability in the recognition criteria. He observed that a large proportion of the respondents to proposals made by the FASB and the IASB to exclude probability from the recognition criteria for contingent liabilities disagreed with those proposals. Mr. Allen said that probability was an issue that the FASAB might address in a standard on measurability. The proposed concepts statement simply indicates that, conceptually, measurability is a recognition criterion. Mr. Mosso said that measurability includes probability, and perhaps that point should be made in the concepts statement to alleviate the concerns of some Board members. Mr. Dacey and Mr. Zavada said something should be included in the concepts statement to preclude recognition of items with a low probability of occurring.

Ms. Wardlow said a majority of the Board had previously agreed that the discussion of uncertainty and probability in paragraphs 59 and 60 of the draft were appropriate and sufficient. Mr. Patton responded that some members disagreed and that the recent proposals of the FASB and IASB constitute new information, so that the Board should reconsider its previous decision. Mr. Mosso asked Mr. Patton whether it would help if the measurability criterion were modified to say something like “measurability, including an assessment of the probability of occurrence,” although he believes that assessment is included in measurability. Mr. Patton said it would be a step in the right direction, but it would depend on whether probability would be used as a threshold or an expected value calculation. Mr. Mosso said he would not wish to prevent future Boards from addressing that issue on a standard-by-standard basis. He agreed with Mr. Allen that how one measures an item, including its probability, is an issue for statements of standards. Mr. Dacey said it was important to distinguish the probability of occurrence from the probability of future cash flows. Mr. Allen agreed with Mr. Mosso’s earlier comment that measurability includes probability. Mr. Mosso added that probability includes occurrence and timing.

Ms. Comes said she agreed that measurability included probability. However, it might help Board members to use the concepts statement in the same way if clarifying language were added to the recognition criteria established in paragraph 5. Part (b) of the second sentence establishes the criterion “The item is measurable.” The following sentence explains “As used in this statement, the term measurable means quantifiable in monetary units.” She suggested adding after “quantifiable in monetary units” the words “and includes assessments of probability in a manner that is consistent with the appropriate measurement attribute.” Ms. Comes said that her proposed wording would envision the selection of measurement attributes through standard setting. It would not establish a threshold as Mr. Patton had suggested but would provide for the selection of appropriate thresholds for certain situations. Mr. Mosso agreed that the notion of measurement attributes is broad and he would leave it to standard setters to sort out.

Mr. Patton said the added wording is an improvement. However, he thought the FASAB would receive negative comments from constituents similar to those received by the FASB on its proposal, and those comments might be preempted by an explanation. Mr. Dacey said Ms. Comes’ suggestion was a start and he would be happy to work with staff on the wording. Mr. Schumacher supported the additional wording but said it would not work if there is a conceptual argument that probability is not part of measurement. Ms. Wardlow said that footnote 1 to the next sentence after the definition of “measurable” states that the issue of which measurement attribute should be selected is an issue for a future concepts statement or for statements of standards. She suggested rewording the footnote to state that how an item should be measured and how its probability should be assessed are issues for a future concepts statement or individual standards. That should clarify for the reader that the concepts statement does not change how items are measured or how probabilities are assessed; it simply does not address those issues. Mr. Mosso asked Ms. Wardlow to work with Mr. Dacey, Mr. Patton, and Mr. Zavada to develop wording that would capture their thoughts on the matter. Mr. Patton said for the record that he appreciated the Board’s willingness to consider the issues.

Additional Issues

In response to Mr. Zavada's question, Ms. Wardlow said that the difference between the second and third sentences in paragraph 43 is that the second sentence refers to a future change in the law made by Congress whereas the third sentence refers to an agency's future ability to renegotiate its obligation with a payee based on circumstances other than a change in the law. Mr. Jacobson gave as examples renegotiation of a contract in dispute or of a discretionary grant because of an issue of performance.

Mr. Patton was concerned that the words "stand ready" in the phrase "obligated to stand ready to fulfill its obligation" in paragraph 45 invoked a notion proposed but not yet adopted by the IASB and the FASB. He suggested either eliminating the words "stand ready" or elaborating on the notion and its implications in the federal government setting. Mr. Mosso said the words "stand ready" were not essential to the sentence and recommended deleting them. Mr. Patton and other members agreed.

Mr. Dacey asked Ms. Wardlow to review the wording of paragraph 42 to ensure that the reference to an entity being external to the government would not encompass intragovernmental receivables and payables. Ms. Cohen asked Ms. Wardlow to review paragraph 13 because she thought the final sentence did not fully respond to an issue raised earlier in the paragraph.

Mr. Patton inquired about the meaning of the third sentence in paragraph 17 (under the definition of an asset), which states that the definition does not address whether or when the economic benefits or services embodied in an asset will be used. Ms. Wardlow explained that for a resource to meet the definition of an asset, it must embody economic benefits or services that the government can control. Meeting the definition does not require a conclusion as to whether or when the economic benefits or services will be used. Mr. Allen agreed and gave as an example oil and gas reserves under a national park. The government may not plan to use the reserves, but they are there and are assets.

Mr. Patton said that the reason for his question is that paragraph 38, which is the parallel paragraph under the definition of liabilities, does not contain an equivalent probability statement about whether payments under the liabilities will ever be made. Ms. Wardlow responded that the definitions of asset and liability are different. One of the essential characteristics of a liability is that there is an obligation to provide assets and the other essential characteristic is that the provision is to be at a determinable date, when a specified event occurs, or on demand. Therefore, the implication is that the government has to make payment of a liability, whereas there is nothing in the essential characteristics of an asset that obliges the government to obtain the resources or services embodied in the asset. Mr. Patton said in that case there was no probability threshold for liabilities. Mr. Allen said that probability is embodied in the measurement criterion for recognition.

> Conclusion: Mr. Mosso asked the members to convey any further concerns to the staff to see if they can be worked out for the next meeting, when Ms. Wardlow would provide the Board with a preballot draft.

The Board adjourned for lunch at 12:00 PM.

- **Social Insurance**

Discussion of Letters Received

Chairman Mosso opened the social insurance discussion by noting that letters had been received from FASAB sponsors requesting a change in priorities.   The Treasury Secretary communicated his strong opposition to a social insurance liability other than on a "due and payable" basis. He preferred expanded disclosures of Federal long-term responsibilities, particularly those that have an aspect of intergenerational transfer payments. Also, in response to the invitation to comment (ITC) on the Board's agenda, the Comptroller General wrote that, rather than devoting resources to the social insurance project, GAO would prefer accelerating the conceptual framework to address the need for information about the nation's large and growing fiscal imbalance and the sustainability of current programs. A third letter had been received from the Social Security Administration's Chief Actuary in response to the ITC in support of the current social insurance accounting standard.

The Chairman said that, in light of these letters and the addition of two new FASAB members, a sounding of members' views was needed regarding their support of the social insurance project's current direction. He asked the members whether they supported liability recognition at 40 quarters of work in covered employment.

Mr. Marron asked whether the Board was trying to replicate private sector standards where a legally enforceable obligation is the criteria; or are there things the federal government does for which there aren't private sector analogs and we're now trying to figure out how that reasoning would apply to these programs.

Chairman Mosso said that the private sector notion is not one of legal liability. Liabilities are recognized whether they are legally enforceable or not. He said the Board is trying to do accrual accounting and differs from the private sector only to the extent that federal assets and liabilities differ.

Mr. Allen said that it appears the Board has not applied pure accrual accounting to social insurance. It appears the Board has reached a sort of compromise with respect to the 40 quarters event. He said, in his mind, that was a reasonable compromise; but he would say that, in the private sector or even the state and local government sector, recognition would actually start at the point that those employees start earning those promised benefits. Chairman Mosso agreed.

Mr. Zavada said that the term "earned" illustrates the fundamental difference between the members who believe that "due and payable" is the appropriate liability recognition point, and those that believe some further liability is appropriate. He said he does not believe an earnings process takes place with respect to social insurance. There is no exchange transaction. He said he believes Social Security is not like a private pension program where you have that exchange transaction.

Mr. Allen agreed that pension programs normally do follow some earnings process. He said a better analog is that of health care promises that are not earned per se. He said that sometimes there will be a minimum amount that must be worked but that is not an earnings process. He said that, nevertheless, the concept of accrual accounting recognizes a cost to the government that should be matched with when the taxpayers receive the benefit. The cost should be allocated to the time period when an employee works for the government even though the employee does not earn some portion of that health care promise along the way. Accrual accounting basically takes the cost and allocates it over the working life of that person. The process is called inter-period equity.

Mr. Allen asked Mr. Zavada how he viewed the 40-quarter event. Mr. Zavada said he thought it was an arbitrary point.

Mr. Schumacher said the participant's social insurance benefit depends on the participant attaining 40 quarters. He said there is some sort of an earning type of scenario to it, or at least a vesting or a qualification.

Mr. Zavada said the 40-quarters event is a criterion for getting benefits but it's not a vesting point.

Mr. Dacey explained GAO's belief that the liability does not exist at a point in time beyond due and payable. The program is funded on a pay-as-you-go basis. The 40-quarter event seemed an arbitrary point on the spectrum and was misleading to the extent that it implies some participants have a stronger claim on future resources than others. He said GAO believes there are other reporting vehicles to demonstrate what that long-term commitment is, e.g., the statement of social insurance, and GAO would be suggesting some enhanced disclosure there. He said GAO sees a need to look at the long-term sustainability of those programs, and that not considering future beneficiaries is somewhat artificial.

Mr. Allen replied that funding is not a prerequisite for liability recognition. For example, most health care obligations are not funded. One of the things that GASB's financial reporting hoped to achieve is that, if an entity is going to promise its employees something, funding should start while those employees are working so that there is a better intergenerational match. Although that's policy and not an accounting decision, accounting ought to provide information to help inform policy makers.

Mr. Zavada said OMB cannot support the exposure draft as currently written. He said, first, that OMB does not believe a "present obligation" exists at 40 quarters of work in covered employment. He said he views the current approach as incorporating the notion of an exchange transaction similar to pension accounting. OMB does not believe that an exchange is taking place, or that benefits vest at a certain point and give participants higher priority. Second, he said that OMB believes a new 40-quarters number along side the many other numbers published by the Trustees and elsewhere and would be confusing and misleading.

Mr. Patton agreed that Social Security is not like pensions. It is not an earnings process. The participants are not exchanging their services for a promise of future benefits. Social Security is a social program. The question arises: are there ever liabilities associated with a social program promise? He thinks the Board has been arguing that the promises constitute a liability once some set of minimum eligibility conditions have been met, and 40 quarters is minimum threshold eligibility condition after which people will get some sort of benefits in the future under current law.

Chairman Mosso explained that, although exchange transaction keeps coming up, the private sector does not require an exchange event to record liabilities. The private sector recognizes all exchange transactions, of course, but they also recognize, for example, subsidies and grants that are promised even though there is no exchange. That distinction is not one that you will find supported in the private sector. He said the Board is not trying to mimic the private sector. The Board is trying to apply accrual accounting, which has its own set of broad principles and is applicable to any kind of entity, be it not-for-profit, corporate or government.

Mr. Dacey said that GAO shared the concern that another number would cause confusion. In particular, he asked rhetorically what that number would represent. Would it be viewed as more certain or likely to occur than other portions of the scheduled future benefit payments? He said he did not think the Board wanted to be in the position of interpreting what Congress may do. He focused on the usefulness of the information that would be provided. He said the total projected future scheduled benefits, for example, for the new Medicare drug benefit obligation would be more useful information than a 40-quarters portion of that amount. He said the SOSI provides useful information and is now a “basic” financial statement. He recommended exploring other options before making a final decision.

Mr. Zavada noted that a 40-quarters liability would be, in effect, equivalent to public debt and OMB disagrees that it is equivalent. Mr. Zavada said OMB supports all three letters under consideration. Mr. Zavada added that he also was uncomfortable with the process whereby a social insurance standard was being considered simultaneously with a new liability definition. He would like to complete the liability concept first.

Mr. Farrell recognized the importance of SOSI but concluded that certain actions the government takes ought to be recorded in the financial statements. He noted that Social Security is characterized in the budget as non-discretionary spending but somehow for liability recognition it is discretionary. On the other hand, he questioned the wisdom of spending resources on a project that the sponsors were likely to veto.

Several members opposed “self-censoring.” They noted that the real and perceived independence of the Board was at risk. Several noted that due process ought to be followed.

Mr. Reid asked whether the Board needed to use the liability approach in the social insurance ED to achieve its objective. A liability would create an entitlement, which he did not think was justified. He could offer alternative ways to display the credit on the balance sheet other than a "liability." The liability would be in the $30-40 trillion range and there is no way to liquidate that. He said characterizing the obligation as something less than a liability might be more informative. He had been uncomfortable characterizing the obligation as a liability but had accepted that as a compromise.

The Chairman polled the members on their tentative positions regarding a liability at 40-quarters. Messrs. Patton, Schumacher, Farrell, Allen, and Mosso, and Ms. Cohen voted in favor of 40 quarters and Messrs. Dacey, Zavada, Reid, and Marron voted against it.

SI Project

The staff objective for the January session was to discuss any open questions from the October meeting and to begin reviewing a draft exposure draft (ED). In the ED the staff directly raised 11 questions numbered 14 through 24.

The ED begins with a section on the statement of social insurance (SOSI) and then presents the liability, expense, disclosures, etc., in subsequent sections. The draft ED proposes changes to the SOSI format. New line items are proposed to identify the liability amount and a new SOSI section is proposed to explain changes in the present values during the reporting period, especially changes relating to the liability and expense amounts.

Regarding question #14 (Does the Board agree that SFFAS 17 should be rescinded?), the staff explained that incorporating all the requirements in a new standard would be clearer than retaining small portions of SFFAS 17. The members agreed to rescind SFFAS 17.

The staff mentioned the proposed effective date of FY 2010, which would give agencies adequate time to prepare. The staff noted also that due process would consume time on this project. The Board discussed the effective date. No objections were raised. Chairman Mosso noted that the issue would probably have to be readdressed near the end of the project.

Regarding question #15 (Does the Board agree that the new SOSI line items and the new SOSI section … should be added?), the staff explained the modifications and changes made to the SOSI. The Board discussed the revised SOSI.

Mr. Reid noted that contributions and expenditures are on separate lines. He said that, for example, if you want a net number for participants who have attained age 62 you have to add and subtract several amounts on separate lines. He mentioned as an alternative reorganizing the SOSI to group the populations by category, e.g., those who are already retired are in one part and then go on to the people who are participants.

The Board discussed the issue of the many line items that the revised SOSI would contain and complexity that that would entail. Chairman Mosso noted one of the objectives is to show the relationship among the various numbers that are floating around. Mr. Reid agreed that showing any new numbers as subsets of existing, more familiar numbers would help users deal with the complexity.
The Board discussed the relationship of the liability to the SOSI. Several members discussed using a term other than “liability” for the balance sheet. Mr. Patton said if the Board is going to call it something other than a liability, then it is another element and the measurement of that element would be radically different from the measurement that we’re proposing for what some have been calling a liability. Mr. Allen said calling the item something like “social insurance obligations” while presenting it in the liability section would not change the substance but may alleviate some concerns regarding the perceptions created through recognition.

No objections were raised to the staff proposed line item sections for the SOSI.

With respect to display, the staff explained that the current draft ED proposes a line item on the balance sheet for the social insurance liability and a disaggregated cost presentation on the statement of net cost (SNC). The increase in the present value of participants’ social insurance benefit based on work in covered employment in the current year and the interest on the obligation would be line items under operating costs. Gains and losses from actuarial changes and/or prior service costs would be a separate SNC line item(s) below operating cost but included in the “net cost” total.

Mr. Reid suggested making the requirement for a separate line item for actuarial gains and losses applicable (1) only at the component entity level and (2) government-wide. With respect to (1), the FR would point back to the agency statements for the details. Mr. Reid noted that at the FR level there presumably would be some condensation of the component entity actuarial display. He said it would be too much for the FR given especially that there are potentially half a dozen programs that have this kind of disclosure, which means six paragraphs explaining how estimates vary. With respect to (2), the Board discussed whether the social insurance ED could be the vehicle for a governmentwide requirement. Many programs would be involved, e.g., the Department of Veterans Affairs, pensions and post-employment health care (OPM). The staff was directed to consider how to accomplish it. Chairman Mosso suggested that it could be done concurrently either as an addendum to the social insurance standard or as a separate statement but issued concurrently.

The Board discussed the issue of Medicare accounting. Mr. Patton raised an issue regarding question #11 (“Are increments in the liability for Social Security after 40 quarters obligating events?”). With respect to the question of whether this is one obligating event for Social Security or multiple objecting events, Mr. Patton said he believes if there were only one obligating event at 40 quarters then at that point the present value of the total estimated benefits payable when the participant attains 62 or otherwise meets the conditions for immediate benefits payments ought to be recognized, similar to what the Board is doing with Medicare HI/Part A. On the other hand, if increments in the present value after 40 quarters were characterized as additional conditions to be met and therefore additional obligating events, then he believes it would be conceptually defensible to limit recognition at 40 quarters to present value of the estimated benefits attributable to only 40 quarters, as the Board is proposing. The Board discussed this issue and agreed to characterize the obligation as involving multiple obligating events: one occurs initially at 40 quarters and additional obligating events occur subsequently with the increments in the obligation due to work in covered employment. Chairman Mosso asked Mr. Patton to work with staff to draft an explanatory paragraph for the basis for conclusions.

In addition to question #11, the Board discussed three Medicare questions presented in the draft ED: question #19 ("Does the Board agree that Medicare HI should be recognized at 40 QC; or, should Medicare HI costs be spread evenly over the participant's working years in covered Employment?"), question #20 ("Does the Board agree that the accounting treatment for Medicare HI and Medicare SMI should be the same?"), and question #21 ("Does the Board agree that Medicare SMI should follow accounting standards for short-duration or long-duration insurance contracts?"). Mr. Reid said Parts B and D of Medicare appeared to be sufficiently different from Part A to justify an obligating event other than 40-quarters.

Mr. Marron noted that under the proposal a social insurance participant would meet the conditions for liability recognition for Part A roughly 30 years before Parts B and D. Yet, politically, the salience of the potential outlays under Parts B and D are not wildly different from Part A.

Staff noted with respect to Parts B and D that it is not an either/or situation. In addition to the liability on the balance sheet, Parts B and D would be displayed as part of Medicare on the SOSI as present values, but not characterized liabilities.

Mr. Allen said he did not think the difference between Medicare Parts A and B was sufficient to justify different accounting treatment. He drew this conclusion because 96 percent of the people are enrolling in Part B and it is heavily subsidized and therefore it is not a true insurance program. He said not enough was known of Part D for him to draw a conclusion about it; but perhaps it could be characterized as insurance accounting if, for example, only 50% of those eligible chose to enroll. He said he would not object to the ED going forward as it is but he would want to ask a question to solicit respondents' view of these programs.

Mr. Schumacher said he agreed with Mr. Allen and emphasized the de facto compulsion of the program. From his own personal experience, when the retiree reaches age 65 the employer's health insurance stops. The retiree either takes Medicare Part B or tries to find health insurance elsewhere. Thus, the private companies are in effect saying that Part B is a social insurance program which the retiree must take.

Mr. Reid noted that the revenue situation in Parts A and B is exactly opposite. The participants pay for Part A while working and then pay nothing when retired. It is the opposite with Part B. He asked rhetorically whether that was significant for accounting purposes.

The staff proposed providing additional analysis of the differences between Parts B and D for the March meeting. The Board agreed.

Regarding question #16 (**"**Does the Board agree that guidance for asset reporting should be included in this standard? If so, is the [proposed] paragraph sufficient?"), the staff explained that SFFAS 17 did not contain guidance on assets and the staff recommended including a paragraph. Mr. Farrell suggested and the staff agreed to move the asset paragraph to the section on the balance sheet display in paragraph 18. The Board agreed with the staff recommendation.

Regarding question #17 ("With respect to assumptions, does the Board agree that the standard should include general guidance requiring the entity's best estimates of demographic and economic assumptions and refer to Actuarial Standards of Practice…?"), the staff explained that SFFAS 17 contains only the first sentence of the recommended paragraph. The staff recommended retaining that sentence and including a general reference to actuarial standards of practice. The staff noted that the wording is from the pension standard, SFFAS 5. The staff explained that the next step is to further develop the technical language regarding the process of selecting assumptions, including the discount rate, and to have the language reviewed by the actuaries and management at the SSA, the CMS/HHS, and the Railroad Retirement Board.

Mr. Allen noted the critical importance of the discount rate in the calculation of the present value.

Chairman Mosso concluded that the goal with respect to assumptions should be to avoid boxing the preparers in and yet provide some reasonable constraints. He noted that there have been problems in the corporate sector because they were assuming a very high rate of return. The SEC cracked down on them and the liabilities went up. Some constraints are necessary but it should be primarily from an actuary's perspective. The Board generally agreed with the staff recommended approach.

Regarding the valuation date requirement, the staff said the proposed language would allow the preparer to use a valuation date within a year of the balance sheet date. This was the approach used in SFFAS 17 to accommodate the Social Security Trustee's and SSA actuaries' timeframe. The Board agreed with the staff approach.

The staff next reviewed the ED's proposed note disclosure. The Board discussed the requirement for a statement regarding the variability of estimates. Mr. Allen noted that the statement of accounting policies normally contains such a statement. Mr. Dacey replied that such statements are usually generic and not targeted to specific estimates.

The staff also reviewed the ED's proposed supplemental information (RSI), noting that it is the same as the current requirement in SFFAS 17.

Mr. Farrell asked if the RSI section presented an opportunity to address the issues raised in the letters from the Treasury Secretary and the Comptroller General. Mr. Dacey mentioned that GAO staff was working on a statement of commitments/contingencies/responsibilities. Mr. Allen cautioned that the disclosures and supplemental information normally is closely related to the primary statements and advised against anything that might be construed as a political statement. Also, the information should be auditable. Ms. Comes noted that the proposed RSI is taken directly from SFFAS 17; which has been in effect for several years. She indicated that she is not aware of any issues raised by auditors in reviewing the information required by SFFAS 17.

Mr. Reid suggested asking SSA for suggestions regarding how to improve the sensitivity RSI, e.g., identify the most significant information. The staff explained that question #18.1 ("Does the Board agree that the sensitivity analysis requirement should provide an option for the preparer (either vary key assumptions or provide a stochastic analysis – or both) rather than require one or the other?"), question #18.2 ("Does the Board agree that the governmentwide entity should be exempt from sensitivity analysis?), question #22 ("Does the Board agree that sensitivity analysis should include the liability and expense amounts as well as the SOSI present values and exclude the cashflow projections?") address sensitivity analysis. Staff added that the FR could refer the reader to the component entity's reports for detailed sensitivity analysis. Several members favored adding such a reference to the draft ED.

Mr. Dacey said he was concerned that if options are allowed regarding sensitivity analysis and the major players chose different options, there could be comparability problems at the FR level. He preferred that, since the preparer community is limited, that staff work with them to develop one approach. Chairman Mosso noted that, if sensitivity is not required at the FR level, then comparability would not be a problem.

The Board discussed sensitivity analysis at the FR level. Mr. Patton wanted the standard to require some sensitivity at the FR level that does not take up too much space and allows flexibility.

Mr. Reid said he was developing a proposal for the FR in that regard. Mr. Reid said he would communicate to staff what he had in mind. He said he and/or Treasury staff needed to develop the idea further.

The Chairman concluded that a general requirement for the FR should be included in the draft ED along with a reference to the component entities where detailed information can be found.

The staff described the governmentwide standard in ED paragraphs 39-44. Staff noted the Board's agreement earlier in this session not to require multiple line items on the operating statement at the FR.

Mr. Dacey questioned the reference to specific financial statement line items. Several members preferred a more general specification that the items be displayed without specifying line items.

Conclusion:

Although some Board members disagreed with some of the discussion, the following actions were agreed to:

Numbered “Questions” discussed and actions taken:

11. Obligating Events – Members of the Board characterize the Social Security liability as having multiple obligation events. The 40-quarter event would be characterized as the initial event and the increments would be characterized as additional conditions and obligating events.
14. SFFAS 17 – Rescind SFFAS 17.
15. SOSI – Use the revised line items and the new line items for the SOSI.
16. Assets – The Board agreed that the standard should address assets.
17. Assumptions – The Board agreed that the standard should contain a general requirement for assumptions that would allow flexibility but also provide constraints. The next step is to further develop the technical language regarding the process of selecting assumptions, including the discount rate, and to consult with the actuaries and management at the SSA, the CMS/HHS, and the Railroad Retirement Board.
18. Sensitivity Analysis – The Board decided to (1) explore component entity sensitivity analysis with the respective entities; (2) add for the governmentwide entity a general requirement for summary sensitivity information for the FR to be developed in conjunction with the Treasury Department; and (3) require the governmentwide entity to include a reference in the notes to the component entities where detailed sensitivity information can be found.
19. Cost recognition for Medicare HI (i.e. all at 40 QC or spread over working life) – The Board did not reach a decision on this issue.
20. Accounting treatment for Medicare HI and Medicare SMI (should it be the same?) – The Board did not reach a decision on this issue. Additional staff analysis will be provided.
21. Medicare SMI accounting (short- or long-duration?) – The Board did not reach a decision on this issue. Additional staff analysis will be provided.
22. The focus for sensitivity analysis – The Board agreed to focus on the liability, expense, and SOSI amounts.
23. The Board did not have time to address this question.
24. The Board did not have time to address this question.

Tasks for March:

1. Make the changes in the draft ED reflecting the Board's decisions in January.
2. Present an update on the IPSASB's social obligations project.
3. Present further analysis of Medicare Parts B and D.
4. Consult with SSA, HHS/CMS, RRB regarding sensitivity analysis and actuarial provisions and develop alternatives.
5. Consult with Treasury regarding the FR sensitivity analysis and develop alternatives.
6. Consult with GAO regarding disclosure and RSI.
7. Mock-up the new SOSI.
8. Change the governmentwide requirement regarding operating statement display so that only one line is displayed on the FR operating statement; include language allowing Treasury to combine line items and to summarize component entity information.
9. Consider how the requirement that component entities separate actuarial changes from other costs on the statement of net cost can be made applicable governmentwide, i.e., to non-social insurance entities.
10. Working with Mr. Patton, develop the basis for the conclusion that there are multiple obligating events rather than one obligating event for Security Security.

- **Discussion of the FR**

Mr. Mosso indicated that the Treasury was hosting a meeting on January 13th to seek input on ways to improve the financial report. In light of the solicitation of input, he invited members to offer suggestions to Mr. Reid for consideration.

Mr. Torregrosa explained that Mr. Marron had not previously been aware of the report, found it useful and hoped that an outreach effort could be undertaken that would increase awareness and use of the report.

Mr. Mosso commended Treasury for the chart explaining the relationship among the financial statements that appears on page 5. Mr. Allen agreed and noted that he would appreciate seeing numbers for the current year on each statement on the table. Mr. Patton complimented GAO for the companion guide to understanding the financial reports.

Members discussed the benefits of a summary report and the potential of reaching a wider audience with such a report.

Mr. Reid raised concerns regarding significant actuarial gains and losses and his desire to consider changes to the measurement of actuarial liabilities. The Board discussed the issue briefly.

The Board meeting adjourned at 4:15 PM.

- **Steering Committee Meeting**

The Steering Committee received an update on the efforts to recruit a new member to fill the January 2007 vacancy. Appointment Panel meetings and interviews will be scheduled for March and April.

The FY2007 budget was approved in the amount of $1,969,000.

Adjournment

The meeting adjourned at 4:45 PM

Thursday, January 12, 2006

Agenda Topics

- **Application of the Liability Definition**

Staff presented the Board with a revised project plan that includes the four classes of liabilities from SFFAS 5 (exchange transactions, nonexchange transactions, government-related events, and government-acknowledged events), maps transaction types to each of the four classes, and proposes the engagement of a task force. The plan also proposes the following five tasks:

- Task One – Test the four Classes and Sub-classes of Liabilities through the use of a task force.
- Task Two through Five – Develop principles for determining when an obligating event has occurred and related recognition criteria for each of the four liability classes, prepare standards for each sub-class, and issue an exposure draft.

Staff solicited input and approval from the Board on the revised project plan.

The Board was in overall agreement with the revised project plan. Several Board members indicated that they preferred that tasks two through five be completed concurrently; they would favor issuing one complete exposure draft over one exposure draft for each class. Two Board members indicated that they would like to see an enhanced discussion on how conditions relate to the determination of obligating event as the project progresses.

> **CONCLUSION:** The Board approved the draft project plan. Staff will begin completion of Task One by assembling a task force of individuals representative of the federal financial management community and each of the four classes of liabilities.

- **Fiduciary Activities**

The Board discussed the following changes based upon comments received on the Exposure Draft, "Accounting for Fiduciary Activities" and staff recommendations.

Reporting requirements for fiduciary activities that issue separately audited financial statements

The Board decided that for fiduciary activities that issue separately audited financial statements, the component entity's fiduciary note should state the basis of accounting separately from the audit opinion on the financial statements.

Aggregation of fiduciary activities that have a fiscal year-end other than September 30

The Board decided that information for activities that have a fiscal year-end other than September 30th may be aggregated with information for activities that have a September 30th fiscal year-end. It was noted that the permission to aggregate applies to individually immaterial fiduciary activities.

Seized monetary instruments

The Board agreed with staff recommendations for language explaining that seized assets do not meet the definition of fiduciary.

Explanation of exclusions

The Board made several edits to the additional language in the Basis for Conclusions that explains the exclusions.

Basis of Accounting

Certain members suggested dropping paragraph 14 (the requirement that information disclosed to be measured in accordance with GAAP). Some of these members believe paragraph 14 is redundant and others believe it is not necessary or appropriate to designate a measurement basis (that is, that cash or modified cash basis measurement is permissible). Chairman Mosso polled the members on the question of deleting paragraph 14. Members voted five to five on the issue. The paragraph remains in the text due to the tie vote.

Other edits

The Board made several other edits, such as dropping the redundant phrase "applicable to the Federal government" in paragraph 14.

CONCLUSION: Staff is preparing a preballot draft. Any members planning to dissent are requested to provide written dissents to staff in a timely manner.

The Board adjourned for lunch at 12:00 PM.

- **Technical Agenda – Project Plan Review**

The Board reviewed plans for accelerating the conceptual framework project and initiating the federal entity project. Members noted that there were substantial resources being applied to the conceptual framework and that the timelines appear ambitious.

CONCLUSION: The Board approved the plans as presented.

- **Natural Resources**

The Board discussed a draft exposure draft (ED), entitled *Accounting for Federal Oil and Gas Resources*. Before discussions on the ED began, staff described the proposed calculation in the proposed standards for valuing the Federal government's royalty share of proved oil and gas reserves, referred to as "estimated petroleum royalties". Staff explained that instead of using national level information to calculate the estimated petroleum royalties, staff proposed using estimated quantity, price, and royalty rate information on a regional basis. The value of estimated petroleum royalties calculated on a regional basis would be added together to provide a national value of estimated petroleum royalties for reporting on the balance sheet. In addition, staff explained it had addressed future royalty rights held for sale in the proposed standards.

During discussions on the draft ED, Board members provided the following comments:
- In the Executive Summary, describe in more detail what the Board is proposing.
- Provide pro forma accounting transactions and the timing of the transactions.
- Provide pro forma financial statements based on the transaction.
- Move the detailed calculation guidance for initial asset valuation (paragraphs 24 through 29) and revaluation (paragraphs 33 through 40) to a new section in the proposed standards.
- Revise structure and content of the proposed standards in accordance with the FASAB standard outline for an ED.
- Clarify the recognition of an unrealized gain or loss when reclassifying the asset estimated petroleum royalties to future royalty streams held for sale.

CONCLUSION: Staff will make the changes suggested by the Board members and develop a pre-ballot ED.

- **Department of Defense Office of Inspector General Request for Guidance**

Staff discussed the Department of Defense (DoD) Office of Inspector General's (OIG) request for guidance regarding the proper presentation of contract financing payments. Staff explained that contract financing payments are funds that the Government provides to contractors prior to delivery and acceptance of the end item. The DoD withholds 20 percent of the financing payment until the contractor delivers an acceptable product. The OIG and the DoD Comptroller disagreed on how financing payments and the amounts withheld should be reported. In 1998, the two parties presented their views to the Office of Management and Budget (OMB). Although the OMB agreed with the OIG position, the disagreement continued. To address the OIG request and resolve the issue on how to report contract financing payments, staff plans to prepare staff implementation guidance.

Some Board members expressed concern that committing resources to preparing the guidance could compete with ongoing projects such as the accelerated conceptual framework project, and that the financing payment issue involved fundamental accounting principles which only affects a single agency. A Board member noted that the Board should be concerned about more widespread issues. Also, some members expressed concern that although the OMB provided guidance, the disagreement has continued for several years.

Ms. Comes noted that the staff implementation guidance does not involve developing a new accounting standard and that some research has been completed on the financing payment topic. In addition, the DoD OIG prepared a report (included in the Board materials) that provides relevant information that staff could use and, given the research and materials staff has currently, Ms. Comes did not expect the project to require a significant amount of additional resources. In addition, some Board members noted that the issue presents the Board with an opportunity to provide guidance and educate constituents on accounting standards.

> **CONCLUSION:** Staff will proceed with preparing staff implementation guidance regarding contract financing payments.

Adjournment

The meeting adjourned at 3:30 PM.