Federal Accounting Standards Advisory Board

October 8, 2010

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Review of Existing Standards: Statement of Federal Financial Accounting Standards (SFFAS) 27: *Identifying and Reporting Earmarked Funds* – Tab **C**[1]

MEETING OBJECTIVES

To review and discuss draft amendments to SFFAS 27 intended to address the following issues:

1. Source of Funds: Must be Non-Federal Source
2. Predominant Source of Funds (with Potential Exception for Medicare B & D)
   (and other options for narrowing the definition)
3. Eliminations (Component Entity reporting only)
4. Placement of Basic Information (Component Entity reporting only)
5. Terminology: "Earmarked Funds"
6. Technical Correction: Consistent use of the term "fund"
7. Technical Correction: Case Study in Appendix C of SFFAS 27

BRIEFING MATERIAL

This memorandum includes a discussion of the above issues, with questions for Board members beginning on page 3.

Attachment 1 contains additional options for excluding funds with large negative net positions

Attachment 2 is a copy of SFFAS 27 with tracked changes showing proposed amendments (with the exception of a new term for "earmarked funds")

[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

BACKGROUND

At the August Board meeting, the Board decided that:

- a proposed amendment to SFFAS 27 should clarify that the specifically-identified revenue or other financing source needs to be from a non-federal source
- a proposed amendment to SFFAS 27 should allow the preparer discretion in the placement of basic information for earmarked funds reporting at the component entity level (on the face of the financial statements or in a note)
- a proposed amendment to SFFAS 27 should clarify the guidance on eliminations regarding earmarked funds for component level entities
- staff should develop draft language that would use the concept of predominant source of funds as a potential filter.

ISSUES

1. Source of Funds: Must be Non-Federal Source

At the August 2010 meeting, the Board decided that staff should draft a proposed amendment to SFFAS 27 to explicitly state that the specifically-identified revenue or other financing source needs to be from a non-federal source. Draft amendments to SFFAS 27 are below with new language underlined and deletions in strikeout font.

Draft amendments to SFFAS 27 re non-federal source of funds

Definition of Earmarked Funds

[11] Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. The three required criteria for an earmarked fund are:

1. A statute committing the Federal Government to use specifically identified revenues ~~and~~ <u>or</u> other financing sources <u>that are provided to the federal government by a non-federal source</u>[2] only for designated activities, benefits or purposes;

---

[2] <u>In some cases, specifically identified revenues or other financing sources are collected from a non-federal source by one agency and transferred or appropriated to another. For example, Social Security taxes are collected from non-federal entities (employees and employers) by the Internal Revenue Service. Those amounts are subsequently appropriated and transferred to the Social Security Administration. This internal process does not change the nature of the revenue or other financing source (i.e., specifically identified revenues or other financing sources originally collected from a non-federal source).</u>

2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and

3. A requirement to account for and report[3] on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

Distinct from the General Fund

[14] Whereas earmarked funds are financed by specifically identified revenues and other financing sources, the general fund is financed by receipts not earmarked by law for a specific purpose and the proceeds of general borrowing. Although there are exceptions, funding decisions regarding activity financed from general receipts usually govern one fiscal year and are made as part of the process of enacting one of the annual appropriations acts. In contrast, legislation establishing earmarked funds reflects a longer (if not indefinite) Government commitment to collect, hold and spend identified revenues for a designated activity, benefit or purpose. Earmarked funds may <u>be given authority to make outlays by means of</u> ~~have~~ a permanent indefinite appropriation, often enacted by authorizing legislation. If not, an appropriation provided in annual appropriation acts is necessary to make expenditures. Whether the ~~appropriation~~ <u>budget authority</u> is provided by authorizing legislation or annual appropriations acts, the ~~cumulative results of operations~~ <u>accumulated resources</u> arising from earmarked funds ~~is~~ <u>are</u> reserved or restricted to the designated activity, benefit or purpose.

<u>Draft Basis for Conclusions for Exposure Draft re Non-Federal Source of Funds</u>

<u>The intent of SFFAS 27 was that the specifically identified revenues and other financing sources required to meet the criteria for an earmarked fund should be from a source that is non-federal – that is, a source that is external to the federal government. However, SFFAS 27 did not explicitly state this. Accordingly, the Board is proposing amendments to paragraphs 11 and 14 to explicitly state that the source of the specifically identified revenues or other financing source must be external to the federal government and clarify the distinction from the general fund</u>.

Question for the Board:

1. Does the above draft language adequately clarify the requirement that the earmarked inflows must come from a non-federal source?

2. Predominant Source of Funds (with Potential Exception for Medicare B & D)

At the August meeting, staff noted that preliminary research had indicated that the funds with the largest negative net positions, such as deferred compensation funds, were funded predominantly by general fund appropriations and not by earmarked revenues. Staff noted

[3] A "report" may be something other than stand-alone financial statements for the earmarked fund.

that a potential filter for excluding such funds could be a requirement that earmarked funds should be funded predominantly by earmarked revenues. The Board decided that staff should develop this potential amendment for discussion at the October meeting.

A "fund" as defined in SFFAS 27 is the smallest accounting unit in the federal government. Many earmarked funds have mixed funding sources, which vary proportionately from year to year. Such funds present a challenge for meeting the objectives of SFFAS 27.

The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[4]

Another objective of SFFAS 27 relates to special accountability:

> All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose. There is often a direct link between the source of fund revenues and designated activities, benefits or purposes in an effort to charge beneficiaries or users for benefits received. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined.[5]

Pro and Con for a potential amendment to SFFAS 27 to exclude funds that are predominantly funded by general fund appropriations

Pro	Con
An amendment would support the objective of presenting "the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits" (par. 63, SFFAS 27).	It is possible for a fund to have earmarked collections that are material even at the government-wide level but also to have general fund appropriations that may exceed the earmarked collections. In such a situation, a rule that would exclude such a fund from earmarked funds reporting would result in the under-reporting of earmarked revenues. Such under-reporting would fail to meet the special accountability objective of SFFAS 27. Note: This "con" can be remedied by an exception. Draft language for the exception

[4] SFFAS 27, Basis for Conclusions, Paragraph 63.
[5] SFFAS 27, Basis for Conclusions, Paragraph 54.

	is presented below.
	This rule might be difficult to apply in cases where the proportion of specifically identified revenues is close to 50%. In such cases, management should use judgment and consider other factors, such as materiality.
	This rule might be difficult to apply in cases where the proportion of specifically identified revenues varies materially from year to year. In such cases, management could use judgment to determine whether to report the fund as earmarked or not, and should disclose when the classification of a fund has changed because the funding has changed.

At the August meeting, the Board was divided on whether or not to make an exception that would cover situations such as Medicare Parts B and D.[6] Although Medicare Parts B and D have earmarked revenues that are material at the government-wide level, they are predominantly funded by general fund appropriations.

For FY 2009, Medicare Parts B and D were funded as follows: (in billions)

General Fund	$209.8
Interest	3.0
Beneficiaries Premiums	62.3
Other	7.7
Total	$282.8[7]

Staff recommends an exception that would remedy one of the "cons" for this option.

Draft language for an exception is below.

Draft Amendments to SFFAS 27 re Predominant Source of Funds

[13] **Fund** in this statement's definition of earmarked funds refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations." {5} This definition requires a self-balancing set of accounts for both budgetary and proprietary information, and corresponds to a "Treasury account fund symbol." As defined in this standard, a fund is accounted for by a "Treasury account fund symbol" and should be classified as earmarked or non-earmarked in accordance with the predominant

[6] Medicare Parts B and D are administered in a single fund: Medicare SMI (Supplementary Medical Insurance)

[7] Source: FY 2009 Medicare Trustees Report

source of its funding, with one exception. Because of the special accountability for earmarked revenues, a fund should be classified as earmarked if the earmarked revenues are material to the U.S. Government as a whole, even if the earmarked revenues are not the predominant source of inflows of the fund in which they are collected. For example, as currently funded, Medicare Parts B and D should be subject to the earmarked funds reporting requirements even though they are supplemented by general fund appropriations that may exceed the amount of premiums collected from participants.

[5] National Council on Governmental Accounting Statement 1, par. 16

Draft Basis for Conclusions language for Exposure Draft

A primary objective of SFFAS 27 was that "under this standard the financial statements would thus present – in a transparent manner – the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits."[8] It was anticipated that this would be achieved by the separate presentation of the cumulative results of operations attributable to earmarked funds.

However, in the actual implementation of SFFAS 27, numerous funds that are primarily funded by general fund appropriations were classified as earmarked funds because SFFAS 27 did not require that a fund should be predominantly funded by specifically identified revenues or other financing sources as described in the definition of an earmarked fund. In some cases, the funding from external sources is insignificant both to the component entity and the government as a whole.

The Board recognized that because a "fund" (a Treasury account fund symbol) is the smallest accounting unit in the federal government, a fund with mixed sources of funding that include earmarked collections presents special challenges in meeting the objectives of SFFAS 27. In the Board's view, separately accounting for the earmarked portion of these funds would impose costs in excess of any benefits. The Board believes that in order to be classified as an earmarked fund, a fund should be predominantly funded by such revenues or other financing source. One exception is provided; if the earmarked revenues in the fund are material on the U.S. Government-wide level, the fund should be classified as earmarked even if the earmarked revenues are not the predominant source of inflows of the fund in which they are collected. The Board believes that this solution will result in a cost-effective approach. Material earmarked funds will be included while funds that have immaterial amounts of earmarked funds and are primarily funded by general fund appropriations will be excluded.

Note: Staff recommends the above draft requirements regarding the "predominant source of funds" with the exception for funds with earmarked collections that are material at the government-wide level in order to exclude funds with very large negative net positions, such as the civil service retirement funds. However, there are other options that were developed by staff but were not discussed at the October meeting due to time constraints.

[8] SFFAS 27, Basis for Conclusions, par. 63.

Accordingly, a copy of the August analysis is attached at page 22 in the event that members may wish to consider any of those options in lieu of "predominant source of funds."

Question for the Board:

2. Does the Board agree with staff recommendation to propose the "predominant source of funds" to exclude funds with very large negative net positions, or does the Board wish to discuss the other options described in Attachment 1 (funds with negative net position and/or deferred compensation)?

3. Placement of Basic Information (Component Entities)

At the August Board meeting, the members decided that staff should develop draft amendments to allow preparer discretion regarding placement of basic information for component entity reporting on disaggregation between earmarked and non-earmarked funds for the statement of changes in net position and the net position portion of the balance sheet. (No change is contemplated for reporting at the government-wide level; the net position portion of the balance sheet and all of the statement of operations and changes in net position would continue to be disaggregated on the face of the CFR financial statements.)

Draft amendments to SFFAS 27 regarding placement of basic information

Financial Statement Presentation and Disclosures for Component Entities

Financial Statement Presentation <u>(Optional)</u>

[19] ~~Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position. Also, t~~ <u>T</u>he portion of ~~cumulative results of operations~~ <u>net position</u> attributable to earmarked funds ~~should~~ <u>may</u> be shown separately on ~~both the Statement of Changes in Net Position, and~~ the Balance Sheet. This standard does <u>not</u> require earmarked funds to be separately shown on the ~~Statement of Net Cost~~ <u>face of the financial statements.</u> (See Appendix C: Pro Forma Illustrations for examples of accounting entries and financial reporting.)

Disclosures

[22<u>] If not presented on the face of the Balance Sheet, the portion of the component entity's unexpended appropriations and cumulative results of operations attributable to earmarked funds should be shown separately from the portion attributable to all other funds.</u>

Appendix D: Illustrative Note

Part 2 – Component Entity Net Position

(If not presented on the face of the component entity's balance sheet)

Net position:	***Current FY***	***Prior FY***
Unexpended appropriations – earmarked funds (Note xx)	$XXX	$XXX
Unexpended appropriations- other funds	XXX	XXX
Cumulative results of operations – earmarked funds(Note xx)	XXX	XXX
Cumulative results of operations – other funds	XXX	XXX
Total Net Position	$X,XXX	$X,XXX

[Note to Board members:

Appendix C is an Illustrative Case Study and only shows the effect of illustrative transactions on financial statements. Because of this, it only shows the line items where the balances from the case study would appear.]

Appendix C – Illustrative Case Study

Effect of Illustrative Transactions on Component Entity's Financial Statements
[9]**(**This is only one example of how the required information could be displayed.**)**

1.D. (2) **Component Entity**
Balance Sheet

with Optional Disaggregation of Net Position	Social Security and Other Earmarked Funds	All Other
ASSETS		
Fund balance with Treasury	$ 10	$ 0
Investments in Treasury securities	1,000	
Total assets	$ 1,010	
LIABILITIES	$ -	$ 0
NET POSITION		
Unexpended Appropriations	$ -	$ 0
Cumulative Results of Operations	1,010	
Total Net Position	1,010	
Total liabilities and net position	$ 1,010	$ 0

Question for the Board:

3. Does the Board agree that the above draft amendments clearly reflect the proposed change to allow preparer flexibility in the placement of basic information on earmarked funds?

[9] This standard does **not** require earmarked funds to be separately shown on the face of the financial statements.

4. Eliminations (Component Entities)

At the August meeting, the Board decided that the guidance on eliminations for component entities is confusing and should be clarified. (The Board agreed with staff that there are no issues or problems with existing guidance on eliminations for the CFR.)

The existing guidance for component entities is in the form of a footnote:

[9] For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.

Paragraph 30 provides the following guidance for the CFR (**bold added**):

[30] Specific information should be disclosed for selected earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be provided for selected individual earmarked funds and in aggregate for all remaining earmarked funds **with eliminations necessary to produce the Government-wide total of earmarked funds:**

1. Condensed information about assets, liabilities and net position.
2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.

The existing guidance implies that for Treasury (and any other component entities where earmarked fund investments are eliminated within the component entity) the earmarked funds disclosure should display eliminations between earmarked funds and non-earmarked funds. However, the presentation of summary data on earmarked funds and an eliminations column with eliminations between earmarked funds and non-earmarked funds would result in an elimination column that does not foot to zero. The Board agreed that the earmarked funds note disclosure should not include eliminations between earmarked funds and non-earmarked funds.

<u>Staff analysis and recommendation:</u>

The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[10]

Another objective of SFFAS 27 relates to special accountability:

[10] SFFAS 27, Basis for Conclusions, Paragraph 63.

> All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose.[11]

The above objectives of SFFAS 27 focus primarily on the accumulated net position of earmarked funds. Because net position is not affected by eliminations, the presentation of eliminations at the component entity level is not necessary to meet the objectives of SFFAS 27, and may even clutter the presentation of earmarked funds at the component entity level. In addition, because the focus of special accountability is necessarily on individual funds (or programs) – the consolidated total is not useful for assessing the earmarked funds available for the specific purpose established in law.

As a practical matter, agency-level eliminations within earmarked funds would be incomplete, because they would only report eliminations within the agency. There is no way for the component agency's disclosure to report transactions with earmarked funds with other component entities. (Said differently, the total of all component entities' elimination disclosures would not equal the government-wide eliminations, because the component entities elimination disclosures would not include intra-earmarked eliminations between different component entities.) However, each component entity does report this information to Treasury. Accordingly, the appropriate place for reporting eliminations within earmarked funds is at the government-wide level.

Although SFFAS 27 does not require eliminations within earmarked funds at the component entity level, the standard did not explicitly state that combined totals for earmarked funds are permitted. Staff recommends that SFFAS 27 be clarified by stating that combined totals are permitted.

SFFAS 27 requires eliminations within earmarked funds at the government-wide level and staff is not recommending any changes to this requirement. At the August meeting, Mr. Reger confirmed that Treasury does not rely on component entity note disclosures in order to prepare government-wide eliminations. In fact, the component entity disclosures would not provide sufficient data for the government-wide eliminations, because the government-wide eliminations need to address transactions within earmarked funds not only within each component entity, but also between component entities. The necessary data for government-wide eliminations is provided to Treasury by component entities in a year-end data transmission called a "closing package."

[11] SFFAS 27, Basis for Conclusions, Paragraph 54.

Draft Amendments to SFFAS 27 re Eliminations

[22] The following information should be disclosed for individual earmarked funds. An exception is provided for component entities having numerous individual earmarked funds. Paragraph 24 discusses criteria to consider in selecting individual funds for disaggregated disclosure. The following information should be disclosed for selected individual earmarked funds and in aggregate for all remaining earmarked funds:

1. Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.
2. Condensed information on gross cost, exchange revenue, net cost, nonexchange revenues and other financing sources, and change in net position.
3. Combined totals are permitted.

   The information required by this paragraph for earmarked funds ~~may be presented separately on the face of the entity's basic financial statements or~~ should be disclosed in the ~~accompanying~~ notes. ~~Information for funds not presented individually may be aggregated, but must be provided even if the aggregate total is immaterial. The total cumulative results of operations shown in the note disclosure should agree with the cumulative results of operations for earmarked funds shown on the face of the component entity's basic financial statements.~~~~[12]~~ (See Appendix D: Examples of Note Disclosure of Summary Financial Information for an illustration of the disclosure required by this paragraph.)

[25] If presented separately on the face of the component entity's Balance Sheet, t~~T~~he total cumulative results of operations and unexpended appropriations ~~of~~ for ~~all~~ earmarked funds shown on the face of the Balance Sheet ~~in the note disclosure~~ should agree with the corresponding ~~cumulative results of operations~~ ~~of~~ totals for earmarked funds disclosed in the note ~~shown on the face of the component entity's Balance Sheet and the Statement of Changes in Net Position~~. Combined totals for earmarked funds and all other funds are permitted. Amounts should be labeled combined or consolidated.

~~[12] For the U.S. Treasury and any other component entity where earmarked fund investments are eliminated within the component entity, the note disclosure should include eliminations, similar to the note disclosure provided by the U.S. Government-wide financial statements as described in paragraph 30.~~

Appendix D: Example of Note Disclosure ~~Summary Financial Information~~ for Component Entity

Part 1:[13] *Detail Summary Information The following illustrates the component entity summary financial information required in paragraph 23. The illustration has been simplified by not showing prior year comparative statements.*

	Fund A	Fund B	Other Earmarked Funds	Combined Total Earmarked Funds
Balance Sheet as of September 30				
(In thousands)				
ASSETS				
Fund balance with Treasury	$ 20,635	$ 15,000	$ 5,000	$ 40,635
Investments	1,364,823	9,000,000	350,000	10,714,823
Taxes and Interest Receivable			10,000	10,000
Total Assets	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
LIABILITIES and NET POSITION				
Cumulative Results of Operations	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
Total Liabilities and Net Position	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458
Statement of Net Cost For the Period Ended September 30				
Program Costs	$ 383,547	$ 450,000	$ 247,000	$ 1,080,547
Less Earned Revenues			5,000	5,000
Net Program Costs	383,547	450,000	242,000	1,075,547
Less Earned Revenues Not Attributable to Programs				
Net Cost of Operations	$ 383,547	$ 450,000	$ 242,000	$ 1,075,547
Statement of Changes in Net Position For the Period Ended September 30				
Net Position Beginning of Period	$ 1,317,760	$ 8,715,000	$ 287,000	$ 10,319,760
Net Cost of Operations	383,547	450,000	242,000	1,075,547
Taxes and Other Nonexchange Revenue	451,245	750,000	320,000	1,521,245
Change in Net Position	67,698	300,000	78,000	445,698
Net Position End of Period	$ 1,385,458	$ 9,015,000	$ 365,000	$ 10,765,458

[13] Part 2 displays the disaggregated net position for earmarked and non-earmarked funds, if not shown on the face of the component entity's balance sheet.

Draft Basis for Conclusions for Exposure Draft: Eliminations
SFFAS 27 provided confusing guidance on eliminations for component entities by implying that the disclosure should include eliminations between earmarked funds and non-earmarked funds. The proposed amendments clarify the guidance by stating that combined totals are permitted in the disclosure.

The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[14]

Another objective of SFFAS 27 relates to special accountability:

> All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose.[15]

The above objectives of SFFAS 27 focus primarily on the accumulated net position of earmarked funds. Because net position is not affected by eliminations, the presentation of eliminations at the component entity level is not necessary to meet the objectives of SFFAS 27, and may even clutter the presentation of earmarked funds at the component entity level. In addition, because the focus of special accountability is necessarily on individual funds (or programs) – the consolidated total is not useful for assessing the earmarked funds available for the specific purpose established in law.

As a practical matter, agency-level eliminations within earmarked funds would be incomplete, because they would only report eliminations within the agency. There is no way for the component agency's disclosure to report transactions with earmarked funds with other component entities. (Said differently, the total of all component entities' elimination disclosures would not equal the government-wide eliminations, because the component entities elimination disclosures would not include intra-earmarked eliminations between different component entities.) However, each component entity does report this information to Treasury. Accordingly, the appropriate place for reporting eliminations within earmarked funds is at the government-wide level.

[14] SFFAS 27, Basis for Conclusions, Paragraph 63.
[15] SFFAS 27, Basis for Conclusions, Paragraph 54.

Question for the Board:
3 Does the Board believe that the above draft language clarifies the guidance on eliminations for component agencies?

5. Terminology: “Earmarked Funds”

Options for a New Term to Rename “Earmarked Funds”

At the February 2010 Board meeting, the Board decided that the term “earmarked funds” is causing confusion for both preparers and users of financials statements between “earmarked collections and earmarked spending. Accordingly, the Board directed staff to develop options for renaming this category of funds.

However, the Board agreed to defer discussion of this topic until the Board has come to some tentative conclusions on how to limit the scope of this category of fund, in particular by excluding certain funds with large negative net positions.

Below are six options for renaming this category of funds, along with pros and cons for each option.

	Pro	*Con*
Funds from Dedicated Collections	• “Funds from Dedicated Collections” is a unique and descriptive term that will not be confused with other commonly used terms. • This term explicitly states the reason for separate reporting (dedicated collections).	• The term “dedicated collections” is not currently used in accounting literature. However, the term “dedicated collections was used in the past (prior to 2006) and included funds later categorized as earmarked funds and fiduciary activities.
Dedicated Funds	• “Dedicated funds” is a unique and descriptive term that will not be confused with other usages.	• This term might imply that appropriated funds financed by the general fund are not dedicated to specific purposes and/or may be used with greater management discretion than really exists.

Funds from Restricted Collections	• "Funds from Restricted Collections" is a descriptive term that will not be confused with other commonly used terms. It explicitly states the reason for separate reporting (dedicated collections)	• This term may imply that "other funds" or "unrestricted funds" may be used with greater management discretion than really exists.
Restricted Funds	• "Restricted funds" would be similar to FASB and GASB term, "restricted funds."	• This term may imply that "other funds" or "unrestricted funds" may be used with greater management discretion than really exists.
Reserved Funds	• "Reserved funds" in GASB means legally segregated for a specific future use. • It has a usable negative (unreserved) for "other funds" reporting/display.	• This term may suggest that a reserve of cash or investments exists at the government-wide level.
Special Accountability, or **Specific Accountability Funds**	• "Special accountability" (or "specific accountability) is a unique term that will not be confused with other usages. • It emphasizes "special accountability," which is a primary basis for this standard.	• This term may imply that a lower level of accountability exists for general and fiduciary funds.

Below are citations from GASB and FASB for the terms "restricted" and "reserved," because the terms "restricted" and "reserved" appear in some of the options above.

Citations from GASB on the terms "Reserved" and "Restricted"

1. "Restricted"

The term "restricted" is used in relation to the net assets for state and local government reporting. Per GASB Statement No. 34 (bold added):

34. Net assets should be reported as **restricted** when constraints placed on net asset use are either: (24)
    a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments
    b. Imposed by law through constitutional provisions or enabling legislation.

Enabling legislation, (25) as the term is used in this Statement, authorizes the government to assess, levy, charge or otherwise mandate payment of resources (from external resources providers) *and* includes a legally enforceable requirement that those resources by used only for the specific purposes stipulated in the legislation.

Footnotes to paragraph 34:

24. Because different measurement focuses and bases of accounting are used in the statement of net assets than in governmental fund requirements, and because the definition of *reserved* includes more than resources that are *restricted* (as discussed in this paragraph), amounts reported as *reserved fund balances* in governmental funds will generally be different from amounts reported as *restricted net assets* in the statement of net assets.
25. Enabling legislation also includes restrictions on net asset use established by a governmental utility's own governing board when that utility reports based on FASB Statement 71.

2. "Reserved"
GASB Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* changed the category of "reserved" to "restricted" for the reasons explained below in the Summary section of GASB 54 (bold added)

> The requirements in this Statement will improve financial reporting by providing fund balance categories and classifications that will be more easily understood. Elimination of the ***reserved*** component of fund balance in favor of a *restricted* classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between **reserved** fund balance and restricted net assets. The fund balance classification approach in this Statement will require governments to classify amounts consistently, regardless of the fund type or column in which they are presented. As a result, an amount cannot be classified as restricted in one fund but unrestricted in another. The fund balance disclosures will give users information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified or eliminated. The clarifications of the governmental fund type definitions will reduce uncertainty about which resources can or should be reported in the respective fund types.

Citations from FASB on the terms "Reserved" and "Restricted"

Example citations from the FASB Master Glossary appear below

1. "Restricted"
The term "restriction" is used by FASB to refer contractual or government provisions, and also to donor-imposed restrictions for non-profit organizations.

Restriction

A contractual or governmental provision that prohibits sale (or substantive sale by using derivatives or other means to effectively terminate the risk of future changes in the share price) of an equity instrument for a specified period of time.

***Donor-Imposed** Restriction*

A donor stipulation that specifies a use for a contributed asset that is more specific than broad limits resulting from the following:

a. The nature of the not-for-profit entity (NFP)
b. The environment in which it operates
c. The purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association.

A donor-imposed **restriction** on an NFP's use of the asset contributed may be temporary or permanent. Some donor-imposed **restrictions** impose limits that are permanent, for example, stipulating that resources be invested in perpetuity (not used up). Others are temporary, for example, stipulating that resources may be used only after a specified date, for particular programs or services, or to acquire buildings and equipment.

Donor-** Restricted Endowment **Fund

An **endowment** fund that is created by a donor stipulation requiring investment of the gift in perpetuity or for a specified term. Some donors may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions. See **Endowment Fund**.
Note: The following definition is pending content; see Transition Guidance in 958-205-65-1.
An **endowment** fund that is created by a donor stipulation requiring investment of the gift in perpetuity or for a specified term. Some donors may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions. The term does not include a **Board-Designated Endowment Fund**. See **Endowment Fund**.

2. "Reserve"

The term "reserve" is generally used by FASB to refer to cash reserves and also for oil and gas reserves.

Claims Stabilization Reserve

The claims stabilization **reserve** is established through deductions from the policy account balance through the cost of insurance charge and is sometimes held in a general account (that is, an account that is intermingled with the insurance entity's assets) as opposed to a legally segregated account (sometimes referred to as a separate account). The amounts are accumulated in this account until a death benefit is paid. The death benefit represents a combination of the policy account balance and the claims stabilization **reserve** based on the contractual terms. The cost of insurance is recalculated periodically based on actual experience of the insured class. Annually, the claims stabilization **reserve** is reviewed and an experience credit may be issued back to the policyholder if the experience has been favorable. The balance in the claims stabilization **reserve** will be reviewed annually and to the extent the balance is greater than the forecasted or expected amount, an experience refund would get credited to the entity's policy account balance. An entity's claims stabilization **reserve** will generally be realized through the collection of death benefits or an experience refund that gets credited to the policyholder's policy account balance or upon surrender of the group policy. A claims stabilization **reserve** is included in a policy as a mechanism for the policyholder and the insurance entity to share in the mortality risk, which in this case is the risk that the deaths will occur sooner than originally expected. Absent a claims stabilization **reserve**, the policyholder's net cost of insurance would typically be higher than in a policy without a claims stabilization **reserve**. The claims stabilization **reserve** is sometimes referred to as a mortality **reserve** or a mortality retention **reserve**. (Note: The use of this glossary term is not consistent among legal contracts. When determining the applicability of this term, the economic substance of the item shall be taken into consideration.)

Proved Developed Oil and Gas Reserves
Proved developed oil and gas **reserves** are **reserves** that can be expected to be recovered through existing wells with existing equipment and operating methods. Additional oil and gas expected to be obtained through the application of fluid injection or other improved recovery techniques for supplementing the natural forces and mechanisms of primary recovery should be included as proved developed **reserves** only after testing by a pilot project or after the operation of an installed program has confirmed through production response that increased recovery will be achieved.
Note: The following definition is Pending Content; see Transition Guidance in 932-10-65-1.
Proved developed oil and gas **reserves** are proved **reserves** that can be expected to be recovered:

> a. Through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared with the cost of a new well
> b. Through installed extraction equipment and infrastructure operational at the time of the **reserves** estimate if the extraction is by means not involving a well.

Staff analysis and recommendation

Staff recommends "Funds from Dedicated Collections" because it is a unique and descriptive term that will not be confused with other commonly used terms. This term explicitly states the reason for separate reporting (dedicated collections).

Note: Staff has not incorporated this proposed change into SFFAS 27 because the change would be too extensive; the term "earmarked funds" appears in almost every sentence of SFFAS 27. Changes will be made once the Board selects a new term.

Question for the Board

5. Does the Board agree with staff recommendation to rename this category of funds "funds from dedicated collections'?

6. Technical Correction: To make use of the term "fund" consistent

In SFFAS 27, the word "fund" most often means a self-balancing set of accounts, akin to a "Treasury account fund symbol," which is the smallest stand-alone accounting unit in the Federal government.

SFFAS 27 defines "fund" in paragraph 13 as follows:

Fund in this statement's definition of earmarked funds refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[5]

[5] National Council on Governmental Accounting Statement 1, par. 16.

However, there are instances in SFFAS 27 where the term "fund" does not refer to a Treasury account fund symbol but rather to a larger entity such as a program. In such instances, SFFAS 27 appears to require component entities to report on an accounting unit that is smaller than a Treasury account fund symbol, which was not the intent of SFFAS 27. The edits below would correct the terminology to prevent misunderstanding.

Draft amendments to SFFAS 27 to correct inconsistent usage of the term "fund"

[13] **Fund** in this statement's definition of earmarked funds refers to a "fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations."[5] This definition requires a self-balancing set of accounts for both budgetary and proprietary information, and corresponds to a "Treasury account fund symbol."

[5] National Council on Governmental Accounting Statement 1, par. 16.

[23] The following information should be disclosed for each individually reported earmarked fund~~, or portion thereof,~~ for which a component entity has program management responsibility (see paragraph 24).

1. A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.
2. The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows.
3. Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.

Question for the Board:

6. Does the Board have any objections to this technical correction?

7. Technical Correction: Case Study in Appendix C of SFFAS 27

Staff has added two entries to the Case Study (at 1C) so that the Treasury Bureau of Public Debt (BPD) does not end the fiscal year with a negative net position:

Treasury Bureau of Public Debt: Entity

Fund Balance with Treasury	10	
Appropriations Received		10

To record appropriations received to pay interest.

General Fund Entity

Warrants Issued	10	
General Fund's Liability for FBWT (Treasury BPD)		10

To record appropriation issued to Treasury BPD.

The CFR worksheet would be updated to incorporate the above entries.

These entries would give Treasury BPD a net position of zero at year-end rather than negative $10.

Question for the Board:

7. Does the Board have any objections to this technical correction?

Attachment 1: Additional Options to Exclude Funds with Negative Net Position

Earmarked Funds with Negative Net Position

The primary objective of SFFAS 27 relates to intra-governmental borrowing/investing:

> Under this standard the financial statements would thus present- in a transparent manner- the cumulative financing provided by earmarked funds to the general fund that will need to be repaid in order to use earmarked funds for the designated activities, purposes or benefits.[16]

Another objective of SFFAS 27 relates to special accountability:

> All earmarked funds have characteristics that justify special accountability. While many Government programs raise implied commitments for the future, there is a more explicit commitment associated with the statutory establishment of earmarked funds. The Government raises an expectation on the part of the public that the Government will use the amounts collected from specific sources and accumulated in earmarked funds for their stated purpose. There is often a direct link between the source of fund revenues and designated activities, benefits or purposes in an effort to charge beneficiaries or users for benefits received. Resource inflow is accounted for separately from general tax receipts, allowing the program's status to be more easily examined. Many earmarked funds receive permanent appropriations in an amount equal to these inflows that become available without recurrent action by Congress through annual appropriations.[17]

However, netting the net position of earmarked funds with both negative and positive net position does not adequately support either objective. With respect to the first objective, including earmarked funds with negative net positions results in an understatement of the net position of earmarked funds supporting the general fund. For example, in FY 2009, nearly $2.3 trillion negative net position for those funds with a negative balance (largely deferred compensation funds) partially offset the $3 trillion positive net position for those funds with a positive balance[18] (largely social insurance funds). With respect to the second objective, the existence of a negative net position means that all funds collected have been "used" – that is, a liability exists that exceeds any exchange revenues earned or non-exchange revenues collected.

At the April 2010 Board meeting, several members indicated that the recognition of a long-term liability for an earmarked fund accomplishes the basic reporting objective of SFFAS 27 and that the additional reporting requirements in SFFAS 27 should not be necessary. The logic being that the balance sheet shows that $3.5 trillion is required to

[16] SFFAS 27, Basis for Conclusions, Paragraph 63.
[17] SFFAS 27, Basis for Conclusions, Paragraph 54.
[18] Note that "all other funds" had an overall positive balance but is likely the net of positive and negative balances.

Attachment 1: Additional Options to Exclude Funds with Negative Net Position

settle existing liabilities of earmarked funds with a negative balance. The negative net position does not represent “cumulative financing provided by earmarked funds to the general fund.” No consensus on an option for eliminating the additional reporting requirements was reached at the April meeting. Instead, staff sought input from the task force on various options.

Staff has identified three options for the Board to consider:

(a) exclude funds that normally have a negative net position from earmarked funds reporting
(b) display a separate breakout of earmarked funds into negative and positive net position
(c) exclude deferred-compensation funds from earmarked funds reporting

The task force members were asked to “field test” this issue by analyzing their FY 2009 data to separate earmarked funds with negative versus positive net position. None reported any significant difficulty implementing this request.

Staff has identified the following pros and cons for each option.

Option A: Exclude funds that normally have a negative net position from earmarked funds reporting
Note: This option would not exclude earmarked funds with a negative net position from the financial statements, but rather would have such funds classified with “all other” funds for purposes of financial statement reporting.

Pro	Con
This would support the objective of SFFAS 27 to report cumulative financing to the general fund that needs to be repaid in order to use the earmarked funds for designated purposes.	This might present an implementation issue for funds that normally have a zero or near-zero balance since their status may change from year to year. If this option is selected, the Board should consider how “zero or near zero” earmarked funds should be classified.
For the largest negative net position earmarked funds, the civil service retirement funds, there are already extensive reporting requirements, such that earmarked funds reporting is redundant.	Information regarding total revenues committed for earmarked fund purposes will not be available. However, currently the largest negative net position funds support deferred compensation programs for which the government wide exchange revenue is likely immaterial.
Task force members indicated that this option would not present significant implementation issues or burden.	

Attachment 1: Additional Options to Exclude Funds with Negative Net Position

Option B: Display a separate breakout of earmarked funds into earmarked funds with negative versus positive net position

Pro	Con
Compared with existing requirements, this would better support the objective of SFFAS 27 to report cumulative financing to the general fund that needs to be repaid in order to use the earmarked funds for designated purposes. The positive net position would reveal this amount.	For reporting on the face of the balance sheet, this would likely produce a somewhat cumbersome and potentially confusing display. 1. It is uncertain how the required extra lines or columns could be succinctly labeled. 2. It would be even more difficult to present two years of comparative data in close enough proximity so that they could be easily compared. 3. It is difficult to explain the significance of the earmarked negative net position.
Presentation of both negative and positive balances would allow all the costs and revenues associated with earmarked funds to be identified.	The additional disclosures required by SFFAS 27 (condensed information about assets, liabilities, gross cost, exchange and nonexchange revenue, etc.) for significant individual and all other earmarked funds would be slightly more cumbersome if negative and positive net position earmarked funds were separately displayed.

Attachment 1: Additional Options to Exclude Funds with Negative Net Position

Option C: Exclude deferred-compensation funds from earmarked funds reporting

Note: This option would not exclude deferred compensation funds from the financial statements, but rather would have those funds classified with "all other" funds for purposes of financial statement reporting.

Pro	Con
This option would also support the primary objective of SFFAS 27 because federal deferred-compensation funds recognize very material long-term actuarial liabilities and accordingly constitute the largest negative-net-position earmarked funds.	Other earmarked funds could potentially recognize material long-term liabilities in the future. Although such funds should also be excluded, they would not be covered by this option.
Those interested in "special accountability" for deferred compensation funds are not members of the general public. They are employees and former employees (civilian and military) whose interests extend beyond the contributions they make. Their interests are more likely to be in the liability accumulated and the changes in that liability over time. Extensive reporting on federal deferred compensation is already required by SFFAS 5, as amended. This reporting is a more likely to meet the special accountability needs of the individuals who contributed revenue to deferred-compensation funds.	To the extent that deferred compensation funds hold investments in Treasury securities, the note required by par. 27 may be significant to users interested in the assets held by the fund. That note would alert financial statement users to the fact that "When the earmarked fund redeems its Treasury securities to make expenditures, the U.S. Treasury will finance those expenditures in the same manner that it finances all other expenditures." However, this could be addressed during the development of an amendment.