Federal Accounting Standards Advisory Board

November 30, 2007

To: Members of the Standard General Ledger Issues Resolution Committee

From: Wendy M. Payne, Executive Director

The Federal Accounting Standards Advisory Board (FASAB) will be considering its technical agenda in early 2008. There are many potential projects to consider and the Board would like to have informal feedback regarding the most important uses of its resources. I appreciate your willingness to devote time to this topic at your meeting on December 13th.

The attached material provides information about the Board's current agenda, criteria that the Board relies on in selecting projects and a list of potential projects. At the meeting, I hope to discuss with the members of your group the list of projects. Areas for discussion include the importance you place on each project, any barriers to success for each project and any issues that you'd like to raise for the Board's consideration.

I recognize that time is limited and have included a place for you to list your top five projects on page 4. It would be helpful if you returned this completed list to me at the end of the meeting. If you are unable to attend the meeting, please feel free to provide your input to me by phone or e-mail.

If you have any questions or concerns before the meeting, please contact me at 202 512-7357 or paynew@fasab.gov.

Attachment 1 – Current Project Status
Attachment 2 – Criteria for Ranking Projects (modified)
Attachment 3 – Potential Projects

441 G Street NW, Mailstop 6K17V, Washington, DC 20548 ♦(202) 512-7350 ♦fax 202 512-7366

FASAB Current Technical Agenda & Status of Projects

Project	Previous Key Milestones	Quarter 4 2007	Quarter 1 2008	Quarter 2 2008	Quarter 3 2008	Staff Contact
Natural Resources		Field Test	Oil & Gas DP	Oil & Gas DP	UR	Rick Wascak, 202-512-7363
Fiduciary Activity	SFFAS 31 Issued – October 2006		Implemen-tation Guidance Finalized			Eileen Parlow, 202-512-7356
Concepts Project:						
Elements	ED – 6/2006 PH-9/2006	UR & Final				Penny Wardlow, 202-512-7350
Measurement Attributes		Project Plan	Research	Research	Research	Penny Wardlow, 202-512-7350
Financial Reporting Communications Methods		Research	ED	DP	DP	Ross Simms, 202-512-2512
Fiscal Sustainability		Research	Research	ED	DP	Eileen Parlow, 202-512-7356
The Federal Entity		Research	Research	ED	DP	Melissa Loughan, 202-512-5976
Social Insurance Liabilities	PV -- October 2006	DP	DP	DP	DP	Richard Fontenrose, 202-512-7358
Reporting Gains & Losses from Changes in Assumptions		ED	DP	DP	UR	Richard Fontenrose, 202-512-7358
Appropriate Source of GAAP		Research	Research	ED or Other Product		Julia Ranagan, 202-512-7377

Key Activities or Status

Research—Staff Research Phase of Project & Board Deliberations
ED—Exposure Draft Issued
DP—Board Due Process, including review of comment letters, public hearings, etc.
PH—Public Hearing
UR—Under Review, document approved by FASAB and sent to sponsors for 90-day review
Final—Final Standard, Concept, Interpretation, etc. issued final.

CRITERIA FOR RANKING PROJECTS

1. **Significance of the issue relative to meeting reporting objectives**
    a. Would alternative solutions contribute to meeting primary near-term focus objectives of operating performance or stewardship?
        i. If so, would an alternative also contribute directly or indirectly to a secondary near-term focus objective?
        ii. If not, are contributions to secondary near-term focus objectives significant?
    b. With respect to meeting reporting objectives, are one or more alternative solutions likely to produce an improvement in information that is important to external, legislative, and executive branch users?
    c. Is the issue so egregious that not resolving it would damage the credibility of federal financial reporting?
    d. Is current practice diverse among federal entities and is comparability between federal entities important in this area?
    e. Is financial information that is relevant, reliable and comparable already available and likely to remain available?
    f. Is it likely that the project will clarify the federal reporting model or lead to concepts that provide a sound foundation for future projects?
2. **Pervasiveness of the issue among federal entities**
    a. Are many federal entities faced with this issue?
    b. Are significant dollar effects on federal financial reports likely?
    c. Is the issue raised by a single event (e.g., major restructuring of departments) unlikely to recur often and/or for which level A GAAP guidance could not be provided in a timely manner?
    d. Is there existing ambiguity, which contributes to divergence of practice or other difficulties for preparers, auditors and users?
3. **Technical outlook and resource needs**
    a. Have other standard setters done research or developed a standard(s) that could be useful to FASAB?
    b. Are other standard setters currently undertaking projects of potential significance to federal accounting such that a simultaneous project would be desirable?
    c. Are there sufficient resources available to research and resolve the question on a timely basis?
        i. Would a task force of preparers, auditors and/or users be needed and available to assist?
        ii. Are Board resources balanced appropriately between major projects and projects that offer technical guidance or fill voids in applying existing standards?
    d. Are there barriers to finding a solution that is likely to be accepted generally? (e.g., Would legislation be required to compel compliance? Would extensive changes to systems or the audit model be needed to successfully address the issue?)

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Identification of Top Five:

Please identify – from the list above or based on issues you've identified – the five projects you believe FASAB should make a priority in the next two years.

1. ______________________________

2. ______________________________

3. ______________________________

4. ______________________________

5. ______________________________

APPLICATION OF THE LIABILITY DEFINITION

The primary objective of this project is to reconsider the recognition, measurement and display of liability and expense, potential new elements/statements, and all related disclosures for commitments of the federal government that have the potential to result in a net outflow of resources. This project is a companion research project to the recently completed work defining "liability" in a concepts statement and the social insurance project. The project will help determine the impact of proposals currently under review by the Board on accounting for non-exchange liabilities and liabilities from government-acknowledged events. This project was deferred until issuance of the element document. In early 2008, staff will be seeking members' input on (1) restarting the project and/or (2) recasting the project so that it focuses on classes of transactions or events.

ASSET RETIREMENT OBLIGATIONS

In some circumstances entities may be required to incur costs to retire assets. The Board has established general standards for liability recognition and specific standards for liabilities associated with environmental cleanup (in SFFAS 5, *Accounting for Liabilities of the Federal Government,* and SFFAS 6, *Accounting for Property, Plant and Equipment (PP&E),* respectively). However, there is no specific guidance regarding asset retirement obligations other than cleanup costs (e.g., hazardous materials required by law to be cleaned up). GAAP for the private sector includes specific guidance regarding asset retirement obligations developed since our issuance of SFFAS 6. Financial Accounting Standards Statement No. 143, Accounting for Asset Retirement Obligations (issued 6/01) requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. This creates three inconsistencies between entities following federal GAAP and those following FASB GAAP. One, certain liabilities recognized under FASB standards would not be recognized in the federal sector. Two, FASB standards require that liabilities be recognized in full when the obligation occurs while FASAB standards provide for incremental recognition so that the full liability is recognized at the end of the useful life of the asset requiring environmental clean up. Three, the asset retirement costs are added to the total cost of the asset under FASB standards and are not in the federal sector; instead these costs are expensed as the liability is recognized.

COMMITMENTS

The financial report of the US Government includes a disclosure regarding commitments. The disclosure is not required through federal standards but is generally accepted practice. It addresses contractual commitments requiring future resources, other contractual commitments that may require future resources (e.g., callable capital), and treaties and other international agreements. The disclosure also notes other risk exposures such as war risk and terrorism insurance. Dollar amounts are presented for lease commitments, undelivered orders and other commitments.

COST OF CAPITAL

The opportunity cost of making an investment in assets is not recognized in the financial statements of agencies using the assets. Some other national governments have incorporated a capital use charge into the determination of the cost of agency operations as a management tool. The Board considered this issue in connection with SFFAS 6 and issued an invitation to comment. Ultimately the Board deferred further work on this project. In doing so, the Board noted that there was interest in incorporating a cost of capital in the budget and that progress in this area would benefit the Board's work. If this project were undertaken, the Board would need to consider the likely effectiveness of incorporating a capital charge in agency financial statements, the appropriate capital base on which to assess the charge, and the selection of an interest rate to apply.

DEFERRED MAINTENANCE AND ASSET IMPAIRMENT

The Board promulgated standards for PP&E in SFFAS 6 and addressed (1) deferred maintenance reporting and (2) complete impairment (e.g., impairment necessitating removal of the item from service or repairs to return the item to service). The Board recognized that the deferred maintenance reporting requirements in SFFAS 6 were permissive with respect to measurement but that the issue was significant enough to require reporting. The Board expected to revisit and improve the requirement after experience had been gained. In addition, the Governmental Accounting Standards Board (GASB) and the International Public Sector Accounting Standards Board (IPSASB) have addressed the topic of asset impairment. Under the GASB standard, a capital asset is considered impaired when its service utility has declined significantly and unexpectedly. In these cases, a loss is recognized. GASB's standard provides a broader notion of impairment than currently addressed in SFFAS 6 because it provides for recognition of losses due to partial impairment.

The FASAB project scope would include definition, recognition, measurement, and disclosure of deferred maintenance and asset impairment. In addition, the impact of deferred maintenance and/or impairment on the estimates of useful life, depreciation expense and related disclosures would be considered. Staff would begin by reviewing the GASB and IPSASB exposure drafts, comment letters, available issue papers and final standards. Staff would identify (1) any provisions incompatible with the federal environment or reporting model and (2) significant issues deliberated by GASB and/or IPSASB for possible re-deliberation by FASAB.

DERIVATES

Staff has not researched the use of derivatives by federal agencies and has not had any inquiries by agencies or their auditors regarding appropriate accounting for derivatives. However, this is an area generally addressed in other domains and the GASB recently issued an exposure draft on the topic. Selected material from the GASB's plain language explanation is presented below as background.

What is a derivative instrument and how does it benefit state and local governments?

A derivative is an often complex financial arrangement in which two parties agree to make payments to each other. Each party has a different obligation. Derivative instruments are leveraged, meaning they are entered into with no or small initial investments. Most derivative instruments are entered into by governments with the intent to lower the costs of borrowing, lock-in prices or lower price volatility.

What would an accounting standard on derivative instruments accomplish?

The proposed accounting standard would require derivative instruments to be reported on the financial statements at their fair values. The changes in the fair value of a hedging derivative instrument would be reported as deferred inflows and outflows. The changes in fair value of other derivative instruments would be reported immediately as income or loss. A hedging derivative instrument significantly reduces an identified financial risk by substantially offsetting the changes in cash flows or fair values of the item it is associated with.

ELECTRONIC REPORTING

The benefits of electronic reporting are increasingly discussed in the federal as well as private and state/local governmental sectors. While operational aspects of such reporting are unlikely to be viewed as aligning with FASAB's mission, advancements in this area may have implications for standard-setting. For example, increased detail may become less costly. In addition, issues of completeness may arise as a result of users increased ability to by-pass comprehensive statements. This project might be viewed as a "monitoring" effort initially.

EVALUATION OF CURRENT STANDARDS

Some have suggested a comprehensive review of current standards to determine their effectiveness. This review could be accomplished as a single project or as multiple individual projects (e.g., focusing on cost accounting, the statement of financing or each previously issued standard in priority order). Particular interest has been expressed in a review of (1) the merits of fair value accounting for property, plant and equipment, (2) evaluation and possible elevation of deferred maintenance information, (3) improvement to cost accounting guidance, (4) review of SFFAS 7 provisions regarding the statement of financing (or parallel note disclosure), and (5) a general review of existing disclosure requirements.

FINANCIAL/ECONOMIC CONDITION

The Board is actively pursuing fiscal sustainability reporting. However, a broader focus on financial condition reporting might result in additional reporting such as key indicators of financial condition at the agency or government-wide level. Questions such as the following could be addressed:

- What key financial ratios are useful in assessing the financial health of the entity?
- What information about the tax system is viewed as an indicator of financial health? (e.g., tax gap, tax expenditures, changes in the tax base/structure)
- Is cost trend information needed at disaggregated levels? (e.g., trends in construction costs for capital intensive operations or personnel costs for labor intensive operations)
- Are there external reports/measures that should be reported such as rating agency reports regarding sovereign nations?
- Are benchmarks against other nations/departments needed?

INSURANCE

The International Accounting Standards Board (IASB) is developing standards for insurance contracts and it is feasible that new approaches will emerge. While FASAB has addressed insurance as one component of SFFAS 5, a thorough review of emerging practice and consideration of risk assumed (see specific project listed under "risk assumed") may be warranted.

INTANGIBLES

The FASAB standards do not address intangible assets other than internal use software. Staff has been contacted by a few individuals with respect to intangibles such as census data and rights to use of inventions. The GASB recently issued *Accounting and Financial Reporting for Intangible Assets.* The issuance is described as follows on the GASB website:

> Statement No. 51 identifies an intangible asset as having the following three required characteristics:
>
> - It lacks physical substance—in other words, you cannot touch it, except in cases where the intangible is carried on a tangible item (for example, software on a DVD).
> - It is nonfinancial in nature—that is, it has value, but is not in a monetary form like cash or securities, nor is it a claim or right to assets in a monetary form like receivables, nor a prepayment for goods or services.
> - Its initial useful life extends beyond a single reporting period.
>
> The standard generally requires intangible assets to be treated as capital assets, following existing authoritative guidance for capital assets, although certain intangible assets are specifically excluded from the scope of the statement. One key exclusion relates to intangible assets that are acquired or created primarily for the purpose of directly obtaining income or profit. Such intangible assets should be treated as investments. The standard also provides guidance for issues specific to intangible assets. For instance, to report the historical cost of an intangible asset in the financial statements, the asset has to be *identifiable.* That means that the asset is *separable*—the government can sell, rent, or otherwise transfer it to another party.

If it is not separable, the asset has to arise from contractual or other legal rights, such as water rights acquired from another government through a contract that cannot be transferred to another party.

INVESTMENTS

FASAB has not issued standards applicable to investments by federal entities in securities (debt and equity) and other financial instruments issued by other than the U.S. Treasury or to investments in marketable Treasury securities not expected to be held to maturity.

LEASES

This project has been rated very highly but action has been deferred in light of the active IASB project on lease accounting. FASAB previously indicated an intention to take the project up when IASB standards are completed.

Current FASAB standards addressing leasing transactions include SFFAS 5 and SFFAS 6. This guidance broadly defines capital and operating leases, outlines the four criteria for capital lease classification, and requires the recognition of liabilities and assets related to capital leases. The criteria on distinguishing between capital and operating leases have been criticized as ineffective because they do not make meaningful distinctions regarding the substance of lease transactions. Some argue that all leases convey rights and obligations which create assets and liabilities.

The primary objective of the IASB project is to ensure recognition of assets and liabilities arising under leases that are consistent with the IASB Conceptual Framework definitions. The IASB has tentatively agreed that accounting for leases should be based on the analysis of the assets and liabilities that arise from contractual rights and obligations. Conceptually speaking, the IASB tentatively agrees that the recognition of assets and liabilities should not be limited to contracts that convey rights that are economically similar to outright ownership. Rather the focus should be on the conveyance of rights to future economic benefits (such as the right of use). The model is described briefly as follows:

(a) A lessor would recognize:
   1) assets that include:
      a) its contractual rights to receive cash
      b) its residual rights in the leased property
   2) liabilities that include its contractual obligations under the lease

(b) A lessee would recognize:
   3) assets that include its right of use (i.e. unconditional rights to use leased property subject to any restrictions on its use imposed under the lease)
   4) liabilities that include its contractual obligations under the lease

LINKING COST AND PERFORMANCE (SEA)

While performance reporting can be viewed as a stand-alone project, the Board has a potentially separate interest in the cost information included in performance reports. SFFAS 4 established managerial cost accounting concepts and standards. At the time, the Board expressed the view that standards and practices would "evolve and improve as agencies gain experience in using them." (par. 24 of SFFAS 4) The objective of a project on cost information might be "to assess the effectiveness of SFFAS 4 in improving the quality and availability of cost information related to programs and consider options for improving the effectiveness of SFFAS 4." If improvements are needed, the Board might then consider whether improvement can be obtained through standards, educational efforts, or other means.

LONG-TERM CONSTRUCTION/DEVELOPMENT/PROCUREMENT CONTRACTS

In its work on National Defense PP&E (ND PP&E), the Board considered the need for disclosures regarding complex, long duration contracts for the development and acquisition of weapons systems. One proposal included a disclosure of the ten largest acquisition programs showing budgeted amounts, expected amounts, cost to date and progress to date. Exposure of this proposed disclosure requirement revealed a number of technical areas that required clarification as well as resistance to this non-traditional disclosure among some commentators. The Board elected to move forward to eliminate the special category ND PP&E and any disclosures unique to the category. As a result, the Board set aside its work in this area. However, the Board noted (in the Basis for Conclusions to a subsequent ED and SFFAS 23 – *Eliminating the Category National Defense PP&E*) its intention to return to this proposal on a government-wide basis in the future.

OMNIBUS AICPA

GASB is undertaking a new project related to AICPA guidance. GASB's project plan notes:

> The objective of this project is to consider incorporating accounting and financial reporting standards that are included in current and recently modified Statements on Auditing Standards (SASs) to more effectively present those standards so that these requirements become the responsibility of the financial statement preparers. The scope of this project would include analysis of current and recently modified SASs to identify accounting and financial reporting standards. The Board would then analyze that guidance to determine if that guidance should be incorporated into the GASB literature.
>
> The primary research issue is identifying, in the SASs, the various accounting and financial reporting requirements. For example:

- Subsequent events requirements
- Related party transactions (focus on government-related issues)
- Materiality consideration (rollover versus iron curtain approaches)
- Going concern

Staff has arranged to collaborate with the GASB staff on this research; with GASB staff bearing much of the initial work load and FASAB staff seeking to identify any federal specific issues.

PERFORMANCE REPORTING

The GASB initiated a project on service efforts and accomplishments (SEA) reporting in spring 2007. The project objective is “principles-based guidelines for SEA reporting that assist governments in meaningfully and understandably reporting measures they select based on the goals and objectives they themselves establish.” A companion project at the federal level may provide insights needed to improve performance and accountability reporting.

PROPERTY WITH REVERSIONARY INTEREST

The Federal Government sometimes retains an interest in PP&E acquired with grant money. In the event that the grant recipient no longer uses the PP&E in the activity for which the grant was originally provided the PP&E reverts to the Federal Government. These arrangements are specifically excluded from PP&E accounting. Some have suggested that a review of this exclusion is needed to ensure that similar arrangements are accounted for similarly and that adequate information is reported in such circumstances.

PUBLIC PRIVATE PARTNERSHIPS

The IPSASB has an active project considering service concession arrangements (a type of public private partnership (PPP)) and recently expanded it to include all PPPs. The issues the project intends to consider include (but are not necessarily limited to):

- Clarifying terminology (eg: service concession arrangements, public private partnerships);
- Adequacy of existing standards for addressing both known and anticipated service concession arrangements for both grantors and operators;
- Symmetry of accounting for both parties to a service concession arrangement;
- Implications for other arrangements governments may have related to the employment of their capital assets - eg: leasing, sale-leasebacks or other arrangements;
- Recognition of infrastructure subject to service concession arrangements; and
- Recognition of revenue and expenditure flowing from these arrangements.

FASAB has considered addressing PPPs in the past. The following excerpt provides some federal perspective on PPPs financial consequences:

> Critics of public private partnerships caution that these ventures are not the least expensive means of meeting capital needs, although they may appear to be in the short-term. They remind decisionmakers that up-front payment of appropriated funds is the least expensive way to obtain assets. Although partnerships may be more costly, it is possible that they could make sense from a mission perspective. However, the full costs should be transparent to decisionmakers through inclusion in primary budget data.
>
> (Source: GAO-03-1011 entitled 'Budget Issues: Alternative Approaches to Finance Federal Capital' which was released on August 21, 2003.)

RESEARCH AND DEVELOPMENT

Research and development (R&D) costs are presented as required supplementary stewardship information (RSSI) and include both direct R&D spending by agencies and spending which supports non-federal research and development. Generally, staff believes FASB standards for R&D are referenced to determine what spending qualifies as R&D (for example, to identify when to begin capitalizing costs as new assets are developed). Given the significant federal investment in R&D ($127 billion in 2006) and the possible differences between sectors, a review of practices in this area may be warranted.

RISK ASSUMED

SFFAS 5 notes that risk assumed information is important for all federal insurance and guarantee programs (except social insurance, life insurance and loan guarantee programs). Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums, based on the risk inherent in the insurance or guarantee coverage in force. Currently, risk assumed information is presented as required supplementary information (RSI). A review of practice after a period of experimentation and consideration of additional requirements was envisioned as a follow on to the initial SFFAS 5 provisions.

STEWARDSHIP INVESTMENTS

The Board undertook the effort to reclassify all RSSI several years ago. It completed work on two of three categories of information – stewardship responsibilities and stewardship property, plant and equipment. The remaining RSSI category is stewardship investments including human capital, R&D, and non-federal physical property. The Board deferred addressing this category so that it could devote additional resources to higher priority projects.

SUMMARY OR POPULAR REPORTING

Agencies are issuing summary reports and some view these as the primary report for citizen users. In addition, some have recommended that a summary report for the government as a whole be issued. Whether there is a need for guidance or standards has not been explored by staff.

SUPPORT AND OUTREACH THROUGH GUIDANCE AND EDUCATION

While this item would best be considered in the context of strategic planning, it is listed here as a reminder of alternatives other than addition of major technical projects. Staff provides advice to preparers and auditors on an informal basis and supports education through review of textbooks, public speaking and other educational avenues (such as the CGFM program). Allocation of additional resources to this area might include (1) development of user guides, (2) more formal implementation guidance, or (3) evaluation of user needs and focus groups on communicating effectively through financial reports.