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FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

FASAB NEWS

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DECEMBER NEWSLETTER COVERS TWO MEETINGS

Because of the short interval between the October and November Board meetings, this newsletter covers both of those meetings. Therefore, this issue is a little longer than usual.

MANAGERIAL COST ACCOUNTING PROJECT

The Exposure Draft on Managerial Cost Accounting Standards for the Federal Government was approved by the Board and issued in mid-October. The draft presents seven broad standards designed to enable federal departments and agencies to begin developing useful cost information for better operational control, performance evaluation, and information reporting.

Copies have also been distributed to financial and cost accounting professional organizations. Comments are due by mid- December.

ACCOUNTING FOR LIABILITIES

FASAB has issued a new Exposure Draft, Accounting for Liabilities of the Federal Government. A copy has been mailed to all recipients of this newsletter in addition to other interested parties. The ED contains six standards on specific liabilities of the federal government, as well as a definition and general principle for the recognition of liabilities. Comments on any section of this document are encouraged and should be received by the end of January, 1995. Those who wish to request a copy of the ED may write, fax, or call the Board.

Both the Cost Accounting and the Liabilities Exposure Drafts will be available to individuals with modems to download from Internet by gophering to financenet.gov.

The Board plans to hold a public hearing on this ED on January 9 and 10, 1995. Formal notice of the date and time of the hearing will be made in the Federal Register. The Board encourages affected parties to participate in the hearings. Those who wish to participate should notify FASAB and provide a copy of their written comments.

Copies of the drafts for both the Cost and the Liabilities ED's have been in greater demand than anticipated, and the first printing of 2,000 copies for each ED was completely distributed within one week. A second printing was made to meet the demand. Among those receiving the draft are federal CFOs and Deputy CFOs, IGs, financial managers, federal program managers and administrators, as well as interested persons in the private sector.

GENERAL RECOGNITION PRINCIPLES

Liabilities arising from reciprocal or "exchange" transactions (i.e., transactions where each party to the transaction sacrifices value and receives value in return) should be recognized when one party receives goods or services in return for a promise to provide money or other resources in the future (e.g., a federal employee performs services in exchange for compensation).

Liabilities arising from nonreciprocal transfers or "nonexchange" transactions (i.e., transactions where one party to a transaction receives value without directly giving or promising value in return) should be recognized in the amount of any unpaid amounts due as of the reporting date (examples include social insurance, grant, and entitlement programs).

Liabilities arising from government-related events, (i.e. events that involve interaction between the government and its environment) should be recognized when the event occurs, or as soon as the future outflow of resources is probable and measurable (examples include accidental damage to private property, or accidents and catastrophes that affect government- owned property).

Liabilities arising from government-acknowledged events should be recognized when and to the extent the government formally acknowledges financial responsibility for the event and an amount is due and payable as a result (examples include toxic waste damage caused by nonfederal entities and natural disasters).

SPECIFIC STANDARDS

In addition to the general recognition principles, the ED includes several specific federal standards:

Contingencies -- Contingencies should be recognized as liabilities when a transaction or event has occurred, a future outflow or other sacrifice of resources is probable, and the related future outflow or sacrifice of resources is measurable. Contingent liabilities should be disclosed if any of the conditions for liability recognition are not met and there is a reasonable possibility that a loss or an additional loss may have been incurred.

Insurance and guarantee programs -- Federal insurance and guarantee programs (except loan guarantee programs) should recognize a liability for claims incurred (including those not yet reported) resulting from insured events that have already occurred, plus contingent liabilities. Life insurance programs should recognize a liability for future policy benefits in addition to the liability for unpaid claims incurred. Federal insurance and guarantee programs also should disclose the present value of unpaid expected losses net of associated premiums, based on risk inherent in the insurance and guarantee coverage in force as of the end of the reporting date, to the extent this amount differs from the amount recognized.

Social insurance programs -- In social insurance programs the government uses its power to require payment of taxes, which it dedicates to finance benefits (e.g., black lung benefits, unemployment compensation, Medicare [hospital insurance], and social security). Social insurance benefit payments are nonexchange transactions. Accordingly, reporting entities recognize a liability for any unpaid amounts due as of the reporting date.

Pensions, other retirement benefits, and other postemployment benefits -- The expense for pensions and other retirement benefits (including health care) should be recognized at the time the employee's services are rendered, and the expense for postemployment benefits should be recognized when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the accounting date. The aggregate entry age normal actuarial cost method should be used to calculate the expense and the liability for the pension and other retirement benefits for the administrative entity's financial statements, and the expense for the employer entity's financial statements.

Federal debt -- Debt transactions are recognized as liabilities when there is an exchange between the involved parties.

Capital leases -- The lessee should report a liability when one or more of four specified capital lease criteria are met.

REVENUE RECOGNITION

At the October Board meeting, Tom Luter, a Treasury Department representative on the Revenue task force, reviewed, for the Board, the reporting model contemplated in the working draft ED on revenue. The discussion was intended to be informational only, rather than for making decisions.

Mr. Luter said that his goal was that any statements could be "automatically" produced from the Standard General Ledger (SGL). He believes that the working draft presented to the Board meets that criterion in general. A pilot test with "live data" from the Department of Energy is planned to be run through this model, as soon as the Board approves the basic ideas. The pilot test may reveal problems or issues about unusual transactions. He noted two other ground rules that influenced the proposal in the working draft:

1.focusing on cost and

2.tying budgetary/proprietary accounting.

He explained that currently the federal reporting model includes a combined operating and capital statement. Using the terms of the revenue working draft, it displays, in essence:

exchange revenue
+nonexchange revenue
+<u>other financial sources</u>
=Total
-<u>expenses</u>
=Net results of operations
+<u>beginning capital or net position</u>
=Ending Capital

Mr. Luter believes that agencies generally tend to focus on forcing net results of operations to be equal to zero i.e., indicating that everything was financed. This focus creates complications: it is necessary to defer recognition of some appropriations already received and expended (e.g., for asset acquisition) and accrue others before they are actually made available (e.g., subsidy reestimates under credit reform).

The matching principle embodied in current federal accounting is to match financing sources with the expenses financed. An alternative principle, embodied in the working draft proposal, would be to match the cost of producing exchange revenue with exchange revenue, then show how the remaining net cost was financed. This involves showing the same items as the current model, but presented differently. Mr. Luter reviewed the mechanics of the proposal for the Board.

This approach would simplify accounting for federal component entities by:

1. conforming the proprietary (accrual-based) definition of appropriations used to acquire or provide goods and services with the budgetary (obligation-based) definition. This would simplify computation and reporting, avoid a reconciliation between the two figures, and provide a direct tie to the budget that does not now exist, which could enhance the credibility and usefulness of the financial statements;

2. eliminating invested capital and absorbing donated and transferred-in capital into cumulative results of operations, thus simplifying the net position (capital) section of the balance sheet;

3. focusing on net cost of operations rather than net results of operations by reporting financing sources other than exchange revenues on a separate statement from that used to report expenses and exchange revenues;

4. standardizing the computation and reporting through which agencies are given credit for custodial activities of collecting monies for others and transmitting the collections to those others;

5. dividing tax collections to be accounted for into a

cash component, which is reported in the federal budget, and an accrual adjustment, a distinction that would provide another direct tie to the budget that does not now exist; and

6. relating obligations incurred as reported in the budget to net cost of operations, which would provide additional ties between budgetary and proprietary reporting to enhance the credibility and usefulness of the financial statements.

Mr. Luter also explained that equity would be comprised of two items: cumulative results of operations and unexpended appropriations (appropriated capital in SGL parlance).

In November the board deliberated on issues related to reporting on other financing sources.

1. Conforming budgetary and proprietary accounting for appropriations

> The Board tentatively endorsed the concept presented for exposure: Appropriated capital used would be recognized as a financing source when the goods or services were received regardless of whether they were capitalized; and appropriations and other budget authority would not be recognized if they were not available for the entity's use.

2. Simplification of capital accounts

> The Board agreed to explore the concept presented for exposure: Donations and transfers-in (asset transfers) would be reported in cumulative results of operations, which would eliminate donated capital and transferred-in capital as separate items.

3. Custodial collections

> The Board agreed that the Exposure Draft would propose that agencies be given the option of using a separate statement of custodial collections or showing these collections as a discrete segment of the operating statement.

4. Criteria for associating cost with exchange revenue

> After some discussion, the following two principles were generally accepted. (1) Exchange revenue that was incidental (i.e., it could not be reasonably allocated to individual products or services) should be offset against the total gross cost of the entire entity. (For example, fees to the national parks could not be reasonably associated with particular expenses that were needed to provide services to visitors rather than to maintain a heritage for future generations.) (2) Exchange revenue from byproducts should be matched against those costs that would be assignable to the byproducts according to the managerial cost accounting standards. (For example, Geological Survey revenue from selling maps would be matched against the costs assigned to these maps according to the cost accounting standards, without regard to other costs of the Geological Survey.)

5. Statement of Financing

> The proposed Statement of Financing would explain the differences between obligations incurred (budgetary basis) and net cost of operations (accounting basis). In performing this reconciliation, it would report the amount of financing sources yet to be provided as a result of the year's operations. The Department of Energy has agreed to test whether it--and other aspects of the proposal--works in practice.

6. Extent to which proposed reports meet objectives

and provide usable information to users

> The Board agreed to include questions to respondents about how meaningful and useful all of the proposed illustrative statements would be.

7.Illustration of how costs and exchange revenues might be presented

> The Board agreed that the ED should include examples as needed to illustrate how revenues could be matched with costs. It should not include a complete illustrative statement showing a variety of displays.

8.Suggested alternative formats, and

How to convey the principles.

The Board endorsed the concept of including narrative accounting standards that would describe in general terms the implicit general reporting principles. The effects of these accounting standards would be illustrated by formats in a separate appendix labeled "illustrative" and "non-authoritative" in order to explain the concepts and provide advice without purporting to recommend the form and content of financial statements.

Don Chapin, chair of the task force on Revenue Recognition, and Hal Steinberg, chair of the Entity and Display task force, will work together to bring their illustrative formats closer to each other. They would then come back to the Board with updated formats in the context of the Revenue ED and/or a revised Entity and Display ED.

HUMAN CAPITAL & RESEARCH AND DEVELOPMENT

At the Board's October meeting, the Board discussed drafts of the proposed standards for Human Capital and Research and Development. These drafts reflect the Board's comments from its September 19 meeting.

In discussing the drafts, the Board reaffirmed many of its prior decisions. For example, the Board will propose requiring the presentation of trend data in constant dollars. Moreover, it will propose requiring reporting of expense data. For reporting expense data, the Board decided to recommend a transition approach. This approach would apply to those entities that do not have expense data available at the time the standard is implemented. It would permit disclosure of investment data on an outlay rather than an expense basis for the first five years after implementation of the standard. Five years after the standard is implemented, this transition provision would become inoperative.

The Board also agreed to recommend that for reporting on investment in human capital, both output and outcomes should be identified. It acknowledged that, in some instances, outcome data might not be available for several years after the initial implementation of an education or training program. However, entities should accumulate outcome data as soon as possible to support investment treatment of education and training programs. The Board expects that there should be no significant delay in accumulating output data.

The Board decided that the designation "intellectual capital" should be changed to "research and development." It reaffirmed its position that there should be no output/outcome test for investment treatment of research and development programs. It also decided that reporting expenses for research and development programs should be subject to the same transition approach as human capital, described above.

After staff incorporates the Board's comments into the drafts, they will be circulated to the Board members for final approval. Once approved, these drafts will be held for inclusion in the exposure draft on Stewardship Reporting, anticipated to be published in Spring 1995.

PROPERTY, PLANT AND EQUIPMENT

The Board moved closer to the completion of its Property, Plant and Equipment (PP&E) Exposure Draft (ED) after review and discussion of a preliminary draft at the October meeting. The preliminary draft was based on decisions made by the Board in past months and reported in this newsletter; no major changes resulted from the Board's discussion.

However, the Board members discussed a new issue--treatment of software costs. At issue was whether to capitalize costs for (1) internally developed software, (2) contractor developed software, and (3) software used in revenue-producing activities (e.g., providing payroll services to other entities). The discussion highlighted several issues:

--Are software costs an integral part of cost of operations?

--Is it appropriate to:

--capitalize hardware without capitalizing the software that is essential to running the hardware?

--capitalize purchased software (e.g., off the shelf products) and expense self-developed software?

--Can we determine a useful life for software?

--Can we establish criteria for successful efforts to avoid capitalizing unproductive expenditures?

--What elements of software costs should be capitalized (e.g., planning, development, training, documentation, and modification)?

The Board did not reach a consensus on these issues. Staff was directed to research these issues and develop options for discussion at the December Board meeting.

Minor issues that arose in the discussion were successfully resolved. The preliminary ED will be revised and returned to the Board for consideration at the December 8th meeting.

LAND; FEDERAL MISSION PROPERTY, PLANT, AND EQUIPMENT; HERITAGE ASSETS; AND NON-FEDERAL PHYSICAL PROPERTY

Drafts of accounting and reporting standards for land, Federal mission property, plant, and equipment (PP&E), heritage assets, and non-Federal physical property were discussed by the Board principally in connection with its discussion of a draft standard relating to property, plant and equipment (PP&E). Definitions of various categories of resources were discussed and guidance was provided to staff as to needed revisions to the definitions.

Staff indicated that the drafts would be revised to complement materials in the PP&E document and to incorporate applicable concepts from the Human Capital and Research and Development standards. The draft standards will be brought back to the Board at its December meeting.

PUBLIC HEARINGS

NOVEMBER 29 AND 30

The Board held a public hearing on November 29 and 30 for the purpose of accepting testimony on the Entity and Display and Managerial Cost Accounting Standards exposure drafts. There were seven presenters on each subject. Presenters included representatives from the National Performance Review, federal agencies, academia and the private sector. The Board found the hearings very informative and useful. A transcript of the hearing was taken and the issues are being summarized by the staff.

JANUARY 9 AND 10

Another hearing is planned for January 9 and 10. The hearings will cover Managerial Cost Accounting Standards, for those who could not participate in November, and Accounting for Federal Liabilities. The January hearings will be held in Room 4N30 (not the usual room) of the General Accounting Office, 441 G St., NW, Washington, DC, from 9:00 AM to 4:00 PM.

NEXT BOARD MEETING

The next Board meeting will be January 19, 1995.

COMMENT DEADLINE EXTENDED FOR LIABILITIES ED

The deadline for written comments has been extended to January 31 for the Liabilities ED. Due to a greater than expected demand for the ED, an additional printing was necessary, leading to some delay in getting it into the hands of all who have requested copies.