



August 8, 2008

Memorandum

To: Members of the Board

From: Penny Wardlow, Consultant and Roberta Reese, GASB Project Manager

Wendy M. Payne

Through: Wendy M. Payne, Executive Director

Subj: **Conceptual Framework: Measurement Concepts for Governmental Financial Reporting.* Joint Meeting between FASAB and GASB —TAB F**

Note: *GASB members have received an identical paper.*

PURPOSE OF THE MEETING

The purpose of the meeting is for the Federal Accounting Standards Advisory Board (FASAB) and the Governmental Accounting Standards Board (GASB) to explore jointly, at a high level, measurement concepts appropriate to governmental financial reporting objectives. The meeting is intended to be informational and to provide an opportunity for Board members to exchange views on how different measurement attributes—primarily fair value and historical cost, broadly defined—may help meet each Board's financial reporting objectives. The two Boards are in the early stages of their conceptual framework projects on measurement and staff has not prepared options for consideration regarding coordination of the Boards' efforts; therefore a discussion of cooperation or coordination is not planned for this meeting. However, this meeting's discussions can make an important contribution, should the Boards wish to consider the possibilities for coordination in the future as the separate projects develop.

* The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

The governmental environments in which the Boards operate have significant similarities. In particular, (a) the mandate of both the Federal government and state and local governments is to provide services to assist in maintaining and enhancing the wellbeing of their citizens, (b) taxation is a major source of government revenues and governments are accountable for the use of tax revenues, (c) governmental entities generally have citizen (rather than shareholder) stakeholders, and (d) governments generally are long lived. Because governments' operating environments are similar, their financial reporting objectives also are similar.

This paper will briefly describe each Board's measurement project, highlight what the Boards' financial reporting objectives have most in common, and present some questions for the Boards to discuss on what those objectives may imply for the selection of measurement attributes. For simplicity, the discussion of measurement attributes will focus on fair value and historical cost, as broadly defined in the next section. The Boards are aware that considerable research and Board deliberations will be needed before conclusions can be drawn as to whether fair value or historical cost better meets some or all financial reporting objectives. For that reason, and because the meeting goal is to encourage members of each Board to express and discuss their views with other members, the paper does not include staff recommendations.

DEFINITIONS

Many terms related to "measurement" and "measurement attributes" have various meanings in concept and in practice. We have provided the following general definitions to encourage meeting participants to use and interpret the terms in the same way for this meeting. This should enhance communication during the exchange of ideas. We are not proposing that the Boards discuss or formally adopt these definitions at the meeting.

Measurement—Traditionally in accounting, the assignment of numerical values to objects or events related to an entity and obtained in such a way that the amounts can be aggregated (such as the total valuation of assets) or disaggregated.¹

Measurement attribute—A property or feature of an object or event that can be measured. For example, measurement attributes of assets include their historical cost and fair value; measurement attributes of liabilities include their historical proceeds and current settlement value.

Fair value—Broadly, any current acquisition, sale, or settlement price of an asset or liability, including replacement cost and value in use.

Historical cost—The transaction price or value when an asset was acquired or a liability was incurred, including subsequent modifications to that price or value, such as through amortization or depreciation.

PURPOSE AND SCOPE OF EACH BOARD'S PROJECT

FASAB

The Measurement Attributes project is part of the FASAB's reexamination and expansion of its conceptual framework. The project follows from SFFAC 5² on elements and recognition in the financial statements, which states that being *measurable* is a basic criterion for recognition of an element in the financial statements but does not address measurement attributes or methods.

The purpose of the project is to provide guidance primarily for the Board on the selection of measurement attributes in future federal financial reporting standards and thereby enhance the consistency of standards. FASAB standards currently include at least seven measurement attributes (acquisition cost, fair market value, amortized acquisition cost,

¹ Adapted from Hendriksen, Eldon S., *Accounting Theory* (Homewood, Illinois: Richard D. Irwin, Inc., rev. ed., 1970), p. 111)

² Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* (2007)

market value, present value of estimated net cash inflows, historical cost, and face or par value net of unamortized discount), without explicit explanation of (a) why a particular attribute was chosen over other attributes for a particular standard, (b) how apparently similar attributes differ from each other, and (c) whether and how such differences may affect assessments of government accountability and the decisions that may be informed or influenced by information reported in financial statements.

The Board has decided to focus initially on measurement attributes in the financial statements (including notes), with the possibility of expansion later in the project or in a subsequent project to include attributes used in required supplementary information and other supplementary information. The concepts statement is expected to include definitions and discussion of different measurement attributes as well as measurement concepts. Additional scope issues remain to be decided, such as whether the concepts statement should provide a neutral list of the merits of each attribute or also should provide criteria for choosing among attributes as standards are set.

To date the FASAB has held four meetings on this project. In addition to deciding on the scope of the project (December 2007), the Board has discussed and tentatively adopted (February 2008) measurement attributes proposed by the FASB and the IASB in their April 2007 summary report on their joint project, as a starting point for further research and deliberation by FASAB. At the April 2008 meeting, the FASAB discussed concepts underlying the FASB/IASB measurement attributes, including measurement concepts and the difference between a “price” and a “value.” The Board also discussed alternatives for proceeding with the project, given the possibility that the FASB and the IASB might change their original project plan. At the June 2008 meeting the FASAB decided that staff should research which measurement attributes are required by FASAB standards and why a particular attribute was selected for a particular standard, if the basis for conclusions addresses the Board’s decision regarding measurement. Also, staff should begin preparations for a staff-level task force meeting to assist in assessing the feasibility and usefulness of the FASB/IASB proposed attributes and other measurement attributes in relation to the federal financial reporting objectives. The

Board expressed a continuing interest in the future course of the FASB/IASB project as well as in the purpose and content of the GASB's measurement project.

GASB

The GASB's conceptual framework project on measurement attributes includes developing conceptual guidance for recognition in financial statements as well. GASB's existing conceptual framework includes GASB Concepts Statement No. 4, *Elements of Financial Statements*, and this project on recognition and measurement is needed to complete the conceptual guidance for reporting items in traditional financial statements.

The GASB's project has two primary objectives. The first objective is to develop recognition criteria for *whether* information should be reported in state and local governmental financial statements and *when* that information should be reported. The second objective is to consider the measurement attribute or measurement attributes (for example, historical cost or fair value) that conceptually should be used in governmental financial statements. The GASB frequently must decide whether an item of information should be recognized in the financial statements, when such an item should be recognized, and at what amount it should be recognized. In the past, the GASB has relied on the conceptual frameworks of other standards setters and analogous examples from practice or previous standards to assist the Board in making such decisions. This method of making decisions tends to lead to certain inconsistencies in financial reporting standards and could result in too much reliance being placed on accounting concepts that were not developed for a governmental environment.

The GASB has tentatively decided that the scope of this project is limited to recognition and measurement concepts for historically-based financial statements and that these financial statements include those prepared using the economic resources (accrual basis), current financial resources, and cash measurement focuses. The GASB began deliberations on this project in December 2007, initially focusing on recognition concepts for current financial resources measurement focus financial statements.

The GASB discussed measurement attributes on a preliminary basis at the July 2008 meeting. The principal objective of this discussion was to review the developments in the FASB/IASB joint conceptual project on measurement and in the FASAB's project in preparation for the August 2008 meeting.

FINANCIAL REPORTING OBJECTIVES

The financial reporting objectives established by the GASB³ and the FASAB⁴ are reproduced in Attachment 1. They have much in common. Because time is limited at this meeting, we have selected two of each Board's objectives and have highlighted (using **BOLD FACE CAPS**) specific sub-objectives within those objectives for use in framing discussion questions for the Boards. We have selected these sub-objectives because they are (a) very similar to each other and (b) should prompt a discussion of which measurement attribute—fair value or historical cost—better helps meet the sub-objectives, or whether one attribute is more likely than the other to meet the sub-objectives in particular circumstances. In this context, the terms *measurement attribute*, *fair value*, and *historical cost*, are as defined in the Definitions section earlier in this paper. The objectives are presented in two pairs, as follows:

³ Governmental Accounting Standards Board, Concepts Statement No. 1, *Objectives of Financial Reporting*, issued May 1987, pars. 76-79 (italics in the original)

⁴ Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts 1: *Objectives of Financial Reporting*, issued September 2, 1993

PAIR I

GASB (par. 77): Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.

- a. Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services. . . .
- b. Financial reporting should demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements.
- c. Financial reporting should provide information to assist users in assessing the service efforts, **COSTS**, and accomplishments **OF THE GOVERNMENTAL ENTITY**.

FASAB—Operating Performance (par. 14): Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

- the **COSTS OF PROVIDING SPECIFIC PROGRAMS AND ACTIVITIES** and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

PAIR II

GASB (par. 78) Financial reporting should assist users in evaluating the operating results of the governmental entity for the year.

- a. Financial reporting should provide information about sources and uses of financial resources. . . .
- b. Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.
- c. Financial reporting should provide information necessary to determine **WHETHER THE ENTITY'S FINANCIAL POSITION IMPROVED OR DETERIORATED AS A RESULT OF THE YEAR'S OPERATIONS.**

FASAB—Stewardship (pars. 15, 16): Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine **WHETHER**

- **THE GOVERNMENT'S FINANCIAL POSITION IMPROVED OR DETERIORATED OVER THE PERIOD,**
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

In Pair I we have highlighted the sub-objectives related to the **COST** of providing programs, activities, or services, which is a primary function of government. In Pair II we have highlighted **CHANGES IN THE GOVERNMENT'S FINANCIAL POSITION,** which is information of major interest to many users.

DISCUSSION TOPICS

1. From Pair I:

USERS NEED INFORMATION ABOUT THE COST OF GOVERNMENT PROGRAMS.

- A. Conceptually, which measurement attribute—fair value or historical cost—better meets the objective of reporting the cost of a current service or program? That is, should the reported amount be:
- a. What taxpayers paid (X years ago in total or adjusted for depreciation or amortization) for the assets consumed? [*historical cost*]
 - b. What today's taxpayers would pay for the assets in the market? [*fair value*]

Example: Government X provides a commodity to citizens from its stockpiles. The commodity was acquired for \$20 but would cost today \$100. Which “cost” better aligns with the reporting objective?

- B. Would your answer change if the example were the use of a capital asset in providing services rather than a commodity?

2. From Pair II:

USERS NEED INFORMATION ABOUT CHANGES IN A GOVERNMENT'S FINANCIAL POSITION.

- A. In what situations would users be more interested in (1) fair value or (2) historical cost of government assets and liabilities? When the government is [*Choose one measurement attribute for each question.*]:
- a. Considering the sale of excess assets? ____ historical cost ____ fair value
 - b. Reporting investments that management expects to hold to maturity? ____ historical cost ____ fair value

- b. Providing education to a stable population of children in existing facilities?
____ historical cost ____ fair value
- c. Issuing bonds? ____ historical cost ____ fair value
- d. Maintaining highways? ____ historical cost ____ fair value
- e. Auctioning rights to resources? ____ historical cost ____ fair value

B. If you chose different attributes for different circumstances, why?

- 3. Financial reporting by both the Federal government and state and local governments uses a multiple-attribute model (different standards require different measurement attributes).
 - a. Did discussions at this meeting lead you to believe that a single-attribute model would be preferable?
 - b. Would a single-attribute model be feasible?

**GOVERNMENTAL ACCOUNTING STANDARDS BOARD'S
OBJECTIVES OF FINANCIAL REPORTING¹**

76. Governmental financial reporting should provide information to assist users in (a) assessing accountability and (b) making economic, social, and political decisions. The duty to be publicly accountable is more significant in governmental financial reporting than in business enterprise financial reporting. For this reason, the Board gave considerable weight to the concept of accountability. It appears throughout the discussion of the governmental environment, and assessing accountability is a pervasive use of financial reporting as indicated in the section on uses of financial reports. Although it is referred to specifically only in paragraph 77, accountability is implicit in all of the listed objectives. The Board considers it to be the paramount objective from which all other objectives must flow.

77. Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.

- a. Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services. This also implies that financial reporting should show whether current-year citizens received services but shifted part of the payment burden to future-year citizens; whether previously accumulated resources were used up in providing services to current-year citizens; or, conversely, whether current-year revenues were not only sufficient to pay for current-year services, but also increased accumulated resources.*
- b. Financial reporting should demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements. [Footnote:*

¹ Governmental Accounting Standards Board, Concepts Statement No. 1, *Objectives of Financial Reporting*, May 1987, pars. 76–79 (italics in the original).

For some items it may be sufficient to demonstrate compliance by identifying items or instances of noncompliance.]

- c. *Financial reporting should provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity.* This information, when combined with information from other sources, helps users assess the economy, efficiency, and effectiveness of government and may help form a basis for voting or funding decisions. The information should be based on objective criteria to aid interperiod analysis within an entity and comparisons among similar entities. Information about physical resources (as discussed in paragraph 79b) should also assist in determining cost of services.

78. *Financial reporting should assist users in evaluating the operating results of the governmental entity for the year.*

- a. *Financial reporting should provide information about sources and uses of financial resources.* Financial reporting should account for all outflows by function and purpose, all inflows by source and type, and the extent to which inflows met outflows. Financial reporting should identify material nonrecurring financial transactions.
- b. *Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.*
- c. *Financial reporting should provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.*

79. *Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due.*

ATTACHMENT 1
to Papers for FASAB and GASB
August 2008 Joint Meeting

- a. *Financial reporting should provide information about the financial position and condition of a governmental entity.* Financial reporting should provide information about resources and obligations, both actual and contingent, current and noncurrent. The major financial resources of most governmental entities are derived from the ability to tax and issue debt. As a result, financial reporting should provide information about tax sources, tax limitations, tax burdens, and debt limitations.
- b. *Financial reporting should provide information about a governmental entity's physical and other nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources.* This information should be presented to help users assess long- and short-term capital needs.
- c. *Financial reporting should disclose legal or contractual restrictions on resources and risks of potential loss of resources.*

FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD'S
OBJECTIVES OF FINANCIAL REPORTING²

The four objectives of Federal Financial Reporting are:

Budgetary Integrity

13. Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations. Federal financial reporting should provide information that helps the reader to determine

- how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization,
- the status of budgetary resources, and
- how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.

Operating Performance

14. Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity;* the manner in which these efforts and accomplishments have been financed; and the management of the entity's

² Federal Accounting Standards Advisory Board, Statement of Federal Financial Accounting Concepts 1: *Objectives of Financial Reporting*, issued September 2, 1993, pars. 13–17.

assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

- the costs of providing specific programs and activities and the composition of, and changes in, these costs;
- the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
- the efficiency and effectiveness of the government's management of its assets and liabilities.

*Footnote: The FASAB has not yet considered criteria for defining, and terminology for describing, federal financial reporting components or units. In this document, therefore, the term "entity" is used in a generic way to refer, depending on the context, to the U.S. government as a whole; to organizational component units of the government, such as an agency; and to other kinds of potential reporting units, such as programs.

Stewardship

15. Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

16. Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,

- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

Systems and Controls

17. Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that

- transactions are executed in accordance with budgetary and financial laws and other requirements, consistent with the purpose authorized, and are recorded in accordance with federal accounting standards;
- assets are properly safeguarded to deter fraud, waste, and abuse; and
- performance measurement information is adequately supported.