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By: David Mosso, CPA

October 2005 marked the 15th year of the Federal Accounting Standards Advisory Board (FASAB). Much has been accomplished—not only by FASAB but also by the federal agencies now able to produce audited financial statements 45 days after the close of the fiscal year. Developing financial accounting standards for what is arguably the largest entity in the world continues to be a challenging and important endeavor. In this article, I will give only my individual views on the subject, not those of the FASAB.

While the budget is the most publicized federal financial benchmark, financial reporting can ensure that information about the full costs of government goods and services provided is available. Fundamental to capturing "full costs" is accrual accounting. Accrual accounting results in reporting the financial effects of transactions and other events and circumstances in the periods in which those transactions, events and circumstances occur rather than only in the periods in which cash is received or paid by the entity.

FASAB dealt comparatively quickly with many controversial accrual accounting issues. In 1995, FASAB issued standards requiring accrual of employee pensions and other post-employment benefits. Also in 1995, standards requiring capitalization and depreciation of property, plant and equipment (except for military equipment, heritage assets and public lands) were issued. In general, where the federal government acquires goods or services that are the raw materials (or inputs) that produce goods and services ultimately delivered to the public, accrual accounting was adopted.

The greater challenge has been developing standards for uniquely federal government activities. FASAB debated the issue of military equipment— many argued its existence provided a "service" to the public—for many years before resolving in 2003 that accrual concepts applied in this area as well.

While FASAB issued reporting requirements for social insurance programs in 1999, FASAB continues to debate the applicability of accrual concepts to social insurance programs such as Social Security. In my Fall 2005 column, I explained why I believe accrual accounting adds a valuable perspective on Social Security. This article points out the anomalies inherent in our current approach to accruing liabilities for nonexchange transactions and government-acknowledged events.

Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government*, defines nonexchange transactions as "transactions in which one party to the transaction receives value without directly giving or promising value in return." This is in contrast with exchange transactions that are defined as "transactions in which each party to the transaction sacrifices value and receives value in return."[1]

SFFAS 5 defines government-acknowledged events as "events that are of financial consequence to the federal government because it chooses to respond to the event." This is compared to government-related events that are defined as "nontransaction-based events that involve interaction between federal entities and their environment."[2]

The distinctions between both exchange and nonexchange transactions and government-acknowledged and government-related events may be clear at the definitional stage, but applying those definitions in a distinctive manner has been more of a challenge than originally anticipated, as indicated by the examples below.

Environmental cleanup is one of many areas where similar costs are treated differently. If a toxic waste spill occurs on a federal facility (government-related event), the full cost of cleanup and the associated liability are recognized in the period of the spill. If the federal government assumes responsibility for cleaning up a toxic waste spill on nonfederal land (government-acknowledged event), the cost and associated liability are recognized as contracts are entered into and work is performed.[3]

In another example, retirement benefits for an employee covered by the Civil Service Retirement System (CSRS) are accounted for differently than retirement benefits for an employee covered by the Federal Employee Retirement System (FERS). Under our current accounting standards, a larger liability is recognized for an employee covered under the CSRS retirement plan than an employee covered under the FERS retirement plan. The difference in accounting is directly attributable to the difference in structure of the plans. CSRS is a defined benefit plan and does not include Social Security benefits. FERS combines a much smaller defined benefit plan with contributions to the federal Thrift Savings Plan (TSP), which are recorded as assets in the TSP fund, and Social Security benefits, which are not captured on the books at all until they become due and payable. As a result, the retirement liability for two employees working side by side in similar jobs with similar pay and years of service are accounted for differently because of the form, not substance, of their underlying retirement plans.

In a third example, under our current accounting standards, a liability is recognized for insurance where a transfer of risk takes place and premiums are paid (Pension Benefit Guarantee Corporation, for example) but not for certain other guarantees where a transfer of risk also takes place but no premiums are paid (Milk Income Loss Contract program and other agricultural commodity price support and stabilization programs).

Distinguishing a liability from a nonliability depending on whether consideration had been received or an event took place on federal government property seems to conflict with the spirit and intent of both accrual accounting concepts and full costing principles. As a result, current practice does not result in comparable treatment of events and transactions that have the same underlying economic substance.

As FASAB continues to tackle the many issues at hand, agreeing on the establishment of liability recognition and measurement standards that can be consistently applied and meet federal financial reporting needs may well be the most difficult challenge that lies ahead.

End Notes

1. Federal Accounting Standards Advisory Board, *Statements of Federal Financial Accounting Concepts and Standards*, Volume 1, Original Pronouncements, June 2004. p. 411.
2. Ibid., pp. 411 – 412.
3. Ibid., pp. 424 – 426.

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