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FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

# FASAB NEWS

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## MANAGERIAL COST ACCOUNTING PROJECT

The Managerial Cost Accounting Project moved closer to the completion of an exposure draft (ED) after review and discussion by the Board members at their June meeting. An initial version of the draft was presented to the Board by project staff Morgan Kinghorn, Joe Donlon, Clif Williams, and Larry Modlin. Accompanying them were task force members Prof. Robert Kaplan of Harvard Business School and Joe Kehoe of Coopers & Lybrand.

The standard on unused capacity costs emerged as a major concern at the meeting. Discussion of the issues took place among Board members expressing strongly opposing views. The draft called for identifying unused capacity costs and reporting of those costs separately from the costs of production; the costs of emergency or mobilization capacity were to be identified and reported. Three Board members strongly favored the standard as written in the draft. They see it as essential for managerial control and proper measurement of performance. Two members, however, see it as unnecessary and believe it will be difficult or impossible to carry out. Other Board members, while they favor identifying and reporting unused capacity, were concerned about the feasibility of doing so in the federal government environment and about the possible effect of identifying assets that may be needed in the future as unused capacity.

The Board reached a compromise under which the ED will present two alternatives for capacity costing. One alternative will be the proposed standard as presented by the staff in the initial draft. The other will provide an opportunity for experimentation and phasing-in of the standard over time. Further, it would allow the management of each reporting entity to determine the usefulness, applicability, and appropriateness for identifying and reporting unused capacity costs which would make the standard optional, at least for now.

FASAB plans to ask for comments concerning (a) whether the concepts supporting the standard are correct, (b) whether implementation is feasible, (c) the desirability of an option, (d) the need for a time of experimentation, and (e) when implementation should occur.

The Board also discussed the criteria for recognition of inter- entity costs. At the April meeting, the Board decided that recognition of nonreimbursed inter-entity costs should occur only when those costs (a) were not in the nature of broad and general support, (b) were not a specific part of the providing entity's mission, (c) had an effect on the price to a non-federal entity, and (d) were material.

Board members decided that the criteria for recognition of inter- entity costs need to be refined and expanded. The "materiality" criterion is to be expanded to include costs that are "significant, direct, and identifiable." In addition, FASAB staff will revise the draft to make the criterion on "mission" clearer. Also, the draft will make it clear that intra-entity costing is accomplished through the costing methodology selected for use within the reporting entity.

Ron Young, Executive Director, summarized the next steps to be taken: Board members will submit their editorial comments on the draft by July 7, if possible. The section of the draft on unused capacity costs will be revised and circulated to all Board members for their comments. The changes called for by the Board on the remaining sections of the draft will be made. When final changes are completed, the full draft will be circulated to Board members for approval.

## STEWARDSHIP PROJECT

At the June Board meeting, FASAB staff briefed the Board members on the initial issues for human capital, research and development, and federally financed but non-federally owned physical property. Following are the highlights of the Board's initial approaches to these issues.

### HUMAN AND INTELLECTUAL (R&D) CAPITAL

1. Asset/Non-asset and Amortization/Non-amortization

The Board discussed whether the federal government should account for the investment in human capital and research and development as federal assets, and whether such investments should be amortized.

The federal government does not own or control the people on whom or the areas in which the investments are made. Further, it does not generally own or control the output/outcome, the increased skills and earning power or the improved production, processes, or knowledge base resulting from the investments. Therefore, the Board does not believe that investments in federal human capital, largely education and training, and research and development should be accounted for as federal assets. Since the Board does not consider these investments federal assets, the issue of whether to amortize the investments does not apply.

2. Flow vs. Stock

The Board discussed whether to develop standards for human capital and research and development stocks, or flows, or both.

Defining and accurately and reliably measuring the stock of federally financed education, training, and research and development would be extremely difficult. It is difficult to measure the useful life of these investments or the pattern of consumption.

However, flow data (expenditure/expense data), currently available from the SGL and budget would be expensed in the operating statement in the period in which the government provides the financing or performs the service. Such data on flows of resources would be reported on a stewardship report in a manner that highlights the investment nature of these expenditures.

3. Human Capital Definition

Board members were divided on how narrowly or broadly to define federal human capital to ensure that only investment expenditures would be reported on a stewardship report.

Some members believe that federal human capital should be limited to the education and training that the government provides to the private sector to benefit the national economy. Other members believe that the definition of federal human capital should be expanded to include any federal investment in people that could demonstrate measurable economic benefits. The Board decided it would expose for public comment both the narrower and broader definitions of federal human capital.

4. Research & Development (R&D) Definition

The Board agreed to base the definition of federal R&D for stewardship reporting on the definition of R&D that is used in the budget and in the scientific community. The established definition will provide the benefits of consistency of reporting (budget, science databases, accounting) and the ability to draw on an existing data base of research and development data for use in benefits analysis, etc. However, to ensure consistency with other stewardship reporting, the Board agreed that the definition should include the irement that research and development .stments have "the expectation of increasing future national economic productive capacity or yielding other benefits."

5. Type of Data to be Reported

The Board generally agreed that information similar to the following categories would satisfy its objectives of providing information for performance measures, accountability over program resources, and measuring a program's success and contributions to the nation's well being (entities could tailor the data elements to specific programs to present the most meaningful information to users): 1) amount spent by federal government; 2) constant dollars where it would make sense (e.g., for time series data); 3) amount spent by others (e.g., state and local government portion of shared programs); 4) outputs; 5) outcomes; and 6) explanatory material. To preclude voluminous reporting, this information would be provided at the ...ior program level and would be phased-in with ently available information being reported in the early years of the implementation of the standard.

NON-FEDERAL PHYSICAL PROPERTY

1. Traditionally Defined Infrastructure vs. All Non-Federally Owned Physical Property

In considering what should be identified as an investment in non- Federal physical property, the Board believes such investments should include Federal grants to State and local governments for investment in all physical property that the Federal government does not own. By including all physical property, the Board members believed that the group of investment expenditures for non-Federally owned items which increase economic productive capacity would be complete.

2. Include Privately Held Physical Property?

e great bulk of Federal payments to finance non- .deral physical property is through grants to public bodies, i.e., the State and local governments. There are, however, Federal subsidy payments to non-public bodies also. These include Federal subsidy payments for land conservation, for purchases of farms and equipment, and for construction of ships in U.S. shipyards.

Conceptually, the Board agreed these subsidies should be included as an investment expenditure. However, because of the small amounts involved, inclusion may not be necessary. The members will focus on material items such as public physical property financed from Federal grants.

3. Consider Federal Tax Expenditures Equal to Grants?

Tax expenditures are subsidies provided through the tax system.From its discussions, the Board agreed that Federal tax expenditures which subsidize the cost of state and local physical property should not be considered the equivalent of grants in acquiring non-Federal physical property. In addition, it was noted that the Revenue Recognition project is currently addressing tax expenditures and is now considering some highlevel disclosure requirements for them.

4. Investment vs. Investment & Consumption Grants

Generally, Federal law prescribes the use of the grants in sufficient detail that one can readily decide whether it is for capital investment or consumption. However, cases exist in which the law allows the recipient unit flexibility to use grants for either purpose. Since it is up to the recipient jurisdiction to decide how to spend the money, the Federal program agency may not even know in detail what the money was spent on.

The Board members believe that identifying only those grants from programs that are intended primarily for investment is a pragmatic approach to defining non-Federal physical property.

5. Budgetary Outlay vs. Operating Expense Data

It was suggested that accountants be allowed to validate the reasonableness of the budgetary submissions and to use that same data to develop stewardship reports. The basis for this is that, if the accountants could validate budgetary data, they could help achieve budgetary integrity; and, simultaneously, avoid requiring possible duplication of the same data at a more detailed level under the SGL.

Participants in the discussion indicated that for grants there is very little difference between budget outlay and operating expense data. However, there would be a slight difference when the Federal government is directly involved in R&D. This would be because depreciation expenses, which budget outlays do not show, might be recognized in the operating statements. Taking into consideration that the difference between outlay and expense data is assumed to be immaterial, the Board noted that budget outlays should be allowed to be used for reporting stewardship data.

## COST OF CAPITAL PROJECT WELL UNDER WAY

The Board's newly formed task force on cost of capital met twice during June. Addressing the issue of whether the cost of capital, or interest, ought to be associated with the programs and activities that require capital to enable them to perform and to examine ways of doing so is the goal of the task force. The task force consensus is that FASAB should address a cost of capital charge. The basic premise of the task force's work is that all assets require financing and financing generates cost of capital or interest expense. Under current Federal accounting practices interest expense is not recognized by and tied to the federal program activities that incur that cost.

As a first step in addressing this complex issue, the task force is preparing a discussion memorandum to raise questions and solicit comments on specific issues that the Board will address. This presents an opportunity for the Board's constituents to participate at an earlier stage.In this discussion memorandum, the Board raises questions regarding the following basic issues:

1.The appropriateness of an imputed interest charge

2.The appropriate measurement and the feasibility of measurement of imputed interest charges (e.g., what interest rates to apply to which assets).

Task force members expect to forward their product to the Board during the summer months.

## PROPERTY, PLANT AND EQUIPMENT

At its July meeting, the Board decided several issues critical to the development of the accounting for property, plant and equipment (PP&E) exposure draft.

Based on those decisions the exposure draft will propose the following categories: (1) general property, plant and equipment; (2) federal mission property, plant and equipment (e.g., weapons systems); (3) heritage assets (e.g., monuments) and (4) land. To assure that categorization of PP&E would be relatively consistent among entities, the Board directed staff to continue testing and possibly modifying the category descriptions. In addition, to aid readers in responding to the exposure draft, members asked the staff to provide illustrations of the categorization of properties fitting into more than one category.

The exposure draft will propose that the acquisition cost of general property, plant and equipment be capitalized on the balance sheet and depreciated over the asset's estimated useful life. To provide information regarding the cost of operations, the Board believes that some measure of the cost of using assets must be incorporated in the operating expense of an entity. The exposure draft will propose historical depreciation expense as the appropriate ..asurement of cost.

However, individual Board members support current value measurement bases for general PP&E. Staff will prepare an appendix to solicit comments on these members' views.

For federal mission PP&E and heritage assets, the exposure draft will propose that expenditures be reported on the operating statement as a separate category of expense. The assets themselves would be reported on the stewardship statement. The Board believes that sometimes there may not be a relevant financial value. In these cases, the Board would require disclosure of nonfinancial information. Staff will explore options for stewardship reporting, draft illustrative stewardship statements, and prepare appropriate language for the exposure draft. The Board also directed staff to provide for recognition of deferred maintenance on land in a proposed accounting 'dard.

The Board believes that deferred maintenance related to land is as important as that related to facilities and equipment. To provide useful information on the condition of land, the Board concluded that the language of the deferred maintenance proposed standard be broadened to result in disclosure of any backlog of maintenance whatever the type of asset to which it relates.

The Board discussed whether the stewardship statement should show all land. Proposals included reporting (1) all land on the stewardship statement, (2) land held for sale on the balance sheet, or (3) land associated with general PP&E on the balance sheet. The Board concluded that any land associated with general PP&E should be on the balance sheet since it ultimately may be the basis for a capital charge. The investment in land creates an interest expense since it requires a commitment of capital. The cost of capital '-sk force is addressing this issue.

## JAMES REID TO JOIN BOARD

The Federal Accounting Standards Advisory Board is pleased to announce that Mr. James E. Reid will succeed Mr. William Kendig, who is retiring in October. Mr. Reid is the Deputy Controller of the Department of Energy, a position he has held since January 1986. His responsibilities for financial management include financial policy, financial systems development, and overall direction of the Department's accounting operations. Before joining DoE, he spent 15 years in the private sector. He was an auditor with Arthur Young, a Group Controller for Fairchild, and held senior level financial positions in companies involved with manufacturing and construction. Mr. Reid has a B.S. degree in Accounting from the University of Maryland, is a Certified Public Accountant, and is a member of the Association of Government Accountants. We all look forward to working with Jim.

## AGENDA FOR JULY BOARD MEETING

The agenda for the upcoming July 21 meeting of the Board includes discussions on: Stewardship issues (Future Claims), Liabilities Draft ED issues, Physical Property (Clean-up cost issues and Deferred Maintenance proposal), and Stewardship issues on Human and Intellectual Capital. Other items may be added later to the agenda.

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