Federal Accounting Standards Advisory Board

October 7, 2004

Memorandum

To: Members of the Board

Wendy M. Comes

Through: Wendy M. Comes, Executive Director

Subj: Agenda Setting – 2004/2005[1]

Until the August 2004 meeting, we had not discussed agenda setting since early 2003. In early 2003, the Board agreed that the conceptual framework and social insurance were our top priorities. The potential project list also included actuarial changes. We now have major projects addressing the conceptual framework (with active discussion of both objectives and elements), social insurance liabilities reconsideration (with the expectation that actuarial changes will be considered in the measurement and presentation phase of that project) and long-term liability research.

Attachment 1 (page 5) provides an estimate of major milestones for each current project. The estimates are based on my assessment of earliest possible attainment of the milestone; some delays should be expected. For example, time for re-exposure due to significant changes resulting from responses to exposure drafts is not included in any projects at this time. Also, the current projects list does not include technical inquiries or AAPC work.

At this time, I expect to use the resulting ranking of projects as a guide to assigning selected staff members a supplemental research project or interns/detailees research projects. I do not anticipate placing a new project on the Board's active agenda until one of our current projects is completed; I believe that one or two staff members will be ready to take on a supplemental research project by March 2005.

In 2002/2003, we included two new features in our agenda setting. First, we held a public hearing to solicit project proposals. Second, we used criteria to rank projects. There are three main questions I would like to raise at our October meeting:

[1] 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.

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

1. Do you find the draft criteria for ranking projects to be helpful? If so, do you wish staff to provide its assessments of the potential projects against these criteria for your consideration? Should other criteria be considered?
2. Should we hold a public hearing on potential projects in conjunction with our March 2005 meeting?
3. Attachment 2 provides a list of potential projects including two proposals received. Do you wish to propose additional projects, alter the scope any of the potential projects, or clarify any projects?

CRITERIA FOR RANKING PROJECTS

Presented below are criteria for ranking the projects. An initial draft of criteria was discussed at the December 2002 meeting. The criteria presented below include revisions based on that meeting. Further discussion of the usefulness of the criteria would be helpful and may lead to additional revisions.

In 2002, I provided you with a numerical assessment of each project against the criteria. If you wish to have staff's views on how each project would fare relative to the criteria, I believe a narrative report would be more useful to you. The narrative would provide a basis for the assessment. I expect that such a narrative could be provided for the March meeting.

1. **Significance of the issue relative to meeting reporting objectives**
    - **a.** 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?
    - **b.** Is the issue so egregious that not resolving it would damage the credibility of federal financial reporting?
    - **c.** Is current practice diverse among federal entities and is comparability between federal entities important in this area?
    - **d.** Is financial information that is relevant, reliable and comparable already available and likely to remain available?
    - **e.** 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 unlikely to recur often and/or for which level A GAAP guidance could not be provided in a timely manner (e.g., major restructuring of departments)?
    - **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?)

Do you find the draft criteria for ranking projects to be helpful? If so, do you wish staff to provide its assessments of the potential projects against these criteria for your consideration?

PUBLIC HEARING

A March public hearing would allow us to hear from preparers and auditors regarding any major issues arising during their audits. Providing a forum for presentation of issues may identify areas where there is no federal guidance, the existing standards are unclear or having unintended consequences, or where staff or AAPC guidance would be helpful. The cost of this outreach would be staff resources and at least one-half day of Board meeting time.

Should we hold a public hearing on potential projects in conjunction with our March 2005 meeting?

POTENTIAL PROJECTS

The list of potential projects (Attachment 2) began with the remaining items from our early 2003 discussion. Excluded from the 2003 items were projects on cost accounting and performance reporting. These were excluded due to the active project to address the Board's objectives. At the last meeting, the Board expressed the preference that we not consider these items until we have made more progress on the issues associated with objectives. In addition to the 2003 items, I've added items based on inquiries to staff as well as staff observations of practice.

You will note that the items listed include issues that could be addressed narrowly – for example, through guidance to specific agencies – as well as issues that would fill significant voids in federal standards. Given this mix of issues, I believe there are some items that are at a nature disadvantage – that is, they are long-standing but narrow issues that may not become Board priorities for sometime given our resource constraints. I would be interested in your thoughts on whether selected issues could be addressed through level B GAAP (Technical Bulletins). For example, the issue of FFRDCs at NSF might be addressed through a Technical Bulletin.

In addition to the listed items, I anticipate that we will have some issues referred following the completion of the FY2004 reporting cycle. We continue to receive more inquiries each year as agencies accelerate publication of their audited financial statements. In addition, Department of Defense is developing its policies on accounting for property. Thus, I believe it is more likely than not that we will add issues to this list before the ranking is complete.

Do you wish to propose additional projects, alter the scope any of the potential projects, or clarify any projects?

Do you believe staff should identify candidates for level B GAAP guidance for your consideration before the ranking of projects is completed?

FASAB Current Technical Agenda & Status of Projects

Project	Previous Key Milestones	Quarter 4 2004	Quarter 1 2005	Quarter 2 2005	Quarter 3 2005	Staff Contact
Natural Resources		Oil & Gas Research	Oil & Gas Research	Oil & Gas ED	Oil & Gas DP	Rick Wascak, 202 512-7363
Heritage Assets and Stewardship Land	ED-2003 PH-2004	DP	DP	UR	Final	Melissa Loughan, 202-512-5976
Earmarked Funds	ED-2003 PH-2004	UR & Final				Eileen Parlow 202-512-7356
Fiduciary Activity	ED-2003 PH-2003	DP	DP	UR	Final	Eileen Parlow 202-512-7356
Concepts Project		Research	Research	Research	Research	Robert Bramlett, 202 512-7355
Social Insurance Liabilities		Research	Research	Research	Research	Richard Fontenrose, 202-512-7358
Research into the Application of the Liability Definition		Research	Research	Research	Research	Julia Ranagan, 202-512-7377
Inter-entity Project	ED-2004	DP/PH	DP	UR	Final	Melissa Loughan, 202-512-5976
Stewardship Investments		Research	Research	Research	ED	Melissa Loughan, 202-512-5976

<u>Key Activities or Status</u>
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.

DRAFT POTENTIAL PROJECTS IDENTIFIED – OCTOBER 2004

DEFERRED MAINTENANCE AND ASSET IMPAIRMENT

The Board promulgated standards for property, plant and equipment (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 its SFFAS 6, *Accounting for Property, Plant, and Equipment,* deferred maintenance reporting requirements 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) has addressed and the International Federation of Accountants Public Sector Committee is addressing asset impairment. A summary of the GASB standard is presented below.

Statement No. 42 of the Governmental Accounting Standards Board

Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries

Summary

This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries.

Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. Impairment of capital assets with physical damage generally should be measured using a restoration cost approach, an approach that uses the estimated cost to restore the capital asset to identify the portion of the historical cost of the capital asset that should be written off. Impairment of capital assets that are affected by enactment or approval of laws or regulations or other changes in environmental factors or are subject to technological changes or obsolescence generally should be measured using a service units approach, an approach that compares the service units provided by the capital asset before and after the impairment event or change in circumstance. Impairment of capital assets that are subject to a change in manner or duration of use generally should be measured using a service units approach, as described above, or using deflated depreciated replacement cost, an approach that quantifies the cost of the service currently being provided by the capital asset and converts that cost to historical cost.

Impairment losses should be reported in accordance with the guidance in paragraphs 41 through 46, 55, 56, 101, and 102 of Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and paragraphs 19 through 24 of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. If not otherwise apparent from the face of the financial statements, the description, amount, and financial statement classification of impairment losses should be disclosed in the notes to the financial statements. If evidence is available to demonstrate that the impairment will be temporary, the capital asset should not be written down.

Impaired capital assets that are idle should be disclosed, regardless of whether the impairment is considered permanent or temporary.

An insurance recovery associated with events or changes in circumstances resulting in impairment of a capital asset should be netted with the impairment loss. Restoration or replacement of the capital asset using the insurance recovery should be reported as a separate transaction. Insurance recoveries should be disclosed if not apparent from the face of the financial statements. Insurance recoveries for circumstances other than impairment of capital assets should be reported in the same manner.

The provisions of this Statement are effective for fiscal periods beginning after December 15, 2004. Earlier application is encouraged.

Source: GASB Original Pronouncements

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 and depreciation recognition and disclosures would be considered. Staff would begin by reviewing the GASB and IFAC 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 IFAC for possible re-deliberation by FASAB.

ASSET RETIREMENT OBLIGATIONS

In some circumstances entities incur costs to retire assets. For example, military assets may be subject to special destruction or disposal provisions such that the cost to comply exceeds the recovery from scrap sales. 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 6 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). We believe that asset retirement obligations other than cleanup costs are not consistently recognized.

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 is made 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.

LEASES

I. Primary Objective

The purpose of this project is to broaden the current Federal accounting standards addressing leasing transactions of Federal entities.

II. Background

Current FASAB standards addressing leasing transactions include SFFAS 5, “Accounting for Liabilities of the Federal Government” and SFFAS 6, “Accounting for Property, Plant, and Equipment.” This guidance broadly defines capital and operating leases, outlines the four criteria for capital lease classification, and the recognition of the liability and asset. Entities seeking additional guidance on leasing transactions rely on the FASB standards developed for private sector use. In some cases the FASB standards are applicable to Federal entity leasing transactions and can be applied for appropriate reporting.

III. Project Scope

This project will address all leasing transactions of the Federal government. According to a GAO report “Budget Issues: Alternative Approaches to Finance Federal Capital” (August 2003 GAO-03-1011) the following are some of the financing approaches involving leases that Federal entities are using to finance capital purchases.

- Operating leases
- Sale-Leaseback*
- Lease-Leaseback
- Public Private Partnerships*
- Outleases

*Note that the issue of consolidation of any special purpose entities resulting from these types of leases could be addressed in this project or in a broader project on special purpose entities. See the project heading “Special Purpose Entities.”

IV. Project Approach

Leasing transactions entered into by Federal entities have drastically changed over the years and recognition of those transactions requires broader and more encompassing guidance. Staff proposes to begin the research phase of the project with a thorough review of the current leasing activities of Federal entities. This review will include the review of the factors surrounding the lease transactions and the current reporting.

> Staff will further analyze the " New Approach" being proposed by a working group consisting of Board members and senior staff members of the standard-setting bodies of Australia, Canada, New Zealand, the United Kingdom, and the United States. [2] The proposed approach would eliminate the "arbitrary" determinants of whether a lease is a financial (capital) or operating lease. Instead, all leases of more than one year would be recognized at their present value. Material assets and liabilities arising from operating leases would be recognized at the beginning of the lease term, and reported in lessees' balance sheets. Reporting on operating leases for lessors would change also. They would report financial assets (representing amounts receivable from the lessee) and residual interests as separate assets.

The Leases project is currently an active long-term project of the IASB that was last discussed at their April 2004 meeting. The primary objective of the IASB project will be 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).

FEDERALLY FUNDED RESEARCH AND DEVELOPMENT CENTERS

SFFAS 3 (Accounting for Inventory and Related Property) and SFFAS 6 explicitly require that assets in the hands of others (e.g., contractors) be recognized by the entity owning the assets. For example, federal equipment provided to contractors must be recognized by the federal entity that owns the property. SFFAS 6 provides an exception for PP&E in which the government retains only a reversionary interest. Such PP&E is not recognized by federal entities. National Science Foundation (NSF) requested and received relief from these provisions with respect to property owned by NSF but used by research centers it funds.

A broader issue regarding these centers is unresolved –appropriate criteria for including Federally Funded Research and Development Centers (FFRDCs) in the sponsoring federal entities' consolidated financial reports. At least four federal agencies (Defense, National Science Foundation, Department of Homeland Security, and NASA) provide support to FFRDCs. These centers receive federal funding through cooperative

[2] McGregor, Warren, Accounting for Leases: A New Approach (Recognition by Lessees of Assets and Liabilities Arising Under Lease Contracts), Financial Accounting Standards Board, 1996.
Nailor, Hans and Lennard, Andrew, Leases: Implementation of a New Approach, Financial Accounting Standards Board, 2000. **[Staff provided copies of these two reports to Board members in October 2003.]**

agreements and contractual arrangements. Some centers engage in research intended to benefit the federal sponsoring agency. Other centers – notably those sponsored by NSF – engage in research not directly supportive of a federal agency's operational needs (that is, R&D is not directed to improving the efficiency and/or effectiveness of agency operations) but consistent with the entity's mission.

There is diversity in practice with respect to the FFRDCs. Some are consolidated into the financial statements of the sponsoring agency and some are not. The scope of this project would include answering questions such as:

a. When should FFRDCs be consolidated with the sponsoring federal reporting entity?

b. If included, are there any new disclosures that should be required?

c. If not consolidated, should specific elements (e.g., assets and liabilities) be recognized or disclosures required about FFRDCs?

Note that the question of consolidating FFRDCs might also be addressed through a broader project on special purpose entities described below under the heading "Special Purpose Entities."

COST OF CAPITAL

The cost of investing 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.

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 NDPP&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* (SFFAS 23 is currently under review and has not been issued.)) its intention to return to this proposal on a government-wide basis in the future.

APPROPRIATE SOURCE FOR GAAP AND CONSOLIDATION QUESTIONS --GOVERNMENT CORPORATIONS AND GOVERNMENT SPONSORED ENTERPRISES

Government corporations[3] typically follow GAAP for non-government entities. FASAB recognized this practice as acceptable in early 2000 to avoid an immediate and unanticipated requirement that these “federal entities” follow “federal GAAP” after FASAB was recognized as the Rule 203 standard-setting body. The American Institute of CPAs has requested that FASAB clarify which entities from among the diverse government corporations should be required to convert to FASAB standards in order to receive a GAAP opinion. Generally, the AICPA's objective is to insure that like entities follow like accounting standards. The scope of the project might extend to other federally sponsored or chartered organizations such as Government Sponsored Enterprises[4] and begin with an evaluation of the criteria for inclusion as a federal entity established in SFFAC 2, *Entity and Display*. (Note that the issue of consolidation might also be addressed in a broader project described below under the heading “Special Purpose Entities.”)

SPECIFIC REQUEST - TREASURY COMPENENT ENTITY FASB GAAP REPORTING

In addition to Government Corporations and Government Sponsored Enterprises, some components of departments following FASAB standards also apply GAAP for non-governmental entities. The following letter from the US Department of the Treasury Acting Inspector General requests FASAB consider “requiring Federal GAAP for the general purpose financial statements of Federal entities, unless there is a statutory or regulatory requirement to report on a different basis of accounting.”

[3] In late 1999, there were approximately two-dozen government corporations. Selected examples of government corporations are Commodity Credit Corporation, Corporation for National and Community Service, Government National Mortgage Association, Legal Services Corporation, and Tennessee Valley Authority.
[4] GSEs include the Student Loan Marketing Association, Federal Home Loan Mortgage Corporation and others.

DEPARTMENT OF THE TREASURY
WASHINGTON

April 20, 2004

PECTOR GENERAL

Ms. Wendy M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, D.C. 20548

Dear Ms. Comes:

I am writing to bring to your attention a matter of concern regarding the consistency of the application of generally accepted accounting principles for Federal financial reporting. The Federal Accounting Standards Advisory Board (FASAB) was recognized in October 1999 by the American Institute of Certified Public Accountants as the standards setting body for Federal governmental entities. This established generally accepted accounting principles for Federal governmental entities (Federal GAAP). However, FASAB has allowed Federal entities that had issued financial statements prior to October 1999 using standards issued by the Financial Accounting Standards Board, (private sector GAAP), to continue to do so.

The allowance for continued use of private sector GAAP has had a significant impact on financial reporting at the Department of the Treasury (Department). Ten (10) of the Department's component entities are required to issue stand-alone audited financial statements, and 6 of these entities have continued to report on a private sector GAAP basis. This has resulted in inconsistent and incomplete financial reporting by the Department's component entities, as well as complications in preparing and auditing the Department-wide financial statements. The effects of using two different bases of accounting at the Department are discussed in more detail in the enclosed excerpt from our management letter for the Fiscal Year 2003 audit of the Department's financial statements.

We understand the rationale for allowing certain Federal entities to continue using private sector GAAP for a limited transition period following the recognition of federal GAAP; however, we do not believe it is advisable to continue this practice indefinitely. Federal GAAP addresses the unique nature of Federal operations, and is designed to meet the particular needs of users of Federal financial statements. Accordingly, we believe it provides more comprehensive and informative reporting for Federal entities than private sector GAAP.

In order to strengthen and promote consistency in Federal financial reporting, we encourage the FASAB to consider requiring Federal GAAP for the general purpose financial statements of Federal entities, unless there is a statutory or regulatory requirement to report on a different basis of accounting.

If you have any questions, please contact me at (202) 622-1090 or Bill Pugh, Deputy Assistant Inspector General for Audit, at (202) 927-5400.

Sincerely,

Dennis S. Schindel
Acting Inspector General

Enclosure

cc: Barry Hudson
Acting Chief Financial Officer

Excerpt from Audit Report OIG-04-022, Management Letter for the Fiscal Year 2003 Audit of the Department of the Treasury Financial Statements, dated February 18, 2004

Financial Reporting for Department of the Treasury (Department) Component Entities Should be Consistent

The Department's financial statements are prepared in conformity with accounting principles prescribed by the Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal government, as recognized by the American Institute of Certified Public Accountants in October 1999. However, certain Department component entities continue to prepare their financial statements in accordance with accounting standards prescribed by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. These entities include the Bureau of Engraving and Printing (BEP), the United States Mint (Mint), the Office of Thrift Supervision (OTS), the Exchange Stabilization Fund (ESF), the Federal Financing Bank (FFB), and the Community Development Financial Institution Fund (CDFI).

Although the FASAB has allowed entities that issued financial statements prior to October 1999 using FASB accounting principles to continue to do so, this has resulted in inconsistent and incomplete financial reporting by the Department's component entities. It has also inhibited preparation of consolidated Department statements, since, in order to consolidate entities reporting on a private sector GAAP basis, the additional information required for Federal GAAP reporting must be developed and crosswalked into the Department's consolidated financial statements. On occasion these crosswalks have been inaccurate, resulting in reporting errors by the Department. For example, the Department's FY 2002 consolidated statements had to be restated to properly record seigniorage related to circulating coins delivered by the Mint. This likely would not have been necessary if seigniorage had been reported in accordance with Federal GAAP in the Mint's financial statements.

The limitations of using private sector GAAP for Federal reporting entities are substantial. Private sector GAAP does not contemplate budgetary reporting and therefore components using this basis of accounting do not prepare statements of budgetary resources (SBR) or statements of financing (SOF), although these statements are an integral part of the Department's financial statements. Moreover, information reported in the Department's SBR must be reconciled to enacted amounts in the President's Budget and disclosed in the footnotes to the Department's financial statements. Considerable additional preparation and audit steps are required to develop and report this data at the Department level for components using private sector GAAP.

Another major limitation of private sector GAAP is that it does not provide adequate information regarding the costs of programs and activities, since costs are aggregated in the statement of operations to arrive at a single net income figure. The statement of net cost (SNC) required by Federal GAAP requires that costs and offsetting earned revenues be presented by responsibility segments, with net costs identified for each of the segments. This provides more meaningful information to evaluate the operating results of each of an entity's major activities.

Enclosure

There are also significant inconsistencies in how certain costs are reported by entities using private sector GAAP. For example, Federal GAAP requires that non-reimbursed costs paid by the Office of Personnel Management (OPM) for retirement plans be recognized by the receiving entity as an imputed cost in order to report the full cost of operations. The imputed cost should be reported in the SNC, with the related imputed financing reported in the SOF. Since private sector GAAP does not require either of these statements, this imputed cost is being reported inconsistently, or not at all, by the Department's component entities. For example, Mint and CDFI report offsetting amounts in their statements of operations; BEP discloses the amount of costs paid by OPM in the footnotes but does not include it in its statement of operations; and, OTS does not report the portion of these costs paid by OPM.

Finally, private sector GAAP does not require management's discussion and analysis (MD&A) of the information presented in the annual report. The MD&A is one of the most valuable aspects of an annual financial report, since it provides management's assessment of key trends, fluctuations, and unusual items. It should also link financial and performance information to provide meaningful analysis of the cost benefit relationships of program accomplishments. Several of the Department's component entities using private sector GAAP do not present an MD&A in their annual reports.

The continued use of private sector GAAP by certain component entities undermines the quality, consistency and usefulness of information reported by these entities. It also limits comparability with other component entities reporting on a Federal GAAP basis. In order to strengthen and standardize financial accounting and reporting throughout the Department, all component entities should be required to prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report on a different basis of accounting.

We note that one component entity, the Office of the Comptroller and the Currency (OCC) has already taken the initiative and changed its financial reporting basis from private sector GAAP to Federal GAAP. This has resulted in significantly more useful information for users of the OCC annual report.

Recommendations

We recommend that the Department research and determine whether component reporting entities reporting on a basis other than Federal GAAP are required to do so by statute. We further recommend that (1) all reporting entities within the Department prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report in accordance with a different basis of accounting, and (2) entities that are statutorily required to report on a basis of accounting other than Federal GAAP provide supplemental information in their annual reports that meets the reporting requirements of Federal GAAP, to include an MD&A.

SPECIAL PURPOSE ENTITIES

In SFFAC 2, FASAB established concepts for identifying reporting entities as well as for identifying what components to include in reporting entities. With respect to the consolidated financial report (CFR) of the US Government, SFFAC 2 states:

> **38. The ultimate aggregation of entities is into the entire Federal Government which, in reality, is the only independent economic entity—although some would say the entire country is the ultimate economic entity. The Federal Government entity would encompass all of the resources and responsibilities existing within the component entities, whether they are part of the Executive, Legislative, or Judicial branches (although, as noted in paragraph 5, FASAB's recommendations pertain only to the Executive Branch). The aggregation would include organizations for which the Federal Government is financially accountable as well as other organizations for which the nature and significance of their relationship with the government (see paragraphs 39 through 50) are such that their exclusion would cause the Federal Government's financial statements to be misleading or incomplete.**

SFFAC 2 provides a conclusive criterion for inclusion in the CFR:

> **42. Appearance in the Federal budget section currently entitled "Federal Programs by Agency and Account" is a conclusive criterion. Any organization, program, or budget account, including off-budget accounts and government corporations, included in that section should be considered part of the U.S. Federal Government, as well as part of the organization with which it appears. <u>This does not mean, however, that an appropriation that finances a subsidy to a non-Federal entity would, by itself, require the recipient to be included in the financial statements of the organization or program that expends the appropriation.</u>**

SFFAC 2 also provides indicative criteria:

> **43. There are instances when, for political or other reasons, an organization (including a government corporation), program, or account is not listed in the "Federal Programs by Agency and Account," yet the general purpose financial statements would be misleading or incomplete—in regard to the objectives for Federal financial reporting—if the organization, program, or account were not included therein. These organizations, programs, or accounts would normally be considered to be operating at the "margin" of what would be considered a governmental function in contrast to providing a more basic governmental function. Thus, in addition to the conclusive criterion, there are several indicative criteria that should be considered in the aggregate for defining a financial reporting entity in the Federal Government. No single indicative criterion is a conclusive**

criterion in the manner that appearance in the "Federal Programs by Agency and Account" section of the budget is. Nor can weights be assigned to the indicative criteria. Thus, while the indicative criteria are presented in descending order of importance, judgment must be based on a consideration of all of the indicative criteria.

44. The indicative criteria for determining whether an organization not listed in the "Federal Programs by Agency and Account" section of the budget is nevertheless part of a financial reporting entity are as follows:

•It exercises any sovereign power of the government to carry out Federal functions. Evidence of sovereign powers are the power to collect compulsory payments, e.g., taxes, fines, or other compulsory assessments; use police powers; conduct negotiations involving the interests of the United States with other nations; or borrow funds for Government use.

•It is owned by the Federal Government, particularly if the ownership is of the organization and not just the property. Ownership is also established by considering who is at risk if the organization fails, or identifying for whom the organization's employees work.

•It is subject to the direct or continuing administrative control of the reporting entity, as revealed by such features as (1) the ability to select or remove the governing authority or the ability to designate management, particularly if there is to be a significant continuing relationship with the governing authority or management with respect to carrying out important public functions (in contrast to selections and designations in which there is little continuing communication with, or accountability to, the appointing official); (2) authority to review and modify or approve budget requests, budgetary adjustments, or amendments or rate or fee changes; (3) ability to veto, overrule, or modify governing body decisions or otherwise significantly influence normal operations; (4) authority to sign contracts as the contracting authority; (5) approval of hiring, reassignment, and removal of key personnel; (6) title to, ability to transfer title to, and/or exercise control over facilities and property; and (7) right to require audits that do more than just support the granting of contracts. (While many of these criteria exist in a client-contractor relationship, it is not necessarily intended that an entity's contractor be considered as part of the reporting entity.)

•It carries out Federal missions and objectives.

•It determines the outcome or disposition of matters affecting the recipients of services that the Federal Government provides.

•It has a fiduciary relationship with a reporting entity, as indicated by such factors as the ability of a reporting entity to commit the other entity financially or control the collection and disbursement of funds; and other manifestations of financial interdependency, such as a reporting entity's responsibility for financing deficits, entitlement to surpluses (although not necessarily the assets acquired from failed units), or the guarantee of or "moral responsibility" for debt or other obligations.

45. The entity or any of the above criteria are likely to remain in existence for a time, i.e., the interest in the entity and its governmental characteristics is more than fleeting.

46. In applying the indicative criteria, the materiality of the entities and their relationship with one another should be considered. Materiality should not be measured solely in dollars. Potential embarrassment to any of the entities' stakeholders should also be considered. Thus, a bias toward expansiveness and comprehensiveness would be justified, particularly if it could contribute to maintenance of fiscal control.[4] [footnote 4 - Any uncertainty as to what to consider as a reporting entity would be resolved by OMB in consultation with the appropriate Congressional committees.]

There are two main questions regarding the above excerpts from SFFAC 2 that bare raising:

1. **Are the indicative criteria sufficient? That is, are they resulting in consistent and appropriate consolidated practices?**
2. **Should the guidance regarding consolidation be included in standards instead of concepts?**

To put these questions in context, a series of examples[5] of "special purpose entities" is presented below:

a. The National Railroad Investment Trust was established pursuant to Section 105 of the Railroad Retirement and Survivors' Improvement Act (RRSIA). The sole purpose of the trust is to manage and invest railroad retirement assets. The RRSIA authorizes the trust to invest assets of the Railroad Retirement Account in a diversified portfolio in the same manner as those of private sector retirement plans, including investments in non-government securities. Prior to the RRSIA, investment of Railroad Retirement Account assets was limited to US Government securities. The trust is a tax-exempt entity independent of from the Federal Government. It is domiciled in and subject to the laws of the District of Columbia.
b. The Public Company Accounting Oversight Board (PCAOB) is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002 (SOX), to oversee the auditors of public companies in order to protect the interests of

[5] Inclusion on this list is not based on an assessment of the entity for consolidation or awareness of whether the entity is or is not consolidated at this time. These are purely illustrative of the types of entities created.

investors and further the public interest in the preparation of informative, fair, and independent audit reports. SOX provides:

SEC. 101. ESTABLISHMENT; ADMINISTRATIVE PROVISIONS.

(a) ESTABLISHMENT OF BOARD.—There is established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. The Board shall be a body corporate, operate as a nonprofit corporation, and have succession until dissolved by an Act of Congress.

(b) STATUS.—The Board shall not be an agency or establishment of the United States Government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.

c. A new federal funded research and development center (FFRDC) was created this year. On April 23, 2004, the Department of Homeland Security (DHS) selected Analytic Services Inc to establish and operate the Homeland Security Institute (HSI), a new Federally Funded Research and Development Center. The HSI will assist the Department in formulating and addressing important homeland security issues, particularly those involving policy and security where scientific, technical and analytical expertise is required. Creation of the HSI was recommended by the National Research Council's 2002 report "Making the Nation Safer," and subsequently mandated by statute in the Homeland Security Act of 2002. ANSER was selected via a competitive process managed by the HSI's primary sponsor, the DHS Under Secretary for Science and Technology.

d. Public Private Partnerships (Source: GAO-03-1011 entitled 'Budget Issues: Alternative Approaches to Finance Federal Capital' which was released on August 21, 2003.):

Given today's budget constraints, evolving private sector markets and the expansion of creative real property development alternatives, several agencies have established public private partnerships as a means of leveraging the intrinsic equity value of real property. Ideally, the partnerships are designed such that each participant makes complementary contributions that offer benefits to all parties. Public private partnerships tap the capital and expertise of the private sector to improve or redevelop federal real property assets.[Footnote 11] They are considered most appropriate where excess capacity exists within the asset and where existing government facilities do not adequately satisfy the current or potential future needs.

OMB Circular A-76 describes the federal government's longstanding policy to rely on the private sector for needed commercial services. Public private partnerships are consistent with this policy so long as the product or service provided by the private partner cannot be procured more economically by the federal government. Partnerships raise questions about what functions are most appropriately performed by the federal government.

Proponents of public private partnerships argue that this approach provides a realistic, less costly alternative to leasing when planning and budgeting for real property needs. Proponents also note that federal partners benefit from improved, modernized, and/or new facilities plus a minority share of the income stream generated by the partnership or use of the asset at a lower cost than a commercial lease.

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.

CFR – FASAB REQUIREMENTS RELIEF PROJECT

The following request was submitted by the Financial Management Service regarding applicability of note disclosures to the Consolidated Financial Report (CFR).

Date: October 4, 2004

To: Wendy Comes
Executive Director
Federal Accounting Standards Advisory Board

From: D. James Sturgill
Assistant Commissioner for Governmentwide Accounting
Financial Management Service
Department of the Treasury

Subject: A Proposal for a FASAB Requirements Relief Project

The Financial Management Service (FMS) prepares the Financial Report of the United States Government (CFR). My organization within FMS has the responsibility for preparing the CFR; consequently, I am following up on the discussion that I heard at the April 2004 FASAB meeting.

The FY 2003 CFR was an agenda item at the April FASAB meeting. During the discussion of the FY 2003 CFR, Mr. Anania asked if there is something the Board should be doing aside from building specific requirements into new standards? Mr. Reid responded that when GAO issues its opinion, it is noted that the CFR does not meet many FASAB disclosure requirements. After further discussion, several board members indicated a willingness to provide relief for FASAB requirements that were not written for the CFR. Chairman Mosso asked Treasury to come up with a list of items needing relief. I am following up on that request and proposing that FASAB undertake a FASAB Requirements Relief Project. The result of such a project could be a Statement of Federal Financial Accounting Standards that amends SFFAS 24 “Selected Standards for the Consolidated Financial Report of the United States Government”.

The items for which Treasury is asking for relief fall into three categories: (1) disclosure items that are inappropriate for a government-wide report because of the excessive, detailed information required; (2) items that are appropriate for a government-wide report but need to be modified so that the information can be aggregated (recently such tailoring was done for heritage assets and stewardship land); and, (3) items that are not appropriate for a government-wide report based on an analysis of the requirement.

I have attached a table setting forth those FASAB requirements for which Treasury is asking for relief. The items in the table are grouped by relief category as described in the preceding paragraph. Categories 1 and 3 are categories for which total relief is being requested. Category 2 consists of items for modification. (We are presently disclosing most of these items in a modified way.)

I was encouraged by what I heard at the April FASAB meeting. If FASAB decides to undertake a relief project, I will provide staff support as needed to move the project forward expeditiously.

CFR FASAB Requirements Identified for Relief

Relief Categories:

1. Disclosure items that are inappropriate for a government-wide report because of the excessive, detailed information required.
2. Items that are appropriate for a government-wide report but need to be modified so that information can be aggregated.
3. Items that are not appropriate for a government-wide report based on an analysis of the requirement.

Item #	FASAB Requirement	Standard Reference	Relief Category
1	Loans – Disclosure is made in notes to financial statements to explain the nature of the modification of direct loans or loan guarantees, the disclosure rate used in calculating the modification expense, and the basis for recognizing a gain or loss related to the modification.	SFFAS 2.56	1
2	Loans - Disclosures when the government acquires foreclosed assets in full or partial settlement of a direct or guaranteed loan: (1) valuation basis used for foreclosed property, (2) changes from prior year's accounting methods, if any, (3) restrictions on the use/disposal of the property, (4) balances in the categories described above, (5) number of properties held and average holding period by type or category, (6) number of properties for which foreclosure proceedings are in process at the end of the period.	SFFAS 3.91	1
3	Inventory – Disclosure, when inventory is declared as excess, obsolete, and unserviceable, of the amount of difference between the carrying amount and the expected net realizable value.	SFFAS 3.30	1
4	Inventory – Disclosure of criteria considered by management in identifying inventory held in reserve for future sale.	SFFAS 3.28	1

5	Seized Property - Disclosures about seized property: (1) explanation of what constitutes a seizure and a general description of the composition of seized property; (2) method(s) of valuing seizures; (3) changes from prior year's accounting methods if any; (4) analysis of change in seized property including the dollar value and number of seized properties that are (1) on hand at the beginning of the year, seized during the year, disposed of during the year, and on hand at the end of the year as well as known liens or other claims against the property. This information should be presented by type of seized property and method of disposition where material.	SFFAS 3.66	1
6	Forfeited Property - Disclosures for forfeited property: (1) composition; (2) method(s) of valuing; (3) restrictions on use or disposition; (4) changes from prior year's accounting method if any; (5) analysis of change in forfeited property providing the dollar value and number of forfeitures that (a) are on hand at the beginning of the year, (b) are made during the year, (c) are disposed of during the year and the method of disposition, and (d) are on hand at the end of the year (This information would be presented by type of property forfeited where material.); (6) if available an estimate of the value of property or funds to be distributed to federal state and local agencies in future reporting periods.	SFFAS 3.71,78	1
7	Goods Held Under Price Support and Stabilization Programs - Disclosures for goods held under price support and stabilization programs (commodities): (1) basis for valuation including the valuation method and any cost flow assumptions; (2) changes from prior year's accounting method if any; (3) restrictions on the use, disposal, or sale; (4) an analysis of change in the dollar value and volume of commodities, including those (a) on hand at the beginning of the year, (b) acquired during the year, (c) disposed of during the year by method of disposition, (d) on hand at the end of the year, (e) on hand at year's end and estimated to be donated or transferred during the coming period, and (f) that may be received as a result of surrender of collateral related to non-recourse loans outstanding. (The analysis should also show the dollar value and volume of purchase agreement commitments.)	SFFAS 3.109	1
8	Stockpile Materials - Stockpile materials held for sale – When stockpile materials are authorized to be sold, those materials shall be disclosed as stockpile materials held for sale. Any difference between the carrying amount of the stockpile materials held for sale and their estimated selling price shall be disclosed	SFFAS 3.55	1
9	Cleanup Cost - Disclosure of (1) the sources (applicable laws and regulations) of cleanup requirements; (2) method for assigning estimated cleanup cost to current operating periods (physical capacity versus passage of time); (3) unrecognized portion of	SFFAS 6.108 - 111	1

	estimated total cleanup costs associated with general PP&E; (4) material changes in total estimated cleanup costs due to changes in laws, technology, or plans and the portion of the change relating to prior periods; (5) nature of estimates and information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.		
10	Whole Life Insurance - All components of the liability for future policy benefits (i.e., the net level premium reserve for death and endowment policy and the liability for terminal dividends) should be separately disclosed in a footnote with a description of each amount and an explanation of its projected use and any other potential uses (e.g., reducing premiums, determining and declaring dividends available, and/or reducing federal support in the form of appropriations related to administrative cost or subsidies).	SFFAS 5.121	1
11	Net Cost - Break out gross costs of providing goods, service, benefit payments, or grants that did not earn exchange revenue, separately from those programs that earned exchange revenue.	SFFAS 7. 43	1
12	Goods or Services to the Public - If goods or services are provided to the public, disclosure of (1) differences in pricing policy from the full cost or marketing pricing guidance for exchange transactions with the public as set forth in OMB Circular No. A-25, User Charges (July 8, 1993) or in subsequent amendments in circulars that set forth pricing guidance; (2) exchange transactions with the public in which prices are set by law or executive order and are not based on full cost or on market price: (3) the nature of intragovernmental exchange transactions in which the entity provides goods or services at a price less than the full cost or does not charge a price at all, for disparities between the billing (if any) and full cost; and, (4) the full amount of the expected loss when specific goods are made to order under a contract, or specific services are produced to order under a contract and a loss on the contract is probable (more likely than not) and measurable (reasonably estimable).	SFFAS 7.46	1
13	Custodial Activity – Disclosure for nonexchange revenues of (1) the specific potential accruals that are not made as a result of using the modified cash basis of accounting, (2) the practical and inherent limitations affecting the accrual of taxes and duties, and (3) reference to other related disclosures, supplementary information, and other accompanying information	SFFAS 7.64	1
14	Custodial Activity – Disclosure relating to future cash flows of factors affecting collectibility and timing of categories of accounts (taxes) receivable and amounts involved	SFFAS 7.65.1	1
15	Direct Loans and Loan Guarantees - Provide a description of the characteristics of programs and disclose for each program: (a) the total amount of direct or guaranteed loans disbursed for the	SFFAS 18.11	1

	current reporting year and the preceding reporting year, (b) the subsidy expense by components recognized for the direct or guaranteed loans disbursed in those years, and (c) the subsidy re-estimates by components. Disclose at the program level the subsidy rates for the total subsidy cost and its components for the interest subsidy costs, default costs, fees and other collections, and other costs, estimated for direct loans and loan guarantees in the current year's budget for the current year's cohorts. Also, disclose, discuss, and explain events and changes in economic conditions, other risk factors, legislation, credit policies, and subsidy estimation methodologies and assumptions, that have had a significant and measurable effect on subsidy rates, subsidy expense, and subsidy re-estimates. The disclosure and discussion should also include events and changes that have occurred and are more likely than not to have a significant impact but the effects of which are not measurable at the reporting date.		
16	Inventory - Disclosure of (1) general composition of inventory; (2) basis for determining inventory values including the valuation method and any cost flow assumptions; (3) changes from prior year's accounting methods if any; (4) balances for each of the following categories of inventory – inventory held for current sale, inventory held in reserve for future sale, excess, obsolete and unserviceable inventory, and inventory held for repair unless otherwise presented on the financial statements; (5) restrictions on the sale of material; (6) the decision criteria for identifying the category to which inventory is assigned; and (7) changes in the criteria for identifying the category to which inventory is assigned.	SFFAS 3.35	2
17	Stockpile Materials - Disclosures about stockpile materials: (1) general composition; (2) basis for valuing including valuation method and any cost flow assumptions; (3) changes from prior year's accounting methods if any; (4) restrictions on the use of materials; (5) balances in each category described in the standard; (6) decision criteria for categorizing stockpile materials as held for sale; and, (7) changes in criteria for categorizing stockpile materials as held for sale.	SFFAS 3.56	2
18	PP&E - Disclosure for PP&E: (1) the cost, associated accumulated depreciation, and book value by major class; (2) the estimated useful lives for each major class; (3) the method(s) of depreciation for each major class; (4) capitalization threshold(s) including any changes in threshold(s) during the period; and, (5) restrictions on the use or convertibility of general PP&E.	SFFAS 6.45	2
19	Deferred Maintenance – Disclosure of each major class of asset for which maintenance has been deferred and the method of measuring deferred maintenance for each major class of PP&E. If	SFFAS 6.83,84	2

	the condition assessment survey method of measuring deferred maintenance is used, the following should be presented for each major class of PP&E: (1) description of requirements or standards for acceptable operating condition, (2) any changes in the condition requirements or standards, and (3) asset condition and a range estimate of the dollar amount of maintenance needed to return it to its acceptable operating condition. If total life-cycle cost method is used, deferred maintenance reporting of (1) original date of maintenance forecast and explanation for any changes to the forecast; (2) prior year balance of cumulative deferred maintenance amount; (3) dollar amount of maintenance that was defined by professionals who designed, built, or manage the PP&E as required maintenance for the period; (4) dollar amount of maintenance actually performed during the period; (5) difference between forecast and actual maintenance; (6) adjustments to scheduled amounts deemed necessary by PP&E managers; and, (7) ending cumulative balance for the period for each major class of asset experiencing deferred maintenance. Optional Disclosures – Stratification between critical and non-critical amounts of maintenance needed to return each major class of asset to its acceptable operating condition. If management elects to disclose critical and non-critical amounts, the disclosure shall include management's definition of these categories.		
20	Custodial Activity – Taxes – Disclosure of cumulative cash collections and refunds by tax year and type of tax for the reporting period and sufficient prior periods to illustrate historical timing and material trends.	SFFAS 7.65.3	2
21	Liabilities – Separate reporting of current liabilities	SFFAS 1.83 - 85	3
22	Liabilities – Disclose the amount of current liabilities not covered by budgetary resources.	SFFAS 1.86	3