

November 13, 2001

The Technical Director
International Federation of Accountants
535 Fifth Avenue, 26th Floor
New York, New York 10017

Dear Sir or Madam:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the International Federation of Accountants (IFAC) Public Sector Committee (PSC) Exposure Draft 21 (ED), *Provisions, Contingent Liabilities and Contingent Assets*.

The FMSB, comprised of 21 members with accounting and auditing backgrounds in federal, state, and local government, academia, and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are encouraged to comment separately.

The FMSB generally supports the proposed guidance contained in the ED. The following reflects both the FMSB's comments on the specific items you requested on pages 4-7, as well as additional comments or questions for clarification.

Comments on "Specific Matters for Comment"

(a) Comments were requested on the plan to exclude from the scope of the standard provisions and contingent liabilities that arise from social benefits that the entity provides to the community and for which no or nominal consideration is expected directly in return from the recipients of those benefits. In the United States, this would apply to welfare payments, such as Medicaid and Food Stamps. The ED indicates that these provisions and contingent liabilities will be addressed in a future standard. We agree that these issues are different from those addressed in the ED and should be addressed separately.

We are not sure whether this exclusion would apply to Social Security benefits, where individuals have contributed substantial amounts and where the benefits are tied to the contributions, but not in a direct

manner. We believe that social security benefits should be recognized as a provision, in some manner.

(b) We agree with the conclusion in the ED that contingent assets should not be booked. We are not aware of significant issues regarding contingent assets that warrant further discussion.

(c) We agree that the application of provisions of onerous contracts to those that were entered into originally with the expectation that both sides would receive approximately equal value from the contract. Most of the "contracts" that originally provided more costs to governments than benefits would be of the social benefits type.

(d) We believe that it is not clear from the ED that the net amount (net of any recoveries) is the appropriate measurement approach. It might also be ambiguous in relation to Paragraphs 61 and 62, which states that disposal of assets are not included as deductions when computing the provision. Therefore, we believe that Paragraph 76 should include the phrase "net of recoveries."

(e) Appendix C is useful in providing examples. In fact, Appendix C is the first place in the document where a reader is provided information regarding situations in which provisions and contingent liabilities would be recognized.

(f) In Paragraph 56 we recommend the government's incremental borrowing rate as the discount rate, not a rate specific to the liability. We believe that the government's incremental borrowing rate, in addition to being easier to determine and apply, properly reflects the recognition of discounting as a financing issue (pay now or pay later), rather than a risk issue.

(g) We agree that the standard should exclude provisions based on employee benefits with the understanding that a later project will address that issue.

(h) We believe that an obligation does not arise until legislation has been enacted. Our experience with government is that the term "virtually certain" is not always as certain as one might believe, when dealing with legislation. It does not seem appropriate to book anticipated losses. It would be appropriate, in some cases, to disclose the anticipated loss as a contingency.

Other Comments and Clarifications

In Paragraph 3, the ED indicates that Governmental Business Enterprises (GBEs) are outside the scope of this document and are to follow general International Accounting Standards, which would be for business enterprises. In the United States, GBEs, as defined on Page 40, would include many state and local government component units and a number of federal agencies. Standards for these entities are prescribed by the Governmental Accounting Standards Board and the Federal Accounting Standards Advisory Board and are often different, even for the same transactions, than those prescribed for business enterprises by the Financial Accounting Standards Board. Some of these differences are due to the absence of a profit motive. On page 42, the ED states “GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.” We question the assumption that GBEs generally operate to make a profit; most exist to provide a service to citizens with no profit motive other than to generate resources to continue service, pay debt, and provide working capital.

The ED has a number of issues that suggest that a separate project will be considered later. However, the ED indicates that the PSC expects to complete the issuance of standards by the end of 2001. Are these two statements in conflict?

Paragraph 64 is the only place that the ED clearly states that a provision will be offset by an expense. Does the IFAC have any plans to provide guidance on the nature of the expense, where it might be displayed, or what it might be called?

Example 3 in Appendix D provides an example of a disclosure exemption due to the fact that a disclosure might affect the outcome of litigation. We agree with the concept. However, the lead-in indicates that a provision has been made, in this example. The note indicates, “The board is of the opinion that the claim can be successfully defended by the agency.” It seems as if the note is misleading. The entity is saying that it believes it will not have to pay anything; while, at the

same time, it has recorded a provision based on the fact that a loss is probable.

Again, the FSMB appreciates the opportunity to provide comments on this ED. If you have any questions, or desire further details on FMSB's position, please contact me at (216) 583-8276 or james.williams17@ey.com or John Engstrom, its facilitator for this project, at (815) 753-6097, or JHEngstrom@niu.edu.

Sincerely,

James M. Williams, CPA, CGFM, Chair,
AGA Financial Management Standards Board

C: Mr. Richard V. Norment, CGFM
AGA National President