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FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

FASAB NEWS

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BOARD NEARS ISSUANCE OF THREE EXPOSURE DRAFTS

At the June 23rd meeting the FASAB will review and discuss an exposure draft entitled Managerial Cost Accounting Standards for the Federal Government. Vice President Al Gore's National Performance Review directed the FASAB to issue "a high-level set of cost accounting standards" by December 1994. The exposure draft does propose such a set of standards. Morgan Kinghorn, Controller of the Internal Revenue Service, together with a broad group of representatives from government, academia and the private sector as well as FASAB staff developed the exposure draft.

After the Board concludes its review of the draft, final changes will be made and the draft will be issued for comment. Ron Young, Executive Director of the FASAB, said that the exposure draft appears to address the Vice President's goals and if the Board is comfortable with it, the draft could be on the street by early August. This could allow the FASAB to present the cost accounting standards to the Board's Principals by December 31. He emphasized that the responses to the draft and the issues raised by the agencies would be a key indicator of whether or not that date could be met. When asked about the need to develop systems to meet the cost accounting requirements, he indicated the Board is well aware of the time needed to fully implement the standards and that it would be taken into consideration by the Board when it recommends the standards.

Another exposure draft, Accounting for Liabilities of Federal Government, is being given to the Board final review at the June meeting. Remaining major issues in the draft were discussed at the May meeting and changes have been incorporated. The document will not be discussed at the June meeting, but the Board members will be asked for their written comments. After that, necessary changes will be made, and, unless a major issues comes up needing discussion, the draft will be issued for comment. According to Ron Young, this exposure draft also could be on the street by early August.

The third major exposure draft about to be issued is a reporting model concept statement entitled Entity and Display. The Board has reviewed the document and final changes are being made to the draft. This could be out for comment by mid-July.

Other projects for which exposure drafts are currently underway address accounting for physical property, plant and equipment and accounting for revenues. The staff is also developing a discussion memorandum asking for views about incorporating a capital charge into financial reporting for the capital used by programs in delivering government services. All of these should be out for comment by the Fall.

According to Ron Young, if the above target dates are met, the FASAB will, for all practical purposes, meet the expectation of the National Performance Review to complete a basic set of accounting standards by March 31, 1995.

LIABILITIES

At the May meeting of the Board, staff presented a working draft Exposure Draft on Accounting for Liabilities of the Federal Government and a related issues paper. The issues paper focused on the two unresolved issues. The first issue related to federal insurance and guarantee programs. OMB's representatives on the liability task force had recommended that insurance and guarantee programs should recognize a liability for all losses at the time the risk is assumed. In the case of pension insurance, this could lead to a larger accrual than is currently calculated under the "insured event" approach.

Justine Rodriguez and Chris Lewis, of OMB, presented to the Board the option to recognize a liability for insurance/guarantee programs when the risk is assumed. They reviewed the differences between the "risk assumed" and the "insured event" recognition points for all types of insurance programs, including fixed period annual, multi-year, and insurer-renewable insurance, and noncancellable or insured renewable insurance. How these concepts applied to different programs and how the cost could be measured for these programs was discussed. The "risk assumed" approach would be similar to the accounting standard adopted by the Board on loans and loan guarantees which recognizes losses in the same manner as the Budget under the new Credit Reform legislation.

Mr. Lewis referred to the staff proposal as a "contingent claims" or "probabilistic" approach versus PBGC's current approach which is a "probable" approach reflecting FASB's SFAS No. 5 and is based on specific identification of troubled plans. The probabilistic approach would net a larger liability than PBGC is currently recognizing because it would include a provision for future losses arising from pension plans of firms that are now in good financial condition but that will, years hence, fail or encounter serious financial difficulty.

Several Board members were concerned about whether the "probabilistic" liability could be reasonably measured and whether it was reliable and auditable. All of the Board members agreed that the "probabilistic" amount was important and informative, but questioned whether it was appropriate to recognize this amount on the balance sheet and operating statement given the current lack of experience with these measures.

Staff presented the following three options to the Board in reference to the task force's recommendation:

- Option 1: Allow additional time for staff to study the modeling techniques used to measure the proposed liability.

- Option 2: Decide now to expose the standard using the "insured event" approach. This option would account for all insurance/guarantee program liabilities, except life insurance and loan guarantee programs, using the traditional "fixed period" perspective. The "risks assumed" approach could be reported in the footnotes or as a part of the "future claims" project.

- Option 3: Decide now to expose the standard using the "risk assumed" approach.

After extensive discussions the Board adopted Option 2, as noted above.

The second issue presented by staff related to the current working definition of a federal liability (... a probable future outflow or other sacrifice of resources as a result of past transactions or events). Staff expressed some concern that there may be some ambiguity in the definition as to what is the "relevant event" (i.e., the event that triggers recognition of a liability). Two Board members had suggested that the definition incorporate the notion of "unpaid expense" and staff asked whether the Board wished to change the word "probable" to "expected". The Board decided to keep the current working definition, as noted above. However, two members later suggested that the definition be reworded to better capture the intent of the Board. The reworded definition would be placed in an appendix to the exposure draft and comments would be requested as to which definition is preferable. Both definitions are intended to accomplish the same thing.

Board also discussed several of the following ;s related to the draft ED on the Accounting for Liabilities of the Federal Government:

- Ron Young asked the Board to comment on the draft accounting standards for federal debt developed by the Treasury Department staff. One member suggested that the fair value of the debt be reported in the accountability statement. Another member suggested that callable debt, defeasance debt, and recourse debt be addressed in the standard. The Treasury Board member noted that callable debt is no longer issued and that there was a small amount currently outstanding. The member also noted that the standard could be modified, as necessary, to address other types of debt not specifically mentioned in the current draft standard.

- Several Board members discussed the level of detail of the exposure draft. Some members believe the Board should keep the standards at a high level and keep the documents shorter. Other members expressed ieed for more detail in the standards to address .cific issues such as Federal Employees Compensation Act (FECA), Unemployment Insurance (for both federal and non-federal employees), and agency "buyouts." The majority of the Board members believe that the standard has about the right balance of detail to allow the serious reader to understand and comment and later apply the standards as needed. However, the Board will request comments about the appropriate level of detail.

- The Board briefly discussed the recognition of service- connected Veteran's medical care benefits. It was agreed that VA medical care will be accounted for on a current outlay basis rather than as an actuarial liability accrued during the individual's military service.

PROPERTY, PLANT AND EQUIPMENT INCLUDING LAND

:d members discussed extensively the issue of a capital charge, and when and how to incorporate it into the full cost of operations of a reporting unit. This issue involves imputing interest expense on capital employed by reporting units (e.g. buildings, land, receivables) to provide a service or product. The issue was originally raised by the Board when considering capital costs (capital consumption such as depreciation and the cost of capital employed) associated with the use of physical assets. The Board later raised the issue to a project level to determine if cost of capital should be applied to other capital used by reporting units.

The Board believes that the property, plant and equipment accounting standard should ensure the availability of any information necessary to calculate a cost of capital. In addition, the cost of using capital assets should be measured in a manner that is consistent with the measurement of any imputed interest expense. Ron Young, the Executive Director, presented illustrations of several methods for calculating cost of capital. The primary methods illustrated were:

1. A mortgage approach that resulted in equal annual operating expense amounts, including interest and depreciation expense, each year of the asset's useful life,

2. A traditional historical cost depreciation approach with interest expense based on the net book value of the asset each period,

3. A fair market rent approach that would encompass both interest expense and depreciation on the asset, and

4. A current value approach with depreciation and interest expense based on current rates recognized in operating expense each year.

While the Board members generally support recognizing the cost of capital, they want the method used to be simple, useful, cost effective, and understandable to all users. The Board members also suggested exploring the use of criteria to limit the application of cost of capital to certain assets. For example, interest expense could be imputed for assets costing in excess of $100 million.

The cost of capital project will proceed to address the following issues:

1. For what assets is it appropriate to impute interest expense?

2. What is the appropriate asset value upon which to apply the interest rate (e.g., net historical cost or current value)?

3. What interest rate is most appropriate?

A Cost of Capital Task Force is being formed and will begin meeting in early June to address these issues in detail. The Board suggested that the task force develop a discussion memorandum, rather than an exposure draft, in order to solicit input from the Federal community.

MANAGERIAL COST ACCOUNTING PROJECT

Joe Donlon of the IRS and Richard Mayo and Larry Modlin of the FASAB staff presented a draft section of the proposed standard dealing with inter-entity costs at the May Board meeting. The Board discussed this draft and responded to points raised by the staff. Originally, the staff had planned to present the standard section on accounting for capacity costs. This was changed, however, when it was determined that certain aspects of the inter- entity cost section needed to be addressed quickly because of the possible impact on other sections of the draft.

Staff had changed the wording of the standard to remove the intra- entity costing issues from this section. It is believed that intra-entity costing issues can be more easily addressed in other sections of the standards. The Board agreed with this change.

The Board members also approved the specific accounting guidance contained in the draft. That guidance states that where an entity provides goods or services to another entity, regardless of whether full reimbursement is received, the providing entity shall recognize in its accounting records the full cost of the goods or services provided. Those costs shall also be reported to the receiving entity. The receiving entity shall recognize in its accounting records the full cost of the goods or services it receives as an expense (or as an asset, if appropriate). To the extent that reimbursement is less than full cost, the receiving entity shall recognize the difference as a financing source. Inter-entity transactions would be eliminated for any consolidated financial statements covering both entities. Staff suggested that the draft standard be expanded to specifically state that the providing entity shall supply the appropriate cost information to the receiving entity. The Board agreed with this change.

Compliance with the standard by the receiving entity requires that the providing entity supply it with the appropriate cost information. The Board decided that the standard should allow an alternative method for compliance should the providing entity not report the cost data. Therefore, the draft will state that a reasonable estimate of the cost may be used by the receiving entity if it is unable to obtain actual cost information.

The draft addressed some recognition limitations by stating that items must be material in amount to be recognized. It also stated that some entities provide broad, general support to many, if not all, reporting entities in the federal government without reimbursement. The draft said that, in such cases, those costs should not be recognized as inter-entity costs.

The Board members agreed with these limitations, but decided that additional criteria should be established uidelines for recognition of inter-entity costs. One these criteria concerns the mission of the providing entity. Generally, if the providing entity supplies goods or services to another entity as a part of fulfilling its prime mission, such costs should not be recognized as inter-entity costs. Another criterion suggested by Board members was whether the final end-user of the good or service is to be charged a user fee in accordance with OMB Circular A-25 and the extent to which transfer pricing and ultimate cost to the user would be affected. Board members realize that professional judgement will be required in some cases to decide whether the criteria have been met for recognition of inter-entity cost. The draft is to be revised to include a discussion of these criteria.

Following the discussion of inter-entity costs, staff handed out a draft of the section of the standard dealing with accounting for capacity costs. This draft has also been provided to members of the task force for their comments. Staff stated they would like to obtain views from Board members on the capacity paper as soon as they can review it. Meanwhile, staff will continue to seek the comments and advice of the task force advisory members in preparing the revised draft on inter-entity costs and all other sections of the statement. An initial draft of the entire statement will be presented for discussion by the Board at the June meeting.

AGENDA FOR JUNE MEETING OF BOARD

The next meeting of the Board will be held on Wednesday, June 22 from 1:00 P.M. to 4:00 P.M. and Thursday, June 23 from 9:00 AM to 3:30 PM in room 7313 of the General Accounting Office, 441 G St., N.W., Washington, D.C. The agenda calls for a discussion Wednesday afternoon on initial stewardship reporting issues for human capital, research and development, and non-federal physical property; and discussions on Thursday on (1) the Cost Accounting Exposure Draft and (2) Physical Assets.

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